



Australian Government
Productivity Commission

Tasmanian Shipping and Freight

Productivity Commission Draft Report

January 2014

This is a draft report prepared for further public consultation and input. The Commission will finalise its report after these processes have taken place.

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au) or by contacting Media and Publications on (03) 9653 2244 or email: maps@pc.gov.au

Opportunity for further comment

You are invited to examine this draft and comment on it by written submission to the Productivity Commission by Friday 7 February 2014 and/or by attending a public hearing.

The final report will be prepared after submissions have been received and will be forwarded to the Australian Government in March 2014.

Public hearing dates and venues

Location	Date	Venue
Melbourne	Monday 3 February 2014	Productivity Commission Level 12 530 Collins Street
Hobart	Tuesday 4 February 2014 Wednesday 5 February 2014	Old Woolstore Apartment Hotel Merino Room 1 Macquarie Street
Launceston	Thursday 6 February 2014 Friday 7 February 2014	Clarion Hotel City Park Grand Tamar Room 22 Tamar Street
Canberra	Monday 10 February 2014	Productivity Commission Level 2 15 Moore Street

If you wish to appear at a public hearing please register online at www.pc.gov.au/projects/inquiry/tasmanian-shipping

If you intend to appear at a public hearing and have not already made a written submission, a summary of the points you wish to discuss should be lodged with the Commission at least two days prior to your appearance.

Commissioners

For the purposes of this inquiry and draft report, in accordance with section 40 of the *Productivity Commission Act 1998* the powers of the Productivity Commission have been exercised by:

Karen Chester

Presiding Commissioner

Draft

Terms of reference

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby request that the Productivity Commission undertake an inquiry into the current arrangements for supporting freight and passenger services between the mainland and Tasmania.

Background

Tasmania is a small economy that relies heavily on sea trade. The shipping costs associated with getting goods to market are a concern for Tasmanian businesses and consumers. These transport costs create an additional cost burden for Tasmanian businesses compared to businesses on the mainland, which may be placing them at a disadvantage. While the Government operates three schemes to address the freight cost disadvantage, there is a concern that these are not delivering an efficient outcome or achieving the stated objectives.

Scope of Inquiry

1. Examine shipping costs, competition and shipping industry competitive structures across Bass Strait.
2. Identify the factors inhibiting the provision of international shipping services to Tasmania.
3. Examine the competitiveness of Tasmania's freight industry, economic infrastructure and possible reforms that would assist in enhancing effective competition, investment and productivity growth.
4. Assess the merits and weaknesses of the current arrangements for supporting freight and passenger services between the mainland and Tasmania and provide recommendations on an appropriate future approach and/or arrangements.
5. In making assessments in relation to matters in paragraph 4, the inquiry should:
 - a. report on the freight and passenger tasks and their costs between Tasmania, Flinders and King Islands and the mainland of Australia; and between Tasmania and international ports;

-
- b. quantify any freight cost disadvantages for goods eligible under the Tasmanian Freight Equalisation Scheme and the Tasmanian Wheat Freight Scheme, identify their primary causes and assess the impact of that disadvantage on Tasmanian business;
 - c. quantify any cost disadvantages for passengers travelling to Tasmania who are currently eligible for support through the Bass Strait Passenger Vehicle Equalisation Scheme;
 - d. assess the effectiveness of the current schemes as a mechanism for addressing cost disadvantages, including identification of the costs and benefits, the impact on stakeholders, and any unintended consequences or distortionary effects of the current arrangements; and
 - e. identify any alternative mechanisms that could more effectively address cost disadvantages, including assessing the full economic costs and benefits of any alternative mechanism.

Process

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report to the public.

The inquiry will inform the broader 'root and branch' review of Australia's competition laws and competition framework and will provide broad scope to identify areas where further competitive reforms of particular benefit to Tasmania could be introduced.

The Commission will conduct the inquiry in consultation with the Australian Competition and Consumer Commission.

The final report should be provided by 7 March 2014.

J. B. HOCKEY

Treasurer

[Received 29 November 2013]

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Draft

OVERVIEW

Key points

- Tasmania, like mainland Australia, is an island economy. Tasmania uniquely receives (Federally) subsidised freight services via long-standing arrangements in recognition of the relative cost 'disadvantage' of Bass Strait transit. The Tasmanian Freight Equalisation Scheme (TFES), Tasmanian Wheat Freight Scheme (TWFS), and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) were designed to partly offset these costs.
- The Australian Government has outlaid more than \$2 billion since the schemes' inceptions, and without change a further \$2 billion can be expected over the next 15 years. In 2011-12 total outlays for the schemes were \$128 million.
- The Australian Government has stated its intention to retain the TFES and the BSPVES and many participants to this inquiry have underscored the significance of the TFES subsidy for the viability of their Tasmanian business.
- Even so, the Commission, as with previous reviews of the schemes, has identified deficiencies in their design and operation, including: a lack of alignment between the objectives and outcomes; continuing use of out-of-date parameters; a number of unintended consequences; and a high level of administrative complexity.
- At a minimum, the integrity of the TFES should be restored by ensuring payment rates reflect the most recent estimates used to calculate the notional cost 'disadvantage' (overall a lower figure than at present).
- The Commission's recommendations aimed at addressing various anomalies in the schemes fall well short of what is needed to put Tasmania on a stronger economic footing — which the Commission considers should be the higher policy imperative.
- Several issues relating to the efficiency of Tasmania's shipping and freight are the responsibility of the Tasmanian Government. These include: rationalising infrastructure assets such as ports and rail; private operation and ownership of freight infrastructure assets where this would improve their efficiency; and developing a sustainable integrated freight strategy.
- Tasmania is serviced by high quality but high cost containerised shipping services. Given its reliance on sea transport, it is particularly vulnerable to coastal shipping regulation which should be reviewed and reformed urgently.
- Tasmania faces broader economic and social challenges and the Australian Government should put less emphasis on freight subsidy schemes in favour of policy reforms which have national and Tasmanian benefits (such as coastal shipping reform) and those which directly enhance the competitiveness and productivity of the Tasmanian economy.

Overview

The broader context

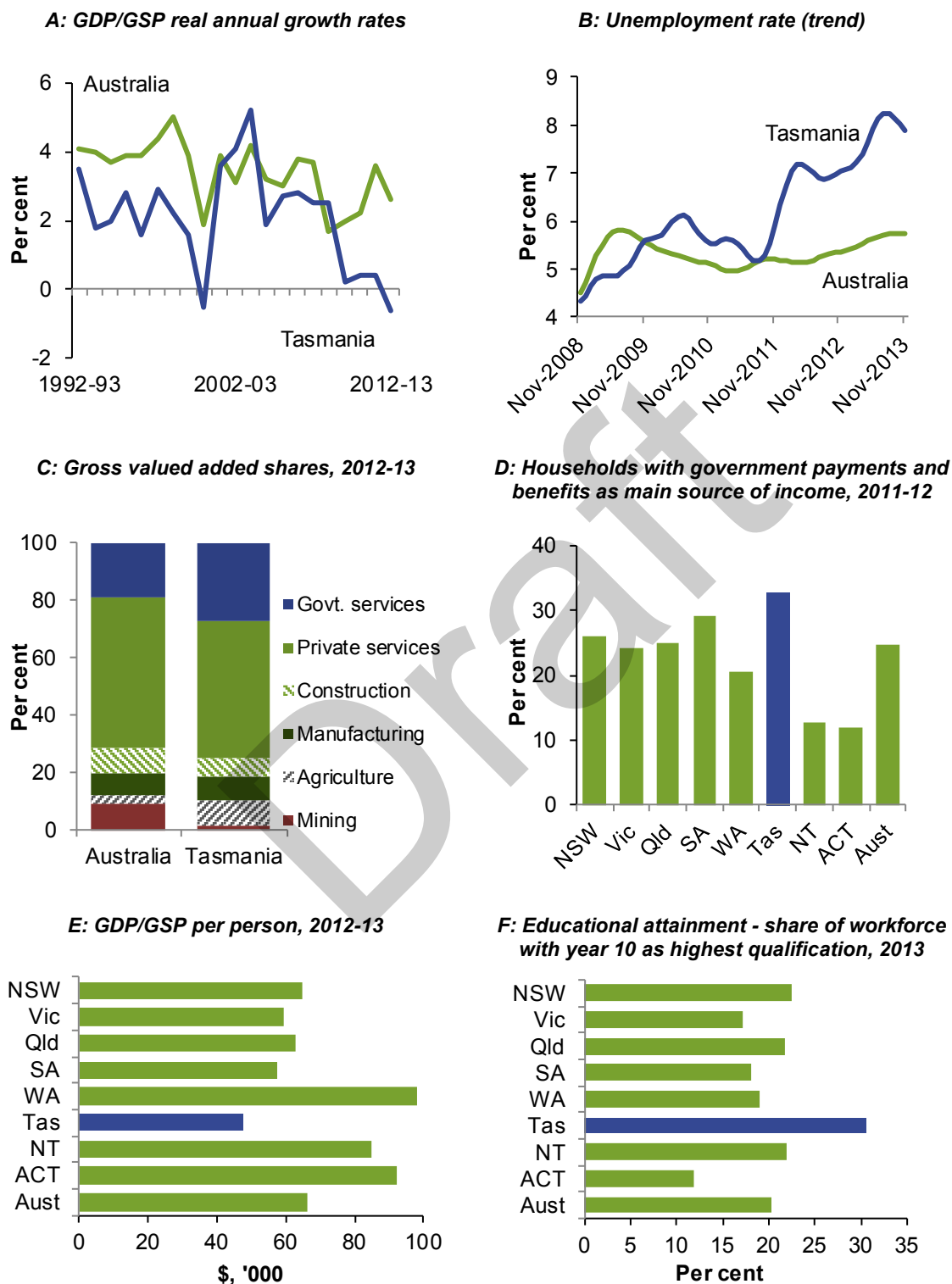
Tasmania is an island state, home to around half a million people. It has a host of natural advantages compared to many regional areas of Australia, but also shares the difficulties of many Australian communities in accessing markets and services. It accounts for less than 2 per cent of Australia's gross domestic product and therefore provides only a small 'domestic' market for producers, who must look to mainland and overseas markets.

Tasmania has consistently lagged other states and territories on most economic indicators including income and employment, as well as on many social metrics such as educational attainment and welfare dependency (figure 1). These factors have contributed to the current net outward migration from Tasmania, exacerbating the small and steadily ageing nature of its population. Recent projections suggest that Tasmania is likely to have the smallest population growth over the period to 2040 and remain the jurisdiction with the oldest population (ABS 2013c).

A number of interconnected drivers influence the performance of Tasmania's economy. Some are a matter of geography — natural resource endowments, distance from key markets, small and dispersed population settlement, and small producers. Others have more to do with the policy environment within which Tasmanian businesses operate. A key feature is the pervasive involvement of government in many aspects of the Tasmanian economy (figure 1). This is particularly evident in the freight industry where the Tasmanian Government owns and operates major freight infrastructure assets including shipping, ports, roads, and rail. The key longer term issue is whether these settings stifle innovation and private sector involvement.

Tasmania has received substantial support through a wide array of Australian Government policy measures over the years. These have included subsidy schemes that were specifically designed to alleviate the costs faced by Tasmanian businesses and consumers in accessing mainland markets (box 1).

However, the widening gap between Tasmania and mainland jurisdictions in terms of income growth and employment indicates that these measures do not address the fundamental issues affecting the underlying competitiveness of Tasmania.

Figure 1 **Tasmania's relative economic performance, selected indicators**

This raises the question of whether more of the same infrastructure and business support policy measures could be expected to deliver different outcomes and reverse a generational trend of disparate performance.

Further, Tasmania is an economy in transition. In response to market forces, it is gradually moving away from traditional resource-based manufacturing industries to higher-value economic activities in agriculture, aquaculture, specialised manufacturing and tourism. As such, what may have been well-intended policy initiatives a few decades ago, are unlikely to be the best policy settings for these economic activities to realise their full potential.

Against this backdrop the Australian Government has asked the Commission to:

- Examine shipping costs, competition and shipping industry competitive structures across Bass Strait;
- Identify the factors inhibiting the provision of international shipping services to Tasmania;
- Examine the competitiveness of Tasmania's freight industry, economic infrastructure and possible reforms that would assist in enhancing effective competition, investment and productivity growth; and
- Assess the merits and weaknesses of the current arrangements for supporting freight and passenger services between the mainland and Tasmania and provide recommendations on an appropriate future approach and/or arrangements.

In responding to these terms of reference, the Commission has examined the issues affecting the competitiveness of Tasmanian business as they relate to shipping, port, road, and rail infrastructure and services. The Commission has examined how these may be addressed, noting that many of the potential policy responses are the responsibility of the Tasmanian Government.

This draft report also focuses on the effectiveness of the freight and passenger subsidy schemes and assesses the alignment of their objectives and their outcomes. Acknowledging the Australian Government's stated intention to retain the schemes, the Commission has considered potential amendments to the schemes that are essentially within their current design. However, in light of the material anomalies inherent in the current design of these schemes, the Commission has also canvassed other options that mitigate or remove some of these anomalies.

Recognising the broader economic challenges faced by Tasmania, the Commission considers that simply addressing the anomalies in the subsidy schemes is likely to fall well short of what is needed to improve the competitiveness of the Tasmanian economy — which the Commission considers should be the policy imperative.

Successfully addressing the endemic problems of comparatively lower income growth, higher rates of unemployment, lower labour productivity, and social disadvantage is likely to require policies and programs that better target the underlying issues.

Box 1 Current subsidy arrangements to alleviate transport costs

The Tasmanian Freight Equalisation Scheme (TFES) subsidises the shipment of eligible Tasmanian-produced goods to the mainland (northbound), and the shipment from the mainland of designated inputs for use in manufacturing, mining, agriculture, forestry and fishing in Tasmania (southbound). While the original, stated policy objective was to make the costs of eligible cargoes shipped from Tasmania to the mainland approximate the costs of moving similar goods by road or rail over similar distances on the mainland, there are several other rationales that have been put forward since then.

The subsidy does not apply to the shipment of bulk freight, imports or goods intended for export. At least 30 per cent of non-bulk Tasmanian freight received TFES assistance in 2011-12, as a dollar amount per TEU (twenty-foot equivalent unit), adjusted by various prescribed parameters.

Since 1976, over \$2 billion has been paid in TFES assistance to firms based in Tasmania. Expenditure for 2011-12 was close to \$93 million — representing less than 1 per cent of total costs in Tasmania's agriculture, mining and manufacturing sectors.

Wheat is the only bulk commodity that is eligible for a specific subsidy under the Tasmanian Wheat Freight Scheme (TWFS). The original policy rationale of the scheme was to ensure domestic price parity for wheat as an ingredient into bread making. Funding is capped at \$1.05 million per year and paid at a flat rate of up to \$20.65 per tonne of wheat. Expenditure on the TWFS has never reached the cap and the last payment made was in August 2009. This is because shippers are able to claim a higher subsidy by 'containerising' wheat and claiming assistance under the TFES rather than the TWFS.

The Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES), introduced in 1996, allows for a rebate for accompanied vehicles transported across Bass Strait. The original, stated policy objective of the scheme was to 'reduce a driver's net fare when sharing a standard cabin to a similar cost as that notionally incurred in driving an equivalent distance on a highway.'

Around \$35 million was claimed under the BSPVES in 2011-12. The Tasmanian government-owned TT-Line dominates the Bass Strait passenger vehicle transport market with 99 per cent of passengers with eligible vehicles travelling on its *Spirit of Tasmania* vessels.

The schemes are administered through Ministerial Directions and managed by the Department of Human Services (DHS) under a Head Agreement between DHS and the Department of Infrastructure and Regional Development.

The key policy levers to increase the competitiveness of the Tasmanian economy revolve around: improved labour market flexibility and educational outcomes; rationalisation of infrastructure assets and private operation and ownership of those assets where this would improve their efficiency; coastal shipping reforms that may have positive spillovers for an economy that is highly dependent on shipping; and, more generally, a regulatory environment that lowers the cost of doing business in Tasmania.

For this reason, the draft report canvasses the elements of an economic development approach that would provide a better alternative to the subsidy schemes in the future, and benefit both Tasmania and Australia as a whole.

Owing to the short timeframe for this inquiry, the Commission has not been in a position to examine all the issues within scope of the terms of reference with the same level of depth. Data limitations have also constrained the Commission's ability to review in detail issues such as the commercial aspects of Bass Strait shipping services and the efficiency of Tasmanian ports.

In some cases, the Commission has had to rely on secondary sources of evidence. It would welcome inquiry participants' views on the robustness of this evidence, or better evidence. There are several outstanding issues upon which the Commission is seeking further evidence through information requests specified in this draft report.

The Commission has drawn on the substantial body of work undertaken by the Freight Logistics Coordination Team — an independent advisory body set up in November 2012 and funded by the Australian Government to inform a long term freight strategy for Tasmania. This work has provided an important input to this inquiry.

Offsetting a cost 'disadvantage'?

Tasmania will always be reliant on shipping and air services, notwithstanding advances in communication and commerce. With over 99 per cent of freight volumes moving in and out of the state by sea, the Bass Strait shipping link and its connectivity with land side freight infrastructure and logistics is vital. Personal and business travel to and from Tasmania is now overwhelmingly by air, with around 90 per cent of travellers choosing to fly. The cost and frequency of sea and air access is even more critical for the sustainability of regional communities on King Island and the Furneaux Group of islands.

Concerns about the costs incurred by Tasmanian businesses and consumers for Bass Strait transit have been the basis for longstanding subsidies for sea freight and

passenger travel. The Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) are designed to partly offset these costs (figure 2).

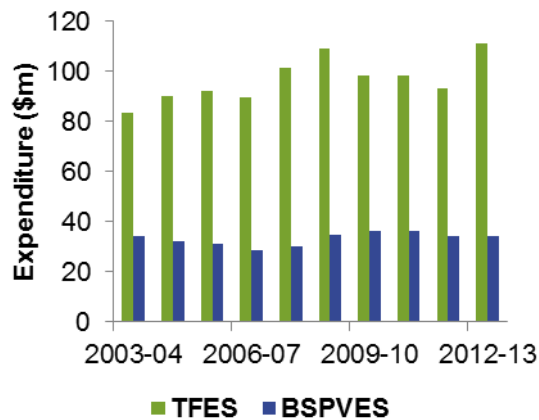
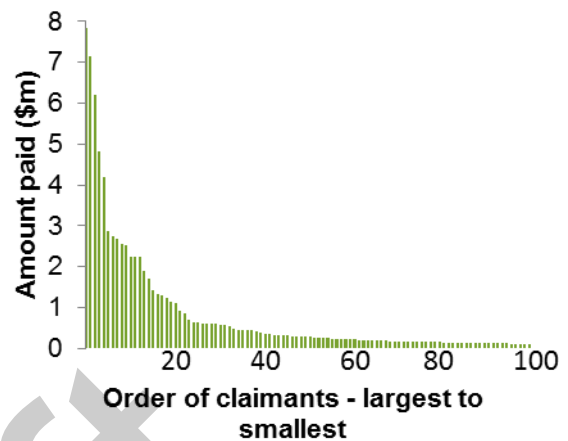
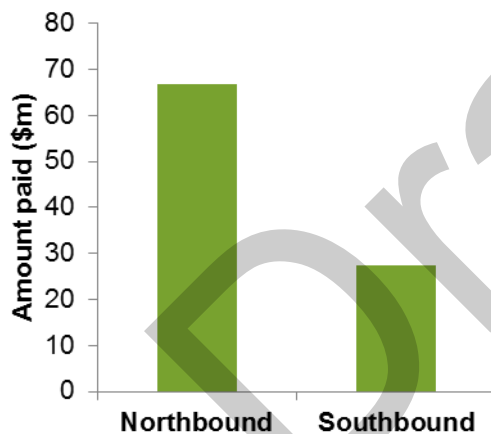
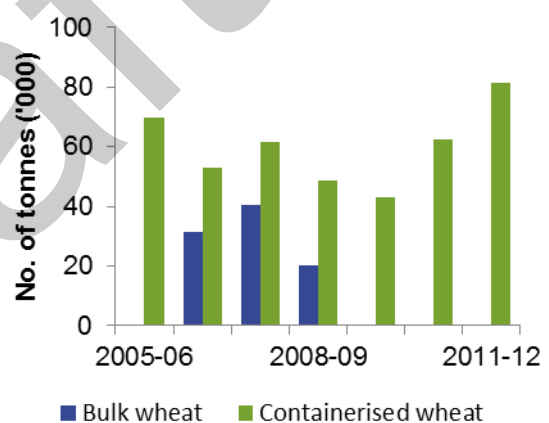
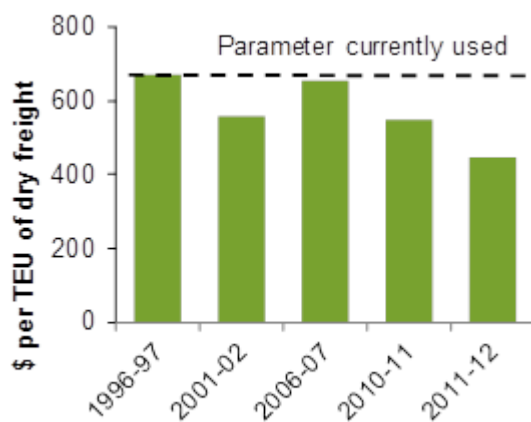
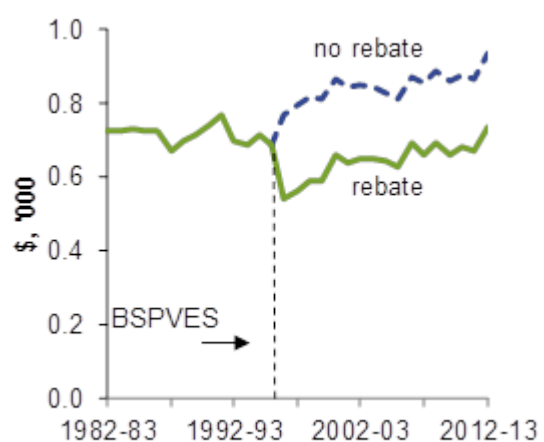
While the names of these schemes suggest that these arrangements are ‘equalisation’ measures designed to align transport costs across Bass Strait to the notional cost of travelling or moving freight on a highway or other inter-capital city corridor, the schemes as currently designed and administered are not consistent with this rationale. The current arrangements are selective in nature and involve paying subsidies to particular recipients on the basis of eligibility criteria which limit access to the schemes in ways that appear arbitrary. In addition, recipients are paid a per unit amount with no mechanism to secure consistency between the actual sea freight cost and the cost that would have applied if there were actually a road bridge across Bass Strait.

A genuine equalisation scheme on the grounds of a notional ‘land bridge’ would entail a significant widening of the scope, scale and cost of the current arrangements. In particular, it would involve paying assistance to all freight and passengers transported by sea across Bass Strait.

In this vein, many stakeholders have expressed concerns and grievances about the inequities and anomalies inherent in the design of these schemes. These deficiencies, combined with the absence of coherent rationales for the schemes, compromise their efficiency and effectiveness as mechanisms to address Tasmania’s relatively high transport costs.

Many participants to this inquiry have underscored the significance of the current subsidies for the viability of their Tasmanian business, at least in the short term. A number of manufacturing enterprises, in particular, have pointed out that their competitiveness against alternative production and investment locations is under regular review and that the TFES provides important assistance at the margin. For a range of reasons, including higher labour and fuel costs, low freight volumes and limited competition, Bass Strait shipping is more costly relative to similar services in the North Sea in Europe. Many businesses claim that it is their single largest transport cost in the supply chain, even for products subsequently sent to distant markets.

It is also clear that the purpose of the schemes is seen by many as reducing costs and offsetting increasing costs, rather than mitigating the relative ‘disadvantage’ of

Figure 2 **TFES, TWFS and BSPVES — key indicators****A: TFES and BSPVES funding****B: TFES assistance paid to the top 100 claimants, 2011-12****C: TFES assistance paid by direction, 2011-12****D: Wheat shipped to Tasmania****E: TFES - sea freight cost disadvantage****F: BSPVES - real sea package prices**

moving freight by sea. Participants' views on the rationales for the schemes exposed the absence of a common understanding of the purpose of the schemes.

The concept of a cost 'disadvantage' that can be measured and offset is in itself problematic. Similarly, the methodology and parameter estimates used by the Bureau of Infrastructure, Transport and Regional Economics (BITRE) to calculate a cost 'disadvantage' cannot be expected to reflect the (widely disparate) experiences of individual firms. The design of any scheme of this nature must balance practicality with the pursuit of the stated policy objectives.

The TFES treats the freight cost 'disadvantage' as the difference between:

- the costs incurred by shippers for moving freight across Bass Strait; and
- the notional cost incurred by moving freight an equivalent distance (approximately 420 kms) on the mainland by road.

Inherent in this formula is the perverse outcome that, as the movement of freight on the mainland becomes more efficient, the cost 'disadvantage' is estimated to increase, leading to an increase in the rate of the subsidy, which dilutes the incentive to increase the efficiency of freight movements across Bass Strait. Conversely, if road freight costs increase more quickly (as has been the case recently), the 'disadvantage' is reduced.

Further, this calculation is by no means straightforward. Freight rates can differ for a number of reasons — the nature of the shipped product and its volume, the source and destination of the freight task, the direction of travel, the timing and frequency of the service, and the degree of competition in the provision of freight services.

Given these considerations, determining with any confidence the precise freight cost disadvantage at a particular point in time is challenging. The Commission noted in its 2006 review of the freight subsidy schemes that it was unrealistic to suggest that any one 'road freight equivalent' was truly representative of a comparable freight task. This remains the case.

Nonetheless, on the basis of the formula used to determine the cost disadvantage under the TFES, the 2011-12 parameter review undertaken by BITRE (2013b) suggests that the current subsidy rate — which has not been updated since 1998 — significantly overcompensates claimants for their notional cost 'disadvantage'. At a minimum, the Commission considers that the Australian Government should ensure that the TFES is configured so that its rates are updated to reflect the latest available parameter estimates. This would restore the policy objective integrity of the scheme. In 2012-13, this configuration would have provided a saving to the Commonwealth budget. If this option were adopted, consideration should be given to initial transitional arrangements over two to three years given the extended lapse in time of

any adjustment. The Commission is also of the view that the process for undertaking parameter reviews by BITRE could be improved by the release of a draft report and a public submission process prior to the release of a final report.

Transparency about the scheme would be further improved by more comprehensive public reporting of scheme data, including assistance paid to individual recipients. This would build on BITRE's publication of scheme data currently covered in its parameter reviews.

More fundamentally though, the schemes create a myriad of distortions and anomalies. They are only available to some firms, and generate entrenched reliance on government support, which may of itself be having an adverse impact on the long term growth potential of the Tasmanian economy.

Further, the practical outcome of a subsidy (that is, who actually benefits) depends on the relative responsiveness of supply and demand to a change in price. If supply is less responsive than demand, then suppliers will get relatively more of the subsidy than users or consumers — who in many cases are the intended beneficiaries.

Removing some anomalies but others remain

The TFES

The Australian Government's stated intention is to retain the TFES. As requested by the terms of reference, this draft report canvasses possible improvements to the scheme that would go some way to correcting the identified deficiencies. These are largely focused on reducing complexity, and thereby reducing the compliance burden on businesses and administrative costs to government, while also addressing some of the perverse incentives created by the scheme.

In particular, the Commission recommends that payments under the TFES should be made on the basis of a flat rate per TEU (20 foot equivalent unit) shipped. As the Commission noted in 2006, this would have significant advantages over current arrangements. It would provide increased incentives for businesses to minimise transport costs, make payments easier to claim and the scheme much simpler to administer, and increase transparency. In the absence of a flat rate subsidy, assistance under the scheme should only be payable on the basis of evidence of actual wharf-to-wharf cost. This would reduce the incentive to structure freight bills in a way that maximises the value of the subsidy.

However, some of the inherent deficiencies and perverse incentives associated with the scheme do not lend themselves to mitigation or removal through redesigning the scheme. Numerous previous reviews into the scheme support this assessment, including the Commission's previous inquiry (PC 2006c) and the Infrastructure Australia review (2012b). In particular, these reviews did not find compelling evidence that the schemes were effective in meeting their policy objectives. However, it was evident that the schemes were having a number of unintended consequences in terms of their effects on incentives. The reviews also highlighted the high level of administrative complexity embedded in the design of the TFES. Despite most reviews recommending changes to address some of these problems, the freight subsidy schemes remain largely unchanged since their inception.

A subsidy to a particular type of business, a particular category of input, or a particular mode of transport creates incentives to modify behaviour, albeit at the margin, to access the subsidy and maximise its value. Evidence provided by participants highlighted how the TFES is influencing firm behaviour in terms of the location of processing activities (perversely and notably in Victoria rather than in Tasmania), the way that goods are shipped (in containers or in bulk), or the way that businesses are structured (vertically integrated or separated).

For example, it appears that some Tasmanian businesses are offshoring 'processing' activities to the mainland, mainly to Victoria, to access the TFES. Given that the northbound component of the TFES is only available for goods that are intended for use or further transformation on the mainland, there is a clear incentive for doing so for goods ultimately to be exported and otherwise not eligible for the subsidy. This is a rational commercial response to the existing incentives, but contrary to the outcome the scheme was designed to achieve.

A change in the eligibility criteria may mitigate current, material anomalies but would ultimately draw 'another line in the sand'. There will inevitably be winners and losers with any criteria changes, and anomalies and undesirable incentives will ultimately remain.

The TFES primarily benefits a small number of firms based in Tasmania, largely in the manufacturing sector (table 1). These firms are important to the Tasmanian economy as large private sector employers. In 2011-12, the top 10 claimants (out of 1400 in total) received around half of the total payments. At the other end of the spectrum, the smallest 1000 claimants received 2.7 per cent of total assistance paid.

By value, the main commodities claimed under the northbound component were frozen and fresh vegetables, newsprint, wood products and beer. Under the southbound component, beer bottles and cans, wheat and animal feed were the main

commodities claimed. The subsidy does not apply to goods intended for export. There is an argument put forward by a wide cross-section of participants that this may be placing export oriented businesses in Tasmania at a disadvantage relative to those who produce for the domestic market.

Table 1 TFES large claimants
Top 10 claimants for commodities shipped in 2011-12

<i>Claimant</i>	<i>Main commodity claimed</i>	<i>Amount paid (\$m)</i>
Norske Skog Boyer	Newsprint	7.8
Net Sea Freight Tasmania Pty Ltd	Various (freight administration services)	7.1
J Boag & Son	Beer	6.2
Cadbury Australia	Confectionery and chocolate products	4.8
Simplot Australia	Frozen/processed/prepared vegetables	4.2
McCain	Frozen/processed/prepared vegetable	3.0
Monson Shipping Pty Ltd	Processed wood	2.9
Cascade Brewery Co	Beer	2.7
Ertler Trading Pty Ltd	Fresh vegetables	2.6
Murray Goulburn Co-op Co Ltd	Dairy	2.5

The 1998 (Nixon) review of the TFES recommended against extending the subsidy to exports given the availability of international shipping services. Since May 2011, Tasmania has been without a direct regular international container shipping service following the weekly AAA Consortium's withdrawal from Bell Bay (though Swire Shipping recently commenced a limited monthly service). Consequently, containerised exports must be transhipped mainly through the Port of Melbourne for access to international markets. The changing commercial dynamics of international shipping suggest that regular container services may not return on an ongoing basis and the Port of Melbourne may therefore remain the main point of exports for Tasmanian containerised freight. This view is supported by a number of the participants directly engaged in shipping services.

The Commission intends to explore the merit of extending payments under the TFES to all eligible commodities shipped to the Port of Melbourne and is therefore seeking feedback and input from inquiry participants. This approach would be more consistent with a long term policy objective of enhancing Tasmania's access to markets. In view of the recent BITRE parameter review and the orders of magnitude potentially involved in extending the subsidy to all eligible (under Schedule 1 of the Ministerial Directions) commodities shipped northbound, the Commission considers that such an extension to the coverage of the scheme could potentially fit within the current TFES funding envelope (as contained in the budget forward estimates).

An alternative option would be to extend payments under the TFES to all eligible commodities shipped to the Port of Melbourne *and* treat all southbound goods in a similar non-discriminatory fashion by removing the southbound component of the scheme. This would remove the distortions created by the different treatment of goods that are currently eligible under the southbound component (that is, inputs into manufacturing, mining, agriculture, forestry and fishing), and those that are inputs into other sectors of the Tasmanian economy such as the services sector. It would also remove the broader distortion created by the different treatment of goods sourced from mainland markets and those sourced from international markets. Removal of the southbound component would also remove the most complex and administratively burdensome components of the scheme.

A number of firms currently receive the TFES subsidies under both the input (southbound) and the output (northbound) components *and* are also exporters to international markets. The Commission considers that the removal of the southbound component may prove a reasonable tradeoff for the extension of the scheme to cover all eligible commodities destined to the Port of Melbourne (that is, whether for sale on the Australian mainland or elsewhere).

These possible changes to eligibility would inevitably create winners and losers. Impacts on particular Tasmanian businesses would depend on their business model. The key question is whether such changes would result in a net reduction in the anomalies and distortions created by the scheme at present, or simply replace one set of anomalies and distortions with another set of similar magnitude.

The Commission is seeking participants' views on the relative merit of the two options and is particularly interested in receiving evidence on their potential impacts on Tasmanian businesses, industries and the economy.

A number of submissions raised the issue of widening eligibility under the scheme to also include air freight. The Commission does not consider that there is a case for such an extension. Reliance on air freight to access markets is a feature of many regional communities and is not a situation unique to Tasmania.

King Island and the Furneaux Group of islands

By virtue of their size, population density and remoteness, the specific economic circumstances of the Bass Strait islands have been raised in submissions. Their economic sustainability is critically dependent on access to larger processing and end-product markets. In the area of transport logistics, they are clearly more exposed than the main island due to smaller volumes, high seasonality and little or no competition in transport services.

Offsetting their higher freight costs is their niche appeal which provides a platform for high-value low-volume products in agriculture and aquaculture, and to a lesser extent, tourism.

The economic viability of the communities on these islands is largely a matter for the Tasmanian Government, within the broader context of market drivers. The Australian Government, through the TFES, provides explicit and additional support to alleviate freight costs between King Island and the Furneaux Group of islands and the main island of Tasmania.

The recent BITRE parameter review suggests that updating the estimates for these intrastate routes would lead to an increase in the TFES rate for King Island and a reduction in the rate for the Furneaux Group.

The TWFS

Wheat is the only bulk commodity that is eligible for a specific subsidy under the TWFS. The scheme dates back to the 1950s when the price of bread affected the determination of the basic wage and it was thought that, as a basic commodity, bread should be available to all Australians at the same price. Over time, the policy rationale appears to have evolved to provide support to Tasmania's agri-businesses that use wheat as a feedstock. Expenditure on the TWFS has never reached its \$1.05 million cap and there have been no claims since 2009. This reflects the incentive to ship wheat in containers to access a higher level of subsidy through the TFES. This highlights another distortion that the TFES causes.

Given its original purpose, the scheme is now redundant and the Commission recommends that the TWFS be terminated. That said, the Commission notes that shipping wheat to Tasmania in containers may not be the most efficient process available, highlighting how these schemes have over time encouraged less efficient practices. In this context, the Commission recommends that the calculation of assistance for wheat (and other grains) shipped in containers under the TFES be based on the lowest cost option for transporting grain to Tasmania.

The BSPVES

The Australian Government has stated its intention to retain the BSPVES. The scheme is designed to alleviate the cost of sea travel across Bass Strait for passengers accompanying an eligible vehicle. However, the BSPVES provides only diluted support to what is generally perceived to be its intended primary beneficiary — Tasmania's inbound tourism sector. The vast majority (more than 90 per cent) of

passengers arrive by air, with air fares much cheaper now than in 1996 when the scheme was introduced. The scheme is narrowly targeted at a minor component of the touring market, largely the ‘grey nomads’ sub-market. This has limited any capacity to sustain growth in overall tourism expenditure. Further, some of the BSPVES subsidy is captured by TT-Line as the main (virtually sole) carrier of passenger vehicles across Bass Strait.

The extent of this ‘leakage’ is difficult to assess without detailed modelling. However, the characteristics of this specific market, combined with the pricing of this service over time (see figure 2F), suggest this is occurring. Support for TT-Line is not a stated objective of the scheme.

Given that the main objective of the scheme appears to be the provision of support for Tasmania’s inbound tourism, the Commission considers there is merit in examining alternative use of these funds to pursue this objective more effectively and transparently.

To the extent that the BSPVES is intended to have a broader objective — including outbound travel from Tasmania, the Australian Government should clearly articulate this objective and evaluate the scheme on that basis.

Shipping and freight

The economics of shipping improve relative to other transport modes with the distance traversed. As such, shipping is typically not economic relative to road for distances comparable to Bass Strait.

The efficiency of Tasmanian shipping and freight is driven by several direct and interrelated factors: the lack of competition; scale; and capital.

Benchmarking of shipping costs is intrinsically difficult and therefore typically subject to caveats. That said, benchmarking work by Aurecon (commissioned by the FLCT) found Bass Strait shipping to be 24 per cent more expensive than comparable European services, which they largely attributed to relatively higher input costs for Bass Strait providers (labour costs and fuel).

Competition

A defining feature of Tasmania’s economic infrastructure is limited competition between transport service providers. This is not dissimilar to the situation in many

regional and remote production and population centres in Australia, but the greater operational engagement of government in Tasmania is a distinctive feature.

Tasmania has a comparable level of competition for air freight and passenger travel to other domestic air routes in regional areas, with low cost carriers servicing Hobart and Launceston airports.

Various characteristics of Bass Strait shipping constrain competition for container traffic on that route and effectively isolate Tasmanian services from international services. Bass Strait shipping faces no competition from road and rail alternatives. Only air transport provides a potential substitute, and only for time-sensitive and/or high-value commodities in small consignments.

There are three shipping lines providing overnight daily services between Tasmania's northern ports and the Port of Melbourne: Toll ANL, SeaRoad Holdings, and the Tasmanian Government-owned TT-Line. Toll has over 50 per cent market share, with the other two providers holding roughly equal shares of the remainder. The later daily departure time and faster speed of the TT-Line service and its capacity for handling trailerised fresh freight mean that it offers a slightly different service.

Overall, and as supported by participants' submission commentary and evidence, the existing shipping lines provide high quality — but high cost — services to Tasmanian shippers. While producers in Tasmania have diverse needs and many would prefer a lower cost and quality service, they have mostly adapted their business operations to the current level of service.

Whether the current shipping industry structure provides for vigorous competition between the service providers is unclear. Some participants to the inquiry consider that the three shipping lines actively compete for volume on both price and service offerings. Others contend that there is an inherent lack of competition on what is essentially a niche route. In their view, there are essentially the two commercial shipping firms operating with high levels of capacity utilisation and limited necessity to compete aggressively on that route, with limited influence from the Tasmanian Government-operated TT-line.

The Commission does not have access to data on operating costs and revenues of the commercial shipping lines and therefore cannot reach a fully informed view about the profitability of their Bass Strait services. However, freight volumes are not growing materially and fixed costs for a new entrant would be high, given the specific requirements of the Bass Strait route. The Commission has not received any indication that a new entrant is likely.

Scale is a major factor (figure 3). The total volume of Tasmanian freight shipped in 2011-12 was just under 13 million tonnes. Non-bulk freight, which is the main freight task on the Bass Strait shipping route, accounted for around 5 million tonnes. From their peak in 2003-04, total trade volumes across Bass Strait have fallen by around 22 per cent over the period to 2011-12, partly driven by declines in forestry and paper products.

The relatively low volumes in the Tasmanian shipping services market are compounded by the diverse and highly seasonal nature of the non-bulk freight task.

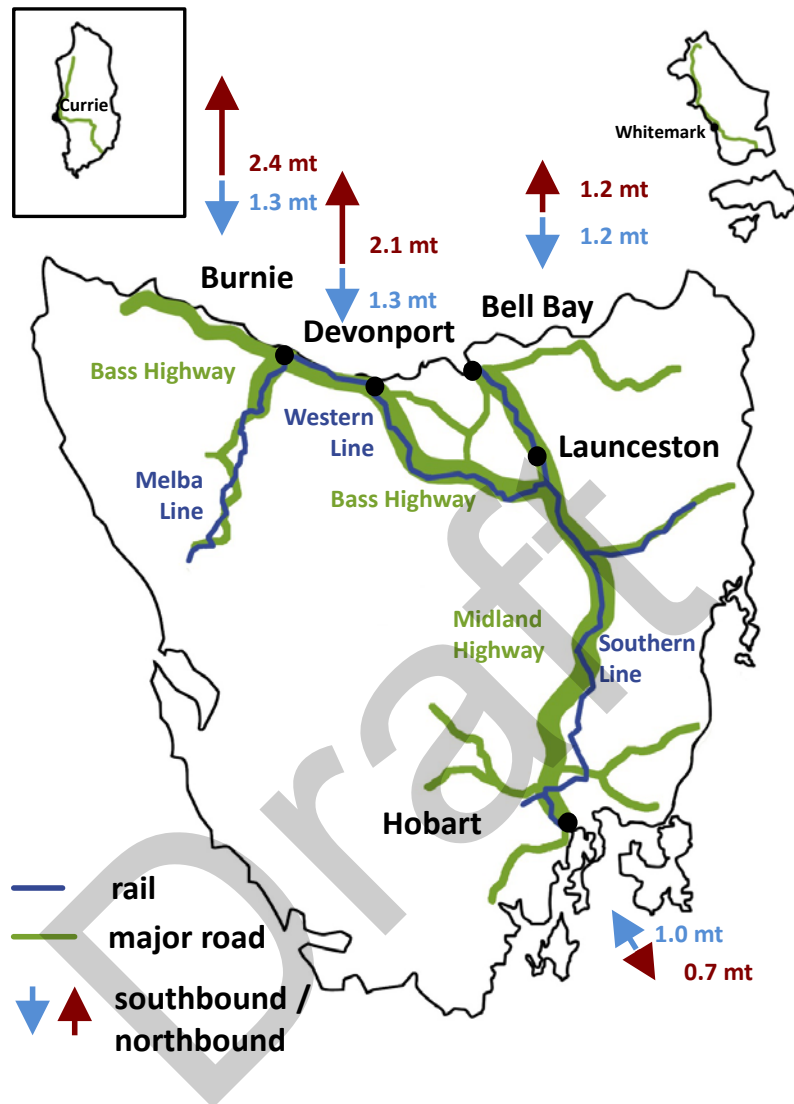
While all three existing operators are understood to be considering new investments which would increase capacity and potentially reduce operating costs, projections of relative low growth in volumes (between 3 and 4 per cent a year on average) over the medium to longer term is a key issue confronting any prospective investor. It is clear that competition in the Bass Strait shipping route is 'thin' by nature and there are practical limits to how much competition is possible.

Importantly, this outlook needs to be set against broader developments in the shipping industry globally. Recent developments to increase the capacity of waterways (such as dredging port channels to greater depths), and increase the size and the specialisation of vessels, have created shifts in market dynamics. These mostly explain why international maritime traffic increasingly bypasses smaller and shallower ports such as those in Tasmania. While it is clear that no single issue has led to the demise of international shipping in Tasmania, it is reasonable to conclude that the lack of consistent volume and the global trend to larger container vessels are important influences on future scenarios. Based on submissions and consultations, it is difficult to envisage the return of a regular direct international service on a purely commercial basis in the foreseeable future.

Coastal shipping regulation

As an island state, Tasmania is especially vulnerable to regulation and regulatory change that increases the cost of engaging in coastal trade. Foreign flagged vessels currently operating in Tasmania predominantly transport dry and liquid bulk freight.

Most inquiry participants have raised concerns about the anticompetitive effects of Australian cabotage regulation and its impacts on the costs of shipping borne by Tasmanian businesses. Various studies have concluded that cabotage restrictions are likely to have a greater effect on Tasmania compared to other Australian jurisdictions (Juturna 2013; Rae 2002). Of particular relevance are amendments to the Fair Work Regulations in 2009 and the introduction of the *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth).

Figure 3 **Tasmanian freight movements, 2012-13**

The 2009 changes extended the application of the *Fair Work Act 2009* (Cwlth) to workers on foreign flagged vessels engaged in coastal shipping. The 2012 changes introduced new hiring, licensing and registration regimes; and tax advantages for certain ship operators.

The Department of Infrastructure and Regional Development (and some other participants) did not see the 2012 coastal trading changes, in and of themselves, as leading to fundamental changes to shipping services:

The Department is not aware of evidence that demonstrates a direct link between any increases in freight costs and the introduction of the new coastal trading legislation ... (sub. 42, p. 12)

However, the Department (and others) acknowledged the high costs faced by Australian flagged vessels:

... Australian flagged ships are faced with a more expensive cost structure than their foreign flagged counterparts, primarily due to higher wage rates through enterprise agreements, higher Australian insurance costs and bunkers (fuel) at Australian prices. (sub. 42, p. 12)

Overwhelmingly though, inquiry participants argued that coastal shipping regulation generally was an important factor in reducing competition and increasing shipping costs for Tasmanian businesses. Some inquiry participants suggested that coastal shipping deregulation would result in the return of main liner consortia calling on Tasmanian ports. For example:

The Australian Competition and Consumer Commission stated:

Additional costs imposed on international lines may affect whether such lines compete in the market for Australian coastal shipping. Where domestic trade represents an international shipping line's marginal business, any additional costs or regulatory requirements to carry domestic cargo act as a general disincentive to entering the domestic shipping market. (sub. 28, p. 10)

The existing regulatory framework clearly affects Australian coastal shipping more broadly. The cumulative effect of the recent changes has been a reduced interest from international vessels engaging in the Australian coastal trade and, consequently, reduced shipping options for users of domestic shipping services. They also increase the costs of providing domestic coastal services, to which Tasmania remains especially exposed.

The Commission notes that the Australian Government has foreshadowed a review of the coastal trading regulatory framework as part of a broader commitment to reducing red tape. In view of the higher shipping costs evident in Tasmania, and the likely broader impacts on Australian businesses generally, it is important that this work be expedited with the objective of increasing the competitiveness of Australia's coastal shipping. At a minimum, the review should recommend the removal of any anticompetitive provisions from relevant legislation, unless a clear case publicly demonstrates that there is a net benefit to the community as a whole.

Investment

Another key issue affecting Tasmania's economic performance is its limited ability to attract private capital. There is a perception amongst stakeholders that government sector involvement, combined with unclear infrastructure strategies, have stifled private sector investment. The purported lack of capital is exacerbated

by constraints on public sector budgets. Most freight-related assets in Tasmania are owned by the state government including TT-Line, TasPorts, TasRail and Tasmania's road authorities. None is earning a sustainable rate of return on assets. This severely limits new investment and future options.

Tasmanian ports

Ports are an integral link in supply chains and, in a capital constrained environment, it is critical that investment decisions be made commercially.

TasPorts, a state-owned enterprise established in 2006, is responsible for the management of 12 Tasmanian ports, including the four major ports: Burnie, Devonport, Bell Bay and Hobart. The majority of freight moves through the three northern ports, while Hobart is largely focused on cruise ships and Antarctic operations.

For the three northern ports, the Tasmanian Government has a strategy of 'one port, three locations'. In 2012-13, the total throughput of Tasmania's three northern ports was around 451 000 TEU, of which Burnie and Devonport accounted for around 56 per cent and 43 per cent of container traffic respectively. Bell Bay is predominantly a bulk port.

However, there are competing perspectives on the future development of Tasmanian ports. The Commission understands that TasPorts is currently in the process of developing a long term plan based largely on retaining the three ports through a strategy of port specialisation and incremental investment in infrastructure. An alternative proposal is for TasPorts to focus its future investment more narrowly through port rationalisation. A number of submissions argued that this would allow greater economies of scale to be achieved through consolidation of the freight task, and provide a more certain environment for planning and investment across other elements of the logistics chain, which could lower costs for users.

There is some evidence put forward by inquiry participants to suggest that TasPorts costs are high relative to other Australian ports. This is not surprising. On the basis of published material, it is difficult to determine whether the cost differences are due to scale or to other factors such as ageing and inefficient infrastructure, or the exercise of strategic behaviour by TasPorts. The fact that TasPorts is not generating a commercial rate of return on its assets, as required in its Statement of Expectations, suggests that it may not be charging users the full cost of the services it provides, or may be doing so for the use of some assets only. The current approach to pricing adopted by TasPorts — statewide uniform pricing — is likely to reduce flexible cost management and investment and involve cross-subsidies across

ports and port activities. The extent to which uniform pricing masks price signals and limits the potential for competition between Tasmanian ports, while supporting less efficient ports at the expense of others, is unclear.

Against this background, there is an urgent need to articulate and implement a clear port strategy for Tasmania. This would provide the basis for a more effective approach to the use of scarce capital, while at the same time removing uncertainty for business development and the establishment of road and rail links.

To ensure that Tasmanian ports have access to appropriate capital to increase their efficiency and improve their competitiveness, the opportunities and possible models for private sector involvement should be considered by the Tasmanian Government. Privatisation and long term leasing of ports is a growing component of structural reform programs in several mainland jurisdictions, with the Port of Melbourne the only major capital city port on the east coast still owned/operated by a state government and the NSW Government further advancing the privatisation of regional ports. Such a move would provide an opportunity to reprioritise and redirect scarce public sector capital to more areas where there is a market failure.

Tasmanian roads and rail

Competitive and cost-effective freight connectivity between ports and land-side freight corridors is an essential enabler for the Tasmanian economy.

The road network in Tasmania accounts for the majority of the freight task to and from ports. As such, the efficiency of road freight networks has implications for other modes of freight infrastructure.

While Tasmania has an extensive road network, there are limitations on the use of high productivity vehicles such as B-doubles. On balance though, road accessibility does not appear to be a significant constraint on the Tasmanian freight task. As is the case nationally, there is a disconnect between road funding and the pricing of, and demand for, road use services.

In its final report to the Tasmanian Government, the Freight Logistics Coordination Team noted the need to prioritise road investment on the main freight corridor linking Hobart to Burnie-Devonport and on the key regional freight roads that connect to this corridor including the Bass Highway, East Tamar Highway and Frankford-Birralee-Batman corridor.

Road funding is provided by all three levels of government — Commonwealth, State and local. Over the period 1998-99 to 2011-12, the Australian Government's

share of road funding in Tasmania has averaged 43 per cent, significantly above the Australia-wide average of 27 per cent. Australian Government funding has been allocated through programs such as: the National Network; Black Spots; Roads to Recovery; and Local Government Financial Assistance Grants Identified for Roads. In addition, funding may also be allocated to particular projects on a case by case basis. Australia's fragmented model for road funding leads to a less than optimal allocation of investment, with funding not necessarily targeted to where it would deliver the greatest net benefits.

A notable feature of Tasmania's land freight infrastructure is the duplication of important elements of the road and rail networks which provides some degree of substitutability between the two modes. Rail accounts for a small share of the Tasmanian land freight task (18 per cent on a tonne kilometres basis in 2011-12 compared to more than 50 per cent nationally in 2009-10), with cement, coal and mineral ores accounting for the bulk of rail freight.

Rail has had a chequered history in Tasmania under Tasmanian and Australian Government ownership, and part-private operation. The rail network returned to full Tasmanian Government ownership in 2009, and has continued to operate at a loss. Rail is generally profitable for long-distance routes, which do not exist in Tasmania.

A key issue for the Tasmanian Government to consider is the long term viability of its rail network. While substantial upgrades to tracks and rolling stock have recently been funded by the Australian and Tasmanian Governments, it is unclear whether these are justified on the basis of the expected rate of return on invested capital. The net benefits of rail investment and ongoing financial support for moving freight need to be judiciously considered from a long term and whole-of-Tasmania perspective, given the possible alternative use of these funds at a time when meeting other demands for infrastructure services is increasingly difficult. This is particularly pertinent in the context of TasRail's poor financial performance.

The commercial sustainability of TasRail could be improved by increasing its revenue base, either through higher freight charges and/or increased capacity utilisation (although higher charges could also reduce usage). To the extent that capital improvements to the network increase the speed and capacity of rail travel, and there is efficient terminal infrastructure for transferring cargo to and from ships and trucks, there may be greater uptake of rail freight. Expansion of the rail freight task is likely to rely on opportunities for new bulk customers such as new mining operations. The Tasmanian Government should assess the relative merit and commercial viability of future strategic options for TasRail.

Alternatively, network rationalisation could provide an opportunity to reduce costs while maintaining most of the current freight volumes. The total distance of operational track is currently around 600 kilometres, which is roughly twice the distance between Hobart and Burnie — the main freight corridor. This suggests there is potential scope to rationalise elements of the network where there is insufficient demand to cover operating costs.

Recent rail investment is likely to have delivered a higher return to the Government and Tasmania if it had been directed to other Tasmanian transport infrastructure (such as increased capacity for B-Double use). Capital constraints and the importance of freight costs to Tasmanian businesses make rigorous comparative analysis of alternative future investment options imperative, including for recent funding commitments. The proposed Tasmanian Freight Strategy provides an avenue to establish the framework for such assessment.

An integrated freight strategy

More generally, Tasmania suffers from a lack of an integrated freight strategy across all components of the supply chain. This increases the risk of inefficient decision making in relation to road and rail corridors, their connectivity to ports and duplicated infrastructure. In this context, the Commission supports the development of a long term integrated freight strategy for Tasmania which addresses the fundamental issues of productivity and effective capital allocation. A jurisdiction with a small population and tax base is unlikely to be able to maintain a full and duplicated array of assets. The development of such a strategy will help to ensure that developments in freight infrastructure are supportive of Tasmania's long term economic growth prospects. While governments should play a key role in developing a long term integrated plan for the state, and the Tasmanian Government is currently undertaking such a process, it needs to be transparent, evidence based and include wide consultations with industry and the community at large, and provide opportunities for private sector investment and operations.

A more integrated and transparent approach to freight movements may also be beneficial in terms of addressing the flow of empty containers in the Tasmanian freight system. It is estimated that empty containers account for around 33 per cent of outbound containers and 21 per cent of inbound containers. Repositioning costs can be significant. The onus is primarily on shippers to ensure that cost saving opportunities are realised through the sharing of information that may assist in reducing the flow of empty containers. The Commission understands that this issue is relevant not just in Tasmania but one that has proved intractable on many trade routes.

Tackling the fundamentals

The TFES, TWFS and BSPVES are understandably popular with most Tasmanian stakeholders. However, collectively the schemes are not able to meaningfully promote Tasmania's economic growth, given the broader economic challenges the state faces.

As articulated in its draft report on geographic labour mobility, the Commission sees merit in policies which encourage people to move in response to changing economic conditions (PC 2013a). Where governments seek to sustain population in a particular region, approaches to make the region concerned more attractive to capital generally — such as improving productive infrastructure, upgrading labour force skills, removing inefficient taxes and improving administrative efficiency — are preferable to sponsoring selected firms or incentivising businesses to locate (or remain) there through subsidies. Importantly, such a strategy should be aligned with an overarching approach that is consistent with comparative advantages.

The draft report on geographic labour mobility also commented on labour market issues in Tasmania specifically. It identified high wages, combined with low skill levels, as a possible cause of persistently high unemployment levels in Tasmania.

In light of this, the Commission considers that the Australian Government should change the focus from freight subsidy schemes to policy reforms which have national and Tasmanian benefits (such as coastal shipping reform) and those which directly enhance the competitiveness and productivity of the Tasmanian economy.

Where governments nevertheless pursue direct expenditure-based programs, the costs and benefits of a range of options should be assessed. For example, funding of the existing freight and passenger schemes could require more than \$2 billion in net present value terms over the next 15 years. Redirected effectively, this funding could provide the fiscal basis for more cost-effective policies and programs to be rolled into an overarching economic development strategy for Tasmania.

The Australian Government should work with the Tasmanian Government and other stakeholders to establish and implement an economic development strategy that maximises the long-term economic prospects of Tasmanian businesses and residents. This should address the competitiveness and efficiency of the transport sector, but also examine other areas of economic and social policy in Tasmania.

Successful economic development strategies give priority to policies and other initiatives (including targeted assistance measures) that remove impediments to industry and regional adjustment, and improve the productivity and underlying cost structure of each region. This is the most meaningful way of achieving positive

outcomes for states or regions like Tasmania. It requires the active involvement of all levels of government in a number of key areas, including:

- improving employment outcomes, for example, through skilling and training
- improving coherence in infrastructure provision — by developing and implementing an integrated long term strategy for investment based on economic returns
- creating an environment for more private sector involvement in infrastructure provision and operation
- removing subsidies to inefficient industries
- creating a regulatory environment that reduces the cost of doing business in Tasmania and delivering efficient public services that make a lesser call on taxes and charges to fund them.

It is also clear that some regional economies experience very different labour market issues relative to the national economy generally. The Australian Government has foreshadowed an inquiry into the Fair Work Act and Australian labour markets. This inquiry has seen indications that regional factors should be examined in that inquiry.

Meshing with existing plans and programs

There is already an assortment of economic development plans and strategies for Tasmania. These include initiatives developed and funded by all levels of government, and covering a range of industries and activities. It is not clear that the existing suite of initiatives is collectively coherent and optimal for Tasmania as a whole. In particular, are the various plans consistent and complementary in their design and intent?

In the limited time and evidence made available for this inquiry, it appears that most strategies are individually aimed at limiting some aspects of disadvantage. They do not appear informed by any genuine questioning of the value of retaining structures that have not delivered improved outcomes for Tasmania over long periods.

The Commission considers that an important first step in improving the existing approach to economic development in Tasmania is the conduct of a stocktake of existing initiatives to clarify their nature, intent, timing, coverage, governance arrangements, and any areas of duplication.

The Australian and Tasmanian Governments should jointly undertake the stocktake and review with a view to having a publicly available report by the end of 2015.

The results should be used by the Australian and Tasmanian Governments to inform a fundamental and comprehensive policy strategy, to enhance structural reform and the economic development of Tasmania, and ensure related policies and programs generate the greatest net benefit to the state as a whole.

The Commission notes that a Joint Commonwealth and Tasmanian Economic Council has recently been established to consider competitive reforms to enhance Tasmania's long term economic growth prospects. This Council is well placed to undertake or commission such a review as part of its initial work program.

Review and evaluation

One of the deficiencies of the existing freight subsidy schemes is the lack of evaluation of their impacts over time.

The Commission considers that programs should be reviewed and evaluated periodically and transparently. Such reviews should be conducted by an appropriate independent body and, apart from an ex-post assessment of the aggregate benefits and costs of the strategy to date, should also include an assessment of the benefits and costs of any continued Australian Government financial contribution to the strategy.

Draft recommendations and information requests

The time frame for this inquiry has constrained the Commission's ability to analyse all the issues in the terms of reference with an equal amount of depth. In areas where the Commission considers that it has sufficient evidence, draft recommendations have been put forward. In areas where the Commission has had access to limited information or considers further evidence is required to inform a recommendation, further information is being sought from participants.

Draft recommendations

Reforms with national and Tasmanian benefits

DRAFT RECOMMENDATION 1

(CHAPTER 4)

The Australian Government should proceed with the foreshadowed review of coastal shipping regulation as soon as possible. The objective of the review should be to achieve the most efficient coastal shipping services feasible for Australia.

The TFES

The Commission does not consider that the Tasmanian Freight Equalisation Scheme is the best way to promote Tasmania's economic development, but acknowledges the Government's intention to retain the scheme in some form. The following recommendations are made on this basis.

DRAFT RECOMMENDATION 2

(CHAPTER 2)

If the Australian Government chooses to retain the Tasmanian Freight Equalisation Scheme in essentially its current form, it should ensure that the payment rates are based on the findings of Bureau of Infrastructure, Transport and Regional Economics parameter reviews. These reviews should be conducted every two years. Payment rates should be revised to reflect the latest available parameter estimates.

DRAFT RECOMMENDATION 3

(CHAPTER 2)

Future Tasmanian Freight Equalisation Scheme parameter reviews should be undertaken by the Bureau of Infrastructure, Transport and Regional Economics using a public multi-stage process, comprising:

- *release of a draft report, containing the estimated parameter updates and underlying assumptions and data;*

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- *a public submission process that allows interested parties sufficient time to provide input; and*
 - *release of a final report that incorporates resulting feedback and evidence.*

DRAFT RECOMMENDATION 4**(CHAPTER 2)**

The Australian Government should respond publicly and in a timely manner to all Tasmanian Freight Equalisation Scheme parameter reviews. All responses should be released before the end of the calendar year in which the parameter review is completed to provide certainty for recipients, and provide sufficient lead time for any resulting revisions to payment rates to be incorporated into Commonwealth Budget processes.

DRAFT RECOMMENDATION 5**(CHAPTER 3)**

The Australian Government should introduce payment of sea freight assistance as a single flat rate of subsidy per TEU (twenty foot equivalent unit) shipped.

The Bureau of Infrastructure, Transport and Regional Economics should recommend a dollar amount for assistance, taking into account:

- *the parameter or parameters that the flat rate should be based on; and*
- *that the flat rate should provide assistance that is compatible with the incentive to seek the lowest shipping cost.*

If the Government does not adopt a flat rate, assistance under the Tasmanian Freight Equalisation Scheme should only be payable on the basis of evidence of actual wharf-to-wharf cost.

DRAFT RECOMMENDATION 6**(CHAPTER 3)**

The Department of Infrastructure and Regional Development should provide more comprehensive public reporting of information under the Tasmanian Freight Equalisation Scheme, including annual payments to recipients.

DRAFT RECOMMENDATION 7**(CHAPTER 3)**

The Department of Human Services should examine the benefits and costs, including compliance costs for claimants, of upgrading its technology to provide greater access to online claims under the Tasmanian Freight Equalisation Scheme and improve internal claims processing.

DRAFT RECOMMENDATION 8**(CHAPTER 3)**

The Department of Infrastructure and Regional Development should impose a threshold on the minimum value of a claim line item under the northbound component of the Tasmanian Freight Equalisation Scheme to distinguish between business and minor transactions.

DRAFT RECOMMENDATION 9**(CHAPTER 3)**

The Department of Infrastructure and Regional Development should extend the self-assessment facility under the Tasmanian Freight Equalisation Scheme to more claimants.

The TWFS

DRAFT RECOMMENDATION 10**(CHAPTER 3)**

The Australian Government should terminate the Tasmanian Wheat Freight Scheme as its original policy rationale and therefore the scheme itself are redundant.

The calculation of assistance for wheat (and other grains) shipped in containers under the Tasmanian Freight Equalisation Scheme should be based on the lowest cost option for transporting grain to Tasmania.

The BSPVES

DRAFT RECOMMENDATION 11**(CHAPTER 3)**

Given that the main objective of the Bass Strait Passenger Vehicle Equalisation Scheme appears to be the provision of support for Tasmania's inbound tourism, the Australian Government should examine alternative use of the funds under the scheme to pursue this objective more effectively and transparently.

To the extent that the scheme has a broader objective — including outbound travel from Tasmania, the Government should clearly articulate this objective and evaluate the scheme on that basis.

*Improving the competitiveness of Tasmanian freight***DRAFT RECOMMENDATION 12****(CHAPTER 4)**

The Tasmanian Government should articulate its underlying objective/s in owning and operating a shipping business and assess whether ownership of the TT-Line is the most cost-effective way in which to achieve those objectives.

DRAFT RECOMMENDATION 13**(CHAPTER 4)**

The Tasmanian Government should assess the commercial viability of TasPorts and potential changes to enhance its operation. The assessment should include a consideration of alternative models for the provision of port infrastructure, including the feasibility of privatisation, long term leases, and targeted divestment of port assets.

*Improving the coherence of infrastructure investment***DRAFT RECOMMENDATION 14****(CHAPTER 5)**

The Commission endorses the need for a comprehensive, long term integrated freight strategy for Tasmania. As the Australian Government will retain a role in funding Tasmanian infrastructure investments, it is appropriate that it (including through Infrastructure Australia) have a role in developing that strategy.

In developing the strategy, there should be broad consultation between industry, all levels of government, and the community more generally. A benefit-cost framework should be applied that identifies the most efficient use of investment capital and which clearly identifies the net benefits or trade-offs arising from community service initiatives or region-specific development objectives. As a matter of urgency, the strategy should:

- identify Tasmania's likely future freight infrastructure requirements across all modes — sea, road, rail and air*
- address port developments, including specialisation or rationalisation of existing infrastructure*
- address the long term role of rail in Tasmania given the high degree of substitutability with road transport*
- ensure that the objectives of government business enterprises for ports, sea freight and rail are consistent with commercial sustainability.*

Improving future economic development in Tasmania

DRAFT RECOMMENDATION 15

(CHAPTER 6)

The Joint Commonwealth and Tasmanian Economic Council should undertake or commission a stocktake and review of existing policies and agencies associated with the pursuit of economic development in Tasmania as part of its initial work program. The review should:

- *cover initiatives established by all levels of government*
- *clarify their nature, intent, timing, scope, governance arrangements and any areas of duplication*
- *assess whether the suite of initiatives represents a coordinated, consistent, targeted, and efficient approach to Tasmania's economic development*
- *include the release of a public report by the end of 2015.*

The results of the stocktake and review should contribute to and inform the development of an integrated economic development strategy for Tasmania.

DRAFT RECOMMENDATION 16

(CHAPTER 6)

The Australian Government should review and evaluate its programs for Tasmania after a reasonable length of time. Such reviews should be transparent, be conducted by an appropriate independent body and should comprise an ex-post assessment of the aggregate benefits and costs of the strategy to date and an assessment of the benefits and costs of any continued Australian Government financial contribution to these programs.

Information requests

INFORMATION REQUEST 1

(CHAPTER 3)

What would be the potential impacts (both positive and negative) on Tasmanian firms and industries, and the Tasmanian and Australian economy more broadly, of the following optional changes to the coverage of the Tasmanian Freight Equalisation Scheme within current funding levels:

- *extending the northbound component of the scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne*
- *extending the northbound component of the scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne **and** removing the southbound component of the scheme for all goods shipped from the Australian mainland to Tasmania?*

INFORMATION REQUEST 2

(CHAPTER 3)

What minimum claim value (per claim line item) would meet the objective of the Tasmanian Freight Equalisation Scheme while reducing administration costs for government and compliance costs for businesses?

INFORMATION REQUEST 3

(CHAPTER 4)

To what extent does the government-owned TT-Line provide competitive pressure in the Bass Strait shipping market? Would a scenario with only the two commercial shippers provide a more cost-effective outcome?

INFORMATION REQUEST 4

(CHAPTER 4)

What would be the potential impacts (both positive and negative) and efficacy of an alternative approach to the current TFES/BSPVES model whereby the Australian and Tasmanian Governments would use their current financial commitments under the schemes to cease paying individuals and businesses and instead secure more directly the Bass Strait freight and passenger services they are seeking through a periodic open tender process?

INFORMATION REQUEST 5

(CHAPTER 4)

What specific benefits would there be for Tasmanian shippers from removing restrictions on coastal shipping?

INFORMATION REQUEST 6**(CHAPTER 4)**

To what extent will the Tasmanian Government and TasPorts' plan for port specialisation enable Tasmanian ports to capture the efficiencies available from greater scale?

INFORMATION REQUEST 7**(CHAPTER 4)**

To what extent is uniform pricing distorting decisions in regards to activities and investment at Tasmanian ports?

To what extent does the current pricing strategy of TasPorts reflect efficient costs of providing the port infrastructure and services?

INFORMATION REQUEST 8**(CHAPTER 5)**

Is the current gazetted road network a significant constraint on the use of High Productivity Vehicles in Tasmania? Is there a case for allowing the use of higher mass limit vehicles on some routes?

INFORMATION REQUEST 9**(CHAPTER 5)**

How do road freight costs in Tasmania compare with costs of equivalent services on the mainland? Are there any competition issues in the road freight market given the presence of integrated freight logistics businesses?

INFORMATION REQUEST 10**(CHAPTER 5)**

What scope is there for parts of the rail network in Tasmania to be rationalised?

What are the nature and extent of any positive spillover benefits from rail that justify continued public subsidisation of rail freight charges? If rail charges were to be increased to reflect the full cost of service provision, what would be the impacts on current users and on the commercial sustainability of TasRail?

What is the scope for some form of private investment or operational service provision in rail?

1 Introduction and scope

1.1 A matter of geography

Tasmania is an island state and so the interstate movement of freight is heavily reliant on shipping services across Bass Strait. The cessation in 2011 of weekly direct international container shipping services to and from Tasmania has meant that most international container freight is currently transhipped through the Port of Melbourne.

Shipping tends to rely on long distances to realise its cost advantages and shipping goods across Bass Strait is generally more costly than transporting goods equivalent distances by road or rail. The costs of getting goods to market and conducting business over Bass Strait are an important consideration for Tasmanian businesses.

Australian Governments have for many years operated subsidy schemes to help offset these costs through the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES). Recent reviews have noted that the schemes do not achieve their stated objectives, or deliver efficient outcomes.¹ Real Australian Government outlays on the TFES have been around \$100 million per year for the past decade.

In a broader context, the Australian Government has noted:

Tasmania has the lowest gross state product per capita in Australia, the nation's highest unemployment rate, the nation's lowest life expectancy, the highest standardised death rate due to suicide, the lowest proportion of adults in the nation who have attained a year 12 qualification, one of the nation's lowest retention rates to year 12 and the highest proportion of people without superannuation coverage. (Coalition 2013, p. 2)

This stark backdrop suggests that the competitiveness of Tasmania's transport infrastructure and services need to be viewed through a wider and longer term lens.

¹ These include the Australian National Audit Office's 2011 assessment of the Tasmanian Freight Equalisation Scheme (ANAO 2011); Infrastructure Australia's Tasmanian ports and freight strategy report (Infrastructure Australia 2012b); and the Freight Logistics Coordination Team (established by the Australian and Tasmanian Governments in 2012 to provide expert advice on Tasmania's freight system) report on delivering improved freight outcomes for Tasmania (FLCT 2013a).

The longstanding lack of clarity about the objectives of the subsidy schemes identified in many reviews adds to the difficulty of determining whether these subsidies aim to offset a natural cost disadvantage, or address fundamental structural issues, or both. A central issue for this inquiry is whether (and to what extent) the subsidy schemes enhance the competitiveness of Tasmania's freight industry, or conversely, work against it by further entrenching reliance on government support.

It is for these reasons that the terms of reference go beyond an assessment of freight subsidies to also embrace matters of integrated supply chain logistics encompassing shipping, port, road, and rail services.

1.2 What the Commission has been asked to do

The Government has asked the Commission to review shipping costs and the competitiveness of Tasmania's freight industry structure, and assess the current arrangements for supporting freight and passenger services between the mainland and Tasmania. The major issues under consideration are:

- Tasmania's freight task in the broader context of Tasmania's economy
- the effectiveness of the current freight and passenger vehicle subsidy arrangements, and how these arrangements could be improved
- the drivers of freight costs in Tasmania, with a focus on the competitiveness of shipping, port, road and rail services, and possible reforms to enhance their efficiency
- alternative approaches that could more effectively address Tasmania's economic challenges.

In responding to these issues, the Commission has examined the underlying causes of the relatively high transport costs facing Tasmanian businesses and consumers and how these might be addressed. It has also focused on the alignment of the objectives and outcomes of the subsidy schemes. In examining some of these matters, the Commission has consulted with the Australian Competition and Consumer Commission.

The Commission's approach

The Commission's approach is guided by the terms of reference and the policy guidelines in the *Productivity Commission Act 1998* (Cwlth). Guidelines of particular relevance to this inquiry are the requirements to encourage the

development of efficient and internationally competitive Australian industries; to promote regional employment and development; and to improve the productivity and economic performance of the economy. As the Commission is required to recognise the interests of the community generally, it must look not only at the interests of Tasmania, but also the impacts of policies on the Australian community as a whole.

1.3 Conduct of the inquiry

Public inquiries involve extensive consultation with all interested parties, participants preparing submissions, and the Commission undertaking policy analysis and developing a draft report. The Commission may conduct public hearings at several stages of the inquiry, including after receipt of further submissions from participants on the draft report prior to a final report being finalised.

The terms of reference for this inquiry were received on 29 November 2013, specifying a final reporting date of 7 March 2014. Given the limited time available, the Commission advertised the inquiry in newspapers, on its website and in a circular, and invited initial public submissions by 14 December 2013. This draft report was released on 24 January 2014. The due date for submissions on this draft report is 7 February 2014, coinciding with public hearings around that time.

Owing to the tight schedule, an issues paper — a normal part of the inquiry process — was not prepared. Instead, the Commission embarked immediately on stakeholder consultations and over the subsequent two months met with producers, shipping companies, government agencies and other interested parties, mainly in Tasmania (appendix A). The Commission has received 61 written submissions (appendix A) which are available on the inquiry web page. Appendix C on coastal trading regulation is an online appendix that can also be accessed on the inquiry web page.

The Commission thanks all interested parties for their endeavours in meeting the short timeframe.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the inquiry report.

Draft

2 Tasmania's freight in context

Key points

- Tasmania faces a number of economic challenges. Relative to the national average, economic growth is slower, unemployment is higher, participation rates are lower and the private sector accounts for a smaller share of economic activity.
- As with all businesses across Australia, the productivity and economic performance of many Tasmanian businesses is affected by their ability to move goods through supply chains to intra- and inter- state markets, as well as markets overseas.
- However, as an island state, Tasmania's reliance on sea freight, as opposed to rail and road, means that Tasmanian producers face relatively high freight costs when competing in mainland markets.
 - The Tasmanian Freight Equalisation Scheme (TFES) and the Tasmanian Wheat Freight Scheme (TWFS) were designed to partly offset these costs.
- Under the TFES, cost 'disadvantage' is defined as the difference between the actual sea freight costs across Bass Strait between northern Tasmanian and Victoria, and the notional road freight costs of moving goods an equivalent distance on the mainland.
- The TFES is currently administered on the basis of 1996-97 parameter estimates. Based on latest Bureau of Infrastructure, Transport and Regional Economics (BITRE) estimates, these parameters substantially overcompensate businesses for the freight cost disadvantage as defined by the TFES.
 - While costs for Tasmanian sea freight have risen over recent years, mainland road freight costs have risen at a faster rate.
- Many other Australian regions face significant costs to transport goods to markets due to their remoteness or the absence of a rail link or all-weather roads. However, businesses in such regions have established there in response to other locational advantages and seldom receive explicit government freight subsidies.
- The Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) is designed to assist in alleviating the cost of sea travel across Bass Strait for passengers accompanying an eligible vehicle.
- Quantification of any cost disadvantage associated with the movement of accompanied passenger motor vehicles across Bass Strait is problematic.
- While the BSPVES led to an initial reduction in real after-subsidy fares, this has been steadily eroded in the decade and a half since the scheme's introduction.
- The total number of passengers travelling across Bass Strait has doubled over the past decade, driven by rising numbers of air passengers following the entry of low cost airlines and discount air fares.
 - Around 90 per cent of passengers travelling across Bass Strait now travel by air.

2.1 Tasmania's economy at a glance

Tasmania is an island state, home to around half a million people. It is endowed with many natural assets — high rainfall, fertile soils, large fish stocks, substantial forestry resources and an attractive natural environment. These features, combined with a relatively low cost of living, low traffic density and a range of cultural attractions contribute to a unique lifestyle enjoyed by Tasmanians.

Despite the host of positive attributes that provide the foundation for Tasmania's comparative advantages, Tasmania's economic performance has persistently been below trend relative to the rest of Australia. This is reflected in a range of economic indicators including income, employment, investment and productivity, as well as in terms of social metrics such as education and health outcomes.

Over the past decade, the Tasmanian economy, measured by gross state product (GSP), has grown more slowly than the Australian economy overall (figure 2.1, A). In 2012-13 Tasmania recorded the lowest average annual GSP growth of all Australian states and territories. In the same year, Tasmania's labour productivity (output per hour worked) was around 15 per cent below the national average. In addition, estimates of multifactor productivity growth (MFP) by state and territory indicate that over the past two decades Tasmanian MFP growth was the lowest of all jurisdictions with the exception of the Northern Territory (Cunningham and Harb 2012).

The widening gap between Tasmanian and national employment outcomes evident over the past five years, including lower aggregate hours worked and higher rates of unemployment (figure 2.1, B), has spurred an increase in migration from Tasmania to mainland states, mainly among younger workers. An inflow of interstate migrants in the older demographic bracket has only partly offset this trend, exacerbating the small and steadily ageing nature of Tasmania's population. Recent projections suggest that Tasmania is likely to have the smallest population growth over the period to 2040 and remain the jurisdiction with the oldest population — with the age gap between Tasmania and the rest of Australia projected to widen in coming decades (ABS 2013c).

Tasmania's industry structure has undergone significant structural change in recent decades (Department of Treasury and Finance (Tasmania) 2013). Once known as the 'Apple Isle', Tasmania's economy has traditionally been based on natural resources — either as primary products or as resource-based manufactures. The Agriculture, forestry, and fishing sector accounts for a larger share of output than for the Australian economy overall (figure 2.1, C). While its share has remained relatively stable in terms of gross value added, significant diversification has taken

place within the sector, with a shift from traditional products (apples and pears) to higher value products such as processed vegetables, stone fruit and salmonoids.

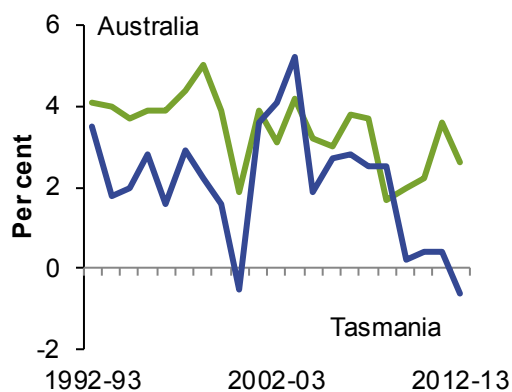
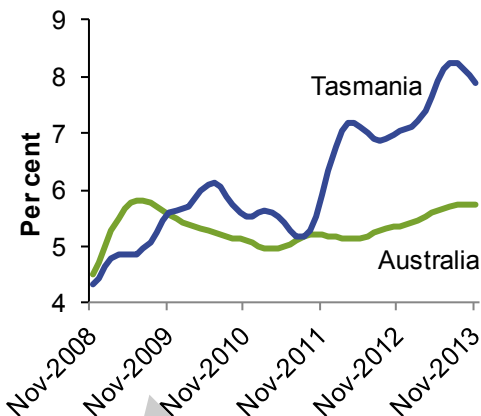
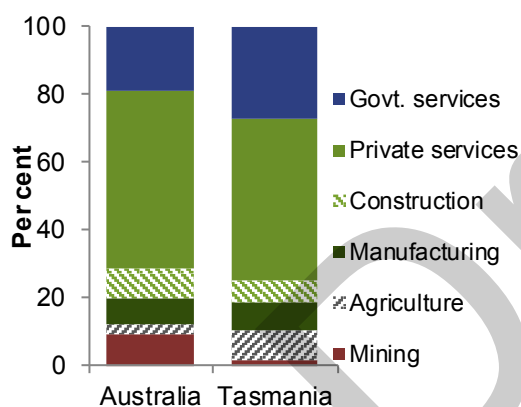
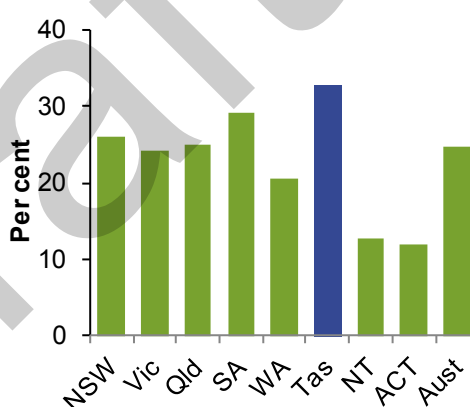
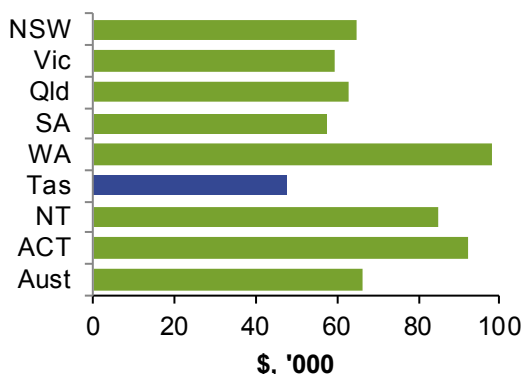
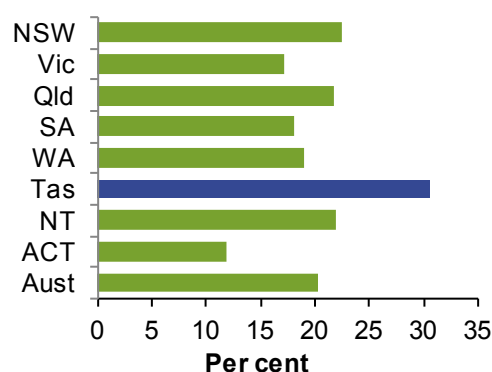
In the last decade, there has been a notable decline in Tasmania's manufacturing output. This sector had for many years accounted for a larger share of Tasmania's output compared to its share for Australia overall. This decline, driven largely by contractions in food and beverages, wood and paper products, and textiles, clothing and footwear, has seen manufacturing's share of gross value added fall to around the national economy average (around 8 per cent).

Structural changes have reinforced the demand for high frequency shipping services across Bass Strait for a number of industries. The high cost of Bass Strait shipping services (for reasons discussed later) is felt most keenly by manufacturers operating in more trade exposed wholesale and retail markets.

Like most advanced economies, growth has typically been in service industries — notably health care, construction and tourism. Within the services sector, the contribution of private services has increased relative to public services. However, Tasmania still retains a large public sector relative to the rest of Australia (around 27 per cent of gross value added compared to a national average of around 19 per cent, figure 2.1, C).² Expenditure on health care and community services is expected to continue to increase in line with Tasmania's ageing demographic profile.

Tasmania's small, dispersed and slow growing domestic market means that for its industries to grow, they must export their products and services, either to markets on the mainland or overseas — or, in the case of tourism, attract visitors from outside Tasmania. For example, around 75 per cent of Tasmania's total food production is currently sold in interstate (50 per cent) or in international markets (25 per cent) (sub. 43). This means the efficient and cost-effective movement of freight, and people, to and from Tasmania is integral to overall economic performance.

² In addition, direct employment by all three levels of government as a share of total employment was over 5 percentage points higher in Tasmania than for Australia as a whole in 2013.

Figure 2.1 **Tasmania's relative economic performance, selected indicators****A: GDP/GSP real annual growth rates****B: Unemployment rates (trend)****C: Gross valued added shares, 2012-13^a****D: Households with government payments and benefits as main source of income, 2011-12****E: GDP/GSP per person, 2012-13****F: Educational attainment — share of workforce with year 10 as highest qualification, 2013**

^a Following Department of Treasury and Finance (Tasmania) (2013), public expenditure is approximated by divisions O, P, Q, and private expenditure covers divisions D, F to N, R and S. Excludes ownership of dwellings.

Data sources: ABS (2013a,b,c,e).

Tasmania's geographic advantages and disadvantages

The economic performance of Tasmania reflects external influences from the national and global economies as well as internal drivers. Previous reviews (TFES Review Authority (Nixon) 1998, BITRE 2008) identified a number of factors affecting Tasmania's long term growth, some of which are natural endowments.

The island's identity and geography provide businesses with advantages in product branding — such as Cascade lager and King Island dairy products. Tasmania's niche appeal also provides a platform for investment in high-value low-volume products and services particularly in agriculture, aquaculture and tourism. Bass Strait provides some 'natural protection' to Tasmanian-based businesses in the form of a freight cost advantage over their counterparts on the mainland in supplying goods to consumers and businesses in the (albeit small) Tasmanian markets.

These advantages notwithstanding, Tasmania's remoteness and decentralised settlement patterns pose challenges, including limiting the benefits available from specialisation, economies of scale and competition between producers and service providers.

All countries and regions are affected by economic geography. Indeed, research by the OECD and others has shown that Australia — as one of the most remote advanced economies in the world — has faced, and through sound overall policy settings, largely overcome, substantial disadvantages stemming from its remoteness from world markets (box 2.1).

While Tasmania's island status means that it faces particular transport challenges that other states and territories do not, many other regions of Australia also incur significant costs to transport goods to markets either because of their remoteness or the absence of a rail link, all-weather roads or, in the case of other islands including Kangaroo Island and the Torres Strait islands, low cost sea links. However, as the Commission noted in its previous study on freight subsidy arrangements (PC 2006c), businesses in such regions have established there in response to other locational advantages and, with some notable exceptions, generally do not receive explicit government freight subsidies.

Australia's experience suggests that the capacity of businesses to exploit the geographic advantages or overcome geographic disadvantages they face is governed largely by the overall policy framework within which workers and individual firms operate. At the broadest level, this covers the extent to which policy settings promote productivity, innovation, efficient investment and flexible labour markets.

Box 2.1 **The economics of geography and remoteness**

Economic geography refers to the location, distribution and spatial organisation of economic activities. The spatial aspects of economic activity can be influenced by different elements of geography and history, including a country's natural resource endowments, location, climate, topography and population settlement patterns.

Research by the OECD and others confirms that differences in economic geography help explain differences in economic performance across countries. Countries that are geographically close to the centres of world economic activity tend to have higher incomes and higher productivity.

It has long been recognised that Australia's geography has at times played an important role in its economic performance (Blainey 1966; Caves 1984). Australia is (with New Zealand) one of the two most remote advanced economies in the world in terms of average distance from world economic activity. Australia's remoteness has imposed economic costs. Battersby and Ewing (2005), for example, found that if Australia was as close to world markets as the United Kingdom, its level of trade would be expected to be around 50 per cent higher.

However, while geographic disadvantage cannot be fully overcome, Australia's experience indicates that the consequences of remoteness can be ameliorated through sound policy settings. Research indicates that Australia has performed well above its predicted level of GDP per capita, given its degree of remoteness. Dolman, Parham and Zheng (2007, p. 36) conclude that '... less tangible differences between countries — such as their institutions, policies and culture — may be more important than remoteness', and have been crucial in Australia's ability to largely offset the 'tyranny of distance'.

Sources: OECD (2008), Dolman, Parham and Zheng (2007), Battersby and Ewing (2005), Caves (1984), Blainey (1966).

Sound transport policies are also critical. In all advanced economies, socioeconomic opportunities are closely related to the mobility of people, goods and services. Tasmania's geography renders it particularly dependent on sea and air transport for accessing mainland and international markets and value chains. With virtually all cargo (over 99 per cent by weight) across Bass Strait carried by sea, shipping links and the associated land side transport infrastructure are vital.

While geography is a significant factor affecting freight costs, other relevant factors are the intrinsic nature of the freight task and the degree of competition in the provision of shipping and land-based freight services. Importantly, government policy settings can also have a major bearing on costs either directly through measures such as cabotage regulation and freight subsidies, or indirectly, through public ownership and other policies that affect the level and nature of competition and investment across freight logistics chains.

2.2 Tasmania's freight task

Tasmanians, like other users of freight transport across Australia, use a range of transport services depending on the freight task. Road and rail move goods to and from ports in Tasmania, and air transport is used for high value and perishable goods. However, unlike most producers on the mainland, Tasmanian producers have a unique reliance on sea freight.

Bass Strait trade

Tasmanian sea freight accounts for 9.3 per cent of the total Australian coastal shipping tonnage, and constitutes over one-third of Australian non-bulk coastal shipping tonnage (BITRE 2013c). However, the short haul nature of Bass Strait shipping means that Tasmania's share of Australia's total coastal shipping task is considerably smaller (5.3 per cent) when measured on a net tonne kilometre basis.

The importance of non-bulk cargo to the Tasmanian coastal trade reflects the unavailability of road and rail freight options for interstate trade. In 2011-12, of all goods loaded and dispatched at Tasmanian ports (for coastal shipping to and from the mainland) over half were non-bulk, compared to 12 per cent of goods handled in all Australian ports.

Total Tasmanian freight shipped in 2011-12 was just under 13 million tonnes, of which an estimated 8.1 million tonnes was bulk trade (table 2.1). Just under half of Tasmanian trade in bulk freight was with the mainland. The main bulk commodities shipped from Tasmania to the mainland were cement and sulphuric acid, while the main commodities received were metallic concentrates and alumina.

International trade accounted for around 52 per cent of bulk trade and was mainly direct, with only around 10–15 per cent of bulk trade transhipped through an Australian mainland port. Major commodities exported were iron ore and wood chips, while the major bulk commodities imported were petroleum oils and manganese ores (BITRE 2013c).

Non-bulk freight accounted for 4.9 million tonnes in 2011-12, with 79 per cent being coastal freight — that is, shipped to and from the Australian mainland — and the remaining 21 per cent comprised international trade. With the cessation of direct international container freight services to Tasmania in May 2011, the majority of Tasmania's containerised international exports and imports are now transhipped (mainly through the Port of Melbourne, see chapter 4).

Table 2.1 **Freight shipped to/from Tasmania, 2011-12**mt = million tonnes, per cent ^a

	<i>Non-bulk trade</i> ^b		<i>Bulk trade</i>		<i>Total trade</i>	
	mt	%	mt	%	mt	%
<i>International</i>						
Exports	0.8 ^c	17 ^c	3.8	47	4.6	36
Imports	0.2 ^c	4 ^c	0.4	4	0.5	4
<i>Coastal</i>						
Northbound	2.0	40	1.9	24	3.9	30
Southbound	1.9	39	1.9	24	3.8	30
Total trade	4.9	100	8.1	100	12.9	100

^a Totals may not sum due to rounding. ^b Excludes empty containers. ^c The majority of Tasmania's non-bulk international trade is transhipped through mainland Australian ports.

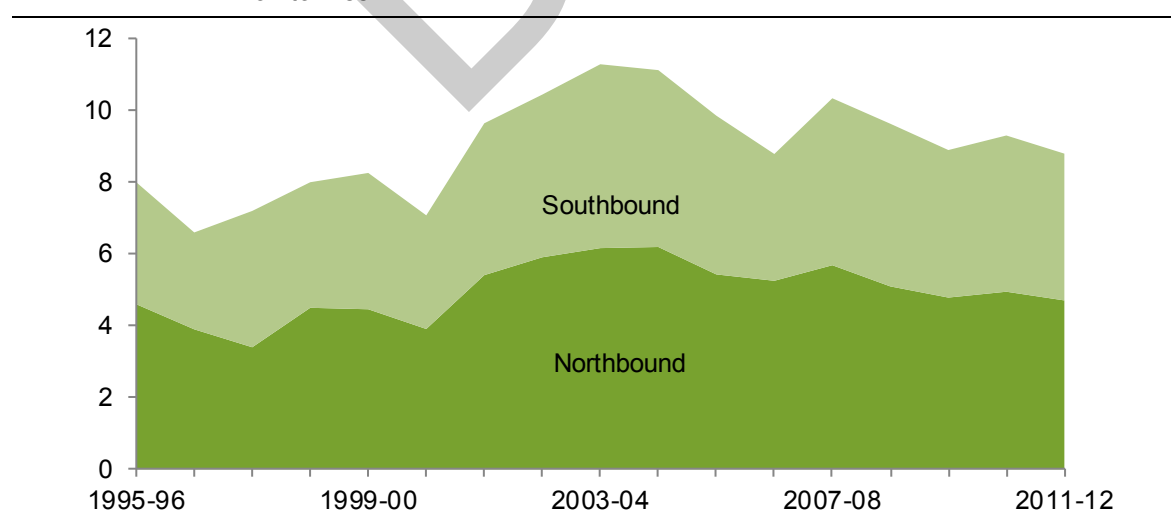
Source: BITRE (2013c).

Trends in sea freight

Sea freight between Tasmania and the mainland grew by nearly 50 per cent between 1995-96 and 2003-04, to reach a peak of just over 11 million tonnes (figure 2.2). Growth during this period was driven by substantial increases in the transport of two significant commodity groups traded on Bass Strait: Metalliferous ores and metal scrap; and Wood and wood products.

Figure 2.2 **Coastal shipping between Tasmania and the mainland ^a**

Million tonnes



^a Includes coastal freight loaded in Tasmania and shipped to mainland Australia ('northbound'), or shipped from mainland Australia to Tasmania ('southbound'). Coastal freight shipped within Tasmania is not included.

Data source: BITRE (2013a) (various years).

From its peak in 2003-04, the total trade volume across Bass Strait has declined — down 22 per cent by 2011-12. Northbound freight makes up slightly more than half of the total tonnage and, in almost all years, changes in the amount of northbound freight were accompanied by broadly similar changes in southbound freight.

Composition of sea freight

The major commodity groups traded between Tasmania and the mainland are listed in figure 2.3. In 2011-12, the major commodity group shipped northwards was Manufactured goods chiefly classified by material, which largely comprised cement, zinc and zinc alloys, and newsprint. Crude materials, including iron ore pellets and sawn timber, were the next largest commodity group shipped to the mainland. Commodities and transactions not elsewhere specified (nes), including large numbers of empty containers, was the next largest group. It is estimated that empty containers account for around 33 per cent of outbound containers and 21 per cent of inbound containers (Aurecon 2013b). The other major commodity groups on the northbound route were Food and live animals; and Chemicals and related products. Significant quantities from these commodity groups were also shipped south to Tasmania, particularly other food preparations (such as frozen or processed foods), unmilled wheat and flours, and meat products. The other major commodity on the southbound route was fuel.

Bass Strait islands' freight task

Industry on King Island and the Furneaux Group of islands (including Flinders Island) is dominated by livestock production. Consequently, the freight task chiefly comprises the export of live animals to markets in Tasmania and Victoria. The nature of the industry means that freight demand is highly seasonal. Key business inputs shipped to the Bass Strait islands include farming goods, machinery and fertiliser.

The King Island beef industry comprises 100 000 head of cattle, representing 22 per cent of Tasmanian beef production. The closure of the island's abattoir in September 2012 saw the nature of the freight task change from refrigerated containerised meat to live shipments — with slaughter cattle now shipped live to Tasmania (and occasionally Victoria if a reverse sailing occurs) (Tasmanian Farmers and Graziers Association — King Island Branch, sub. 8). In addition, Shipping Australia noted that King Island cattle are also carried on a return journey by a regular shipping service from New South Wales (Eden) to Bell Bay (sub. 53).

Because of their geographic isolation, businesses located on King Island and the Furneaux Group of islands are relatively more vulnerable to changes in the cost and reliability of shipping services. The Flinders Council noted:

As a remote island chain, the Furneaux Group has a critical need for timely, reliable and cost effective shipping and freight services to support the ongoing viability of the island's productive economic sectors and community at large (sub. 23, pp. 3–4).

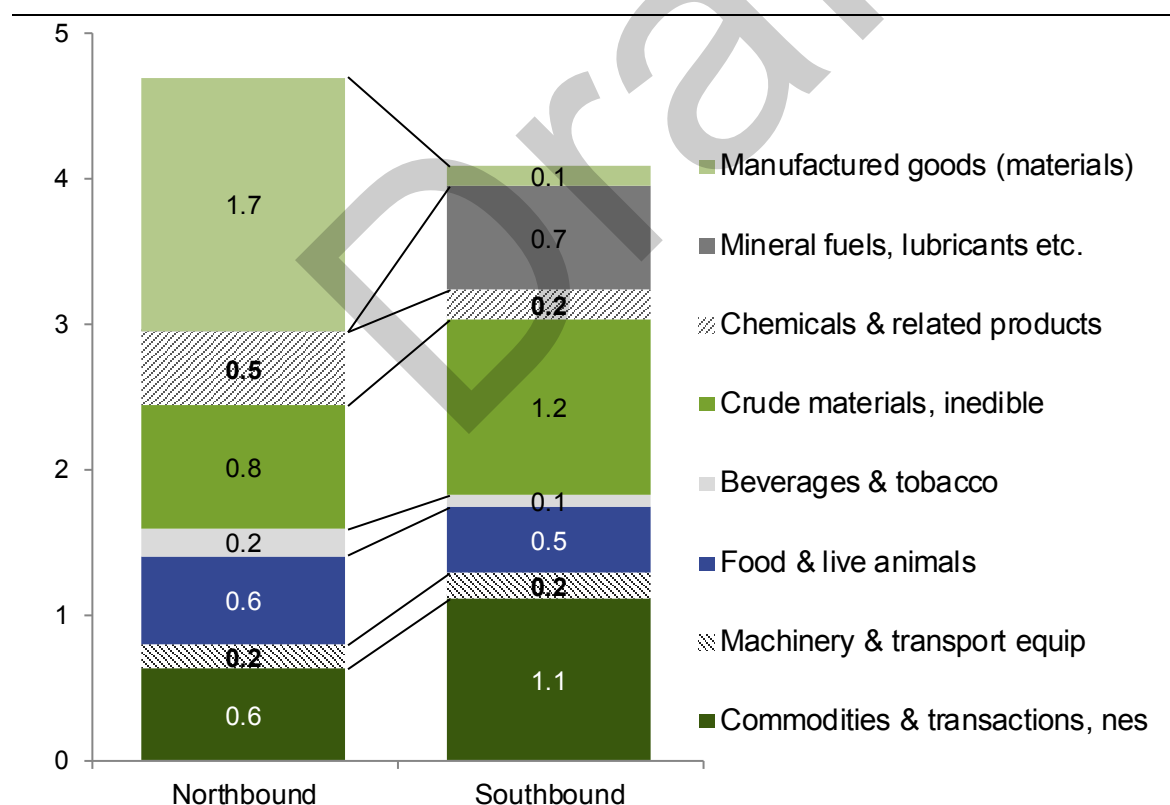
The major freight challenge for King Island is the availability of a suitable vessel. Also, restrictions to existing wharf infrastructure capabilities mean that access to the island is severely limited (King Island Shipping Group, sub. 19).

In addition, JBS Australia Pty Limited noted:

The cost of transporting livestock from locations such as King Island and Flinders Island to Tasmania for processing is expensive and on a cost per kilometre considerably greater than on mainland Australia. (sub. 49, p. 2)

Figure 2.3 Major commodities traded with Tasmania, 2011-12^a

Million tonnes



^a Includes coastal freight loaded in Tasmania and shipped to mainland Australia ('northbound'), or shipped from mainland Australia to Tasmania ('southbound'). Coastal freight shipped within Tasmania is not included. 'nes' = not elsewhere specified.

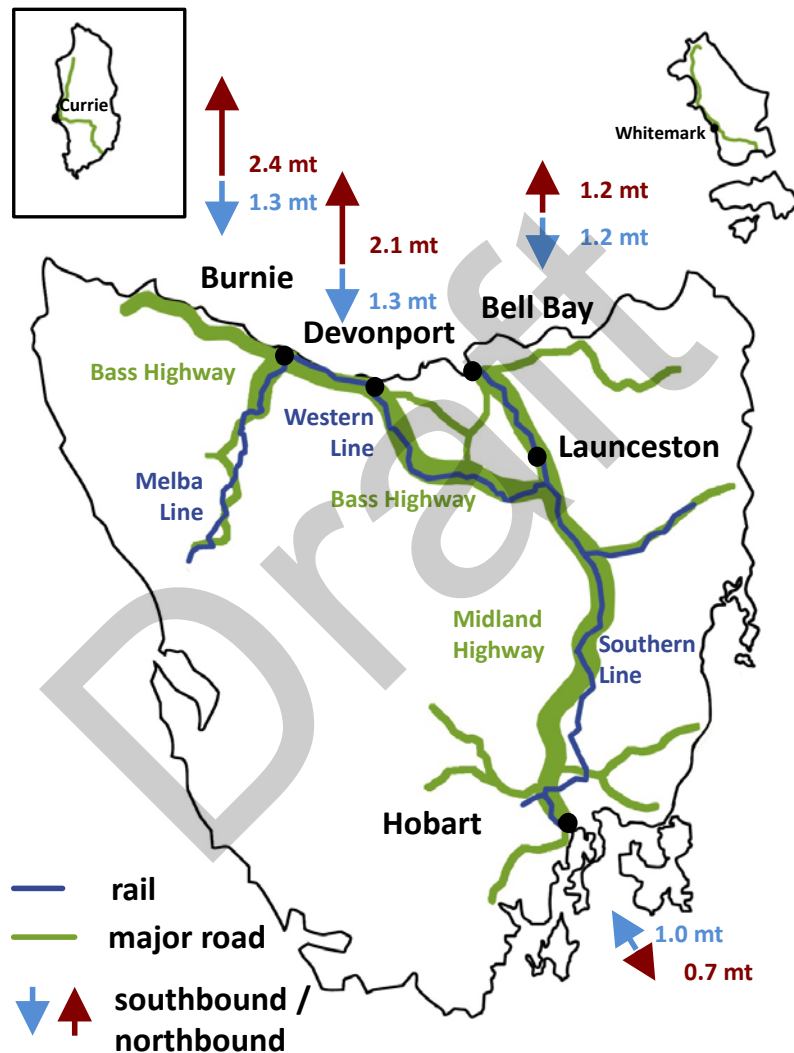
Data source: BITRE (2013a).

Other freight modes

Most of the freight shipped to and from Tasmania (around 80 per cent) is shipped through the three northern ports — Bell Bay, Burnie and Devonport (figure 2.4).

Figure 2.4 **Tasmanian freight movements, 2012-13**

mt = million tonnes



Data sources: Adapted from DIER (2009) (figure 1). Southbound/northbound data from TasPorts (2013).

Tasmania's road transport network is chiefly responsible for moving freight to and from the ports. In 2011-12, Tasmania's total land freight task was 23 million tonnes, 82 per cent of which (on a tonne kilometres basis) was carried by road. Tasmania's National Network (the designated road network funded by the Australian Government) carries almost half of the land freight task. The Tasmanian Government funds the State Road network, which accounts for 28 per cent of the total land freight task (table 5.1, chapter 5). It is also owner and operator of the State

Rail network — which accounts for 18 per cent of total freight movements on a tonne kilometre basis. The extensive network of local government owned roads carry a smaller proportion of the state's overall freight task, but are important for the 'last mile' of the overall freight task (Department of Infrastructure, Energy and Resources (DIER) 2009).

The heaviest freight volumes are carried through the Burnie-Devonport to Hobart corridor due to its linkages to major ports, key urban areas and industrial and processing areas in Burnie, Devonport, Launceston and Hobart (FLCT 2013a).

Air freight carries less than 1 per cent of freight (by volume) in Tasmania. Given its relatively higher costs, it is used for high value products including perishable, time sensitive products such as abalone, crayfish, cut flowers and berries.

A number of submissions raised the issue of widening eligibility under the Tasmanian Freight Equalisation Scheme (TFES) to also include air freight. Launceston Airport called for the subsidy for domestic freight to be applied to air freight as well as shipping and highlighted the potential role that air freight can play in helping Tasmanian businesses establish new markets:

... the Bruny Island Cheese Company in order to break into new markets, improve their profile and establish the business, used airfreight to get their product to mainland shelves and restaurants. At first they were air-freighting only a few 5kg boxes, but their reputation has grown, a cheese club has been established and shipments now are in the order of 1500 cartons being distributed all over Australia. Airfreight can provide the initial inroads to break into and establish new markets for niche Tasmanian products, until later in their growth cycle, when volumes will dictate that sea freight will come into its own again. (sub. 25, p. 2)

Hobart International Airport also called for the subsidy for domestic freight to be applied to air freight as well as shipping, noting:

Air freight is a crucial option for the future of Tasmania's high value producers ... The fast developing, high quality fresh produce industry which is vital to the Tasmanian economy is ideal for air freight. (sub. 46, p. 2)

However, the Commission does not consider that there is a case for this extension of the TFES. Reliance on air freight to access markets is a feature of many regional and remote communities and not unique to Tasmania. (The issue of scheme scope and coverage is discussed in chapter 3.)

2.3 Freight cost disadvantage

The terms of reference of this study require that the Commission quantify any comparative freight cost disadvantage for goods eligible under the TFES and the Tasmanian Wheat Freight Scheme (TWFS) — and identify its primary causes.

The cost of freight, across Bass Strait and for comparable tasks on land, and elements of Tasmania's interstate freight disadvantage are discussed below, drawing largely on published data on freight rates, information provided in submissions to this study, and the TFES administrative database.

Factors influencing the cost of freight

Participants to this inquiry raised a number of concerns about the high costs of freight to and from Tasmania. Some of these are included in box 2.2.

Similar concerns were raised in the Commission's 2006 study into Tasmanian freight subsidy arrangements, with participants indicating that Bass Strait shipping costs were as much as two to two and a half times greater than comparable road freight costs.

A wide range of factors influence the cost of freight, including mode of transportation (road, sea, rail, air), cargo weight and volume, distance to destination, points of pickup and delivery, and the actual goods being shipped. Key factors affecting Tasmanian freight costs include:

- *mode of transportation* — for Tasmania, mode and distance factors are critical. A consequence of the short-haul nature of Bass Strait shipping is that it does not exploit the economics of sea transport, resulting in higher freight rates. As sea freight is characterised by higher fixed costs and lower marginal costs than land freight, it tends to be relatively cheaper over long distances, while land freight tends to be relatively cheaper over short distances (box 2.3).
- *intermodal costs* — the use of a combination of land and sea freight means that Tasmanian shippers incur costs of loading and unloading their cargoes. Unlike freight sent between mainland states and territories that can be transported by only one mode, freight sent between Tasmania and the mainland has to change mode at least twice. Intermodal transfers can also apply to land freight, particularly if rail transport is involved. Changing modes also adds to transit times and increases the likelihood of damage to goods.

Box 2.2 Participants' views on Tasmania's freight cost disadvantage

Forth Farm Produce Pty Ltd trading as Harvest Moon

A frequent, reliable and cost effective refrigerated transport service is absolutely fundamental to the business's supply chain and therefore viability ... With the TFES in place the cost per tonne to ship produce from Devonport to Melbourne is between \$75 and \$80/tonne. Road freight for the equivalent freight service ... from Melbourne to Bairnsdale is \$54/tonne and from Bairnsdale to Melbourne is \$64/tonne. The TFES does not provide Tasmanian based shippers with an unfair advantage versus mainland companies. It simply means we are only disadvantaged by \$15 to \$20/tonne rather than \$85 to \$90/tonne. (sub. 21, p. 2)

Viewbanks Pty Ltd

The cost component across Bass Strait equates to \$1450+, making these charges comparable with the longer Asia/Melbourne haul. Tasmanian business cannot afford the component cost of the Bass Strait haul. (sub. 16, p. 2)

Bell Bay Aluminium

Shipping across Bass Strait is one of the most expensive components of freight export ... The factors affecting cost on Bass Strait are complex, and include shipper characteristics (volumes shipped, seasonal vs. regular shipper); high fixed costs associated with shipping (fuel, wages); and particularly cabotage legislation ... BBA's costs remain higher than comparable operations exporting goods from other Australian ports. For shipping providers, fixed costs are high. Benchmarking of shipping costs for users found Bass Strait shipping to be 24% more expensive than a similar European service, largely due to estimated input costs for Bass Strait providers (labour costs and fuel) to be 23% more expensive than in Europe. (sub. 12, p. 5)

Mondelez Australia Pty Ltd

The current level of TFES assistance does not fully compensate Mondelez International's total level of disadvantage it experiences for manufacturing in Tasmania. The current level of assistance falls short by approximately 30% and places us in an uncompetitive position when compared with Swiss and German peer chocolate companies. Correcting the freight inequity is pivotal to future investment in our Tasmanian operations. (sub. 24, p. 3)

Cuthbertson Bros. Pty Ltd

We suffered a 25% increase overnight on the Burnie leg to Melbourne. No warning, no discussion; pay or you don't ship, and when you have forward contracts, you pay ... Everyone will tell you [the Bass Strait] is the dearest freight crossing in the world. (sub. 3, pp. 1–2)

Tasmanian Farmers & Graziers Association — King Island Branch

When comparing to other freight movements across Bass Strait [rates] for livestock and fertiliser movements, appear to be extremely excessive. ... Freight costs on fertiliser in containers are hindering the ability of farmers to improve their production with freight rates 3 to 4 times that of shipping from Melbourne to Tasmania and in excess of double that of shipping from Bridport to Lady Barron (Flinders Island) ... There is a large differential in the diesel price on King Island versus the Victorian and Tasmanian regional price averages — in the order of 125%. The general differential between Terminal Gate Price vs. Regional Pricing is in the order of 4.5 – 12%, however on King Island it is in the order of 26%. (sub. 8, pp. 1–2)

Kelp Industries Pty Ltd

A major issue is the cost of shipping from King Island to Melbourne both for export and domestic sales ... It is often more cost effective for potential customers to import Irish or Canadian seaweed into Australia than it is for them to pay the freight from King Island to Melbourne ... freight to Melbourne or Devonport is not available on a weekly basis. There can be a wait of 1–5 weeks before the local agent sends a container of general freight. (sub. 4, p. 1)

Box 2.3 Stylised cost structures of road and sea freight

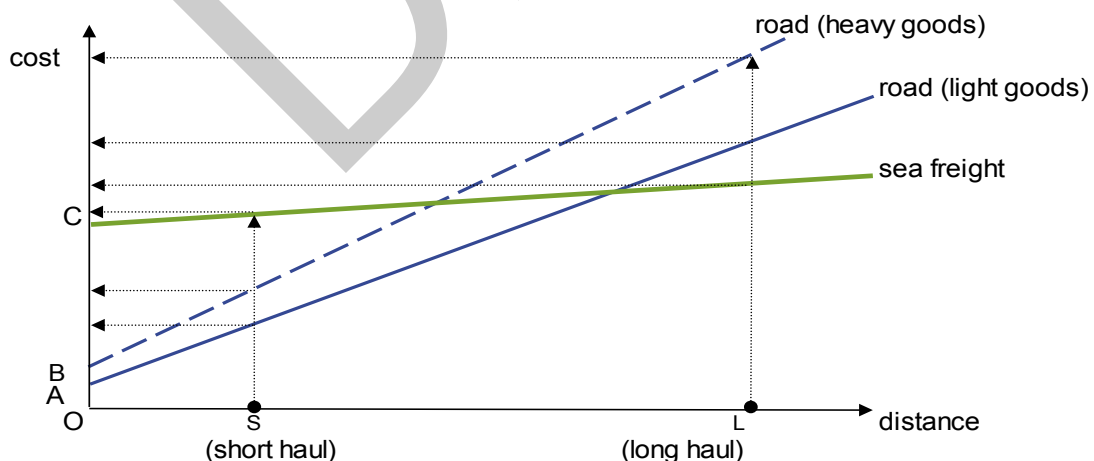
The figure below depicts different cost structures for road and sea freight as they relate to the distance involved in transporting a given volume of goods, such as a 20ft container equivalent unit (TEU).

Sea freight is characterised by large fixed costs (shown as OC on the cost axis) and relatively low marginal costs (represented by the gradient of the sea freight cost curve). The fixed costs include the overhead of owning or leasing vessels, crewing them and the port costs (such as wharfage) associated with loading and unloading the goods. Marginal costs relate to costs that vary with use of vessels over different distances such as fuel, wages and additional repairs and maintenance. For example, the fixed costs of 'getting the ship running' represent roughly 80 per cent of total costs of liner shipping (PC 2005, p. 281). As such, running a fully laden vessel costs little more than an empty one (or a vessel carrying empty containers).

By comparison, road freight has significantly lower fixed costs (OA), representing its relatively low overheads, and a higher degree of flexibility for loading and unloading cargoes. However, this greater flexibility is progressively offset by a steeper marginal cost curve as fuel and crew costs increase at a faster rate with distance. Additionally, as road transport is more weight constrained than sea freight (which is essentially volume constrained), high density cargoes are more costly per unit of capacity to transport by road.

As indicated, road transport is typically cheaper over a short haul (OS on the distance axis), while sea freight is cheaper over a long haul (OL). Rail freight tends to be intermediate between the two.

Freight cost by mode of transport and distance travelled



Source: PC (2006c).

- *direction of travel/trade flow imbalances* — can also cause the price of transport to vary. Prices for 'backhaul' (freight travelling in the opposite direction to the main trade flow) can differ from, or even be included in, the price on the main trade leg of the journey. For Tasmania, an imbalance in trade flows necessitates

the movement of large numbers of empty containers to and from the mainland, adding substantially to costs for some producers (sub. 43).

- *the impact of government policies* — a range of government policies affect freight costs including:
 - the extent of under- or over-recovery of costs for some road and rail infrastructure through registration fees, diesel excise, flagfall charges and other fees (discussed in chapter 5)
 - the efficiency of port facilities, in particular, Tasmania's reliance on four principal ports (Burnie, Bell Bay, Devonport and Hobart), which raises issues associated with scale economies (or lack of) and capacity to handle larger, more efficient vessels (discussed in chapter 4, along with the issue of port charges, including the levy imposed by the Victorian Government on freight movements through the Port of Melbourne)
 - coastal shipping regulations, such as cabotage, which can increase costs and reduce competition (discussed in chapter 4 and appendix C).

The short haul nature of the Bass Strait route, combined with the seasonality of much of the Tasmanian freight task and the inherently high cost nature and use of roll-on roll-off (RORO) services all add to the costs of Tasmanian shipping. Recent benchmarking work suggests that Bass Strait shipping is materially more expensive than similar European shipping services (Aurecon (2013c) — discussed further in chapter 4).

Trends in freight rates

Following the introduction of the TFES and changes to the arrangements for subsidised shipping services in the mid-1970s, Bass Strait freight rates increased rapidly in real terms to peak in the early 1980s (figure 2.5).³ Rates then fell equally rapidly until the end of the decade before settling into a pattern of fluctuation around a slowly declining trend. Latest available data indicate that by 2007-08 the fall in real rates had levelled out, with real rates remaining above those available prior to the commencement of the subsidy.

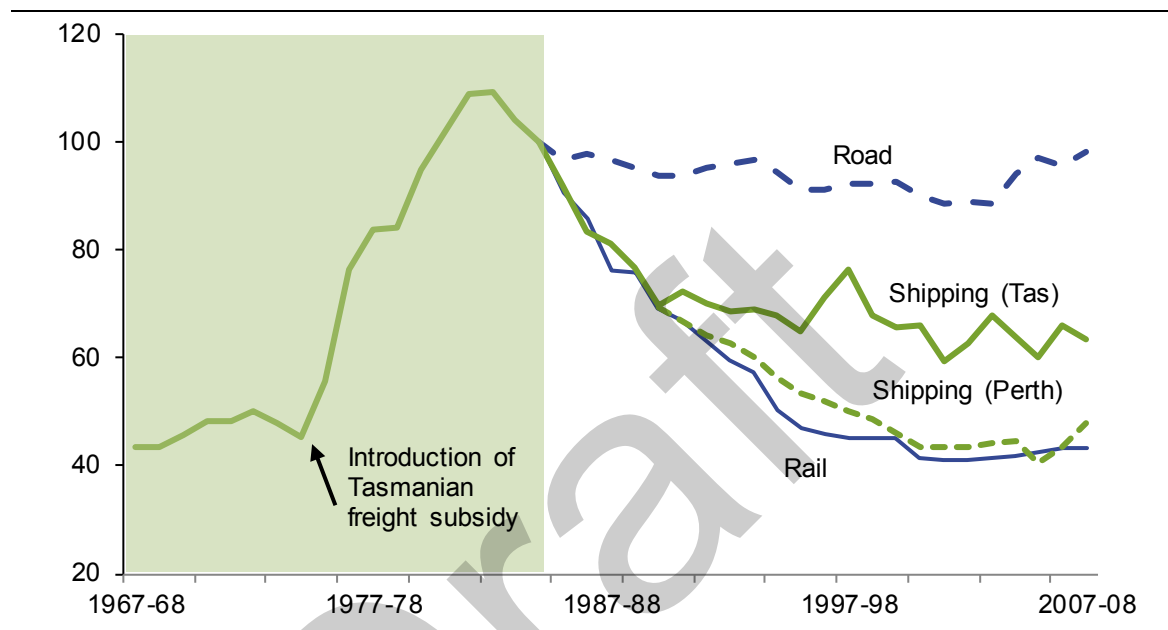
Changes in Australia-wide transport more broadly differ markedly by sector. Sea freight rates between the east coast and Perth and Australia-wide rail freight rates experienced marked and sustained declines, before flattening from the start of the

³ These increases followed the decision to allow the (then) major carrier ANL to increase its rates after a period of almost five years without general rate increases, in response to cost pressures arising, in large part, from an increase of 82 per cent in waterside workers' real earnings (ISC 1985b).

2000s. The falls in sea rates correspond with the increasing use of single and continuous voyage permits, in particular, international vessels carrying domestic cargo between the south-eastern ports and Western Australia (discussed in chapter 4).

Figure 2.5 Real freight rates for land and sea based transport

Index (1984-85 = 100)^a



^a Shipping (Perth) 1990 = 70.

Data source: BITRE (2008a).

Real road freight rates, by contrast, barely declined over the period. Between 1984-85 and 2003-04, when real Tasmanian shipping freight rates fell by almost one-third, real road freight rates fell by only around 10 per cent, before increasing so that by 2007-08 they were back to almost the same level as in 1984-85.

These results mean that the absolute difference between shipping and road freight rates has declined over time.

While data on real rates are only available to 2007-08,⁴ data on nominal freight rates show that the upswing in road freight rates continued through to 2011-12. Nominal freight rates for Bass Strait shipping also increased over the same period, but the rate of growth was slower. Overall, and in nominal terms, road freight rates increased 32.7 percentage points more than sea freight rates between 1996-97 and 2011-12 (figure 2.6). The main factors influencing cost increases for road freight

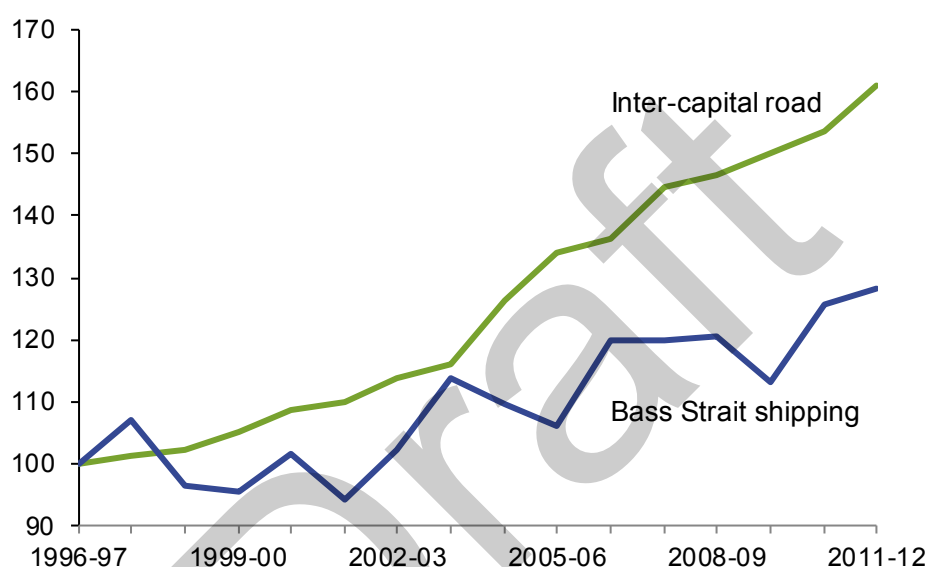
⁴ The most comprehensive time series data on trends in real freight rates for Australian land and sea based transport are compiled by BITRE. The most recent update to this series, which includes data for the period 1964-65 to 2007-08, was provided in BITRE (2008a).

over the period were fuel and driver costs and increasing regulatory compliance costs (SKM 2013).

Latest Australian Bureau of Statistics (ABS) data on producer price indexes (PPIs) also lend support to these conclusions. The data show that between 2007-08 and 2012-13 PPIs for road freight increased substantially faster than for coastal shipping over the same period (ABS 2013e).

Figure 2.6 Nominal freight rate indices: road and Bass Strait shipping^a

Nominal index, 1996-97 = 100



^a Estimated Bass Strait freight rates are weighted average nominal freight rates per tonne for wharf-to-wharf full container loads in the TFES database. Inter-capital road rates assume zero empty running.

Data sources: BITRE (2013b); SKM (2013).

Freight costs for Tasmanian shippers

The TFES database provides a measure of the freight costs paid by Tasmanian shippers.⁵ Using these data BITRE calculated median wharf-to-wharf freight rates paid by all wharf-to-wharf full container load shippers. For 2011-12, these were \$1098 for dry shipments, \$1130 for refrigerated shipments and \$1129 for all shipments.

⁵ The TFES data set is administrative data used by the Department of Human Services to administer claims. BITRE (2013b) advises that the structure of the database reflects how shippers arrange freight shipments and make claims and chosen claim method can affect the median calculation where a large quantity of freight and/or a large number of shipments are involved.

An analysis of TFES data confirms that freight costs per TEU varied considerably for different shippers and commodities. An indication of the extent of variation is provided by (preliminary) estimates in table 2.2, which show freight rates per TEU for full container loads submitted with wharf-to-wharf invoices between northern Tasmania and Victoria. These indicate that there was substantial variation in costs per TEU, with most claims recording a Bass Strait equivalent cost of between \$600 and \$1400 per TEU. Similarly, rates varied by commodity. For example, fresh fish and fresh vegetables recorded higher average freight rates than commodities such as plastic products and processed wood.

Table 2.2 Freight rates per TEU, 2011-12^a
Bass Strait shipments^b

<i>Freight rate per TEU</i>	<i>Proportion of claimants^c</i>	<i>Proportion of TEUs shipped</i>
	per cent	per cent
Less than \$600	1.9	0.3
\$600 to \$800	7.3	20.8
\$800 to \$1000	15.8	21.5
\$1000 to \$1200	26.5	19.7
\$1200 to \$1400	31.1	35.9
\$1400 to \$1800	16.9	1.6
Over \$1800	0.4	0.1

^a Data are preliminary and may be subject to revision. ^b Based on claims recorded as full container loads travelling northbound from Northern Tasmania to Victoria, and travelling southbound from Victoria to Northern Tasmania, on a wharf-to-wharf basis. In total, just over half of all full container loads for this route were submitted with wharf-to-wharf invoices. ^c Claimants may be charged differing freight rates and therefore may be included more than once.

Source: Estimates based on PC analysis of TFES claims database (accessed November 2013).

These differences are unsurprising. Differences in rates across commodities and routes are a feature of sea freight. Carriers may charge different rates for different commodities on the same voyage, different rates for similar commodities on different legs of a voyage, and different rates for similar commodities on the same voyage. More valuable cargoes tend to attract higher rates (PC 2005). In addition, ability to negotiate freight rates can be a significant factor in actual rates charged. Medium to large, frequent and fairly uniform shipments generally attract lower freight rates. Shippers of these goods can use their status as ‘anchor’ clients to negotiate more favourable rates with carriers.

However, care is needed in interpreting freight rate data based on TFES claims. The Commission noted in its 2006 review of freight subsidies that the scaling factors and set allowances incorporated in the TFES to cater for the different eligible freight tasks, types of packaging and methods of payment are likely to result in

estimates of shippers' average Bass Strait sea freight costs being overstated (PC 2006c).

Estimating the sea freight cost disadvantage

The essential feature underpinning the levels of assistance provided under the TFES is an estimate of the cost disadvantage associated with moving goods across Bass Strait. For the purposes of the scheme, this is defined as the difference between the actual sea freight costs across Bass Strait between northern Tasmanian and Victorian ports, and the notional road freight costs of moving goods an equivalent distance on the mainland (the 'road freight equivalent' or RFE).

Inherent in this formula is the perverse outcome that, as the movement of freight on the mainland becomes more efficient, the cost 'disadvantage' is estimated to increase, leading to an increase in the rate of the subsidy, which dilutes the incentive to increase the efficiency of freight movements across Bass Strait. Conversely, if road freight costs increase more quickly (as has been the case recently), the 'disadvantage' is reduced.

Determining the road freight equivalent cost

Estimating road freight equivalent costs is by no means straightforward, and a range of different considerations and key assumptions need to be made in determining road freight equivalent costs including:

- *road costs per kilometre* — including fuel consumption, tyres, driver costs, capital costs/depreciation, registration costs and capacity utilisation
- *shipper characteristics* — such as how regularly they use freight services/average monthly spend (as achieved freight rates are very sensitive to bargaining power)
- *commodity carried and level of urgency* — assumptions are generally for typical commodities carried in the typical way for the most common level of urgency
- *actual rates versus tendered prices* — the former are often slightly lower due to post-tender negotiation
- *choice of benchmark journey* — different interstate corridors have different costs (SKM 2013).

In addition, there will always be rates paid that are substantially greater and substantially less than typical rates quoted. For example, backloading rates can

frequently be less than half of forward rates, as on many Australian freight routes there is a lot more freight flowing in one direction than the other.

Parameter estimates

In its calculations of the road freight equivalent, BITRE uses a road benchmark of a B-double heavy vehicle with a maximum payload of 39 tonnes and approximately one third empty running.⁶ Based on this, BITRE's latest estimates (released in December 2013) of road freight equivalent costs were \$650 per TEU for dry freight and \$715 for refrigerated freight in 2011-12 (up from \$281 per TEU and \$309 per TEU, respectively in the 1996-97 parameters, box 2.4).

These increases in the RFE have had a substantial impact on estimated sea freight cost disadvantage. In particular, they imply that the 1996-97 parameters currently in use significantly overstate the cost disadvantage for shipping freight across Bass Strait. For 2011-12, BITRE estimates show that shippers were receiving on average \$223 per TEU (\$671 minus \$448, see table 2.3), or around 33 per cent, more than the estimated sea freight cost disadvantage for dry freight.

Given the magnitude of the difference, updating TFES parameters would have substantial implications, both in terms of scheme funding costs and the payments to shippers. BITRE concluded that updating the TFES parameters to reflect 2011-12 values would significantly reduce payments to most shippers, noting that if the parameters were revised to reflect the latest estimates, compensation paid through the scheme may have fallen by around \$90 million for freight shipped between 1 July 2010 and 30 June 2012 (BITRE 2013b).

Commenting on these findings in its submission to this inquiry, the Commonwealth Department of Infrastructure and Regional Development noted:

While the sea freight disadvantage has declined, shipping costs have continued to rise and successive governments have chosen not to adjust TFES and TWFS parameters because such action would have reduced Australian government assistance to Tasmania at a time when Tasmanian producers were facing rising shipping costs and difficult economic conditions (sub. 42, p. 24).

⁶ SKM (2010) suggested that approximately one third of potential carrying capacity on average may not be utilised for inter-capital long haul routes.

Box 2.4 TFES parameter reviews

The level of assistance provided to shippers through the TFES is derived from calculations using a set of parameters which are unchanged since 1998 (and relate to freight costs in the year 1996-97). Regular reviews of the parameters were recommended by the Nixon Review in 1998 and the Commission in 2006.

Since 2006, BITRE has conducted periodic reviews, most recently in 2013. The latest BITRE modelling shows that TFES expenditure may be overcompensating shippers because payments are based on 1996-97 parameters which overestimate the sea freight cost disadvantage as defined by the scheme (BITRE 2013b).

BITRE's latest updated parameters (relating to the year 2011-12) are shown in table 2.3, along with the 2006-07 estimates and the current parameters (1996-97).

Table 2.3 **Estimates of selected TFES parameters, 1996-97, 2006-07 and 2011-12^a**

	1996-97	2006-07	2011-12
Road freight equivalent (dry freight)	281	507	650
Road freight equivalent (refrigerated freight)	309	558	715
Wharf-to-wharf sea freight cost disadvantage (dry freight) ^b	671	653	448
Wharf-to-wharf sea freight cost disadvantage (refrigerated)	671	631	415
Intermodal costs allowance	100	100	100

^a Current parameters are shown in bold type. ^b For 2001-02 the estimated disadvantage was \$562 and in 2010-11 it was \$549.

Overall, the latest BITRE parameter review found that based on updated RFE rates and the median wharf-to-wharf freight rates, the sea freight cost disadvantages for 2011-12 were:

- \$448 per TEU for dry freight (down from \$671)
- \$415 per TEU for refrigerated freight (down from \$671).

For the intra-State TFES (King Island and the Furneaux Group of islands) the sea freight cost disadvantages (which have not been updated since 2006-07) for 2011-12 were:

- \$350 per TEU for dry freight between King Island and Tasmania (up from \$275 per TEU in 2006-07)
- \$1226 per TEU for dry freight for the Furneaux Group of islands to Tasmania (down from \$1601 per TEU in 2006-07).

BITRE also recommended that the high density discount be reduced to 30 per cent (from 40 per cent in the 1996-97 parameters) and the stowage factors for high density freight increased from 1.1 to 2.6 tonnes per cubic metre.

Source: BITRE (2013b).

A number of participants expressed concerns that any changes to payment rates could have substantial adverse impacts on the Tasmanian economy. The Tasmanian Government stated that:

... it is absolutely critical that the Commission recognises both the extent to which the equalisation schemes are embedded in the Tasmanian freight system and the current vulnerability of the Tasmanian economy, including the tourism sector, to the impact of further short-term shocks. In this context, even relatively minor changes to scheme parameters need to be carefully considered and introduced progressively. (sub. 43, p. 16)

Other evidence on cost disadvantage

Estimates of freight costs prepared by Aurecon for the Freight Logistics Coordination Team (Aurecon 2013a) were cited in several submissions. The Tasmanian Government noted:

The benchmark Hobart to Melbourne shipping cost derived by Aurecon is \$1403 per TEU. With TFES applied, this cost can reduce to \$853. However, this is still more expensive than a comparable mainland freight journey, which Aurecon estimated at between \$564 and \$799. These estimates suggest that some form of indexation and/or benchmarking is required to ensure the TFES can fulfil its freight equalisation objective into the future. (sub. 43, p. 14)

Differences between estimates of freight cost disadvantage are unsurprising given the range of different approaches, assumptions and data sources that can be used. On the basis of the Commission's initial assessment of the data, and in the limited time available, it appears the differences in the estimated freight cost disadvantage between the Aurecon estimates and the estimates published in the BITRE parameter reviews largely reflect:

- how 'lift on lift off' (intermodal) costs are treated
- differing costs per kilometre for road freight used by Aurecon (data and assumptions underlying the BITRE per kilometre road freight rates are published in SKM (2013))
- capacity utilisation — BITRE's estimates assume 30 per cent empty running, whereas there is no allowance for 'operating empty' in the Aurecon work⁷
- variations in point of origin/destination.

A number of participants stated that, even with the level of subsidy currently being provided through the TFES (using the parameters for 1996-97), Tasmanian businesses continue to face an overall freight cost disadvantage and called for even

⁷ However the Aurecon (2013a) study does acknowledge elsewhere that the cost of moving empty containers may be included in the freight rates for some shippers.

greater support through the TFES to help defray high shipping costs. Similar views were provided in the Commission's 2006 review, where the Commission heard that even after receiving the subsidy, there was still a disadvantage, varying generally from 3 to 20 per cent, with some goods facing higher disadvantages (PC 2006c).

Many participants to this inquiry underscored the significance of TFES subsidies for the viability of their Tasmanian business, at least in the short term. In particular, a number of manufacturing enterprises pointed out that their competitiveness against alternative production and investment locations is under regular review and that the TFES provides important assistance at the margin. For many businesses, Bass Strait shipping is the single largest transport cost in the supply chain, even for products sent to distant markets (FLCT 2013a).

The Commission received evidence from a number of participants on their shipping costs. Norske Skog Boyer stated that comparison of their freight costs paid (with supporting evidence provided to the Commission in a confidential submission), compared to similar transport tasks on the mainland:

... clearly show an ongoing freight cost disadvantage, notwithstanding all our efforts to contain costs in conjunction with our logistics suppliers. ... If there was a land bridge to the mainland, the Boyer Mill could transport paper to its Melbourne customers for approximately 27% less than the current cost including the benefit of TFES. This would be a much more significant impost, at around 57% if the current level of TFES assistance did not exist. It can therefore be concluded that while TFES payments meet part of the additional cost, they do not fully 'equalise' for the whole difference and the difference remains substantial. (sub. 39, p. 17)

The level of intermodal allowance was also identified as an issue by some participants. Mondelez Australia Pty Ltd, for example, noted:

The intermodal allowance must be increased with immediate effect to reflect the actual additional costs incurred ... Mondelez International recommends the annual review of the intermodal assistance to adequately compensate shippers for the annual rise in intermodal costs. (sub. 24, p. 3)

Given that the intermodal cost allowance is based on an average across all freight, it is unclear how average intermodal costs, across all shippers, have changed over time.

Overall, while the Commission acknowledges that some costs shippers face can be higher than the rates used in the TFES parameters, the methodology and parameter estimates used by BITRE to calculate the 'cost disadvantage' are based on assessments of median/average costs and rates. As such, they cannot be expected to reflect the (widely disparate) experiences of individual firms.

Ensuring TFES payment rates are soundly based, transparent and up-to-date

The notion of a ‘cost disadvantage’ that can be measured and compensated for is problematic. Regardless of the method employed, any calculation will be subject to challenge. As noted earlier, freight rates can differ for a number of reasons. In its 2006 review, the Commission found that even for a given freight task there is considerable variation in the costs underlying these averages both within jurisdictions and between them. The additional information provided to the Commission in this review (both public and confidential) reinforces this conclusion.

Given this, determining with any confidence the absolute magnitude of sea freight cost disadvantage at a particular point in time has many problems, with methodology and assumptions open to dispute. The Commission noted in its 2006 review that it was unrealistic to suggest that any one ‘road freight equivalent’ was truly representative of a comparable freight task. This remains the case.

Nevertheless, principles of sound public policy design indicate that for a policy program to be able to be administered effectively, clear, consistent and transparent rules are required. Such rules need to provide ongoing certainty to all affected parties, including recipients, those administering the scheme, and taxpayers who ultimately fund the scheme.

A consistent and transparent mechanism for determining TFES funding rates over time is therefore essential. Further, notwithstanding the problems in establishing a benchmark noted above, tracking changes in underlying costs for different freight modes over time is likely to involve fewer problems than establishing the initial benchmark.

The Commission considers that current arrangements for determining TFES parameters — which involve the preparation and public release of comprehensive parameter reviews undertaken by BITRE on a periodic basis — are consistent, transparent and robust and should therefore be used as the basis for determining future payment rates. Further, in the Commission’s view, the BITRE review methodology and approach reflect the broad scheme objective of addressing the relative cost disadvantage.

DRAFT RECOMMENDATION

If the Australian Government chooses to retain the Tasmanian Freight Equalisation Scheme in essentially its current form, it should ensure that the payment rates are based on the findings of Bureau of Infrastructure, Transport and Regional Economics parameter reviews. These reviews should be conducted every two years. Payment rates should be revised to reflect the latest available parameter estimates.

Updating TFES payment rates to reflect current parameter estimates would result in a saving to the Commonwealth Budget. However, a one-off change from the 1996-97 to the 2011-12 parameters has the potential to create adjustment pressures for businesses as their planning is likely to have been undertaken on the basis of the current level of assistance. It is also likely to represent a significant withdrawal of assistance to some firms, notably large claimants. Therefore, if this policy option were to be adopted, consideration should be given to appropriate transitional arrangements over 2–3 years.

Further, the Commission notes that BITRE has been making available the results of its regular parameter reviews as well as underlying assumptions, cost estimates, methodology and other supporting information — most recently in BITRE (2013b) and SKM (2013). This approach is consistent with public policy principles of transparency and accountability.

However, the Commission acknowledges the range of views and evidence that has been provided to this inquiry about the level and underlying drivers of freight transport costs, estimated levels of cost disadvantage, including the assumptions that underpin them, and appropriate scheme payment rates.

In this regard, one area of potential improvement to scheme administration worthy of consideration would be to further strengthen the consultation processes used in parameter reviews. Consistent with leading practice stakeholder consultation processes, parameter reviews could be undertaken in two stages. This would involve the release of a draft report, containing the updated parameter estimates and underlying analysis and providing an opportunity for stakeholders to comment and provide any additional evidence through public submissions. Following this, a final report would be released that would include any changes or additional analysis stemming from the consultation process, as well as discussion of the outcomes of the consultation process, and how the resulting feedback and evidence were taken into account in the preparation of the final report.

Such a two stage process would allow for an open testing of the merits of different data, estimates and assumptions provided by stakeholders prior to the finalisation of updated parameters.

DRAFT RECOMMENDATION

Future Tasmanian Freight Equalisation Scheme parameter reviews should be undertaken by the Bureau of Infrastructure, Transport and Regional Economics using a public multi-stage process, comprising:

- ***release of a draft report, containing the estimated parameter updates and underlying assumptions and data;***
- ***a public submission process that allows interested parties sufficient time to provide input; and***
- ***release of a final report that incorporates resulting feedback and evidence.***

The failure of successive Australian Governments to respond to the many parameter reviews that have been undertaken in past years has eroded the integrity of the TFES. As noted, restoring the scheme's integrity, in its current form, will require substantial adjustments to bring payment rates in line with latest estimates. This situation should be avoided in the future with regular and incremental adjustments to payment rates being made as revised parameters become available.

DRAFT RECOMMENDATION

The Australian Government should respond publicly and in a timely manner to all Tasmanian Freight Equalisation Scheme parameter reviews. All responses should be released before the end of the calendar year in which the parameter review is completed to provide certainty for recipients, and provide sufficient lead time for any resulting revisions to payment rates to be incorporated into Commonwealth Budget processes.

2.4 Tasmania's passenger vehicle task

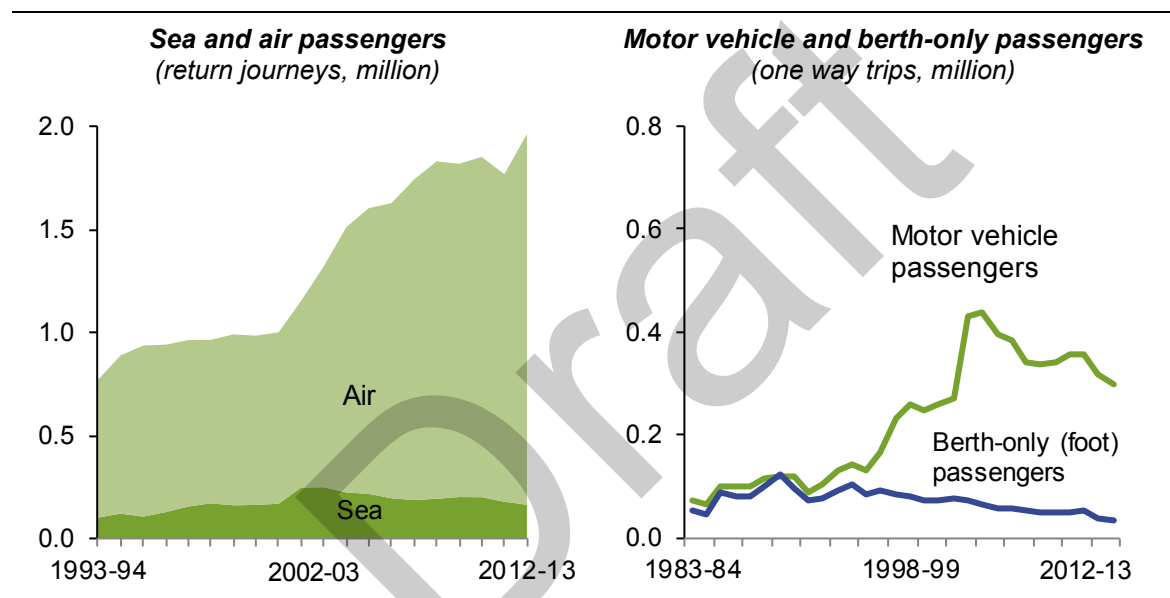
The terms of reference of this study require that the Commission quantify any cost disadvantage for passengers travelling to Tasmania who are currently eligible for support through the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES). The scheme provides a subsidy for passengers accompanying an eligible vehicle across Bass Strait. Eligible vehicles include cars, motor homes and buses.

In 2012-13, almost two million adult passengers travelled by air and sea across Bass Strait (figure 2.7, left panel). Air travel accounted for around 90 per cent of this total.

After remaining flat during the second half of the 1990s, the total number of passengers travelling across Bass Strait increased sharply from the early 2000s, driven by a doubling in annual air passengers following the entry of low cost airlines into the Tasmanian market and the resulting marked fall in fares (BITRE 2014).

In contrast, the number of eligible passengers accompanying an eligible motor vehicle has declined since the mid-2000s, with just under 300 000 people making the trip (with their vehicles) across Bass Strait in 2012-13 (figure 2.7, right panel). Given that there were 1.9 passengers per vehicle, this amounted to 152 000 eligible vehicles being shipped under the scheme in 2012-13.

Figure 2.7 **Sea and air traffic across Bass Strait^a**



^a Includes both visitors and Tasmanian residents.

Data source: BITRE (2014).

2.5 The cost for passenger vehicles

On 30 June 2013, the fare for shipping a standard (accompanied) passenger car across Bass Strait was \$288, which, with a rebate of \$199, resulted in a net fare of \$89 (BITRE 2014). An indication of changes in pricing over time is provided by BITRE's benchmark one way sea fare provided in the most recent BSPVES Monitoring Report (figure 2.8).

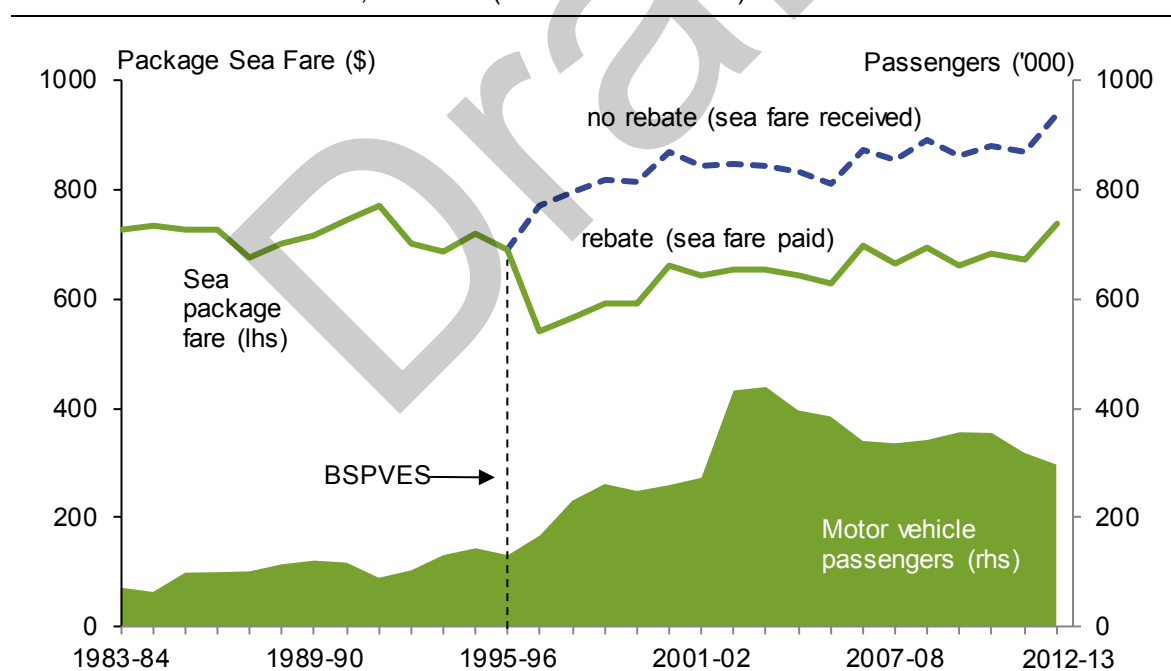
These data indicate that prices did not increase in real terms in the decade and a half to the mid-1990s. Following the introduction of the BSPVES, real package sea fares (excluding rebate) increased to be around 25 per cent higher a decade later. However, with the rebate, the package sea fare paid by passengers remained at

around the same level, or below the fare paid prior to the introduction of the scheme in real terms in most subsequent years. However, latest data provided to the Commission by DIRD indicate that:

- sea fares increased substantially in 2012-13. In real terms, BITRE's benchmark fare index fell 1.6 per cent in the year to June 2012, then increased sharply — by 10.1 per cent in the year to June 2013
- sea passenger numbers declined in both 2011-12 and 2012-13, to levels last seen in 2001-02, with the modal share of sea travel falling to 8 per cent. This contrasts with air travel, where passenger numbers decreased in 2011-12 then increased significantly in 2012-13
- the number of TT-Line voyages decreased from 827 in 2010-11 to 748 in 2012-13. Average passenger numbers per TT-Line voyage decreased from 493 in 2010-11 to 442 in 2012-13 (sub. 42, p. 15).

Figure 2.8 Real sea package prices and passengers accompanying an eligible motor vehicle, 1983-84 to 2012-13^{a, b}

Peak season, end June (real 2012-13 dollars)



^a BITRE advises that this fare series is indicative and should be treated with caution given changes in the characteristics of the ships used and the fact that passengers can choose different standards and prices of accommodation. ^b Series break from 2010-11 due to TT-Line fare restructure (on 17 May 2010).

Data source: BITRE (2014).

Overall, while the introduction of the BSPVES saw a sharp immediate reduction in real fares paid, most of the real reductions were recouped by TT-Line through increases in real fares in the four subsequent years to 2000-01. In the decade to

2010-11 real fares paid (by passengers) increased slowly before the strong upswing in the most recent year.

Comparative cost disadvantage

The transportation of passengers differs fundamentally from the transportation of freight. Each load of freight must be managed from its origin to its destination, loaded, unloaded and transferred. By contrast passengers are relatively autonomous and can board, exit and transfer without assistance, processing information and making choices between transport modes. Further, unlike freight, comfort and safety considerations are an important element of passenger travel (Rodrigue et al 2013). The greater range of options and decisions that need to be taken into account makes assessing cost disadvantages challenging.

A number of interrelated factors are likely to have a bearing on decisions by people to travel with their vehicle across Bass Strait including: budget; vehicle shipping prices; the length of the stay; the purpose of the visit; vehicle type; preferred travel route; and accommodation needs. Travel mode preferences are also important. The actual process of travelling often constitutes a valued service in and of itself. Hence, unlike freight, people will have preferences for different modes of travel. Some enjoy flying, while others enjoy driving or travelling by train or ship.

These factors make assessments of passenger costs more complex than freight costs. A range of assumptions would need to be made including in relation to:

- *vehicle costs* — including fuel and other on-road costs, drawing on, for example, Australian Taxation Office allowable per kilometre claim rates for motor vehicles of different sizes
 - the 2012-13 rate of 74c per kilometre for cars up to 2.6 litres applied to the 427 km ‘straight line’ land bridge used in the TFES yields a vehicle cost of \$316. Similarly, the NRMA estimate for the current running cost for an average family saloon (a standard Holden Commodore Sedan) in 2013 was 79.43 cents per kilometre (Tourism Industry Council Tasmania, sub. 48)
- *accommodation costs* — this would depend on the number of people travelling as well as the length of the journey/point of origin
 - Australian Taxation Office allowable travel rates for Melbourne in 2012-13 for one person, for example, totalled \$289, of which accommodation accounted for \$173.

-
- *time costs* — including the opportunity costs of time spent behind the wheel — including fatigue breaks and refuelling — time that could have been spent sightseeing and engaging in other leisure activities.

The resulting estimates could then be used as a basis for comparison with other costs such as travelling across Bass Strait either by sea, with a vehicle, or flying and hiring a passenger motor vehicle on arrival.

Such an approach would need to assume away many factors to produce an estimate of cost ‘disadvantage’. This would potentially lead to a significant overestimation or underestimation of the cost disadvantage for any one individual. BITRE does not maintain a set of parameters for accompanied passenger vehicle disadvantage. In its first BSPVES monitoring report, the (then) Bureau of Transport and Communications Economics included an estimate of the passenger vehicle costs based on the notional cost of driving an equivalent distance on a highway using NRMA estimates of an average family saloon (39.87 cents per kilometre) (BTCE 1997). This provided an equivalent highway cost of \$170 for a one-way trip. However, in all subsequent monitoring reports this approach has not been used.

In summary, while the lack of an option to drive a vehicle can impose a cost disadvantage relative to travelling a similar distance on the mainland, as well as other indirect costs such as the loss of convenience for travellers unable to use their own vehicle, quantifying the extent of any ‘disadvantage’ is likely to be more problematic than for freight.

That said, the rapid declines in air fares across Bass Strait over the past decade mean that Tasmania’s overall geographic disadvantage for passenger travel has declined. The real costs of transport between the mainland and Tasmania — including the costs of flying and car rental — are much lower than at the time the subsidy was introduced.

Car rental rates have also been declining in relative terms for some time. ABS data indicate that over the period between 2000 and 2012 the underlying producer prices for the Australian rental car industry increased at around half that of prices for the economy overall (ABS 2013d). These data do not provide a breakdown of prices for the Tasmanian car rental industry; however the declining long-term trends in the national data are likely to be broadly reflective of trends in passenger motor vehicle rental rates in Tasmania. A comparison of car rental rates between Hobart and other capital cities by Austrade (sub. 41) indicated that Hobart’s rental rates were below those of the other capitals. Austrade noted that the competition provided by the BSPVES is likely to assist in keeping car rental rates down in Tasmania, although the extent to which the BSPVES has played a role is unclear. The broader question

of the scheme's overall impacts, as well as those of the TFES, are discussed in the following chapter.

Draft

3 Current and alternative arrangements

Key points

- In their current form, the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) continue longstanding arrangements to subsidise the cost of moving freight and passengers across Bass Strait by sea.
- The schemes have cost more than \$2 billion since their inceptions and are expected to cost more than \$2 billion in net present value terms over the next 15 years. The benefits of the TFES are concentrated among a small number of businesses — in 2011-12 the top 10 claimants received around half the total amount paid.
- The design of the TFES, which attempts to calculate a precise freight cost disadvantage, is complex and has numerous documentation requirements. This creates compliance costs for business and an administration burden for government, while not providing a true measure of any cost disadvantage. The scheme's design inevitably creates incentives to maximise claims.
- To address complexity, the Commission recommends a flat rate of assistance. In the absence of a flat rate subsidy, assistance should be paid based on evidence of actual wharf-to-wharf costs to restore integrity to the scheme.
- To reduce the compliance and administrative burden, the Commission recommends a minimum threshold for access to northbound assistance. To streamline compliance, the Department of Infrastructure and Regional Development should extend its current self-assessment facility to more claimants and the Department of Human Services should examine the benefits and costs of upgrading its technology for online claims and processing. There should also be more comprehensive public reporting of scheme data to improve transparency.
- As incentive effects arise from eligibility boundaries which are an integral feature of the TFES it is not feasible to address all the scheme's deficiencies through scheme redesign. The exclusion of exports encourages exporting businesses to transfer manufacturing processes to the mainland but changing eligibility creates new issues.
- The TWFS is redundant as no claims have been made since 2009 and its objectives have been met and are no longer relevant. It should be terminated. However, the Commission also recommends that assistance under the TFES for wheat and other grains be based on the lowest cost option for transporting grain to Tasmania.
- The main objective of the BSPVES appears to be to increase Tasmania's inbound tourism. But the scheme provides only diluted support and the Commission recommends examining an alternative use for BSPVES funds to pursue this objective more effectively and transparently. However, to the extent that the BSPVES is intended to have a broader objective, this should be clearly articulated and the scheme evaluated on that basis.

3.1 About the schemes

A brief history

The Tasmanian Freight Equalisation Scheme (TFES), Tasmanian Wheat Freight Scheme (TWFS) and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) continue longstanding arrangements to subsidise the cost of moving freight and passenger vehicles across Bass Strait by sea (box 3.1).

The basis for assisting freight and passenger movements across Bass Strait is that the transport cost by ship is greater than for a comparable journey by road or rail. However, the schemes have also assumed broader economic development objectives expressed in the reviews that led to their introduction (table 3.1) and in subsequent understandings about their purpose.

In the case of the TFES and BSPVES, these broader objectives were to promote economic development and a better-functioning transport system in the context of developing transport markets in sea, road, rail and air. The TWFS reflected the need to address impediments to a nationally-consistent price for wheat, a staple commodity at the time, and then subsequently to provide transitional support to Tasmanian wheat users for the move away from an administered wheat price.

A brief overview of the schemes

Tasmanian Freight Equalisation Scheme

Specified commodities, and commodities used by particular industries, shipped by container between Tasmania (including King Island and the Furneaux Group of islands) and the mainland can claim a rebate for the cost of transporting the goods by sea.

The northbound component of the TFES covers around 150 goods specified in schedule 1 of the Ministerial Directions for the scheme, which are produced in Tasmania. A wide range of fresh, processed and manufactured goods, as well as ores and concentrates, that are shipped northbound are eligible for assistance. As northbound goods must be intended for further processing or use on the mainland, goods for export are not included unless they are transformed on the mainland prior to export.

Box 3.1 A brief history of the TFES, TWFS and BSPVES

The TFES was introduced in 1976 following the 1976 Commission of Inquiry into Transport to and from Tasmania that found that the cost of freight was seen to be an obstacle to expanding existing Tasmanian industries and establishing new ones. The original stated policy objective was to make the costs of shipping eligible cargoes between Tasmania and the mainland approximate those moved over a similar distance by road or rail on the mainland. A 1998 review of the scheme's structure by the TFES Review Authority recommended defining the freight cost disadvantage by applying a number of parameters (box 3.2). The Australian Government adopted the Review Authority's recommendations and the scheme took its current form.

Under the TWFS, wheat is the only bulk commodity that receives specific financial assistance for shipment to Tasmania. The TWFS had its origins in the Tasmanian Wheat Freight Levy which aimed to ensure the administered price for wheat was the same for Tasmanian and mainland users. In 1989, coinciding with the deregulation of the Australian wheat market, the levy was replaced by the Tasmanian Wheat Freight Subsidy Scheme (TWFS) to address additional transport and handling costs for Tasmanian wheat users and provide transitional support to adjust to the removal of administered pricing for wheat. The TWFS was introduced in 2004 as an alternative to the TWFS. Containerised wheat was included in the TFES in the 2004-05 Budget.

The BSPVES was introduced in 1996, extending a longstanding subsidy for passenger travel across Bass Strait. The BSPVES had the broader aim to help the Tasmanian tourism sector in particular, and the Tasmanian economy more broadly. In 2001, the scheme was extended to cover eligible vehicles transported between King Island and the mainland. In 2002, the rebate was extended to caravans, motor homes, vehicles of people with disabilities and bicycles and became a set rate for each category of eligible vehicle that has been indexed to the consumer price index since 2008.

Sources: CIE (2001); Department of Infrastructure and Regional Development (sub. 42); Nimmo (1976); TFES Review Authority (1998); Sharp (1996).

The southbound component covers non-consumer raw materials, machinery and equipment for use in the manufacturing, mining, agriculture, forestry and fishing industries in Tasmania.

The cost of shipping brood mares and equipment used by professional sportspersons and entertainers can also be claimed under the TFES.

Imports, bulk freight and the back hauling of empty containers are not eligible for TFES assistance. Price equalised goods, where a vendor averages their mainland and Tasmanian transport costs and charges the same price free-into-store, are not eligible for assistance under the southbound component of the scheme.

The TFES subsidises the estimated freight cost 'disadvantage', not the full freight costs. The cost disadvantage is calculated as the difference between:

-
- the costs incurred by shippers for moving freight across Bass Strait; and
 - the notional cost incurred by moving freight an equivalent distance (approximately 420 kms) on the mainland by road.

This amount is adjusted according to the parameters used to estimate the cost disadvantage (box 3.2).

The scheme is administered by the Department of Human Services (DHS) in Tasmania. Claimants submit a claim form comprising claim line items (details for each individual shipment) and evidence of shipment (box 3.5).

Tasmanian Wheat Freight Scheme

The TWFS provides a flat rate of assistance of up to \$20.65 per tonne for bulk shipments of wheat from the mainland to Tasmania. Total payments are capped at \$1.05 million each financial year. Claimants submit claims to the DHS in Tasmania accompanied by evidence of shipment.

Bass Strait Passenger Vehicle Equalisation Scheme

Persons travelling across Bass Strait by sea accompanying an eligible passenger vehicle receive the subsidy. Eligible vehicles include cars, motorhomes, buses, motorcycle and bicycles. For travellers with TT-Line, which carries more than 99 per cent of eligible vehicles, the subsidy is deducted from the passenger fare at the time of payment and then claimed by TT-Line. The amount of the subsidy for a return journey ranges from up to \$58 (for a bicycle) to up to \$816 (for a car towing a caravan or motorhome).

Box 3.2 TFES parameters

Road freight equivalent (RFE)

The cost of transporting goods a similar distance by road on the mainland is deducted from the claimant's wharf-to-wharf freight cost. Different RFEs are used for the scheme's intrastate component.

Part container load

The TFES assistance is based on a standard 6.1 metre container known as a 'twenty foot equivalent unit' container, or TEU. Shipments that are less than a full container load are converted to a TEU-equivalent size/full container load basis.

Intermodal costs

A fixed allowance of \$100 per TEU is added to the wharf-to-wharf freight cost for the cost of transferring goods between different modes of transport.

Dry or refrigerated freight

Transporting refrigerated ('reefer') freight by road is more expensive than transporting dry freight. Thus the RFE is higher for refrigerated goods thereby lowering the TFES rebate available.

Door-to-door billing

As the TFES is only intended to provide assistance for wharf-to-wharf costs, up to \$460 is deducted from freight costs billed on a door-to-door, wharf-to-door or door-to-wharf basis. For those with high land freight costs, this has the effect of increasing the rebate.

Route

Freight shipments between different parts of Tasmania and different states are eligible for the TFES, but adjustments are made because sea freight is cheaper than road or rail over longer distances. The freight charge is divided by a scaling factor to achieve a Bass Strait equivalent. Longer distances therefore have a larger scaling factor and attract a lower rebate.

Density

As high density or heavy cargo is cheaper to move by sea than by road or rail, it receives 60 per cent of the standard weight assistance.

Median cost

The rebate reduces as the cost disadvantage increases to provide an incentive for shippers to seek lower freight rates. Per TEU, the subsidy is 100 per cent up to \$335.50, 75 per cent on amounts over \$335.50 and up to \$671, and 50 per cent on amounts over \$671 and up to \$1006.50. This caps the subsidy at \$855 per TEU including fixed intermodal costs of \$100. The thresholds are based on a 'median' cost disadvantage per TEU (\$671) as recommended by the TFES Review Authority (1998).

Source: DITRDLG (2013).

Scheme funding

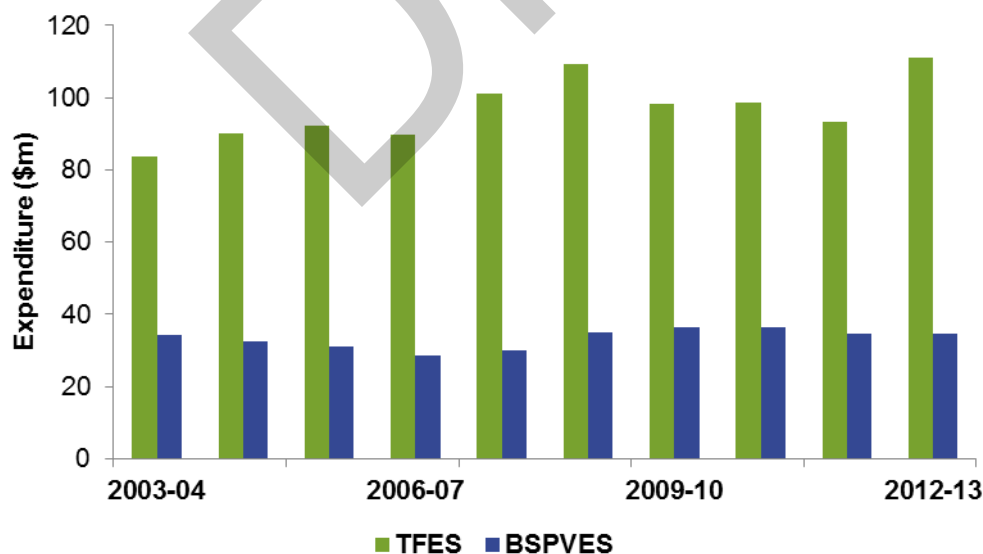
The TFES, TWFS and BSPVES receive appropriations across the forward estimates each year in the Commonwealth budget. More than \$2 billion has been paid under the three schemes since their inceptions, including more than \$400 million under the BSPVES since 1996. Over the next 15 years, the net present value of expenditure under the three schemes is estimated to be more than \$2 billion — including around \$500 million for the BSPVES — assuming the schemes continue to grow in line with trends over the last 10 years.

The \$111 million in funding assistance under the TFES in 2012-13 is the largest annual expenditure on the scheme (figure 3.1). This represented around 0.5 per cent of Tasmania's gross state product in 2012-13, or around \$217 for each Tasmanian resident.

Expenditure on the TWFS has never reached the \$1.05 million cap and there have been no claims since 2009.

BSPVES expenditure grew rapidly in line with the strong take-up of the subsidy in the late 1990s and early 2000s, but has moderated over the last decade (figure 3.1).

Figure 3.1 **TFES and BSPVES annual expenditure**
2003-04 to 2012-13



Source: Department of Infrastructure and Regional Development from departmental annual reports.

Previous reviews and monitoring of the schemes

The schemes have been subject to review and monitoring over the past three decades with aspects of the schemes considered in some detail (table 3.1). In addition to these reviews, there has been a series of Bureau of Infrastructure, Transport and Regional Development (BITRE) reports on the TFES parameters and the BSPVES.

Despite most reviews recommending changes to address problems with the TFES and TWFS, these schemes, and the BSPVES, remain largely unchanged since their introduction. While the Australian Government agreed in 2007 to the recommendations of the Commission's inquiry into Tasmanian freight subsidy arrangements, and some minor changes to administration and scope were subsequently implemented, most of the changes to the scheme that were recommended were not ultimately adopted. This was on the basis that the Global Financial Crisis warranted maintenance of the level of assistance to Tasmanian businesses (Albanese 2008).

For ease of reference, the Commission's 2006 inquiry recommendations are at appendix B.

3.2 Impacts of the schemes

The Tasmanian Freight Equalisation Scheme

Who benefits from the subsidy?

In 2011-12, commodities shipped from Tasmania to the Australian mainland accounted for 71 per cent of the value of all claims. By value, the main commodities claimed for were frozen/processed/prepared vegetables, newsprint and fresh vegetables (table 3.2).

Table 3.1 Reviews of Tasmania's freight subsidy schemes

<i>Review body/year</i>	<i>Key recommendations</i>	<i>Outcome</i>
Commission of Inquiry into Transport to and from Tasmania (Nimmo inquiry) – 1976	Financial assistance for exporting goods for sale on the mainland ^a Increase passenger vehicle subsidy Changes to vessels, scheduling and port operation Government-owned services to charge economic freight rates	The TFES was introduced in 1976
Interstate Commission - 1985	Replace the TFES with a Tasmanian Freight Compensation Scheme Exclude bulk commodities and cargoes shipped by air Continue the exclusion for exports Specified eligibility for cargoes and compensation rates Shippers pay a prescribed minimum of shipping costs Payments to major recipients discounted above a minimum level Ongoing monitoring and review of the scheme Establish a Tasmanian Association for Interstate Shippers to address other coastal shipping matters TFES and TWFS should be separate schemes as they have different objectives	All adopted, with the exception of changing the nature of the scheme from equalisation to compensation
Tasmanian Freight Equalisation Scheme Review Authority (Nixon inquiry) – 1998	Basis of assistance should be a defined sea freight cost disadvantage expressed on a dollar per TEU basis Adjustments for freight density, export to states other than Victoria, door-to-door consignments, reefer freight Assistance for intermodal costs Increase in assistance as disadvantage increases up to a cap Regular review of scheme/parameters	Adopted
Productivity Commission - 2006	See appendix B for recommendations	Accepted, but mostly not implemented
Auditor-General TFES performance audit - 2011	Introduce arrangements to reduce the risk of incorrect payments Strengthen quality assurance Improve data entry and data integrity	DIT and DHS agreed with the report
DIT Simplification Review - 2011	Changes to simplify the scheme were recommended in the lead up to the 2011-12 Budget	Not adopted
National Infrastructure Coordinator – TFES, Tasmanian ports and shipping - 2012	ACCC to review shipping costs and competition policy for sea freight and passenger services Refer possible TFES fraud to the Australian Federal Police Update BITRE examination of Tasmania's freight disadvantage Consider including all non-bulk goods in scheme Withdraw TFES funding and request Commonwealth Grants Commission consider the scheme in distributing GST revenues Create a freight logistics coordination team Consider compensation for the withdrawal of international shipping only if there is a strong case	Mostly not accepted

^a The Nimmo inquiry also recommended extending the scheme to southbound goods but had insufficient time to complete investigations into this element of the scheme. The Department of Transport conducted the investigations and the scheme was extended retrospectively to southbound commodities (ISC 1985b). DIT = Department of Infrastructure and Transport. DHS = Department of Human Services. Sources: Nimmo (1976); ISC (1985b); TFES Review Authority (1998); PC (2006c); ANAO (2011); National Infrastructure Coordinator (2012).

Table 3.2 **TFES top 10 commodities**

TFES paid for commodities shipped in 2011-12

<i>Direction/commodity</i>	<i>Amount paid (\$m)</i>	<i>Direction/commodity</i>	<i>Amount paid (\$m)</i>
Northbound		Southbound	
Frozen/processed/ prepared vegetables	8.1	Beer bottles/cans	3.0
Newsprint	7.7	Wheat	2.9
Fresh vegetables	6.8	Fodder/straw or pellets	2.4
Processed wood	5.5	Animal feed preparations	1.8
Fresh/chilled fish	3.7	Mixed or other cereals	1.7
Processed milk	3.6	Other paper products/printed matter	1.4
Waste and scrap metal	3.5	Cattle (adult)	1.3
Confectionery and chocolate products	3.4	Glass (other articles)	1.2
Beer	3.1	Paper	1.1
Cheese and curd	2.7	Sugar/molasses	1.1
Total (all commodity groups)	66.7	Total (all commodity groups)	27.4

Source: TFES database (unpublished).

The impact of the subsidies can be assessed by examining the direct benefits they provide to recipient industries and firms.

By industry, a substantial amount of the subsidy was paid for commodities produced by the manufacturing sector. The top claimant industry in 2011-12 was the other food, beverages and tobacco industry which includes a range of processed foods and alcoholic beverages including vegetables, fish, confectionery, flour, oils, and beer (table 3.3).

Table 3.3 TFES assistance by industry category

For assistance paid in 2011-12

<i>Category</i>	<i>Amount paid (\$m)</i>
Other food, beverages & tobacco	29.4
Other agriculture	18.0
Paper & paper products	15.0
Wood & wood products	7.9
Dairy products	6.8
Metal products	3.5
Livestock	3.4
Chemical products	2.4
Other non-metal mineral products	1.7
Meat products	1.6
Rubber & plastic products	1.4
Other categories	1.8

Source: TFES database (unpublished).

The subsidy is mostly paid to a small number of large firms. While the subsidy assisted around 1400 claimants in 2011-12, the top 10 claimants received around half of the total payments (table 3.4). At the other end of the scale, the smallest 1000 claimants received 2.7 per cent of total assistance paid in 2011-12.

Table 3.4 TFES large claimants

Top 10 claimants for commodities shipped in 2011-12

<i>Claimant</i>	<i>Main commodity claimed</i>	<i>Amount paid (\$m)^a</i>
Norske Skog Boyer	Newsprint	7.8
Net Sea Freight Tasmania Pty Ltd	Various (freight administration services)	7.1
J Boag & Son	Beer	6.2
Cadbury Australia ^b	Confectionery and chocolate products	4.8
Simplot Australia	Frozen/processed/prepared vegetables	4.2
McCain	Frozen/processed/prepared vegetable	3.0
Monson Shipping Pty Ltd	Processed wood	2.9
Cascade Brewery Co	Beer	2.7
Ertler Trading Pty Ltd	Fresh vegetables	2.6
Murray Goulburn Co-op Co Ltd	Dairy	2.5

^a Rounded to nearest \$ million. ^b Mondelez Australia Pty Ltd.

Source: TFES database (unpublished).

The incentives built into the scheme, and its longevity, are likely to have had a significant impact on production, consumption and investment decisions by Tasmanian businesses and government over several decades.

Many participants highlighted the important role the TFES played in reducing freight costs and making Tasmanian businesses competitive with those on the

mainland and internationally (box 3.4). It is notable that a number of the large claimants mainly operate outside Australia.

A common misconception is that all production and employment in those categories eligible for the TFES can be ascribed to the subsidy, when in fact it is the marginal or incremental effect of the subsidy that is relevant. Businesses consider a range of factors in choosing where to locate, particularly inputs of labour and capital and the business environment. The availability of the freight subsidy would be one factor in determining the relative commercial merit of alternative locations.

However, in the long term, the availability of the subsidy is unlikely to be a sufficient determinant of location. The third-largest claimant in 2005-06, Australian Paper, which was paid \$6.3 million in that year, was sold in 2009 and its two Tasmanian plants subsequently closed (PaperlinX nd).

This would be consistent with the small contribution overall the scheme makes to business costs. The scheme represents less than 1 per cent of total production costs in Tasmania's agriculture, manufacturing and mining sectors and a little over 2 per cent of industry value added (table 3.5).

Subsidy 'leakage'

Even where claimants are eligible for the subsidy, the extent to which they benefit from it depends on the 'incidence' of the subsidy (box 3.3) — who ultimately 'captures' the subsidy. This depends on the relative price responsiveness of shippers and shipping companies and the competitiveness of shipping.

In 2006, the Commission found that there was the potential for subsidy leakage to occur where shipping companies were able to increase their freight rates; that is, some of the subsidy could be captured by shipping companies.

Information from the Australian Competition and Consumer Commission, which examined the Bass Strait shipping market in 2006, 2009 and 2013 as part of its merger assessments involving Bass Strait shipping and freight forwarding services suggested that the Bass Strait shipping market is competitive (sub. 28). However, it does not necessarily follow that all shippers are able to negotiate with shipping companies to minimise their freight costs. Smaller shippers in particular are likely to have less negotiating power than shippers with large regular volumes.

Table 3.5 **TFES assistance, industry costs and value added**

By assistance paid in 2011-12

Industry	Proportion of industry costs	
	Northbound TFES	Southbound TFES
	per cent	per cent
Livestock	0.9	0.7
Other agriculture	1.3	1.3
Fishing	0.0	n/a
Forestry	n/a	0.0
Coal mining	n.r.	n.r.
Other metal ore mining	0.0	n/a
Other mining	0.0	0.1
Meat products	0.4	0.0
Dairy products	1.3	0.0
Other food, beverages and tobacco	1.4	0.3
Textiles, clothing and footwear	0.3	0.1
Wood and wood products	1.0	0.1
Paper and paper products	2.0	0.4
Other petroleum and coal products	n/a	n.r.
Chemical products	0.1	0.4
Rubber and plastic products	0.4	0.4
Other non-metal mineral products	0.3	0.7
Metal products	0.5	0.4
Other equipment	0.1	0.0
Other manufacturing	0.0	0.0
Total costs (agriculture, mining, manufacturing)	0.6	0.2
Value added (agriculture, mining, manufacturing)	1.7	0.6

n/a = not applicable. n.r. = not recorded as industry costs are unspecified.

Sources: TFES database (unpublished); ABS (2013a).

Impact of the scheme on the Bass Strait islands

Intrastate claims are a very small proportion of overall claims, representing 0.4 per cent of the number of claim line items and 1.2 per cent of the total amount paid in 2011-12. By amount of assistance paid, the main commodities shipped were cattle and fertiliser. In 2011-12, around 85 per cent of the amount paid out under the intrastate component of the scheme was for southbound-shipped commodities.

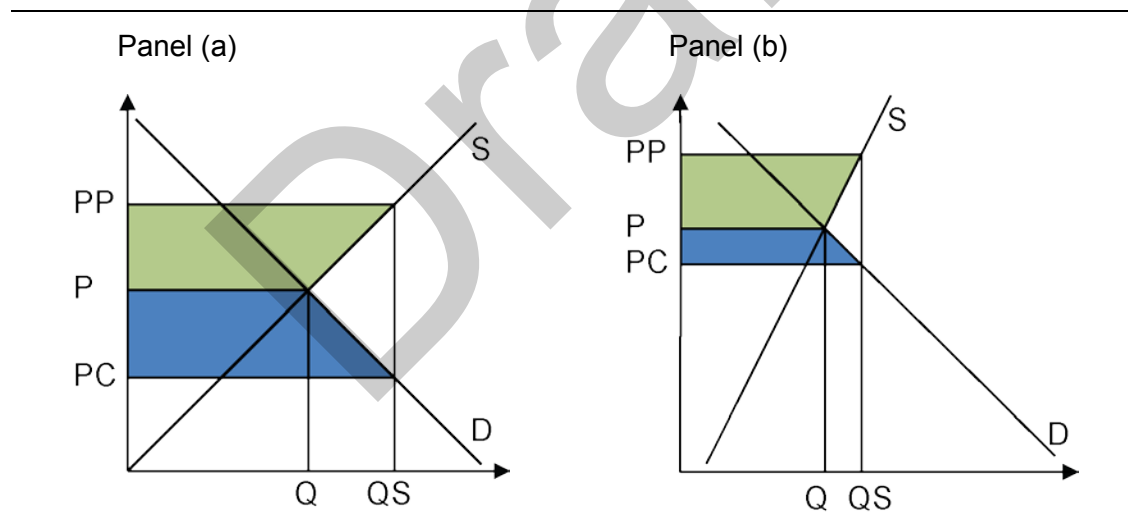
Despite the 2008 extension of the scheme to intrastate freight, inquiry participants said that disadvantages remain.

Box 3.3 The incidence of a subsidy

The economic rationale for a subsidy is to increase the production and consumption of the subsidised good or service. The subsidy increases the quantity produced and consumed from Q , without the subsidy, to Q_S (panel (a) and panel (b) in figure 3.2). Producers receive a higher price for their goods (an increase from P , the price without the subsidy to PP , the price with the subsidy) and consumers pay a lower price (a decrease from P to PC , the price with the subsidy). The amount of the subsidy is the difference between the price paid by consumers and the price received by producers.

Where producers and consumers respond in a similar way to the change in price, the benefit is shared fairly evenly between them. Panel (a) shows the benefit to producers (shaded green) and consumers (shaded blue) to be similar. However, where a producer or consumer is less sensitive to price changes they will receive a greater benefit from the subsidy. This is because the subsidy is less effective at changing behaviour making it more likely that they receive a 'windfall' gain. Panel (b) shows that the benefit to producers (shaded green), who are less responsive to the price change than consumers, is larger than that for consumers (shaded blue).

Figure 3.2 The effect of a subsidy



This means that while the benefit of the subsidy is shared between producers and consumers, the extent to which they benefit (the incidence of the subsidy) depends on their relative responsiveness to the price change. In turn, this responsiveness depends on factors including the ability to substitute one set of goods or services for another set of goods and services.

Flinders Council said that air freight as well as sea freight was considered critical to ensure sustainable access for the region (sub. 23). Air transport is eligible for the subsidy in very limited circumstances such as when a shipping service is not available due to industrial dispute, mechanical failure or vessel maintenance.

The Commission notes that adopting a level of assistance reflecting BITRE's 2013 estimation of the freight cost disadvantage for the Bass Strait islands would increase the subsidy to King Island and reduce it for the Furneaux Group of islands. This reflects changes in the sea freight cost and road freight equivalent cost per TEU. As noted in chapter 2, if the draft recommendation to revise payment rates to reflect the latest available parameter estimates were adopted, consideration should be given to initial transitional arrangements over two to three years.

Bass Strait Passenger Vehicle Equalisation Scheme

The Tasmanian Government-owned TT-Line dominates the Bass Strait passenger vehicle transport market carrying more than 99 per cent of passengers accompanying eligible motor vehicles in 2011-12 and 2012-13 (BITRE 2014). SeaRoad Holdings was the other operator providing (very limited) Bass Strait services. TT-Line's ships are licensed to carry up to 1400 people and 500 vehicles and also carry freight. TT-Line provides travel options for those wishing to cross Bass Strait with their vehicle on day trips, or on overnight crossings with accommodation and entertainment options.

Who benefits from the subsidy?

Around 330 700 passengers travelled on TT-Line ferries in 2012-13 with reimbursements that year for around 151 900 eligible vehicles (TT-Line 2013, BITRE 2014). The number of passengers fell by 17 per cent and 9.3 per cent in 2011-12 and 2012-13 respectively, dropping to levels not seen since 2000-01 (BITRE 2014).

BITRE data show that the major growth areas for vehicles using the subsidy has been vehicles with caravans and motor homes. Participants at the December inquiry roundtables advised that the passengers of these vehicles were likely to be 'grey nomads'. Between 2002, when these vehicles became eligible for the subsidy, and 2012-13, vehicles with caravans grew by 42 per cent, and motor homes grew by 34 per cent, to comprise 7 per cent and 5 per cent of eligible vehicles respectively (BITRE 2014). By contrast, the number of motor cars fell by 37 per cent over the same period (BITRE 2014).

The Tourism Industry Council Tasmania, Tourism and Transport Forum, and Cradle Coast Tourism Executive stated that the traditional touring market remains critically important to Tasmania's tourism industry and economy (sub. 48). Tourism Research Australia indicates that there were around 1.3 million visitors to areas in Tasmania outside Hobart in 2012-13, generating 48 per cent of total domestic

overnight visitor expenditure in Tasmania, excluding airfares and long distance transport costs (Tourism Research Australia 2013). To provide a sense of contribution, some 18 000 vehicles with caravans or motor homes were transported by TT-Line to Tasmania in 2012-13 (BITRE 2014).

One unintended consequence of the scheme, suggested by Austrade, was that passengers travelling with their own vehicles provide competition for hire car companies which put downward pressure on hire car prices (sub. 41).

A further unintended consequence of the subsidy is that part of the benefit of the subsidy is likely to be captured by TT-Line, thereby diluting the subsidy's effectiveness. Although the subsidy is paid to TT-Line, as is the case generally with subsidies it would be shared between the passengers and TT-Line, depending on their relative response to the price change induced by the subsidy (box 3.3). The incidence of a subsidy does not depend on who the subsidy is paid to.

The extent of subsidy 'leakage' is difficult to assess without detailed modelling. However, the characteristics of this specific market combined with pricing over time suggests that TT-Line receives at least some of the benefit of the subsidy.

Initially, there was a sharp fall in real fares when the subsidy was introduced (chapter 2, figure 2.8). Since then real fares have steadily increased which could signify that some of the subsidy is being captured by TT-Line.

To the extent that TT-Line benefits from the subsidy, indexation creates less pressure on TT-Line to minimise its costs, as part of these may be able to be recouped through the subsidy. In its submission to the inquiry, TT-Line argued that indexation by the consumer price index (CPI) was inadequate as increases in maritime operating costs were significantly above the CPI (sub. 9).

3.3 Effectiveness of the schemes

The Australian Government's stated intention is to retain the TFES and BSPVES. The terms of reference request that the Commission assess the effectiveness of the current schemes and recommend appropriate future approaches.

The complexity of the TFES creates a (voluntary) compliance burden for business and an administration burden for government. Successive governments have not administered the scheme according to the Ministerial Directions which has undermined the integrity of the scheme and entrenched its undesirable impacts. The Commission has provided recommendations to improve the integrity of the TFES and address issues with complexity and regulatory and administration burdens.

The scheme design inevitably provides perverse incentives for business to restructure or reorganise their activities to access the subsidy and maximise its value. This encourages inefficiencies for businesses and discourages some production activities in Tasmania in favour of Victoria. The Commission would like to explore the possible merit of changes to the scheme to address some of these issues.

In addition, the scheme lacks a clear and commonly-understood economic rationale as shown by the varied assessments of participants as to its objectives (box 3.4). This makes any meaningful assessment of the scheme against its objectives difficult.

Some of the inherent deficiencies associated with the scheme will not be eradicated. The scheme design relies on eligibility rules which are to some extent arbitrary. Any eligibility rules place limits on the extent to which changing the scheme design can address these issues.

The options provided by the Commission in relation to the schemes are not able to address all issues raised by participants, or the more fundamental economic challenges facing Tasmania. Alternative options for improving Tasmania's transport systems, and addressing Tasmania's fundamental and broader disadvantage, are provided in chapter 6.

Given its original purpose, the TWFS is now redundant and the Commission recommends that it be terminated. However, the Commission notes that shipping wheat to Tasmania in containers may not be the most efficient process available. In this context the Commission recommends that the calculation of assistance for wheat (and other grains) shipped in containers under the TFES be based on the lowest cost option for transporting grain to Tasmania.

The BSPVES, which was intended among other things to provide direct benefits to the tourism industry, provides only diluted support and has a limited capacity to generate future expansion in the tourism sector with growth concentrated in the 'grey nomads' touring sub-market. The Commission considers there is merit in examining alternative use of BSPVES funds to benefit Tasmania's tourism industry more effectively and transparently.

Tasmanian Freight Equalisation Scheme

Complexity, compliance and administration issues with the scheme

The scheme's complexity arises from its use of several parameters in an attempt to measure a precise freight cost disadvantage per TEU shipped. However, the scheme is unable to achieve a true measure of cost disadvantage while imposing onerous reporting obligations on businesses and administration costs on government. The diversity of circumstances and experience of shippers also means that they may not be able to reconcile their own individual experience with BITRE's estimate of the cost disadvantage.

Complexity was one of the issues raised by participants (box 3.4). Claimants who are not able to self-assess must provide numerous pieces of information for each claim line item to enable DHS to calculate eligibility for the subsidy and the amount of assistance (box 3.5). DHS processes around 200 000 claim line items each year.

The Department of Infrastructure and Regional Development (DIRD) (sub. 42) raised a number of concerns about the scheme's complexity including:

- that it reduced transparency and complicated administration, which added to the regulatory burden
- the large number of requests to review claims, which generated administrative work for DHS assessors and DIRD
- ambiguity in the Ministerial Directions which led to multiple and conflicting interpretations. This led to situations where a significant proportion of claims appeared to be made on an 'inferred' basis, with the potential to provide an arbitrary advantage or disadvantage to businesses depending on the interpretation
- eligibility for some niche categories such as sportspersons, entertainers and broodmares, that are not commodities intended for sale. In 2011-12, there were around 400 claim line items for sportspersons, entertainers and horses receiving around \$224 000 in assistance.

Adopting the parameters proposed by BITRE in its 2013 parameter review would improve the integrity of the scheme. However, it would not address concerns about the complexity of the scheme. It would also not address the Commission's finding from its 2006 inquiry that the use of a sliding scale, around a median, creates weaker than normal commercial incentives for cost minimisation, or incentives to maximise claims.

In 2006, the Commission recommended a single flat rate of assistance which would:

- improve the commercial incentives for Tasmanian producers to minimise transport costs
- reduce compliance and administration costs as it would be simpler to claim and administer
- avoid the ongoing need to update scheme parameters
- address the in-built incentives to overestimate the sea freight cost disadvantage
- recognise that an accurate assessment of each shipper's freight cost disadvantage is an unattainable goal.

DIRD also proposed that complexity could be reduced by introducing a flat rate of assistance and removing the reduction in assistance for heavy weight freight (sub. 42).

Moving to a flat rate of assistance would create 'winners' and 'losers' compared to the current scheme parameters. Large shippers would gain relative to small shippers in cases where large shippers were able to negotiate lower freight rates.

While not supporting the introduction of a flat rate, Mondelez Australia Pty Ltd said there could be a case for a simplified calculated percentage rate compensation, based on a comparison of mainland freight rates and Bass Strait sea freight rates (sub. 24). GA Cossar & Co Pty Ltd also suggested a percentage subsidy (sub. 7).

Moving to a flat rate of assistance would remove the main source of scheme complexity — the parameters used to calculate claimants' notional wharf-to-wharf freight cost disadvantage.

It would also remove the incentive for claimants to structure freight bills in a way that maximises the value of the subsidy. A particular concern raised by the Commission in 2006 is the potential for door-to-door, door-to-wharf and wharf-to-door claims to provide this opportunity. While the TFES provides assistance for the notional wharf-to-wharf freight cost disadvantage, claimants can also claim on a door-to-door, door-to-wharf or wharf-to-door basis and deduct \$230 for each land-side component.

Box 3.4 Participants' views on the TFES

Participants stressed the importance of the TFES to businesses located in Tasmania. Mondelez Australia Pty Ltd said:

The TFES is critical to Mondelez International's operations in Tasmania. (sub. 24, p. 3)

Norske Skog highlighted the scheme's importance to its ongoing operations:

... any reduction in assistance would jeopardise Norske Skog's ability to operate a sustainable business in Tasmania. (sub. 39, p. 17)

Harvest Moon pointed to the scheme's contribution to addressing the disadvantage faced by Tasmanian shippers:

The TFES does not provide Tasmanian based shippers with an unfair disadvantage versus mainland companies. It simply means we are only disadvantaged by \$15 to \$20 / tonne rather than \$85 to \$90 / tonne. (sub. 21, p. 2)

Submissions also provided evidence of problems stemming from the design of the scheme. Participants outlined the perverse incentives the exclusion for exports created to move manufacturing processes to the mainland, with Cuthbertson Bros Pty Ltd saying that the scheme:

... discourages capital investment and employment in Tasmania to the benefit of Victoria, in particular. (sub. 3, p. 1)

Participants also said the scheme's complexity and compliance requirements created onerous compliance. According to GA Cossar & Co Pty Ltd:

The [TFES Guidelines] is a document of 82 pages. At the risk of understatement, it would be reasonable to conclude that the interpretation of this complex document may be beyond some of those it is intended to assist. (sub. 7, p. 2)

According to the Department of Infrastructure and Regional Development, the scheme's complexity increases errors and the incentives to maximise claims:

A number of administrative issues have arisen from the complexity of the scheme including a very large overpayment (notified to DHS by the firm involved) and incorrect and inconsistent payments. (sub. 42, p. 20)

Participants' views on the purpose of the scheme exposed the absence of a common understanding of the purpose of the scheme. Its objectives in respect of freight costs were described variously as being to 'normalise' (SeaRoad Holdings Pty Ltd, sub. 35, p. 6), 'offset' (Net Sea Freight, sub. 26, p. 11) or 'compensate' (Regional Development Australia - Tasmania, sub. 17, p. 26 and Mondelez Australia Pty Ltd, sub. 24, p. 10).

Box 3.5 Shipment details required to make a claim

According to the TFES guidelines, each shipment requires the following details for the processing of claims:

- transport company used
- consignment note number
- date of shipment
- invoice number
- evidence of payment of freight costs
- type of goods shipped (used to assess TFES eligibility).

In addition, the following information is required to determine the amount of assistance payable:

- the number of tonnes or cubic metres shipped (not required for livestock)
- the type of goods shipped
- the density of the goods shipped
- whether the goods were shipped as dry freight or reefer freight
- if livestock, the number of head and type of livestock
- origin and destination of the shipment (also to assess shipment eligibility)
- transport task (for example wharf to wharf or door to door)
- total freight paid excluding GST
- if the shipment is a full container load — the container or trailer size and the number of containers or trailers
- if the shipment is a less than full container load, the number of pallets.

Source: DITRDLG (2013).

In 2006, the Commission found that where the door-to-wharf or wharf-to-door cost component is more than \$230, it provides an incentive to claim using a door-to-door invoice which would provide a higher rebate.

Analysis of the TFES database suggests that most claim line items are still presented on a basis other than wharf-to-wharf costs.

DIRD stated that further work would be required to assess the dollar amount of a flat rate that would provide reasonable assistance without introducing disincentives to find the cheapest shipping cost (sub. 42). The Commission has reflected this view in its draft recommendation below.

DRAFT RECOMMENDATION

The Australian Government should introduce payment of sea freight assistance as a single flat rate of subsidy per TEU (twenty foot equivalent unit) shipped.

The Bureau of Infrastructure, Transport and Regional Economics should recommend a dollar amount for assistance, taking into account:

- ***the parameter or parameters that the flat rate should be based on; and***
- ***that the flat rate should provide assistance that is compatible with the incentive to seek the lowest shipping cost.***

If the Government does not adopt a flat rate, assistance under the Tasmanian Freight Equalisation Scheme should only be payable on the basis of evidence of actual wharf-to-wharf cost.

The limited uptake of online claiming increases compliance and administration costs. In 2011, the Auditor-General found a number of shortcomings in several areas of program administration, including compliance, quality assurance and claim management (ANAO 2011). DIRD advised that while actions have been taken to improve compliance in response to the Auditor-General's report, funding to pursue compliance activities is limited (sub. 42).

In 2007, in response to the Commission's inquiry, the Australian Government increased funding to develop a new approach to verifying wharf-to-wharf costs, supported by upgraded technology and risk management. However, DIRD advised that while online claiming is available, the complexity of the process and the need for detailed supporting evidence mean that most claims are lodged through the TFES bulk upload system by mail to DHS or in person (sub. 42).

Adopting the draft recommendation for a flat rate is likely to lead to a substantial reduction in the compliance and administration burden under the TFES. However, this would not address the compliance burden on claimants and the administration burden on government arising from the material required to accompany claims. DIRD states that some actions which could be taken to improve compliance, in particular improved information technology systems, have not been pursued due to a lack of funds (sub. 42). Improved information technology systems may provide some scope to reduce the compliance burden on businesses and administrative costs to government without compromising quality assurance and the integrity of the scheme.

The scheme's administration and auditing would be further improved by greater transparency in the publication of scheme data, particularly the assistance paid to scheme recipients. In its 2006 inquiry, the Commission recommended more comprehensive reporting of scheme data, including payments to recipients. This would build on BITRE's publication of scheme data in its parameter reviews.

DRAFT RECOMMENDATION

The Department of Human Services should examine the benefits and costs, including compliance costs for claimants, of upgrading its technology to provide greater access to online claims under the Tasmanian Freight Equalisation Scheme and improve internal claims processing.

DRAFT RECOMMENDATION

The Department of Infrastructure and Regional Development should provide more comprehensive public reporting of information under the Tasmanian Freight Equalisation Scheme, including annual payments to recipients.

The scheme's complexity also increases the need for many claimants to use agents.

Changes to the scheme in 2002 attempted to address this issue by allowing companies who supply goods under the southbound or intrastate components of the scheme to act as agents on behalf of their customers (DITRDLG 2013). The TFES guidelines require that agents pass the full amount of TFES assistance to eligible claimants (DITRDLG 2013).

However, other claimants use third parties to claim on their behalf. Net Sea Freight dominates this market with a total claim value of around \$7.1 million in 2011-12 (table 3.4). DIRD noted that simplifying the scheme would reduce the need for agents (sub. 42).

A small number of claimants have been invited by DHS and DIRD to enter an agreement to 'self-assess' their claims (ANAO 2011). Self-assessed claimants are selected based on their history of compliance and the accuracy of their claims (ANAO 2011).

In 2010-11 there were nine self-assessed claimants who received 30 per cent of all TFES assistance in that year (ANAO 2011).

Self-assessed claimants have the following obligations (ANAO 2011):

- they submit the same claim form as other claimants, but are not required to submit supporting documents
- they must keep records of all documents for five years
- they provide an independent annual audit of their claim forms and supporting documentation.

Further, their claim forms are not verified against supporting documents before being accepted and paid (ANAO 2011).

As self-assessment reduces the compliance burden for these claimants, and the administration burden for government, the Commission considers that there would be merit in extending the self-assessment facility to a broader pool of claimants.

DRAFT RECOMMENDATION

The Department of Infrastructure and Regional Development should extend the self-assessment facility under the Tasmanian Freight Equalisation Scheme to more claimants.

In 2011-12, the average amount paid for a claim line item was \$463.50. However, the median amount paid for a claim line item in 2011-12 was less than \$44. This means that around 100 000 claim line items, each of which generally would have been a separate shipment, required the information outlined in box 3.5 in order to receive a very small TFES benefit. Around 123 300 claim line items had amounts paid of less than \$100 and around 61 400 claims had amounts paid of less than \$10.

The Commission considers that in addition to a flat rate payment per TEU, given the large number of small claim line items, each of which is generally for a separate shipment, it would be appropriate to introduce a minimum threshold for payment. This should be set at a rate which distinguishes business transactions from those that are minor or likely to be personal in nature.

For example, a \$250 minimum threshold would have reduced the number of claim line items by around 138 000 in 2011-12, and reduced the total claim value by \$5 million. The Commission is seeking views on an appropriate minimum claim line item value that would meet the objectives of the scheme, while reducing administration and compliance costs.

DRAFT RECOMMENDATION

The Department of Infrastructure and Regional Development should impose a threshold on the minimum value of a claim line item under the northbound component of the Tasmanian Freight Equalisation Scheme to distinguish between business and minor transactions.

INFORMATION REQUEST

What minimum claim value (per claim line item) would meet the objective of the Tasmanian Freight Equalisation Scheme while reducing administration costs for government and compliance costs for businesses?

Anomalies with the scheme

The scheme creates ‘dividing lines’ for eligibility through inclusions and exclusions for firms and commodities which in turn creates incentives for businesses to change their behaviour to access and maximise the value of assistance.

Evidence from participants suggests sources for these incentives are:

- the exclusion for exports
- the scheme’s disparate coverage for bulk and non-bulk goods under the southbound component of the scheme
- eligibility for the southbound component of the scheme which is based on the Australian and New Zealand Standard Industrial Classification (ANZSIC) division the business belongs to.

These boundaries are in some cases creating perverse incentives, distortions in economic activity and business inefficiencies.

Northbound component

The exclusion for exports attracted the most common criticism from inquiry participants (box 3.4). The TFES Review Authority (1998) recommended against providing the subsidy to exports because international shipping services were available. However, since May 2011, Tasmania has been without a direct international container shipping service following the AAA Consortium’s withdrawal of weekly services from Bell Bay. Consequently, non-bulk shipping exports have to tranship through Melbourne to access international markets.

As a consequence, participants said this encouraged the transfer of production processes from Tasmania to the Australian mainland to access the subsidy. It also encourages some form of minimum ‘transformation’ of intended exports in Melbourne sufficient to access the subsidy and inquiry participants indicated that this occurs.

Southbound component

The TFES provides assistance for some commodities that would otherwise be shipped in bulk. Wheat shipments under the TFES are a particular beneficiary with wheat the second largest southbound claim by value in 2011-12 (table 3.2). Since 2004-05, the TFES has provided a subsidy for containerised wheat in addition to the TWFS which provides a subsidy for bulk-shipped wheat.

This duplication arose in the 2004-05 Budget when the Australian Government ceased the bulk wheat freight subsidy and provided additional funds to the TFES to pay the TFES subsidy for containerised wheat. The bulk wheat freight subsidy was subsequently reinstated but the additional assistance under the TFES remained. The Commission notes that shipping wheat in containers may not be the most efficient process available.

Claims for wheat under the southbound component of the TFES have increased significantly in recent years, as shippers moved from bulk shipping to containers to access the higher TFES subsidy. Figure 3.3 shows that the number of tonnes shipped and the subsidy paid per tonne were higher for the TFES than for the TWFS and there were no claims under the TWFS in 2005-06, and there have been none since August 2009. For wheat shipped in containers, the number of tonnes increased by 17 per cent and the subsidy paid per tonne increased by 19 per cent between 2005-06 and 2011-12.

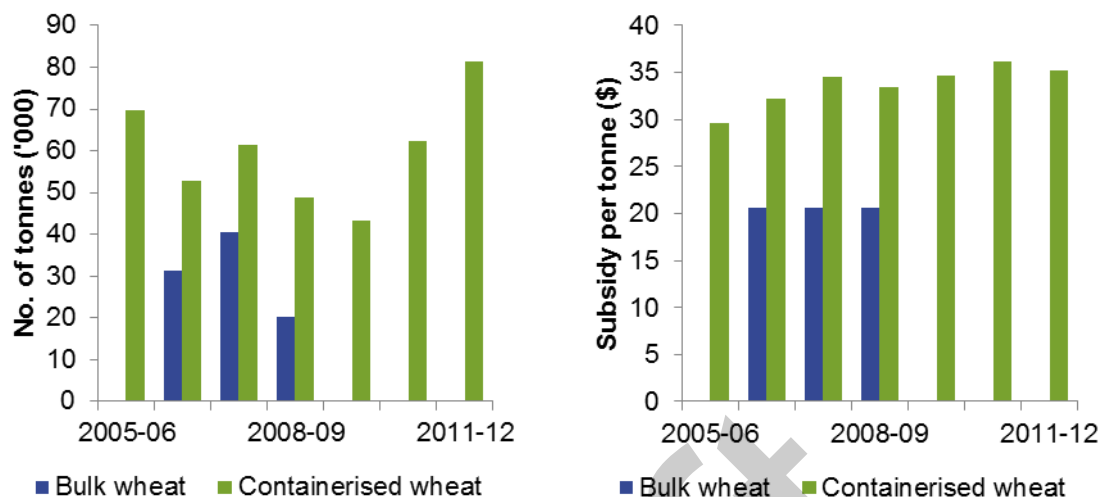
There is likely to have been a loss of efficiency in the move to containerised wheat transport.

To be eligible to claim under the southbound component of the scheme, a person must be engaged in one or more of the following industries — manufacturing, mining, agriculture, forestry or fishing. However, eligibility is determined by ANZSIC division. Where an applicant is involved in activities that cover more than one ANZSIC division, DHS decides which ANZSIC division the business belongs and therefore whether it is eligible for TFES assistance.

Participants at the industry roundtables advised that this discourages efficient business structures as the design of the scheme requires separate entities to claim for commodities for use in different ANZSIC classified business activities covered under the scheme, that would otherwise be claimed by one vertically integrated entity.

In light of issues raised with the northbound component of the scheme, the Commission intends to explore the merit of extending payments under the TFES to all eligible commodities shipped to the Port of Melbourne. This approach would be more consistent with the policy's stated objective (partially ameliorating Bass Strait shipping cost disadvantage) and a long term policy objective to enhance Tasmania's access to markets. The Commission is seeking feedback and input from inquiry participants on the potential impacts of such an extension to eligibility.

Figure 3.3 Trends in bulk and containerised wheat shipments
2005-06 to 2011-12



Source: BITRE (2013b).

An alternative option would be to extend payments under the TFES to all eligible goods shipped to the Port of Melbourne *and* treat all southbound goods in a similar non-discriminatory fashion by removing the southbound component of the scheme. This would:

- remove the distortions created by the different treatment of goods that receive assistance under the southbound component of the scheme and inputs to other sectors of the economy
- remove the broader distortion created by the different treatment of goods sourced from mainland markets and those sourced from international markets
- address the complexity and, therefore, the compliance and administration burden embedded in the southbound component of the TFES.

The Commission is seeking participants' views on the relative merits of these options.

Changes to eligibility would inevitably create winners and losers and the effect on particular businesses would depend on their particular circumstances. The Commission is particularly interested in evidence of the potential impacts of these options on businesses, industries and the economy.

Around 600 claimants only made claims under the southbound component in 2011-12 with total claims paid of around \$10 million. The median claim line item was \$1370 and 45 per cent of claim line items were for amounts less than \$1000.

INFORMATION REQUEST

What would be the potential impacts (both positive and negative) on Tasmanian firms and industries, and the Tasmanian and Australian economy more broadly of the following optional changes to the coverage of the Tasmanian Freight Equalisation Scheme within current funding levels:

- *extending the northbound component of the scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne*
- *extending the northbound component of the scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne **and** removing the southbound component of the scheme for all goods shipped from the Australian mainland to Tasmania?*

The Tasmanian Wheat Freight Scheme

Issues with the scheme

The TWFS had its origins in the 1948 Commonwealth Wheat Marketing Plan which assumed the States would enact legislation fixing the price at which wheat would be sold by the Australian Wheat Board in Australia (ISC 1985a). Each state enacted provisions fixing the price of wheat and the same price was prescribed by each state (ISC 1985a). However, the legislation did not oblige the Australian Wheat Board to supply wheat to Tasmania and this led to controversy as to who would pay the cost of shipping wheat to Tasmania, complicated by the determination of the basic wage, influenced by the price of bread. The Commonwealth introduced a levy on all domestic wheat sales to finance the shipping costs in 1953.

In 2004, the TWFS was refocused to address Tasmanian wheat users' extra transport and handling costs and to provide transitional support to these users while they adjusted to the removal of administered pricing.

Sixty years on, there has been significant deregulation and reform in wheat and labour markets. Further, the price of wheat is estimated to contribute only around 5 to 10 per cent to the retail price of bread (ACCC 2008b), which in turn is not the uniform commodity of the 1950s. This suggests that the objectives of the scheme have been met and are no longer relevant.

As well as wheat for human consumption (which was the rationale for the TWFS), animal feed companies appear to make a significant proportion of claims for wheat shipped in containers under the TFES.

Options for the scheme

No claims have been made under the scheme for five of the last eight years, and none have been made since August 2009, meaning the scheme has become redundant with the subsidisation of wheat shipped under the TFES.

However, it is clear that at least some of these shipments would be more efficient in bulk form and the current practices induced by the schemes involve the loss of this efficiency. In 2006, the Commission recommended that wheat should no longer be eligible for assistance under the TFES as it distorted the efficient pattern of wheat transport (PC 2006c).

Abolishing the scheme would acknowledge its redundancy and that its objectives have been met. However, the calculation of assistance for wheat (and other grains) shipped in containers under the TFES should be based on the lowest cost option for transporting grain to Tasmania.

DRAFT RECOMMENDATION

The Australian Government should terminate the Tasmanian Wheat Freight Scheme as its original policy rationale and therefore the scheme itself are redundant.

The calculation of assistance for wheat (and other grains) shipped in containers under the Tasmanian Freight Equalisation Scheme should be based on the lowest cost option for transporting grain to Tasmania.

The Bass Strait Passenger Vehicle Equalisation Scheme

Issues with the scheme

The stated aim of the scheme when it was introduced in 1996 was to reduce the net fare of a driver sharing a standard cabin to a similar cost driving an equivalent distance on a highway (Sharp 1996). However, the scheme was clearly expected to assist Tasmania's tourism industry and Tasmania more broadly (Sharp 1996):

This Coalition initiative will encourage demand for travel across Bass Strait, with direct benefits to the tourist industry and potential growth in jobs, investment and population for Tasmania.

Objectives of the scheme, as articulated by participants, generally focused on its support for Tasmanian tourism.

The scheme also provides choice to passengers (visitors and Tasmanian residents) who prefer to travel with their own vehicle. In respect of the passengers' option to take their own vehicle on the Spirit of Tasmania, the Spirit of Tasmania website states that (TT-Line nd):

This adds value for passengers and is possible due to the Federal Government's Bass Strait Passenger Vehicle Equalisation Scheme which are deducted from Spirit of Tasmania fares.

The main issues identified with the BSPVES are:

- it provides only diluted support to tourism and there are likely to be better options for the use of these funds
- there is a lack of transparency about the main beneficiaries of the subsidy, and the extent to which it provides financial support for TT-Line
- participants identified anomalies in the treatment of travel between the Bass Strait islands and mainland Tasmania.

Impact on tourism

Tasmania's tourism industry offers a diverse range of experiences through its natural wilderness and heritage assets and cultural activities. Tasmania's tourism industry is a significant contributor to the Tasmanian economy and a potential growth area.

Sea travel is a small share of overall passenger travel, representing around 10 per cent of passenger traffic to Tasmania. Demand for sea travel is also influenced by factors largely outside the sector's control such as economic conditions and general trends in tourism travel. TT-Line has described the tourism climate as 'challenging' (TT-Line 2013).

Sea travel is a small part of overall passenger travel and, coupled with limited capacity for sea tourism operators to influence demand, means the scheme has had a limited impact on Tasmania's tourism industry.

Demand for sea travel on the TT-Line may have become less responsive to price changes (such as discounting) due to the availability of cheaper air travel and cheaper vehicle rental. According to DIRD, increased competition in domestic aviation since 2003-04 has lowered airfares and resulted in a modal shift from sea to air travel — sea travel is more time consuming and can be more expensive than air even allowing for the rebate (sub. 42).

The Tourism Industry Council Tasmania, Tourism and Transport Forum and Cradle Coast Tourism Executive suggested the total value of direct visitor spending by leisure visitors arriving in Tasmania by sea in 2012-13 was around \$255 million (sub. 48).

However, the additional benefit (that is, the marginal tourism spend) the scheme may provide appears to be small both in absolute terms and in the context of overall tourism spending.

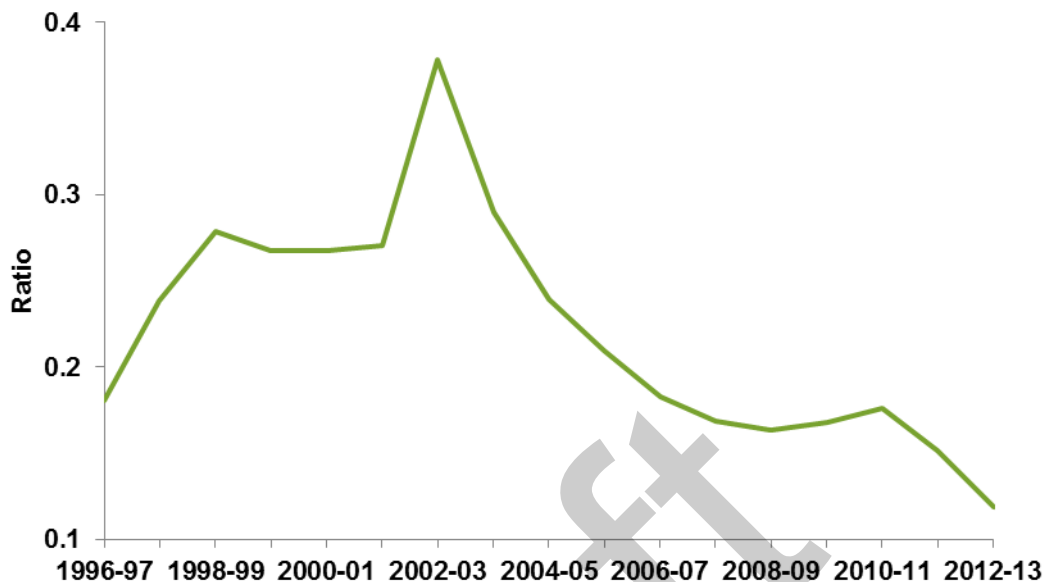
According to BITRE, as a significant number of passengers would have travelled as berth-only passengers in any case, the net effect of the scheme in 2012-13 is an estimated 24 000 additional motor vehicle passengers making a return trip (BITRE 2014). Of these additional passengers, BITRE estimates that 14 400 were leisure visitors, a fall of around 3000 since 2011-12 (BITRE 2014).

The BSPVES is estimated to have contributed around \$42 million to Tasmania's tourism industry in 2012-13, down from \$46 million in 2011-12 (BITRE 2014). This represents around 3 per cent of overall tourism expenditure in that year (Tourism Tasmania 2013). In 2012-13, the scheme provided around \$34 million in funding assistance for eligible passenger vehicles.

Participants suggested other more effective means of increasing tourism in Tasmania, including to regional areas. Lindblad Expeditions (sub. 1) and Australian Pacific Touring (sub. 11) said the Coastal Trading Act is an impediment to tourists travelling on smaller vessels visiting Tasmania.

Against the backdrop of materially lower air fares to Tasmania, an overall picture of the scheme's lack of effectiveness in encouraging additional sea passengers can be shown by the ratio of sea to air visitors (figure 3.4). For adult visitors travelling to Tasmania, the ratio of those travelling by sea to those travelling by air rose after the introduction of the BSPVES, peaking in 2002-03. However, as a proportion of overall adult visitors travelling to Tasmania, travel by sea is now lower than it was when the scheme was introduced.

Figure 3.4 Ratio of sea travel to air travel
Sea travel and air travel, Tasmania



Source: BITRE (2014).

Tasmania's tourism industry, like that of other Australian states and territories, has been affected by structural changes in the Australian economy. The rise in the value of the Australian dollar has made overseas destinations more affordable and Australia relatively less attractive for overseas visitors.

The composition of visitors to Tasmania is changing away from areas traditionally associated with passenger sea travel. Future growth is likely to come from emerging Asian markets. Arrivals in Tasmania from Australia's fastest growing international markets (China, Malaysia and France) are growing at three times the rate for Australia overall, albeit off a low base (Tourism Tasmania 2012). Targeting these growth areas may deliver higher returns to Tasmania's tourism industry and Tasmania more broadly. By contrast, the BSPVES relies primarily on the domestic market.

Broader impact on travel — Tasmanian residents

The stated aim of the scheme — to reduce the net fare for travel across Bass Strait — also applies to Tasmanian residents as well as tourists.

BITRE data show that in 2012-13 Tasmanian residents comprised around 29 per cent of adults making return journeys by sea between Tasmania and the

mainland (BITRE 2014). The primary purposes of travel for Tasmanian residents were (BITRE 2014):

- for holiday or leisure (43 per cent)
- to visit friends and relatives (31 per cent)
- for business or attendance at conferences (19 per cent)

In the early years after the BSPVES was introduced, the number of visitors to Tasmania increased more rapidly than the number of Tasmanian residents travelling to the mainland (BTRE 2001). This indicates that the take up of the scheme was relatively stronger for tourists, which is consistent with the scheme's objectives.

BITRE estimates indicate that fewer Tasmanian residents have chosen to travel by sea over the past few years consistent with falling passenger numbers overall for sea travel. In 2012-13, 5 per cent of adult Tasmanian residents making return journeys to the mainland travelled by sea, while the comparable figure for inbound tourists was 11 per cent (BITRE 2014). While the availability of the subsidy provides Tasmanian residents with travel choice, the data indicate that, consistent with overall passenger travel trends, they have a relatively low reliance on sea travel, and by inference, the BSPVES.

Anomalies with the Bass Strait Passenger Vehicle Equalisation Scheme

Participants raised anomalies with the BSPVES. Several pointed to the perceived inequity of permitting vehicles with caravans to access the subsidy, whereas vehicles with trailers or boats are not permitted (National Sea Highway, sub. 54; Brohier, sub. 59). The Boating Industry Association of Victoria (sub. 13) and TT-Line (sub. 9) suggested that the subsidy be extended to trailers towed by eligible passenger vehicles.

The King Island Shipping Group raised the cost of travel for King Island residents (sub. 19). This included that the subsidy was not available for travel between King Island and Tasmania, despite the high cost of passenger transport which was limited to air travel. Passengers who travel by air between Melbourne and King Island of the Furneaux Group of islands are eligible for the subsidy where they ship their passenger vehicle between King Island and Melbourne.

Options for the scheme

The Australian Government's stated intention is to retain the BSPVES (Coalition 2013).

A stated outcome of the BSPVES is to encourage demand for travel across Bass Strait to benefit Tasmania's tourism industry and economy. However, the scheme provides only diluted support for Tasmanian tourism as it is targeted at a relatively small market that has limited capacity to provide significant growth in tourism expenditure at least compared to Asian markets.

Further, there is a lack of transparency as to who is benefitting from the subsidy and the extent to which it encourages provision of passenger services at the lowest possible cost.

As the main objective of the scheme appears to be the provision of support for Tasmania's inbound tourism, the Commission considers there is merit in examining alternative options that would provide:

- more effective support to Tasmania's tourism sector
- greater transparency in funding
- efficiencies in the provision of tourism services
- greater benefits for consumers.

However, the aim of the scheme is to reduce the transport cost for passengers travelling with an accompanying vehicle across Bass Strait. To the extent the BSPVES is intended to have a broader objective, including outbound travel from Tasmania, the Australian Government should clearly articulate this objective and evaluate the scheme on that basis.

DRAFT RECOMMENDATION

Given that the main objective of the Bass Strait Passenger Vehicle Equalisation Scheme appears to be the provision of support for Tasmania's inbound tourism, the Australian Government should examine alternative use of the funds under the scheme to pursue this objective more effectively and transparently.

To the extent that the scheme has a broader objective — including outbound travel from Tasmania, the Government should clearly articulate this objective and evaluate the scheme on that basis.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the inquiry report.

Draft

4 Sea freight

Key points

- Tasmania relies heavily on shipping for its interstate and international freight task.
 - The relatively small size of its economy and freight volume (and the lack of growth in this volume since 2007) limits the scope for competition, economies of scale and hence more efficient shipping and port costs.
 - The viability of direct international shipping is constrained by low volumes and port infrastructure that restricts access for larger vessels.
- The low volumes of the Tasmanian freight task place added emphasis on the need for efficient infrastructure provision and use. However the Tasmanian Ports Corporation (TasPorts) operates the three northern ports as a single entity with uniform pricing.
 - This masks price signals, potentially supports less efficient ports at the expense of others, reduces opportunities for scale economies and hinders investment in port infrastructure.
- Government ownership of TT-Line appears to create distortions to private investment in more efficient Bass Strait shipping operations.
 - The rationale behind Tasmanian Government involvement in the shipping market is not clear.
- Recent Australian Government changes to coastal shipping policy have reduced competition on Australian coastal trades and adversely affected Tasmanian shippers and businesses.
- Participants' concerns throughout the inquiry have primarily related to containerised freight across Bass Strait. There appear to be fewer concerns regarding bulk trade.

4.1 Key features of Tasmania's domestic and international shipping

Shipping accounts for over 99 per cent of all freight to and from Tasmania by volume, and about two-thirds of Tasmania's total inter- and intrastate freight task.

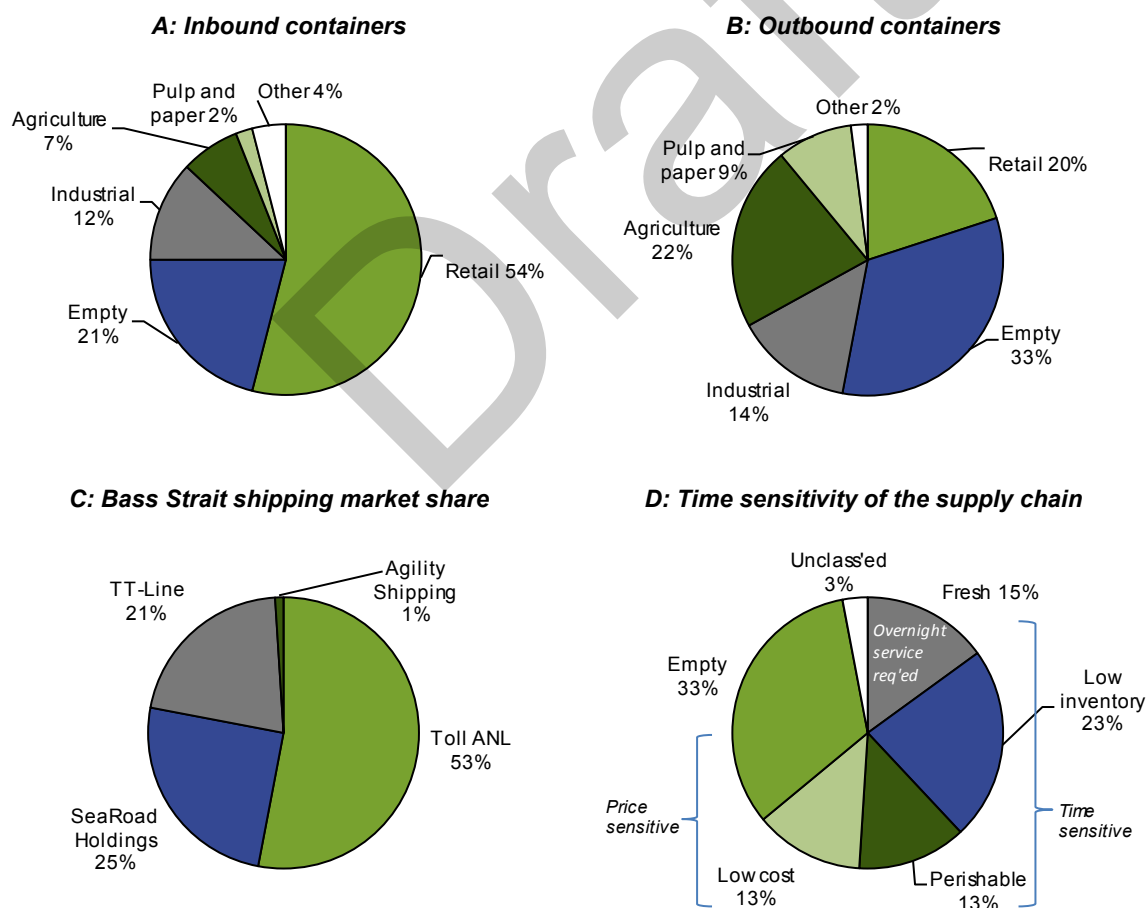
The total volume of Tasmanian freight (bulk and non-bulk) shipped in 2011-12 was just under 13 million tonnes.

About 8 million tonnes of that total (some 62 per cent) was bulk freight (BITRE 2013c). Around half of this bulk freight (48 per cent) was for Australian domestic use, with the remainder shipped internationally (40 per cent shipped on a direct service). Bulk freight is largely the domain of single companies that charter vessels to transport their commodities, and commonly use private wharf facilities (Aurecon 2013a, p. 17).

The remaining 4.9 million tonnes — around 38 per cent of the total freight task — was non-bulk (container and break bulk) freight (BITRE 2013c). Of this total, about 1 million tonnes represented international imports and exports. This non-bulk traffic is the main subject of this report.

The main characteristics of the domestic container shipping task are shown in figure 4.1.

Figure 4.1 **Characteristics of Bass Strait container shipping in 2011-12**



Data source: Aurecon (2013c).

Domestic shipping across Bass Strait

The diverse nature of Bass Strait non-bulk freight is catered for by roll-on roll-off (RORO) vessels. Three shipping operators provide freight services with six vessels across the Bass Strait: Toll ANL, SeaRoad Holdings, and TT-Line (table 4.1).

The daily Bass Strait shipping capacity in one direction is around 860 twenty-foot equivalent units (TEU) (Aurecon 2013a). Demand over peak periods is higher and the shipping companies increase their sailings to meet this demand. TT-Line estimates its average capacity utilisation is currently around 90 per cent, and considers that Bass Strait shipping has reached its capacity limit (sub. 9, p. 2). Toll, however, considers that:

... there is currently more than enough freight capacity on Bass Strait. The only exceptions to this are the weeks leading up to Christmas and Easter each year. (sub. 55, p. 1)

The service is a fast, reliable overnight service between Tasmania and the mainland, enabling products to access markets quickly. The faster travel time of TT-Line's *Spirit of Tasmania* vessels makes it more suited to highly time-sensitive products.

Table 4.1 Features of Bass Strait shipping services

Feature	Toll ANL	SeaRoad Holdings	TT-Line
Vessels	Two RORO vessels: <i>MV Tasmanian Achiever</i> and <i>MV Victorian Reliance</i>	Two RORO vessels: <i>MV SeaRoad Tamar</i> and <i>MV SeaRoad Mersey</i>	Two RORO vessels: <i>Spirit of Tasmania I</i> and <i>Spirit of Tasmania II</i>
Frequency	Overnight, six days per week plus extra sailings during peak demand	Overnight, six days per week between Tasmania and the Mainland, and a weekly service to King Island	Overnight, daily plus extra day sailings in peak demand
Ports	Operates between Port of Burnie and Port of Melbourne	Operates between Devonport East and Port of Melbourne	Operates between Port of Melbourne and Devonport
Capacity	500 TEU plus general freight	180–260 TEU plus trailers	175 TEU
Freight carried	General purpose containers, refrigerated containers, cars and trailers, equipment, and livestock	Break-bulk, general and refrigerated containerised freight, and road trailers	Road freight trailers, cars and trailers, caravans
Other services offered	Logistics and freight forwarding services	Logistics and freight forwarding services	Vessels primarily designed to carry passengers

Sources: Aurecon (2013a, 2013c).

However, only around 15 per cent of freight requires an overnight service. According to a study prepared for the Freight Logistics Coordination Team (FLCT) (2013a) around 46 per cent of freight in 2011-12 was more sensitive to price than time (or speed with which freight could be transported). Amongst this group are products such as zinc, aluminium, pulp and waste paper, furniture and timber, as well as empty containers. Even amongst the time sensitive group, an overnight service may exceed some shippers' needs. For example, some perishable items (confectionery and frozen vegetables) and low inventory items (paper, beer, crude fertiliser and animal foods) may be better suited to a regular but low cost service, rather than overnight.

While producers in Tasmania have diverse needs and many would prefer a lower cost and lower quality service, they have mostly adapted their business operations to the current level of service.

The Commission notes that some other limited services operate from Tasmania to the mainland. For example, Shipping Australia Limited commented that:

There is a regular service from NSW – (Eden) a vessel operates carrying explosives to Bell Bay and returns carrying cattle from King Island. (sub. 53, p. 2)

However, the overwhelming focus of participants' concerns throughout the inquiry has been on non-bulk shipping services between Tasmania and the Port of Melbourne.

Bass Strait Islands

King Island is serviced by SeaRoad Holdings with a weekly service provided by the *MV SeaRoad Mersey* (sub. 35, p. 4). The service, catering for livestock, plant and machinery and containerised general freight, sails from Melbourne to Grassy, and on to Devonport. LD Shipping also provides a livestock freight service, transporting livestock on open decks between Grassy and Stanley (King Island Beef Producers Group, sub. 15, p. 1).

The Furneaux islands are serviced by Furneaux Freight, which sails from Bridport (in North-Eastern Tasmania) to ports on the Furneaux islands, including Lady Barron and Cape Barren. The Furneaux islands freight task mostly services the livestock industry, particularly demand generated by the export of live animals to markets in Tasmania and Victoria, and imports of goods such as fertiliser and machinery (Flinders Council, sub. 23, p. 3).

International shipping

In May 2011, direct international container shipping to and from Tasmania ended with the withdrawal of the AAA consortium's weekly Bell Bay–Singapore service.

This occurred against a background of strong commercial pressures in global shipping and a trend to larger vessels on international routes, which led to commercially marginal services withdrawing and larger vessels providing international container services from the Port of Melbourne. These changes may further isolate Tasmania (and other ports in Australia) from regular international services.

As a result of the withdrawal of the AAA service, most international container freight that was shipped through Bell Bay is now transhipped through the Port of Melbourne. Transshipment has added to transport costs and transit times.

These higher costs and transit times were exacerbated when Agility Shipping terminated its Melbourne–Bell Bay service in August 2011. For some businesses, that decision added distance to their land leg as it required containers to be shipped through Burnie or Devonport on their journey to or from the Port of Melbourne.

In response to the cessation of direct international container shipping services, in 2012 the Australian and Tasmanian Governments agreed to a \$20 million temporary assistance package for Tasmanian exporters (box 4.1).

Limited international container shipping resumed in 2013, when Bell Bay Aluminium negotiated with Swire Shipping to collect freight from Bell Bay for delivery to Asia (BBA and Swire 2013). Swire now provides a monthly service for breakbulk and containerised freight.

The new service caters for almost half of Bell Bay Aluminium's container shipping needs (with the remainder shipped via the Port of Melbourne), and provides some capacity for other Tasmanian exporters and importers (BBA and Swire 2013).

As the Department of Infrastructure and Regional Development (DIRD) notes in its submission, a range of other vessels call at Tasmania, destined for overseas ports, carrying a range of products including chemicals, crude oil, liquid petroleum, cement and wood chips (sub. 42, p. 13). Concerns from inquiry participants, however, have focused on a direct containerised freight service between Tasmania and international markets.

Box 4.1 Temporary assistance for Tasmanian exporters

The assistance agreement provided funding for:

- (a) Direct shipping transition assistance for exporters with funding to be provided via a two-tranche allocation process.
 - (i) \$11 million for previous users of direct international services who can demonstrate they have suffered increased costs as a result of cessation of those services, and who can provide evidence of positive measures that they have implemented or planned in response to the new shipping environment.
 - (ii) \$3.5 million for other exporters who are able to provide evidence of positive measures they have implemented or plan to implement to maintain competitiveness on an ongoing basis.
- (b) Burnie Port improvements — \$4 million to fund Stage 1.1 of the planned redevelopment of Burnie Port, which includes the redevelopment of the Southern railyard and the closure of a public street and creation of a High Productivity transport link within the port precinct from the Southern railyard to the existing shipping terminal.
- (c) An industry-led Freight Logistics Coordination Team — \$1.5 million to establish an industry-led freight logistics coordination team to consider strategic issues associated with the development of Tasmania's freight and logistics sector.

Source: COAG (2012).

Cost of shipping

The cost of operating a ship across Bass Strait is a function of various fixed and operating costs (table 4.2) and the size and configuration of the vessel. Aurecon, for example, has noted that the cost of shipping services on RORO vessels is generally higher than container shipping:

... the way freight is presented causes significant operational issues and inefficiencies with receipt, handling and storage at terminals; and stowage on board RORO vessels. (Aurecon 2013c, p. 6)

The relatively short distance across Bass Strait (about 420 kilometres) is also an important influence on the costs of these shipping services. The short voyage means freight is loaded and discharged twice in every 24 hour period, subjecting vessels to higher wear and tear (Aurecon 2013c, p. 6). RORO vessels also spend more time in port, incurring proportionately higher port and stevedoring charges compared to vessels on longer routes (Net Sea Freight sub. 26, p. 5).

The costs (prices) faced by users of Bass Strait shipping are not uniform. They differ based on factors such as size of shipment, variability of user demand and type

of container required. Thus, freight users with low volumes or who have highly seasonal requirements will generally pay more than users with large and consistent volumes (FLCT 2013b). The unit costs they face will also reflect the capacity utilisation of that service (and, thus, the ability of the shipping line to spread its costs over the volume of freight carried).

Table 4.2 Bass Strait voyage costs

<i>Costs</i>	<i>Proportion</i>
<i>Fixed costs</i>	(per cent)
Capital and financing costs (such as interest payments)	35–45
Crewing, wages, administration and on-costs	15
Repairs, surveys, dry-docks and maintenance	15
<i>Variable costs</i>	
Fuel costs for voyage	30
Port costs, such as berthing and pilotage	5

Source: Aurecon (2013c).

For the typical freight user, the cost of shipping across Bass Strait is the largest single transport cost in their supply chain (FLCT 2013b, p. 25). Data from the Bureau of Infrastructure, Transport and Regional Economics (BITRE), for example, indicate that in 2011-12, the median wharf-to-wharf cost was \$1129 while total door-to-door cost was \$1800 per TEU (62 per cent of the total cost) (BITRE 2013b, p. 21).

Bass Strait shipping rates fell significantly in real terms from the early 1980s to the end of that decade, and appear to have since settled into a pattern of fluctuation around a slowly declining trend (figure 2.5). Commenting on recent shipping costs, Net Sea Freight noted:

There has been a reduction in costs and improved service through shortening lead times, removing logistics steps, improving asset utilisation and introducing automation where appropriate. (sub. 26, p. 9)

Despite these gains, many participants expressed concerns about excessive Bass Strait shipping costs. Mondelez International, for example, claimed that the costs were inefficiently high:

The freight services between Tasmania and the mainland are reasonably adequate in terms of time and capacity. However, the inefficient costs of the freight on Bass Strait results in substantially higher costs for the operations of Mondelez International in Tasmania. (sub. 24, p. 3)

The cost of shipping across Bass Strait is also an issue for international shippers. Compared to direct international shipping through Bell Bay, transshipping through

the Port of Melbourne adds an average of about \$800–\$1500 per container in transport costs. It can also add up to 3–5 days to the transit times of northbound shipments and 7–10 days to southbound shipments (GPS 2013, pp. 12–13). Participants provided examples of how this was affecting their business:

Harvest Moon export approximately 220 TEUs per year. The extra handling cost of containers due to transhipping through the Port of Melbourne is equivalent to \$1025/TEU or a \$225 500 per annum bottom line impact on Harvest Moon. (Harvest Moon, sub. 21, p. 2)

We have been exporting logs in containers to Asia to undertake tests to make advanced wood products which we hope to produce here in Tasmania. The impact on timing and cost as a result of containerized wood products being sent via Melbourne or elsewhere and the lengthy turnaround time has made our plans for innovation more costly and less efficient. (Forestry Tasmania, sub. 37, p. 1)

The loss of the Bell Bay service was a cost blow for Simplot. Transition to a ‘via Melbourne’ supply chain added \$400 000 to the route per annum. (Simplot, sub. 50, p. 4)

These added costs have made it difficult for many Tasmanian exporters to remain competitive and are claimed by some to be responsible for a fall in exports:

The loss of an international shipping service has caused sea freight exporters ... to bear significant additional costs as a consequence of shipping through the Port of Melbourne. Many companies cannot absorb this cost as they are price takers in international markets. (TCCI 2012, p. 5)

Benchmarking of shipping costs is intrinsically difficult and therefore typically subject to caveats. That said, benchmarking work by Aurecon compared the costs of Bass Strait shipping with two similar RORO services in Europe (box 4.2) and found that Bass Strait costs were about 24 per cent higher. However, it notes that this should be viewed in the context of higher labour and fuel costs in Australia (Aurecon 2013c).

Toll disputed that comparison, arguing that a more accurate assessment shows Bass Strait costs to be similar or less than the European examples:

Comparisons of other sea freight costs, while interesting, are not equivalent given cost of bunker fuel, crew and economies of scale on ship maintenance and wharf infrastructure. ... [The Immingham to Rotterdam] rate does not include any terminal charges, power or equipment because typically the shipper supplies the trailer or container in Europe. By comparison, Toll’s 20ft GP rate of \$700–\$950 (depending on weight and service) includes the cost of terminals which is in the order of \$250 a TEU plus the supply of equipment of approximately \$60. On that comparison, the European rate would be in the range of \$922 plus fuel and wages. (sub. 55, p. 2)

Box 4.2 Bass Strait costs compared to similar services overseas

The FLCT investigation compared the shipping costs on the Bass Strait route against services across the Cook Strait in New Zealand and the North Sea in Europe.

The Cook Strait comparison is marred by large differences in the nature of the supply chain. Of the North Sea routes, the route between Immingham in the United Kingdom and Rotterdam in the Netherlands was found to be a similar distance to Bass Strait, an overnight RORO service and highly freight oriented. Generally there is substantial competition in the North Sea area due to more choice of ports and routes than across Bass Strait.

The analysis found prices typically ranged from \$800 to \$1200 per TEU. A 'rack rate' of \$1050 to \$1150 was indicated by major freight providers for Bass Strait for an ad hoc customer per TEU, while an average of nominal rates from Europe was \$800.

The study found that adjusting for port handling charges, currency effects and averaging rates, nominal Bass Strait freight prices appeared to be higher than an average nominal 'rack rate' from Immingham to European ports by around 24 per cent. However, the study notes that this should be considered in context — it is influenced by higher costs in Australia, particularly Australian labour costs and bunker fuel, which were about 23 per cent higher than European costs.

Source: Aurecon (2013c).

4.2 Efficiency drivers of Tasmania's shipping

Scale and composition of freight flows

The size and composition of Tasmania's interstate and international freight flows have a major influence on the cost of shipping services provided to Tasmania.

The relatively small volume of trade across Bass Strait limits the scope to realise economies of scale, and the number of competitors that the market can sustain. On this issue, the Australian Competition and Consumer Commission (ACCC) observed:

The relatively small size of Tasmania's economy and limited trade volumes is likely to explain some of the freight cost differential between it and mainland markets. ... Because economies of scale generally prevail in shipping, lower volumes are likely to affect the cost of supplying freight and shipping services to Tasmanian businesses. (sub. 28, pp. 1, 3)

Similarly, Net Sea Freight stated:

... the low volume of trade is likely to dictate that the present number of operators is about appropriate, given the relatively high fixed costs operators incur; fragmentation of the market may well require higher prices for services to ensure sustainability of operators. (sub. 26, p. 5)

The Burnie Chamber of Commerce and Industry noted the inherent disadvantages of Tasmania including that ‘the volume of cargo is small’ and ‘With low cargo volume it is essential to accumulate freight at one port for regular and frequent collection’ (sub. 57, p. 2). They further commented:

It must be remembered at all times that scale and volume are the key components in the planning and delivery of an efficient freight infra-structure and services. (sub. 57, p. 4)

Tasmania faces a number of economic challenges (chapter 2). However, there are differing views of how this will translate into future freight flows. In 2009, the Port of Melbourne Corporation estimated that Tasmanian container trade would grow at an annual average growth rate of 4.0 per cent to 2025 and 3.8 per cent to 2035 (Port of Melbourne Corporation 2009). The recent decline in container trade suggests these estimates may be optimistic, and the FLCT has adopted a growth forecast of 3.0 per cent in its report (FLCT 2013a). Among participants, the Tasmanian Exporters Group presents a range of container trade growth forecasts, and suggests a range of 3.4-5.3 per cent growth is possible (sub. 14, p. 7).

Freight volumes are fundamental to the viability of international services, with firm commitments for minimum volumes necessary for attracting direct liner calls. Currently, Tasmania’s total international container volumes are around 37 000 TEU out of a total container task of over 450 000 TEU (FLCT 2013a, p. 30). As participants noted:

... international shipping services are inhibited, in that current volumes are not sufficient to have a port-to-port service. (Net Sea Freight, sub. 26, p. 2)

The underlying factor inhibiting the provision of international shipping services to Tasmania is volume(s), or lack thereof. This has a direct impact on costs and has been the catalyst for the ... decline in shipping lines being able to service and meet our needs. (Veolia, sub. 38, p. 2)

Low volumes to/from Tasmania (especially containers) make it difficult to provide a regular service of sufficient frequency ... (Shipping Australia Limited, sub. 53, p. 1)

GPS Logistics estimated the freight volume required to attract a weekly service (the minimum frequency that most Tasmanian exporters need to meet customers’ requirements). It found a weekly service similar to the previous AAA service, using a 2500–3500 TEU vessel, would require an exchange of 700–1000 TEU per call to be viable (about 36 000–52 000 TEU per year). A similar weekly service by a

smaller 1500–2500 TEU vessel would require an exchange of 450–700 TEU per call (GPS 2013, p. 3).

On the basis of volume alone, GPS Logistics (2013, p. 7) estimates current levels would be marginally sufficient to support a weekly, direct international container service and would only do so if it were aggregated in one port. At present, though, Tasmania's international container freight is predominantly spread across the three main northern ports. This feature of Tasmania's freight logistics chain serves to reduce the critical mass of freight volume available at any port to support an international service.

The Commission notes the FLCT's view that the viability of a commercially sustainable international shipping service must be determined by the market (FLCT 2013a, p. 30).

Based on submissions and consultations, it is difficult to envisage the return of a regular direct international service on a purely commercial basis in the foreseeable future.

The composition of Tasmania's domestic and international freight flows is also responsible for the high proportion of empty containers shipped to and from Tasmania (figure 4.1) (Aurecon 2013b; FLCT 2013b). These empty container shipments add significantly to costs for shippers, as repositioning them can cost around \$400–600 per container, depending on their final destination (Aurecon 2013a).

The FLCT identified opportunities to reduce empty container movements and shipping costs (such as carrying domestic freight in international containers and dry freight in refrigerated containers). However, while shippers have a powerful incentive to pursue options that reduce the cost of empty containers, their efforts are only likely to have an effect at the margin (GPS 2013). As the Tasmanian Government noted:

There are no obvious or simple solutions to addressing the empty container issue, given this issue is driven largely by an imbalance in Tasmania's northbound and southbound container types ... (sub. 43, p. 14)

Competition

The ACCC observed to the inquiry that competition has a role in encouraging businesses to operate at lowest sustainable cost and to ensure that prices facing shippers will be lower and quality higher than would be the case if there were little or no competition (sub. 28, p. 3).

Shipping services carrying freight across Bass Strait face no competition from road or rail alternatives. Air transport offers some competition, but is generally only feasible for time sensitive, high value freight, such as shellfish and abalone, and passengers.

However, within the freight shipping market, three companies — Toll ANL, SeaRoad Holdings, and TT-Line — compete for business.

Each of these operators have expressed intentions to invest in new vessels to service the route. These vessels will be larger than their current ships (in Toll's case, increasing capacity by up to 50 per cent) and have potential to deliver improved operational efficiency. For example:

SeaRoad's planned investment in new vessels will expand freight capacity in the Bass Strait market ... The new vessels will be more efficient and economical than existing ships dedicated to the Bass Strait trade. (sub. 35, p. 5)

Accordingly, these next generation vessels should lower the cost of shipping across Bass Strait. However, the extent to which any lower costs are passed on to users via lower freight rates depends on the level of competition in the market.

Participants had differing views on how effective this competition was in practice. Some argued that the number of providers is not sufficient for a competitive market. RDA-Tasmania, for example, stated:

A key theme that emerged from the comparing of 15 recent reports into Tasmanian Shipping is an inherent lack of competition in the marketplace. There are only two commercial shippers who compete on the Bass Strait route with limited influence from the Tasmanian Government operated TT Line. (sub. 17, p. 1)

Ship owners and their representatives see the market as genuinely competitive:

Strong competition exists between the three Bass Strait shipping companies. It also exists between the freight transport providers who use Bass Strait shipping services ... SeaRoad and its competitors all actively compete for volume on both price and service offerings. (SeaRoad Holdings, sub. 35, pp. 2, 5)

Simplot and other major users of Bass Strait shipping services tend to view the market as competitive:

Simplot's significant freight task is sought after by both major shippers, and therefore Simplot is able to perform a competitive tender process. ... Simplot is comfortable with the competitiveness of Bass Strait Shipping. (sub. 50, p. 3)

And the Tasmanian Government argued that the existence of TT-Line imposes competitive discipline on freight costs:

... TT-Line's financials present prima facie evidence that it is disciplining Bass Strait freight rates. (sub. 43, p. 12)

Information from the ACCC, which examined this market in 2006, 2009 and 2013 as part of its merger assessments involving Bass Strait shipping and freight forwarding services, also suggests the presence of some effective competition in the Bass Strait shipping market:

- In 2006, it considered the proposed acquisition by Toll of Patrick Corporation, and found that divestiture by Toll of Patrick's Bass Strait shipping operations (subsequently purchased by SeaRoad Holdings) would ensure a vigorous and effective competitor to Toll would remain in the market (sub. 28, p. 4).
- In 2009, it concluded that a proposed joint venture between Toll and ANL would not substantially lessen competition for Bass Strait shipping services. The ACCC considered the joint venture parties were likely to be competitively constrained by the two existing competitors — SeaRoad and TT-Line (sub. 28, p. 5).
- In 2013, it concluded that a proposed acquisition of Linfox's Trans-Bass Freight Forwarding business by Toll would not substantially lessen competition. In the market for Bass Strait shipping services, it considered the proposed acquisition would not materially affect competition between Toll ANL, SeaRoad and TT-Line or the extent to which SeaRoad and TT-Line would provide an ongoing competitive constraint on Toll ANL (sub. 28, p. 5).

The ACCC, however, cautions that its test relates to the lessening of competition, and its merger analysis '... is not an analysis of the competitiveness of the market per se' (sub. 28, p. 4).

Accordingly, on available information, it is not possible to reach a definitive conclusion on the level of competition between the current Bass Strait shipping operators.

Regardless of the competitiveness of the current shipping industry structure, barriers to entry and government ownership of TT Line may operate to constrain competitive pressures in the Bass Strait shipping market.

Barriers to entry

Barriers to entry may inhibit competition in the Bass Strait shipping market. As Net Sea Freight observed:

It is not a simple matter to enter the Bass Strait shipping trade due to high barriers to entry arising from the need to gain access to ports, the high cost of assets, relatively low and irregular volumes, the high cost of infrastructure, and the need to have the

benefit of complete supply chains enjoyed by existing operators, such as the existence of vertically integrated services. (sub. 26, pp. 6–7)

A new shipping entrant would require a significant initial investment in ships and terminal infrastructure. In the case of Bass Strait shipping, purpose built vessels are required to meet Bass Strait conditions, on-land infrastructure and the particular nature of the freight task. This introduces the associated risk of this investment not being readily transferable to another shipping route. Combined with low container volumes across Bass Strait, these characteristics represent a significant deterrent for potential entrants.

Other factors are also likely to act as barriers to new Bass Strait shipping operators. Port access has been suggested as a fundamental constraint to new entrants. The inability to secure a permanent berth at the Port of Melbourne was one factor contributing to the 2011 withdrawal of Agility Shipping from the Bass Strait trade (MMC Link 2012). Toll and SeaRoad have both informed the inquiry of the importance of securing berths at the Port of Melbourne when their current leases expire. For example, Toll noted that ‘the renewal of commercially sustainable long-term leases at Webb Dock is a core concern for Toll Group in 2014’ (sub. 55, p. 3).

The Port of Melbourne Corporation is redeveloping Webb Dock (used by Toll ANL and SeaRoad) as an international container handling terminal. It has stated that throughout the project the port will continue to provide ‘the vital freight connections between Tasmania and the mainland’ (Port of Melbourne Corporation 2012).

While the existing RORO services have dedicated terminal facilities at Tasmanian ports, it is not clear whether new entrants would have difficulty in accessing Tasmanian berths. RDA–Tasmania consider that ‘new entrants may find the process of sharing facilities and infrastructure with established operators challenging’ (sub. 17, p. 24). However, information from TasPorts on berth occupancy suggests that current capacity is underutilised (sub. 30, attachment 2).

Participants (such as Net Sea Freight) also commented on vertical integration (between freight forwarders and shipping companies) in the Bass Strait freight market as a barrier to shipping entrants.

The ACCC examined the issue of vertical integration in the context of Toll’s acquisition of Linfox’s Trans-Bass Freight Forwarding business and found it imposed no substantial lessening of competition among existing Bass Strait shipping operators (sub. 28, p. 5).

Government ownership of TT-Line

One of the three main shipping companies carrying freight across Bass Strait is the Tasmanian Government-owned TT-Line. TT-Line accounts for around 25 per cent of the annual volume of non-bulk freight carried across Bass Strait.

Publically available financial data for TT-Line (table 4.3 and box 4.3) indicate that it is covering its operating costs but not earning a commercial rate of return.

The Commission notes that TT-Line's reported profitability can be subject to fluctuation due to the treatment of line items such as vessel revaluation or impairment which can have a material impact on reported results.

Table 4.3 Financial performance of TT-Line

Indicators	Units	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Profit before tax	\$'000	5 103	13 422	6 379	-11 696	273	1 554	16 782
Operating profit margin	%	4.0	7.9	4.5	-5.6	0.3	0.1	8.0
Cost recovery	%	104.2	108.6	104.7	94.7	100.3	100.1	108.7
Return on assets	%	3.2	5.2	2.9	-3.0	0.7	0.6	6.4
Return on total equity	%	5.7	6.3	-0.2	-5.8	-1.2	0.1	3.6
10-year Australian government bond yield ^a	%	5.73	5.74	5.70	5.60	5.55	5.36	5.15

^a An historical ten year average of the 10-year Australian Government bond yield.

Sources: Commission estimates derived from TT-Line annual reports; PC (2008); RBA (2014).

A lack of transparency around the financial relationship between the Tasmanian Government and TT-Line makes it difficult to understand TT-Line's commercial performance.

The Tasmanian Government's ownership of TT-Line has been represented as a significant barrier to further private investment and to new entrants in the Bass Strait shipping market (Juturna 2013). According to RDA–Tasmania, the provision of a government-owned service:

... is seen by many industry stakeholders as interventionist and an unwelcome intrusion into the market. The existing shipping providers currently determine their price based on the traditional supply and demand determinants and the inclusion of a government owned service competing with them could potentially distort the true market price of shipping. (sub. 17, p. 29)

Box 4.3 Financial performance of Government Trading Enterprises

Profitability indicators provide governments and the community with a means of evaluating how well Government Trading Enterprises (GTEs) are using the assets vested in them.

- Profit before tax — the performance of an entity before income tax is paid.
- Operating profit margin — the surplus (before interest expense and income tax) earned on operating revenue.
- Cost recovery — the ability for an entity to generate adequate revenue to meet operating expenses. A GTE that persistently achieves cost recovery below 100 per cent is unable to fully recover its depreciation and maintenance costs in the long term.
- Return on operating assets — the rate of return earned from operating assets. In order for a GTE to be commercially sustainable, it would need to achieve a rate of return that includes a premium for non-diversifiable risk.
- Return on equity — the rate of return that an entity is providing to shareholders.

The 10-year Australian Government bond rate is widely used as the risk-free rate of return benchmark. Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that GTEs should be generating returns on assets above the risk-free rate.

Source: PC (2008).

Recent reports of TT-Line's plan to introduce a dedicated freight service may deter potential Bass Strait shipping entrants who could expect that TT-Line would compete on an uncommercial basis. However it is likely to have a more immediate impact on investment planning by the other carriers on this route. The Burnie Chamber of Commerce and Industry commented:

There can be no justification for the T.T. Line to consider purchasing a freight only vessel to compete with the commercially owned shipping services, nor to leave passengers' vehicles on the wharf so as to take freight. (sub. 57, p. 7)

TT-Line's enabling legislation (TT-Line Arrangements Act 1993) states that:

The principal objective of the Company is to manage and facilitate the operation of a shipping service to and from Tasmania in a manner that is consistent with sound commercial practice.

However, it is not apparent (and not specified in the Act) what the underlying objectives are for government ownership and operation of a shipping service across Bass Strait. In the absence of any explicit objectives, it is difficult to assess whether the operation of TT-Line is achieving those objectives in an effective or efficient manner.

Given the effect that TT-Line has on the Bass Strait shipping market, the Tasmanian Government should clearly articulate the case for TT-Line's presence in this market and the implications for future TT-Line investment in increased capacity.

Government ownership of TT-Line prompts inquiry about whether this might result in higher economic costs for the services TT-Line provides across Bass Strait.

Empirical evidence generally indicates that private ownership delivers services more efficiently (at lower cost) than does government ownership, although there are many mitigating factors (King 2002; Villalonga 2000). Among these factors, the level of market competition is significant (a government-owned business in a competitive market will usually be forced to operate efficiently or perish).

In this regard, TT-Line competes with air travel for passengers, but is effectively a monopoly provider in the passenger/accompanied vehicle market⁸ and, by its own admission before the Tasmanian Parliament's business scrutiny commission, primarily operates in a niche freight market, not provided for by Toll and SeaRoad:

TT-Line is very much focused on time-sensitive freight. SeaRoad and Toll don't have overnight. They deal with bulk and a whole range of predominately containers — roll on, roll off. (O'Byrne 2013, p. 5)

This suggests that TT-Line is somewhat insulated from market pressures (in two of its markets) that would otherwise sharpen incentives to deliver efficient shipping services.

For these two services the question remains: would a privately owned firm operate more efficiently in the same (relatively) uncompetitive or near monopoly circumstances? On this issue, theory and empirical evidence is mixed, although Shirley and Walsh suggest private ownership might deliver a lower cost service:

... recalling that competition effects fail to dominate ownership ... it is entirely possible that a private firm in an imperfect market may perform better than a SOE. (2000, p. 38)

Government ownership of TT-Line may be an impediment to more efficient shipping services in the market niches in which it operates. The Commission is therefore seeking participants' views on this matter.

⁸ Toll and SeaRoad have minimal capacity to service this market.

INFORMATION REQUEST

To what extent does the government-owned TT-Line provide competitive pressure in the Bass Strait shipping market? Would a scenario with only the two commercial shippers provide a more cost-effective outcome?

DRAFT RECOMMENDATION

The Tasmanian Government should articulate its underlying objective/s in owning and operating a shipping business and assess whether ownership of the TT-Line is the most cost-effective way in which to achieve those objectives.

An alternative approach?

The scale realities of the Tasmanian freight task may lend merit to considering a potential alternative to the TFES/BSPVES model — for the Australian and Tasmanian Governments to collectively use their current financial commitments to secure more directly the Bass Strait freight and passenger services they are seeking. A similar approach was suggested by the National Sea Highway (sub. 54).

In markets where competition is likely to be limited or ineffective there are some situations where it may be more efficient to subsidise a contracted service rather than individual transactions. This can be achieved through a periodic open tender process, and is a model that is used for a variety of services, including in parts of the transport sector, albeit typically for those transport sectors with relatively lower capital expenditure requirements. In cases where there are significant economies of scale, there may be efficiency gains from a single operator providing a service against transparent and enforceable pricing and performance requirements.

For such a model to have merit, the relevant governments would need to have sufficient clarity about their policy and commercial objectives and budget for the service and operating realities and costs, a capacity to develop an effective contract and be confident that future tenders would attract competitive bidding. In some of the more successful uses of this model there are lower barriers to entry than is the case for shipping services. The governments would need to have a clear understanding of the costs and benefits of moving from a competitive market to a contracted service model in both the short and longer term.

The Commission is seeking views on the potential impacts and efficacy of more fundamental reforms of Bass Strait shipping services, including the model described above.

INFORMATION REQUEST

What would be the potential impacts (both positive and negative) and efficacy of an alternative approach to the current TFES/BSPVES model whereby the Australian and Tasmanian Governments would use their current financial commitments under the schemes to cease paying individuals and businesses and instead secure more directly the Bass Strait freight and passenger services they are seeking through a periodic open tender process?

Regulatory environment

Coastal shipping regulation

From the early 1990s, Australia relaxed its coastal shipping requirements, resulting in a downward trend in coastal shipping costs (Bertho 2011). However, in recent years, changes to the regulations under the Fair Work Act (2009) and a package of coastal shipping policy changes introduced in 2012 appear to have reversed that trend. These regulations involve: extending Australian wage rates to workers on foreign flagged vessels inside Australia's Exclusive Economic Zone; new hiring, licensing and registration regimes; and tax incentives (appendix C).

The new regulations reduce the commercial attraction for international vessels to engage in the Australian coastal trade. According to the ACCC:

Additional costs imposed on international lines may affect whether such lines compete in the market for Australian coastal shipping. Where domestic trade represents an international shipping line's marginal business, any additional costs or regulatory requirements to carry domestic cargo act as a general disincentive to entering the domestic shipping market. (sub. 28, p. 10)

They also increase costs of providing domestic coastal services and reduce the level of competition in Australia's coastal trading network.

As an island state, Tasmania is particularly vulnerable to regulatory changes that increase the cost of engaging in coastal trade (box 4.4). As DIRD noted:

Tasmania's heavy reliance on shipping services means that it is likely to be more sensitive to changes in domestic coastal shipping arrangements ... (sub. 42, p. 12)

Box 4.4 The effects of cabotage on Tasmania

Various studies have concluded that cabotage restrictions are more likely to adversely affect Tasmania than other Australian jurisdictions:

Cabotage has meant that the cost of coastal shipping services in Australia has been well above international levels and has worked against the use of sea transport for interstate trade in those areas where Tasmania may be expected to have a competitive advantage. Given Tasmania's reliance on shipping for moving most of its imports and exports, cabotage has had the effect of limiting its capacity to export to both mainland Australia and the rest of the world. (Rae 2002, p. 44)

... the policies of successive Federal Governments have continued to entrench practices that impose a disproportionate cost on the transport of goods across Bass Strait when compared with similar movements on the mainland. These include ... Perpetuating high operating cost structures in Australian coastal shipping ... (PC 2006, sub. 34, pp. 2–3)

Of all Australian state and territories, any inefficiencies in national coastal shipping laws impact most strongly on Tasmania — Tasmania's island setting means that any inefficiencies in or a failure to take advantage of all the benefits of Australia's Coastal Trading shipping legislation, which limits coastal trade to Australian-flagged vessels — would impact on the efficiency of Tasmania's freight task far more than in other states, because unlike other states, Tasmanian shippers do not have access to 'substitute' freight service providers on rail or road to overcome any coastal shipping deficiencies. (Juturna 2013, pp. 4–5)

For Tasmania, the regulatory changes affect two main areas:

- vessels transporting dry and liquid bulk freight under temporary licences must now hire Australian workers and pay Australian wages; increasing shipping costs and freight rates in the process
- Australian vessels carrying containerised cargo across Bass Strait (all three shipping lines) are entitled to the company tax exemption and accelerated depreciation. However, the extent to which these benefits pass through to freight rates is unclear.

DIRD was circumspect about the effects of the 2012 Coastal Trading Act:

The Department is not aware of evidence that demonstrates a direct link between any increases in freight costs and the introduction of the new coastal trading legislation ... (sub. 42, p. 12)

However, DIRD (and others) acknowledged the high costs faced by Australian flagged vessels:

... Australian flagged ships are faced with a more expensive cost structure than their foreign flagged counterparts, primarily due to higher wage rates through enterprise agreements, higher Australian insurance costs and bunkers (fuel) at Australian prices. (sub. 42, p. 12)

While the exact nature of their impact is uncertain, some participants argued that the coastal shipping regulation changes were an important factor in increasing shipping costs for Tasmanian businesses. For example, participants noted:

Following introduction of the Coastal Trading Act 2012, BBA faced increased costs from \$18.20 a tonne in 2011 to \$29.70 in 2012, or 63 per cent. This compared with \$17.50 a tonne charged by international operators in 2012. (BBA, sub. 12, p. 3)

The new licensing arrangements have led to greatly reduced shipping options and competition in the market and an associated increase in the cost of shipping. (Australian Aluminium Council, sub. 10, p. 1)

Since the 2012 legislation was introduced, there is evidence that the costs associated with using coastal shipping services across Australia (including routes to and from Tasmania) have risen. One company has experienced a 63 per cent increase in shipping costs to Tasmania. Another company estimates an additional 1000 hours of labour annually are required to administer the new scheme. (BCA, sub. 47, p. 2)

The changes to the Fair Work Act ... directly added \$150 000 to Simplot's Tasmania to Fremantle route. In addition the omission of coastal bookings on certain vessels creates a lumpy supply chain, excess wharf power charges and additional charges to use alternative methods to re-supply WA (i.e. train or road). (Simplot, sub. 50, p. 5)

There is also some indication that the regulatory changes have adversely affected cruise ship operators, with APT and Austrade noting:

... we have no plans to return to Tasmania in the foreseeable future which is driven by two main issues.

1. Australian Cabotage laws (Coastal Trading)
2. The cost of Ports in Tasmania (APT, sub. 11, p. 1)

The Coastal Trading Act (the Act) is currently having a negative impact on expedition cruise shipping costs, acting as a barrier to foreign flagged operators wishing to include Tasmania on domestic itineraries that commence from another Australian port. (Austrade, sub. 41, p. 7)

INFORMATION REQUEST

What specific benefits would there be for Tasmanian shippers from removing restrictions on coastal shipping?

The Australian Department of Infrastructure and Transport has previously estimated that the policy changes could cost the Australian economy as much as \$202 million in net present value terms over 20 years (DIT 2011). In addition, the tax incentives are likely to cost the Australian Government around \$70 million a year in forgone revenue (Swan 2012), and the more the objectives of the policy changes are realised, the more they would cost Australia overall (DIT 2011).

In addition, the Regulatory Impact Statement that found a net benefit to Australia from the 2012 changes (and so provided the justification to introduce them) appears flawed in retrospect. It assumed that substantial benefits would flow from a productivity compact with the maritime unions, and help offset costs otherwise associated with the licensing and taxation reforms.

However, there is little evidence to date that the productivity compact has delivered benefits. For example, manning levels were expected to fall significantly from an average of 18–20, but this does not appear to have eventuated.

Accordingly, the justification for the 2012 changes is now questionable.

Some participants called for a review of coastal shipping regulation and suggested that immediate changes were also warranted. The Maritime Union of Australia (MUA), for example, raised concerns with the operation of the changes to the Coastal Trading Act and endorsed the announced review, calling for it to occur sooner rather than later (sub. 32, pp. 4–5). In particular, the MUA believed that the provision allowing the Minister (or Minister’s delegate) to consider commercial matters such as freight rates is unwarranted. It argued that this provision ‘... must be amended to restrict consideration of freight rates by the Minister (Minister’s delegate)’ (sub. 32, p. 5).

The Business Council of Australia (BCA) suggested immediate changes to the regulations including:

- Abolish the requirement of five voyages for a temporary licence and extend the 12-month temporary licence period.
- License the entire consignment to cover all ports used by the vessel while unloading the consignment, instead of requiring each port visited to be specified.
- Enable licences to be granted within two days, particularly where there is an urgent business need.
- Reduce information requirement in forms and reporting to the minimum specified in legislation. (BCA, sub. 47, pp. 1–2)

The Australian Shipowners’ Association also nominated areas for change, including:

- temporary Licence voyages should not be subject to Australian pay rates
- reduce red tape by removing the 5 voyage minimum for Temporary Licence applicants
- introduce an ‘express’ Temporary Licence in certain circumstances. (sub. 29, p. 3)

The Commission notes that Deputy Prime Minister Warren Truss has recently foreshadowed a review of the coastal shipping arrangements:

... I am determined to put the current system under the microscope to streamline processes and foster a vibrant and sustainable shipping industry in Australia. This will include looking at the eligibility requirements around the Temporary licence application process and applications for a variation to a permit. (Truss 2013)

DIRD also drew attention to that proposed review:

The coastal trading regulatory framework is currently being reviewed as part of the Government's broader commitment to reducing the burden of excessive red tape on the Australian economy. (sub. 42, p. 12)

It would be appropriate for the review of coastal shipping regulation to commence as soon as possible, given higher shipping costs, adverse effects reported by Tasmanian shippers and some cruise operators, the likely deleterious impact on Australian businesses, and concerns about the integrity of the Regulatory Impact Assessment accompanying the introduction of the policy changes. At a minimum, the review should identify and remove any anticompetitive provisions from the legislation, unless a robust and transparent case can be demonstrated that they deliver a net benefit.

DRAFT RECOMMENDATION

The Australian Government should proceed with the foreshadowed review of coastal shipping regulation as soon as possible. The objective of the review should be to achieve the most efficient coastal shipping services feasible for Australia.

4.3 Key features of Tasmanian ports

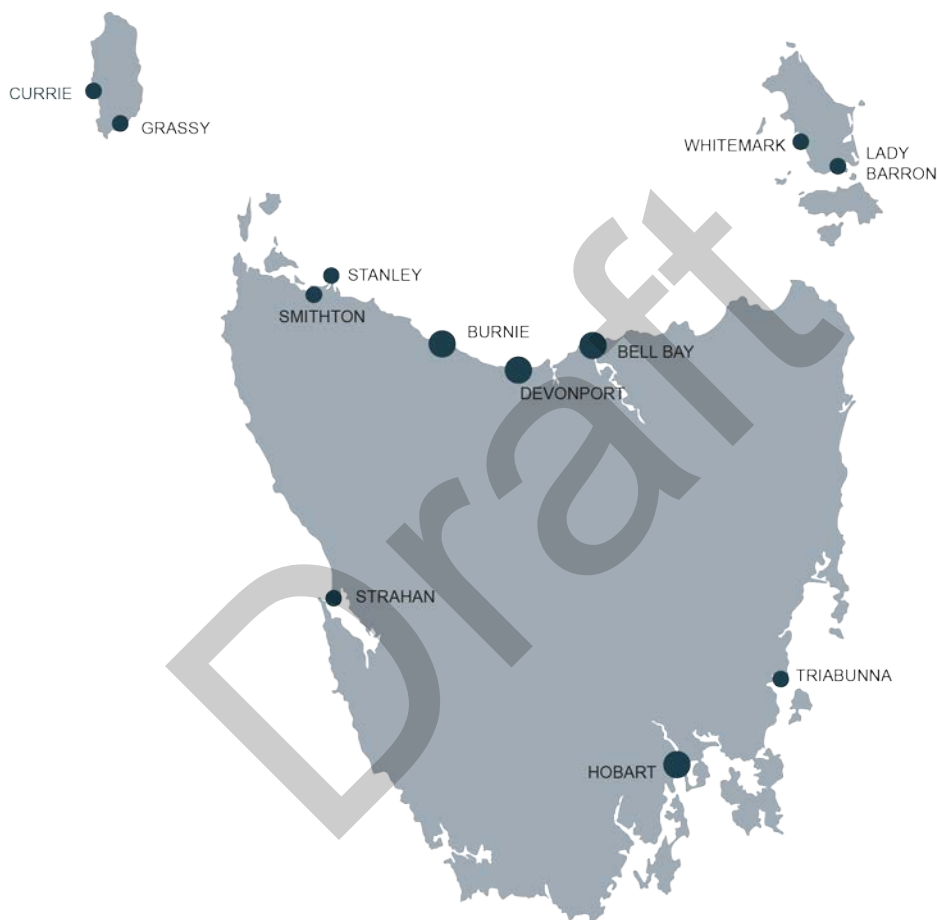
Port costs constitute a relatively small share of the supply chain cost — around 5 per cent (Aurecon 2013c) — and a small share of the cost of shipping across Bass Strait:

The fixed port costs in a round-trip voyage (e.g. the fixed port costs would be a combination of costs in Burnie and Melbourne for a Bass Strait container vessel voyage) are estimated to encompass only 5% of that total amount. (TasPorts, sub. 30, p. 1)

Accordingly, the potential for port efficiency improvements to directly reduce shippers' costs is commensurately small. However, as ports are an integral link between shipping and land freight, inefficiencies in the port system can significantly hinder the optimal functioning of the logistics chain and, thus, have cost implications beyond those otherwise suggested by the direct share of supply chain costs (see earlier discussion of access to berths).

While Tasmania is served by a large number of ports (figure 4.2), the main ports are Bell Bay, Burnie, Devonport and Hobart. The majority of freight and virtually all regular sea passenger travel to and from Tasmania flows through the northern ports of Bell Bay, Burnie and Devonport, while Hobart is largely focused on cruise ships and Antarctic operations.

Figure 4.2 The 12 ports managed by TasPorts



Data source: TasPorts (2012a).

The characteristics of the three main northern ports are described in table 4.4. For these ports the Tasmanian Government has a strategy of ‘one port, three locations’.

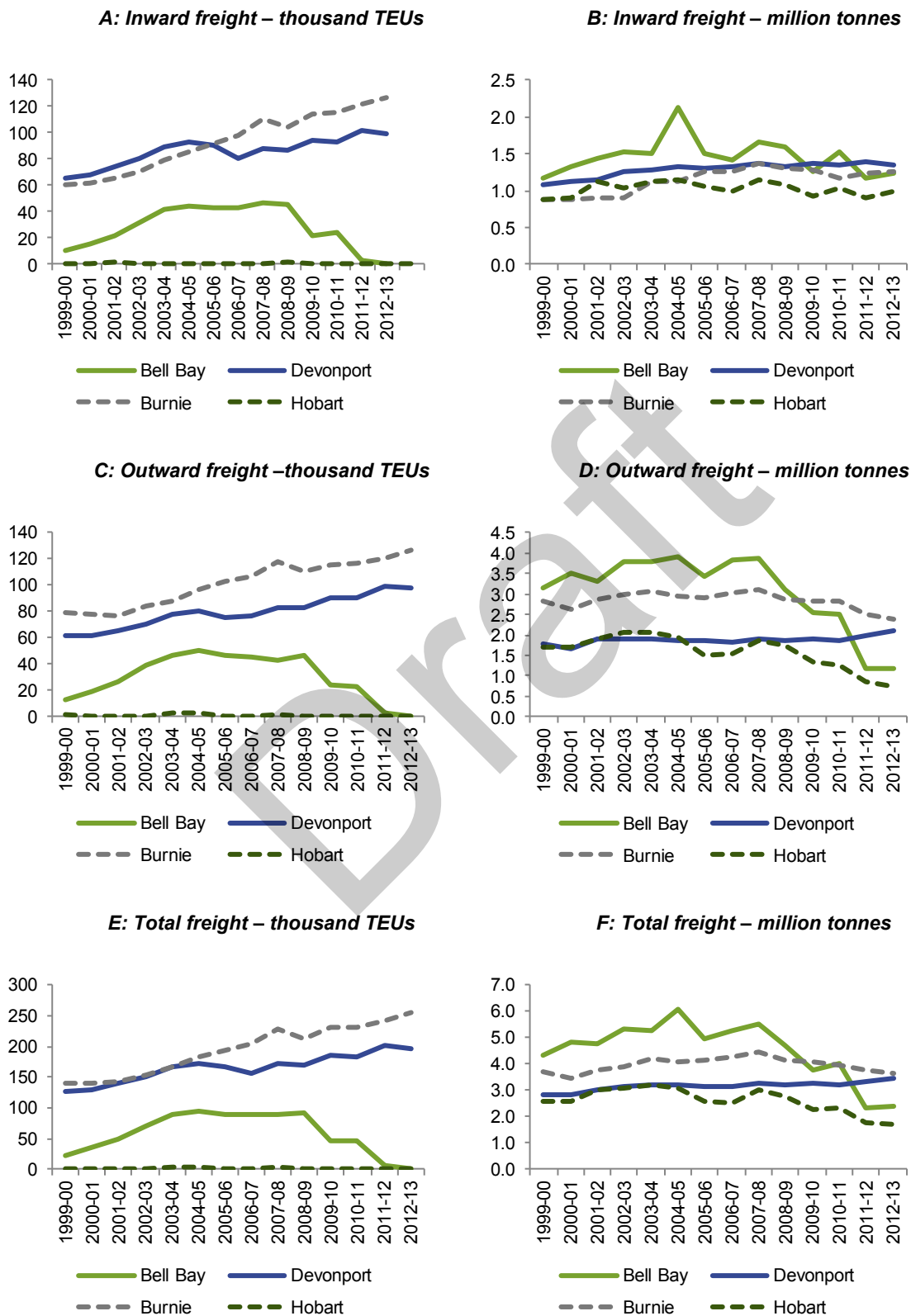
Table 4.4 Characteristics of Tasmania's northern ports

	<i>Devonport</i>	<i>Burnie</i>	<i>Bell Bay</i>
Operator	TT-Line and SeaRoad Shipping	Toll ANL	Not used at present for domestic Bass Strait freight Used by international service
Position of port	Along the Mersey river; port straddles the Mersey river with the west bank for bulk goods and east bank for containers and passengers	On the north coast	Along the Tamar river
Distance from sea	Approximately 1.5 nm from river entrance	On the sea	Approximately 9.0 nm from river entrance
Navigational issues	Turning basin of 300m in river; vessel length limited to 205m due to width of river	No issues	Turning basin in river and sharp turns in the river make navigation difficult; length limited to 250m.
Depth of channel	9.2m	10m	+12m
Dredged depth at berth	6.7m TT-Line (berth 1E) 8.6m SeaRoad Shipping (berth 2E)	10.5m (berth 4)	12m (berth 5)
Available terminal space	TT-Line: 2 ha SeaRoad Shipping: 7 ha	6 Ha	7 Ha

Source: Aurecon (2013b).

The throughput of the four major ports is shown in figure 4.3. In 2012-13, the total throughput of Tasmania's three northern ports was around 451 000 TEU, of which Burnie accounted for around 56 per cent. This may be compared with the current volume (full and empty) going through Flinders Ports' Adelaide Container Terminal of just under 350 000 (ACCC 2013).⁹ Over the last five years, the total volume of freight through Burnie and Devonport has increased while volume through Bell Bay and Hobart has declined.

⁹ Flinders Ports was privatised by the South Australian Government in 2001 and operates seven ports, including Port of Adelaide.

Figure 4.3 Freight movements through Tasmania's main ports

Data source: TasPorts (2013).

TasPorts, a state-owned enterprise, is responsible for the management of 12 Tasmanian ports, including the four major ports. The port system had historically been operated by independent port corporations — four were remaining in 2005. Several studies over the past two decades identified benefits from moving to one statewide port entity, culminating in the passage of the *Tasmanian Ports Corporation Act 2005* (Tas), creating TasPorts. On 1 January 2006, all assets, liabilities and employees of the former port corporations passed to the new entity (Auditor-General 2012).

The Bass Strait RORO services operate their own terminals at the northern ports, while other terminals are operated on a ‘community access’ basis.

4.4 Efficiency drivers of ports

Participants expressed concerns about port costs in Tasmania. Bell Bay Aluminium was particularly critical, claiming:

Port of Bell Bay costs are higher than other ports when comparing the same size and type of ship and reason for the port call. ... For example, for coastal alumina shipments between Gladstone and Tasmania, BBA pay the following port costs in their freight rate:

- Gladstone Port costs ~A\$38 000 versus
- Port of Bell Bay costs ~A\$107 000. (sub. 12, pp. 5, 6)

At Tasmania’s main freight ports, three factors appear to be of particular importance in determining the scope for those ports to operate more efficiently: scale of operations, adequacy of infrastructure and government ownership.

Participants also expressed concern about increased costs at the Port of Melbourne, arising from the recently introduced Port Licence Fee.

Scale of port operations

As with shipping, volume (or the scale of throughput in the case of ports) is a major factor affecting port efficiency.¹⁰

It is generally accepted that there are economies of scale in the operation of ports. The efficiencies available to a larger operator, typically in terms of management and

¹⁰ Efficiency and productivity of ports is often captured in measures such as average container turnaround time, the number of containers a dockside crane lifts on or off a container ship in an hour, and the rate at which the ship is unloaded (BITRE 2013d).

coordination of workforce and equipment, may not be available to ports operated on a smaller scale. In fact, economies of scale have been found to be a more significant factor in market entry and exit than the associated costs (ACCC 2013).

Related to economies of scale is the concept of a minimum efficient scale (MES) of operations at ports (box 4.5). This is the point at which the average costs fall to the efficient level, and implies that port operations must be of a sufficient size to operate most efficiently. For container terminals, recent analysis suggests it could be in the region of 0.5–1 million TEU (ESC 2007, p. 145). In 2008, the ACCC investigated the minimum total volume of container traffic that would be required to justify investment in a second terminal on a greenfield site. Market inquiries suggested a minimum total volume of approximately 550 000 TEU per annum, though a number of submissions suggested that 600 000 TEUs per year was a more realistic threshold for new entry at Port Adelaide (ACCC 2008a).

However, there is no consensus on a uniform MES across all ports, and no consensus on the MES for Tasmanian ports.

Box 4.5 Minimum efficient scale at Australian container ports

An analysis of the Port of Melbourne in 2007 suggested that the market would be sufficient to support a third terminal once throughput reached 2.8 million TEU (ESC 2007). While in Sydney, a third terminal was deemed appropriate when throughput reached 1.784 million TEU. In Brisbane, a third terminal was approved in 2008, when the Port of Brisbane's throughput was 943 000 TEU (Kaslimi et al. 2011).

Given Tasmania's relatively low freight flows, and those flows being spread across three terminals, Tasmanian ports have been limited in their ability to achieve economies of scale (Infrastructure Australia 2012b; Juturna 2013).

According to Infrastructure Australia (2012b), subscale operations and fragmentation of the freight task across ports has likely had a negative impact on the competitiveness of Tasmanian business and the Tasmanian economy generally.

Similarly, lower levels of throughput reduce the potential for competitive stevedore services to develop at terminals. While three terminal competitors can theoretically be a significant enabler of port competition (as is occurring at several mainland ports), without adequate scale, multiple port operators are unlikely to be viable. For example, Kaslimi et al. (2011) has suggested that viable competition between terminals is only thought to be possible where the market size is at least twice as large as the MES for providing terminal services. If not, scale economies are only realised with one supplier of port services.

Given the advantages that come from greater scale at ports, there may be scope to increase efficiency through rationalisation and increasing the volume of port throughput.

The Commission understands that a strategy of terminal specialisation will be part of the 30 Year Plan currently under development by TasPorts. This approach is likely to bring some consolidation of freight services, although the extent to which this will enable ports to achieve economies of scale is currently unknown.

INFORMATION REQUEST

To what extent will the Tasmanian Government and TasPorts' plan for port specialisation enable Tasmanian ports to capture the efficiencies available from greater scale?

Adequacy of port infrastructure

Recent reports have identified ageing and inadequate infrastructure as a problem for Tasmanian ports; acting as a bottleneck to capacity and limiting their ability to deliver cost-effective port services. The Tasmanian Freight Logistics Council, for example, suggests that Tasmanian ports already have capacity constraints on their land side operations and that physical capacity limits will be reached in the near term (TFLC 2013, p. 10). Similarly, RDA–Tasmania drew attention to ‘Ageing Infrastructure at multiple port facilities that are small and specialist’ (sub. 17, p. 3).

Not all infrastructure at Tasmania’s major ports is old or inadequate though. As Toll noted:

Our dedicated terminals at ... McGaw Wharf in Burnie utilise cutting edge RORO cargo handling technology to efficiently handle all cargo types. (sub. 55, p. 1)

For international shipping services, these infrastructure deficiencies (particularly in channel depths) can mean vessels are physically unable to call into a port. A global trend to larger container ships (box 4.6) means Tasmanian ports will increasingly face the need to upgrade their infrastructure if they are to attract and retain an international container service:

By Australian and worldwide standards, Tasmania’s potential international container ports ... all face challenges with regard to access and infrastructure. Bell Bay has potentially the best opportunity to support an international service; however there are many issues such as tidal constraints, suitable cranes and berth length which would impact on an international shipping line or consortium considering a call into Tasmania. (GPS 2013, p. 2)

Box 4.6 Global trend to larger container vessels

Annual reviews of maritime transport reveal that container vessels are getting larger (UNCTAD 2012). In part, this trend to larger vessels is a consequence of the widening and deepening of the Panama Canal, to allow the passage of bigger vessels:

... the ... plan to widen and deepen the Panama Canal will have a significant impact on the global trading patterns of the current containership fleet and will most likely create a spurt in new building activity in the 5000–12 000 TEU size range with the existing class of 4000–4500 TEU Panamax containerships and 60 000–70 000 dwt bulk carriers cascading down to minor and newly developing trades. (Meyrick and Associates 2007, p. 37)

In Australia, that trend is supported by local factors:

... analyses we have performed for various port authorities suggests that the average and maximum containership sizes deployed on Australian trades will rise within 20 years from a current average of 2700 TEU and maximum of 4100 TEU to a future average of around 4500 TEU and maximum of around 6000 TEU. (Meyrick and Associates 2007, p. 40)

... the maximum size of containerships is expected to increase from the current 4100 TEU to around 6000 TEU after completion of the planned Melbourne channel deepening in 2010. (Meyrick and Associates 2007, p. 48)

Sources: UNCTAD (2012), Meyrick and Associates (2007).

An Infrastructure Australia report highlighted channel depths at Tasmania's northern ports (table 4.5) as a major obstacle to attracting direct international shipping services given that, in future, navigation channels will need to cater to vessels with a draught of 12–13 metres (GPS 2013, p. 8). That report also noted that the cost to address this deficiency would be prohibitive (Infrastructure Australia 2012b, p. 6). The ports at King Island and the Furneaux Group of islands also face similar physical constraint issues (box 4.7).

Table 4.5 Tasmania: main ports and channel depths

<i>Port</i>	<i>Channel depth</i>
Bell Bay	10.8 m
Burnie	9.4 to 10.0 m
Devonport	9.4 to 10.0 m
Hobart	12.5 to 13.7 m

Source: Infrastructure Australia (2012b), citing TasPorts.

The physical constraints inherent in Tasmania's northern ports (where channel depths and other restrictions impose a draught limit of around 12 metres and a vessel length of 265 metres) are likely to be too costly to address or face intractable environmental hurdles. If this proves so, then port access will be limited to 3000–4000 TEU vessels, which will only be adequate for the domestic Bass Strait trade.

Box 4.7 Port infrastructure at King and Flinders Islands

Ports are central to industry and the communities on King and Flinders Islands. In 2012-13, 92 ships called at King Island, with a freight task of around 8110 TEU (TasPorts, sub. 30, p. 2).

As the Flinders Council states:

Having a modern port facility to ensure the proper handling of goods and livestock, while maximising efficiencies in stevedoring are essential to the economic future of Flinders Island. (sub. 23, p. 3)

Both the King and Flinders Island ports have size restrictions. Currently, the existing volume is easily serviced by the current vessels operating from these ports (TasPorts, sub. 30, p. 4).

However, there is concern that future increases in vessel size may put a sea freight service to the islands at risk (Tasmanian Farmers and Graziers Association – King Island Branch, sub. 8, p. 3).

This is an issue facing many smaller ports in Australia (such as Adelaide) and around the world, as international shipping moves towards a hub and spoke model. As ANL commented in regard to Tasmanian ports:

These container ports are very small by world standards and the dilemma facing small ports the world over is the increasing size of container ships ... The issue for the smaller ports is having enough throughput for a big and more expensive (in overall daily cost) vessel calling direct and having the necessary infrastructure to service them in terms of draft, berths and number of quay cranes. (sub. 33, p. 4)

According to TasPorts, however, some northern ports are still capable of handling international vessels, and it does seem likely that Tasmanian port infrastructure is not the main impediment to international shipping operations:

TasPorts has assessed the capability of Burnie and Bell Bay ports to accommodate calls by international container ships currently serving the Australian market. With berth parameters of 280 ML (at Burnie) and 265 ML (at Bell Bay), Tasports' infrastructure could handle in excess of 50 per cent of container vessels calling at Melbourne within the current channel, berth depth and quay length parameters. (sub. 30, p. 4)

Addressing infrastructure deficiencies is essential if Tasmanian ports are to cope with the freight task required of them and deliver more efficient port services. However, being able to do this is closely linked to the issue of scale — greater throughput can provide justification for investments needed to overcome capacity bottlenecks and improve infrastructure efficiency — and issues around ownership of the port system. As such, infrastructure investment implications would need to be considered in any strategy for port rationalisation.

As noted, TasPorts is developing a 30 Year Plan which scopes future need for the ports in Tasmania:

The strategy is based on an incremental infrastructure plan, the benefits of which include building capacity as required, avoiding duplications and maintaining the ability to flexibly manage ongoing pressures and potential innovations. (sub. 30, p. 5)

The FLCT (2013a) has suggested that incremental investment in port infrastructure at Burnie would provide sufficient capacity to handle growth in volume. The main port related recommendations of the FLCT are outlined in box 4.8.

Box 4.8 FLCT port recommendations

The final report of the FLCT made a series of recommendations regarding Tasmanian ports and the Port of Melbourne:

- Port development is critical for Tasmania and should be progressed on the following basis:
 - Formalise a long-term port strategy that recognises Burnie Port as Tasmania's principal domestic container port in the medium to long term, based on potential for deep water expansion, closest sea travel time to Melbourne, the ability to develop at comparatively lower cost and alignment with land transport networks.
 - Ensure investment in other ports is targeted to meet specific freight needs, with no investment in duplicated functions.
 - Formalise an involvement by the Tasmanian Government with the Victorian Government in Port Planning that recognises Tasmania is a significant customer of the Port of Melbourne.

Source: FLCT (2013a).

Port ownership

Most Tasmanian ports are owned and managed by TasPorts, a Government Business Enterprise. This contrasts with most mainland capital city ports which have been privatised — the Port of Melbourne is the only remaining mainland capital city port still government-owned (van Duyn 2013).

Ports have also generally adopted a landlord model, separating ownership of the port from the operation of services such as stevedoring and towage. Under this model, investment decisions at terminals should be driven by core commercial imperatives.

In Tasmania, the three Bass Strait shipping companies use dedicated terminals, and invest in the infrastructure at their terminal. The Commission understands that this

has led to significant private investment in infrastructure at these terminals. It has also prompted some private investment in land transport infrastructure, including a tripartite project between TasPorts, TasRail and Toll to redevelop the Burnie rail yard and improve access to the Toll terminal (DIER 2013b).

That said, government involvement in the port system introduces the risk of weaker incentives for effective management of assets compared to private sector businesses (PC 2008). Studies indicate that private sector involvement in infrastructure provision more generally can deliver savings, for example of around 22 per cent in the design and build phase under a Public Private Partnership model (Mercer 2011).

The TasPorts Members Statement of Expectations sets out the principal commercial objective of TasPorts as:

- be a successful company by operating in accordance with sound commercial practice and as efficiently as possible
- achieve a sustainable commercial rate of return in accordance with its corporate plan, having regard to the social and economic objectives of the State, as agreed in writing with the Members (TasPorts 2012b, p. 2).

TasPorts does not have any explicit community service obligations that might require it to operate in a non-commercial manner (TasPorts 2012b).

An assessment of the financial performance of TasPorts suggests that it is not operating commercially (table 4.6). The rate of return on equity, for example, is significantly below the risk-free rate of return. TasPorts does not appear to be covering its costs and is not likely to be covering its operating costs for some ports.

Table 4.6 Financial Performance of TasPorts

<i>Indicators</i>	<i>Units</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Profit before tax	\$'000	7 604.0	1 483.7	34.2	-7 713.0	-1 334.8
Operating profit margin	%	8.2	3.0	0.0	-9.0	-0.9
Cost recovery	%	108.9	103.0	100.0	91.7	99.1
Return on assets	%	5.4	1.7	0.8	-2.7	0.1
Return on total equity	%	4.1	1.7	0.2	-2.4	-0.4
10-year Australian government bond yield ^a	%	5.70	5.60	5.55	5.36	5.15

^a An historical ten year average of the 10-year Australian Government bond yield.

Sources: Commission estimates, based on TasPorts annual reports; PC (2008); RBA (2014).

Information provided at the recent Tasmanian Parliamentary Scrutiny Committee further indicated that TasPorts has made decisions on non-commercial grounds.

According to the TasPorts chairman, regarding a recent redevelopment at Macquarie Wharf 2:

When we did the business case on MAC2 it did not meet the commercial benchmark. We set a rate of return for investment, so just looking at it from a purely commercial basis you would say it would be fairly marginal but the board considered, in the broader context of the contribution that that facility would make beyond the revenue that we get in the tourism industry. We spoke to our owners and said, 'This is what we propose to do. It's not strictly a commercial investment but we are disposed to do it. Tell us if you have a problem with that'. They were comfortable with what we did. (Norton 2013, pp. 10-11)

In some cases, factors that contribute to poor performance may be outside TasPorts' control. For example, in 2011-12, performance was impacted by structural changes to Tasmanian markets, including rationalisation of container shipping and reductions in woodchip exports (TasPorts 2012a).

Ageing port infrastructure and a corresponding lack of investment in new infrastructure (notwithstanding examples of private investment in infrastructure noted above) have also been suggested as factors contributing to poor performance. Indeed, Tasmanian ports appear to have suffered from a lack of capital investment over many years (Juturna 2013). The Commission understands that TasPorts has more recently sought to enhance its infrastructure investment.

Contributing to the lack of new investment is the prospect that government ownership may artificially sustain the three terminal structure in the north of Tasmania. TasPorts, if operating commercially, would likely have consolidated terminals in order to access economies of scale and focus investment in port infrastructure.

While under-investment or inadequate asset maintenance may increase returns in the short term, viability and service quality is likely to be impaired in the longer term, and can compromise output (PC 2008). It also reduces the potential for TasPorts to raise the debt needed for further investment.

TasPorts would be better able to attract investment if it operated on a commercial basis. As the FLCT noted:

At a minimum, Government should create greater options for private sector involvement through supporting efficiency led improvements in government business returns, and increased information transparency (FLCT 2013a, p. 22).

It would also be appropriate for TasPorts to explore alternative funding models for infrastructure. Privatisation, long term leases and targeted divestment of port assets are options that could be considered.

Another factor contributing to the commercial position of TasPorts may be its pricing strategy. Under the Members' Statement of Expectation, TasPorts is expected to set prices, fees and charges which:

- meet the objectives of efficiency, and financial sustainability
- represent fair value to its customers
- to the extent possible, move towards a commercial return on assets employed as set out in the annual Statement of Corporate Intent (TasPorts 2012b).

However under-recovery of TasPorts' costs indicates it may not be charging users the full cost of services it provides. Below-cost pricing would reduce future profitability of TasPorts and exacerbate a cycle of poor profitability and poor capital management.

Additionally, the approach to pricing adopted by TasPorts — a system of statewide uniform pricing — introduces a lack of flexibility in cost structures, and may result in some cross-subsidisation across ports and port activities. Uniform pricing can mask price signals, limit potential for competition between ports, and potentially support less efficient ports at the expense of others.

Participants provided evidence that costs at TasPorts are high relative to other Australian ports. For example, Bell Bay Aluminium stated:

Port of Bell Bay costs are higher than other ports when comparing the same size and type of ship and reason for the port call. (sub. 12, p. 4)

While APT, a cruise shipping operator, cited the cost of ports in Tasmania as one reason why it is unlikely to return to Tasmania in the foreseeable future (sub. 11, p. 1).

Based on the evidence presented and available data, it is difficult to determine whether the cost differences are due to scale factors, or result from cross-subsidies to support unprofitable ports.

INFORMATION REQUEST

To what extent is uniform pricing distorting decisions in regards to activities and investment at Tasmanian ports?

To what extent does the current pricing strategy of TasPorts reflect efficient costs of providing the port infrastructure and services?

DRAFT RECOMMENDATION

The Tasmanian Government should assess the commercial viability of TasPorts and potential changes to enhance its operation. The assessment should include a consideration of alternative models for the provision of port infrastructure, including the feasibility of privatisation, long term leases, and targeted divestment of port assets.

Facilitating a more efficient future for Tasmanian ports

Previous sections have identified barriers to improving the efficiency of Tasmanian ports. Addressing those barriers will require substantial investments in port and landside infrastructure.

However, that investment will occur within the policy framework of the Tasmanian Government and reflect its vision for the future of the ports it owns and operates (box 4.9). In this regard, TasPorts is developing a ports specialisation strategy, due to be released in 2014. This long term plan is intended to be consistent with the National Ports Strategy, which aims to identify: effective regulatory and governance frameworks; ways to improve land planning and corridor preservation; and the future infrastructure requirements of Australia's ports, including road and rail links (Infrastructure Australia 2011).

Box 4.9 Tasmania's port development plan

Tasmania's port strategy is aimed at developing a single port system of specialised terminals (one northern port with three terminals at Bell Bay, Devonport and Burnie). The strategy involves:

1. The short term development of container terminal and intermodal capacity at Burnie (0–5 years)
2. Medium to long term — Tasmanian Port development (three terminals)
 - (a) Bulk minerals terminal at Burnie and dry bulk terminal at Bell Bay
 - (b) Specialised terminal (i.e. TT-Line, Cement Australia) at Devonport
 - (c) Priority Container terminal (Location still being developed)

The Port of Hobart is to specialise in Antarctic operations and cruise vessels.

It is estimated that Burnie, through proposed expansions, can handle up to 350 000 TEU per year. Based on this figure and a projected 3 per cent average annual growth, Burnie is forecast to reach capacity by 2020. Based on this, it is not anticipated that the Bell Bay Intermodal Expansion would be required before 2020.

Source: DIER (2012).

Ports are key to effective long-term freight planning for Tasmania, with appropriate planning processes for ports also critical to decisions around key road and freight corridors (FLCT 2013b). For example, planning for landside infrastructure such as rail access and the length of rail marshalling yards are closely linked to issues of scale, rationalisation and specialisation.

The Commission notes that the FLCT has made a number of recommendations on Tasmanian ports, including that Burnie become Tasmania's principal domestic container port (box 4.9). The Commission considers that any decision on port strategy should be made within the context of Tasmania's broader freight transport planning framework. These issues are discussed further in chapter 5.

Port of Melbourne licence fee

The efficiency and associated costs of the Port of Melbourne have an important role in the cost of transporting freight, especially non-bulk freight, to and from Tasmania given that most of this freight moves through that port.¹¹ It is likely that transshipment through the Port of Melbourne will remain the dominant means of shipment for Tasmania in the future (Juturna 2013).

In 2011, the Victorian Government introduced the Port Management Amendment (Port of Melbourne Corporation Licence Fee) Bill 2011, which required the Port of Melbourne Corporation (PoMC) to remit an annual fee (PLF) to the Government. The PLF was \$75 million in 2012-13 and will be indexed to a CPI based adjustment factor (in 2013-14, the PLF is to be \$76.4 million). The PLF is recovered through an increase in the general fees and charges included in the PoMC's Reference Tariff Schedule, with the intent of spreading the cost across all of the port's trade sectors (Port of Melbourne Corporation 2013). The estimated impact of the PLF is described in table 4.7.

While the cost increase associated with the PLF represents only a small proportion of shippers' total costs (around 1 per cent), some inquiry participants drew attention to the significant added costs this licence fee imposed on their businesses. Harvest Moon, for example, estimated that the introduction of the PLF has an impact equivalent to \$96 000 per annum (sub. 21, p. 2), while Simplot noted it adds \$350 000 to its Bass Strait shipping task (sub. 50, p. 6).

¹¹ Tasmania's inbound and outbound non-bulk freight constitutes around 25 per cent of the freight flow through the Port of Melbourne (Tasmanian Government, sub. 43, p. 13).

Table 4.7 Changes to container freight charges

<i>Containerised</i>	<i>Tariff 1 July 2011, excluding GST</i>	<i>Estimated tariff with PLF impact, excluding GST</i>
	(\$/TEU)	(\$/TEU)
Full	40.10	60.15
Full Bass Strait	41.80	62.70
Empty	10	15
Transshipment	50 per cent of published rate	50 per cent of published rate

Source: Infrastructure Australia (2012b).

The Victorian Government has advised the Commission that the PLF is a revenue raising measure, unrelated to port services or costs. While the licence fee is levied across all users, the nature of freight movement through the Port of Melbourne means that Tasmanian shippers bear a large proportion of the cost of the licence fee.

5 Land freight

Key points

- The road network carries most of the land freight task in Tasmania — 82 per cent on a tonne kilometre basis in 2011-12.
 - While Tasmania has an extensive road network, there are limitations on the use of high productivity vehicles, such as B-doubles, as there are on most mainland networks.
- Road freight rates in Tasmania do not appear to be substantially out of step with rates on the mainland.
- Rail accounts for a relatively small share of the Tasmanian land freight task — 18 per cent on a tonne kilometre basis in 2011-12. In comparison, rail accounts for over half of the land freight task nationally. Bulk commodities including cement, coal and minerals account for the majority of rail freight.
 - Rail has had a chequered history, with various operating arrangements including Australian Government ownership and part-private operation. The rail network returned to full Tasmanian Government ownership in 2009 and has continued to operate at a loss.
 - While substantial upgrades to tracks and rolling stock have recently been funded by the Australian and Tasmanian Governments, it is unclear whether these are justified on the basis of the potential growth in freight volumes and the forgone benefits from alternative investments in other Tasmanian infrastructure.
- There is a relatively high degree of substitutability between road and rail in Tasmania because of duplicated networks and relatively short distances.
- Many inquiry participants have identified the lack of an integrated freight strategy for Tasmania. The absence of such a strategy raises the risk of inefficient decision making in relation to road and rail corridors and their connectivity to ports, and whether developments in freight infrastructure support Tasmania's long term economic growth prospects most effectively.

Intrastate land transport represents a significant component of Tasmania's economic infrastructure and the overall freight task for many Tasmanian businesses. The efficiency of road and rail infrastructure and service provision is therefore an important element in the overall costs of moving freight between Tasmania and the mainland, particularly in the context of the more limited scope for public investment over, at least, the medium term.

This chapter looks at the land freight sector in Tasmania with a focus on the adequacy and efficiency of road and rail infrastructure and their interface with port infrastructure.

5.1 Land freight movements

In 2011-12, the total freight task moved on Tasmanian roads and railways was estimated at around 23 million tonnes, down from 28 million tonnes in 2008-09 (DIER 2009, 2013a). This was roughly double the volume of freight shipped to and from Tasmania. On a tonne kilometre basis (that is, the movement of one tonne of freight over one kilometre) the total freight task totalled almost 1.9 billion tonne kilometres (table 5.1).

Table 5.1 **Tasmanian freight movements, 2011-12**

By road type and rail^a

	<i>Total length (km)</i>	<i>Tonne kilometres travelled (million)</i>	<i>Per cent of tonne kilometres travelled</i>
National Network roads	404	872	47
State roads	3 592	512	28
Local government roads	16 826	105	6
Other roads	28 200	39	2
Total roads	49 021	1 528	82
Total rail	632	329	18

^a National Network roads are those roads identified as part of the National Land Transport Network and are the key roads linking the urban centres and ports. State and Local road figures exclude those parts of State or Local roads included in the National Network. Other roads includes roads operated by Forestry Tasmania, Hydro Tasmania, TasPorts and privately owned roads, of which 26 000 km are authorised access or privately owned. The rail network of 632 km includes 432 km which is included in the National Network.

Source: DIER (2013a).

The Tasmanian road network comprises around 49 000 kilometres, although most freight movements occur on a relatively small proportion of the road network. The National Network roads (which comprise the main freight corridors between the major population centres and ports) accounted for almost half of total land freight movements. Given their small share of the total road network, these roads operate at much higher levels of utilisation relative to regional and local roads.

In moving road freight, larger capacity vehicles are typically used for longer journeys. Accordingly, their share of the freight task is larger in terms of tonne kilometres travelled than in absolute tonnage. In 2008-09, B-doubles accounted for

28 per cent of the total freight task, but 34 per cent in terms of tonne kilometres travelled (DIER 2009).¹²

Five sectors account for most of the freight moved by road or rail — agriculture, construction materials, consumer goods, forestry and mining. The biggest change in the land freight task recently has been a significant decline in the transport (by road) of forestry products (figure 5.1).

Figure 5.1 Total freight moved by road or rail, key industries
Million tonnes



Data sources: DIER (2009, 2013a).

5.2 Road freight

Road transport accounts for the bulk of intrastate freight movements. For some businesses, the intrastate transport leg represents a significant share of the cost of moving goods between Tasmania and the mainland. Inquiry participants located in the south of the state have noted that the efficiency of the road freight sector in Tasmania is an important factor in their overall freight costs.

¹² B-doubles were reported separately in the 2008-09 Tasmanian Freight Survey, but combined with rigid trucks and trailers in the 2011-12 survey.

The efficiency of road freight transport is influenced by: the adequacy of road infrastructure and its accessibility for high productivity vehicles; the efficiency of investment in road infrastructure and pricing structures; and competition in the provision of road freight services.

Adequacy of road infrastructure

While the Tasmanian road network is extensive, the bulk of freight movements are concentrated on key roads (see chapter 2, figure 2.4). The primary freight corridor — part of the National Land Transport Network — runs from Burnie (through Devonport) to Hobart, comprising the Bass Highway, Illawarra Road (which bypasses Launceston), the Midland Highway and the Brooker Highway (south of the Derwent River). The East Tamar Highway connects Bell Bay to the Midland Highway. Beyond these major trunk roads that connect Hobart and the major northern centres and ports, road freight is dependent on numerous regional roads, as well as the network of local roads for the initial collection and final distribution of freight.

The Tasmanian Government, in its 2012 *Nation Building 2* submission to the Australian Government, outlined a number of proposed road projects, including:

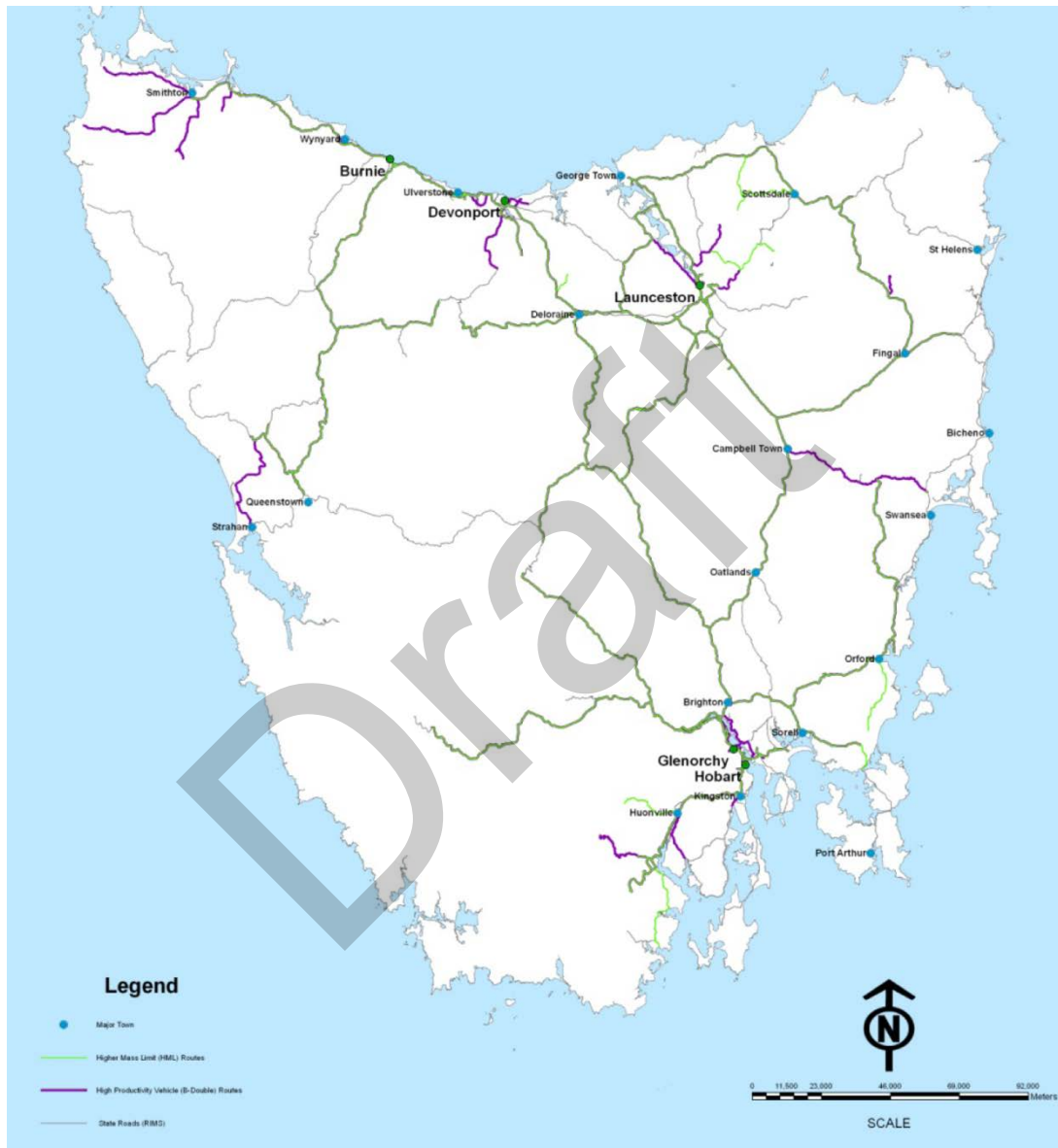
- Brooker Highway upgrades
- Illawarra Main Road South Perth bypass and upgrades on the western section of road
- Midland Highway projects
- Murchison Highway upgrades
- Birrallee Main Road upgrades (Tasmanian Government 2012).

Access for high productivity vehicles

High productivity vehicles (HPVs), such as B-doubles, are restricted to a gazetted road network (figure 5.2). While in 2008-09 B-doubles accounted for around a third of freight movements in Tasmania, concerns have been raised, particularly by Infrastructure Australia (2012b), that the use of HPVs in Tasmania is being constrained by the condition of the road network. While the gazetted routes cover the main Tasmanian roads, there appear to be gaps in the routes that might prevent greater utilisation of higher mass vehicles. Many gazetted roads are not considered to be of a sufficient standard for use by HPVs. A 2011 review, against some newly developed Tasmanian guidelines, determined that 32 per cent of the gazetted network met the guidelines, 35 per cent was marginally below the guidelines and

33 per cent did not meet the guidelines (DIER 2011a). This may be an optimal investment strategy by the Tasmanian Government.

Figure 5.2 **Gazetted routes for high productivity vehicles^a**



^a Shows both higher mass limit (HML) routes (in green) and high productivity vehicle (HPV) routes (in purple). HML routes allow slightly higher gross weights, 67 tonnes, versus 62 tonnes on HPV only routes

Data source: DIER (2011a).

Nationally, reform options to increasing the efficiency of road transport have been proposed, including by Infrastructure Australia (2012b). These include the introduction of even higher productivity vehicles, such as B-triples or super B-doubles.

Infrastructure Australia previously raised the issue of HPV vehicle access in its discussion paper on development of a National Land Freight Strategy in February 2011. But in response, the Tasmanian Department of Infrastructure, Energy and Resources (DIER) stated that:

... in Tasmania's case, it is unlikely that further major road productivity improvements would be justified in the short to medium term. Tasmania's current road network would require significant upgrades to meet the geometric standards required for the highest productivity vehicles available (i.e. B-triples). It is the Department's position that the focus for Tasmania's freight network needs to be on maximising the productivity and capacity of the three key northern ports and the relative efficiency of their connection to major road and rail freight corridors, both in Tasmania and interstate. (DIER 2011b, p. 2)

Infrastructure Australia's June 2012 update on developing the National Land Freight Strategy maintained that Tasmania should:

... more widely introduce the higher productivity vehicles necessary to reduce costs to the local businesses that trade with the mainland and internationally. (Infrastructure Australia 2012a, p. 5)

While the use of HPVs offers advantages, such as lower unit freight costs and reduced vehicle movements, it also imposes a cost on road infrastructure, including through the need for better road geometry and higher capacity bridges. A benefit-cost approach should be used to assess expanding access for HPVs (B-doubles) and higher mass vehicles.

INFORMATION REQUEST

Is the current gazetted road network a significant constraint on the use of High Productivity Vehicles in Tasmania? Is there a case for allowing the use of higher mass limit vehicles on some routes?

Addressing road deficiencies

While there appear to be some access constraints for high productivity vehicles, road accessibility overall does not seem to currently be a constraint on the Tasmanian freight task. As the Freight Logistics Coordination Team (FLCT) recently concluded:

Generally, capacity across the road and rail network is sufficient, and this is a benefit to users. (FLCT 2013a, p. 13)

Nonetheless, the FLCT noted the need to prioritise road investment on the main freight corridor in its final report recommendation:

Road investment in Tasmania should target one high standard freight corridor, supported by key regional connections and –

- a. Prioritise road expenditure to the Burnie-Devonport to Hobart primary freight corridor, which is part of the National Freight Network, developing this corridor as Tasmania's highest standard freight route.
- b. Ensure that investment outside this corridor prioritises key regional freight roads that connect to the primary freight corridor. This include the Bass Highway west of Burnie, East Tamar Highway and Frankford-Birrallee-Batman corridor.
- c. Inform the development of a high-productivity vehicle access policy by the Tasmanian Government. (FLCT 2013a, p. 5)

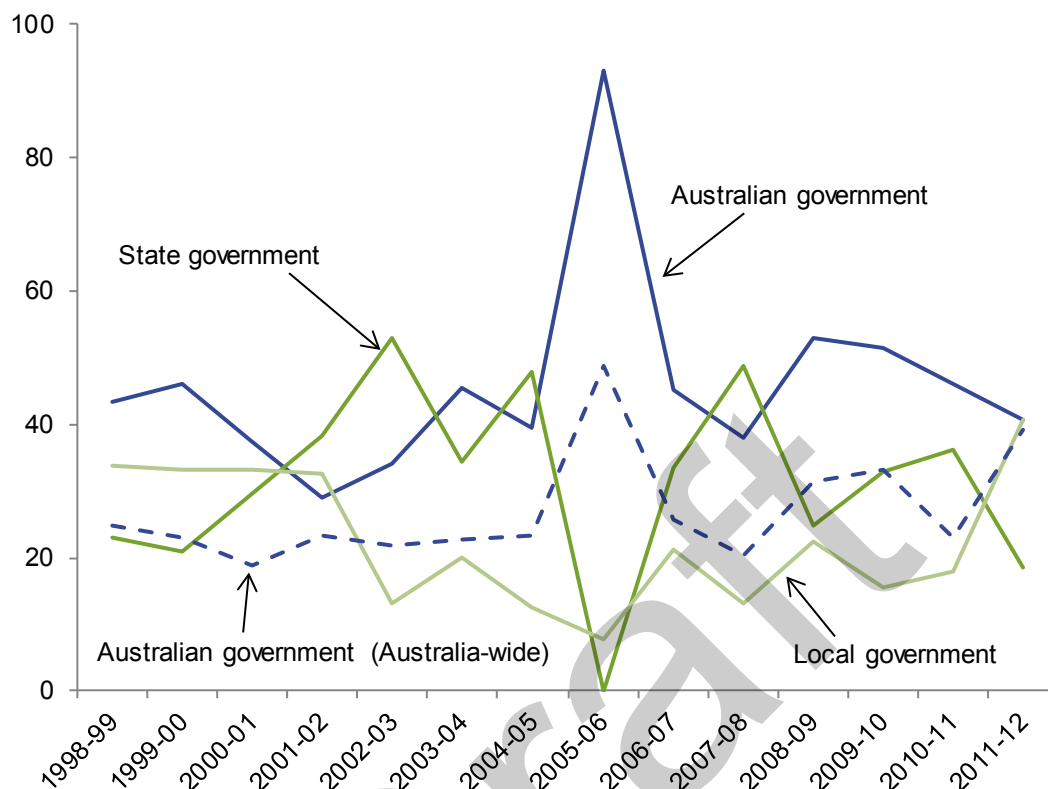
The Tasmanian Government has indicated its support for this FLCT recommendation and indicated that development of a HPV access policy will be completed by December 2014.

Road funding and user pricing

Roads are largely funded by governments because they display a range of features — such as large lumpy capital expenditure, economies of scale, network planning and management requirements, and benefits from interconnectivity — that generally make provision of a single integrated network the most efficient outcome. Roads also tend to have public good like characteristics, in that they are non-rival in consumption — that is, up to a point, use of the road by one user does not impact on the road's availability. Also, they exhibit a degree of non-excludability, in that it is difficult to directly charge users (which may include light and heavy vehicles, cyclists and pedestrians) of a particular road.

Road expenditure is undertaken by all three levels of government. Over time, there have been substantial changes in the share of road expenditure by level of government, with significant year to year volatility (figure 5.3). Over the period 1998-99 to 2011-12, the Australian Government's share of road expenditure in Tasmania has averaged 43 per cent, significantly above the Australia-wide average of 27 per cent.

Figure 5.3 Share of Tasmanian road expenditure by level of government
Per cent



Data source: BITRE (2013e).

Road funding is allocated through a range of programs. For instance, Australian Government funding has been allocated through funding programs such as: the National Network; Black Spots; Roads to Recovery; and Local Government Financial Assistance Grants Identified for Roads (BITRE 2011). In addition, funding may also be allocated to particular projects on an individual basis, separately from broader funding programs. For example, in its election commitments (along with the commissioning of this inquiry) the Coalition committed to providing \$400 million (comprising \$40 million a year for ten years commencing in 2014-15) for upgrading the Midland Highway (Coalition 2013).

The current funding model for roads can lead to a less than efficient allocation of investment, with funding not always directed to projects, especially maintenance, that deliver the greatest net benefits. As Infrastructure Australia (2012b, p. 9) noted:

... roads are more prone to highly politicised spending decisions, especially in the absence of data on baseline road cost and condition. The lack of information on road cost and condition means that governments are perceived to allocate funding on the basis of particular needs within the political cycle, rather than for the longer term.

Of course, the weaknesses in Australia's road funding arrangements are not unique to Tasmania, although the greater dependence on Australian Government funding in Tasmania may exacerbate the issue.

One underlying road funding issue — which contributes to less than optimal investment decisions — is the current manner in which road users are charged. Notwithstanding the use of toll roads in most major capital cities, road user charges, for both light and heavy vehicles, are levied in the form of fixed annual vehicle registration charges and fuel excise. The latter crudely approximates use-based charging, as fuel use (and hence excise paid) will generally be higher for heavier vehicles or those that travel longer distances. However, these charges are not location determined, that is, they do not reflect the difference in costs that heavy vehicles impose on different types of road.

As the Commission found in a previous inquiry into *Road and Rail Freight Infrastructure Pricing*:

The main efficiency losses with current road charging arrangements derive from the averaging of costs and charges ... and the disconnect between road revenue and spending decisions.

– These provide poor price signals and distort the incentives needed for efficient road use and provision. (PC 2006b, p. XXVI)

Likewise, the Australian Competition and Consumer Commission (ACCC) submitted that:

Existing national road pricing structures do not encourage efficient investment in essential freight infrastructure. ... In particular, the ACCC considers that reform of heavy vehicle road provision and charging is necessary to better reflect the cost of road use and ensure the right investments in roads are undertaken. (sub. 28, p. 7)

This issue was also noted by the Tasmanian Government in its recent *Nation Building 2* submission:

Unlike the rail sector, the road sector does not operate within a market framework. Although heavy vehicle registration charges are set to cover past expenditure on roads used by these vehicles, there is currently little direct relationship between use of the road network and road funding allocations. Within current frameworks, the opportunity for private sector funding of freight roads is limited. (Tasmanian Government 2012, p. 20)

However, in its 2006 inquiry, the Commission noted that developments in road pricing technology could create opportunities for more cost reflective pricing which, in combination with institutional changes to link road supply and demand, could offer substantial efficiency gains. It subsequently recommended a phased approach

to reform which could see the roll out of location-based charging, subject to an assessment of the costs and benefits (PC 2006b).

National reform options are being developed through the Heavy Vehicle Charging and Investment (HVCI) project. The Commission notes that this is a reform best undertaken at a national rather than specific State level. The Council of Australian Governments identified heavy vehicle charging as a major transport reform at its December 2013 meeting and is seeking further advice on the HVCI proposals for its next meeting (HVCI 2014).

Road freight charges

Tasmanian road freight charges appear to be comparable to those for mainland services.

Aurecon (2013a), in its report to the FLCT, compared Tasmanian road freight rates (for a 19 metre semi-trailer, assuming a load of two twenty foot equivalent units) with those in Victoria. It concluded that rates were marginally more expensive than in Victoria, which it attributed to higher fuel costs in Tasmania relative to the mainland.

Relative to other transport modes such as rail or shipping, the scope for anticompetitive behaviour in the road freight industry is limited. Barriers to entry in the industry are relatively low, and while there are economies of scale in the industry, road freight can be efficiently conducted on a relatively small scale, including by businesses themselves. However, a feature of the road freight market is the presence of integrated freight logistics businesses, whereby the Bass Strait shipping operators, Toll and SeaRoad, also provide road transport services.

INFORMATION REQUEST

How do road freight costs in Tasmania compare with costs of equivalent services on the mainland? Are there any competition issues in the road freight market given the presence of integrated freight logistics businesses?

5.3 Rail freight

Railways in Tasmania can be divided into the freight-only Tasmanian Rail Network that operates for commercial purposes, and the historic rail lines. There are no passenger services.

In 2011-12, rail carried 10 per cent of the total Tasmanian freight task by tonnage, and 18 per cent of the total freight task based on tonne kilometres travelled (DIER 2013). Bulk freight (coal, ore and cement) accounted for most freight moved by train, but there has recently been an increase in non-bulk (or ‘intermodal’) freight volumes, including containers and a recommencement of log transportation (TasRail 2013).

While rail accounts for a small share of the total land freight task in Tasmania (nationally, rail accounts for over half of the land freight task¹³), for many of those businesses that use rail, it is their primary form of intrastate freight transport. For instance, Norske Skog submitted:

Given 96% of all production is shipped across Bass Strait, the Boyer Mill has a clear reliance on moving its freight as efficiently as possible between the Mill, near Hobart to the Port of Burnie on Tasmania’s North West Coast. This is undertaken with the support of TasRail which represents a vital link in Boyer’s inbound and outbound freight task. Rail freight between the Mill warehouse hardstand and the Port of Burnie offers the lowest cost option to move large volumes of containerised product in an efficient manner, while also removing the significant freight volumes from the Tasmanian road network.

All sales volumes destined for markets outside Tasmania are transported by TasRail on a dedicated northbound train to Burnie leaving the Boyer Mill 6 days per week. (sub. 39, p. 8)

The Tasmanian rail network consists of a single line narrow gauge track. There are 632 kilometres of operational track (there are also a further 211 kilometres of non-operational lines), with the main rail line following a similar route to the main road corridor (figure 5.4).

TasRail, a Tasmanian Government-owned corporation, is now responsible for all aspects of the rail system — track, terminals and rolling stock. This follows a period of private ownership and operation of above rail assets from 1997 to 2009.

¹³ In 2009-10, national rail freight movements (bulk and non-bulk) totalled 259 billion tonne kilometres, versus 192 billion tonne kilometres moved by road (BITRE 2013e).

Figure 5.4 Tasmanian rail network



Source: TasRail (2013).

Issues facing Tasmanian rail

The issues facing Tasmanian railways have been well documented, including by Juturna (2013), Infrastructure Australia (2012b) and Engineers Australia (2010). As a business, it has been constrained by small volumes and short distances. The network itself has been hampered by the lack of commercial success and resulting poor track condition and aged rolling stock, which have further limited the attractiveness of rail for moving freight. As TasRail submitted, it:

... had inherited a business characterised by many decades of capital under-investment. This had critically constrained the ability of rail to contribute to the business development of the State and led to increased volumes of freight being transferred to the road network. (sub. 22, p. 2)

In its 2010 assessment, Engineers Australia rated the Tasmanian rail network as an 'F', finding that the infrastructure was:

... inadequate for current and future purposes, and that the magnitude of the works required to provide any reasonable utility from this infrastructure is enormous. (Engineers Australia 2010, p. 25)

TasRail is in the process of undertaking substantial capital upgrades. The Australian Government, through its *Nation Building* funding program from 2008-09 to 2013-14, has contributed \$210.5 million for track upgrades. In addition, the Tasmanian Government has committed capital funding of \$137.2 million over seven years to 2015-16. The capital upgrades have comprised track renewal, particularly the replacement of sleepers and bridge works. Rolling stock is also being upgraded, with 17 new locomotives and 191 wagons to be rolled out in late 2013 and 2014. Other capital works include a new train control system and refurbishing of the bulk minerals shiploader at Burnie (TasRail 2013).

There are also plans for further capital upgrades. Under the *Nation Building 2* program¹⁴, the Australian Government announced funding of \$119.6 million over five years from 2014-15 to 2018-19, conditional on a matching level of funding being contributed by the Tasmanian Government (TasRail, sub. 22).

There is some evidence that these capital upgrades are attracting additional business for TasRail. The Department of Infrastructure and Regional Development submitted:

There is a clear correlation between the improvements in rail efficiency and demand in the market. As a result of the recent investment in rail upgrades, new contracts have been entered into with Venture Minerals and coal mining company Hardrock. TasRail has secured an extended service agreement with MMG for haulage of mineral concentrates between Rosebury and Burnie; and have also reached agreement with Forestry Tasmania for transportation of log freight between Brighton and Bell Bay. These contracts indicate the growing confidence in rail due to the infrastructure upgrades. (sub. 42, p. 19)

Further, TasRail submitted that its contract with Venture Minerals ‘will increase TasRail’s annual tonnage by approximately 35%’ (sub. 22, p. 3).

A key question should have been whether the expected growth in freight volumes was sufficient to warrant this additional investment. While the Tasmanian Government considers that keeping the future rail system option open is critical for supporting the development of key industries in Tasmania (such as mining), it is not clear to what extent this option has been assessed against alternatives.

¹⁴ This program has been retitled as the Infrastructure Investment program under the current Australian Government.

As a general rule, there is limited substitutability between road and rail because the two modes are generally best suited to different types of freight tasks. Rail's strength lies in the movement of large quantities of non-time sensitive freight over relatively long distances between a limited number of fixed points. Conversely, trucks move smaller loads, but can do so more quickly and between almost any locations.

However, in Tasmania there is a higher degree of substitutability between road and rail because of the relatively short distances involved. In its submission, TasRail noted that the rail freight network in Tasmania is duplicated by the road network:

... rail has no unique markets or geographic advantage and faces very strong competition from road transport. (sub. 22, p. 4).

Given the availability of road as a viable alternative option, the long term viability of rail in Tasmania needs to be carefully assessed from a long term, economy-wide perspective. This is particularly pertinent in the context of TasRail's financial performance coupled with the State's fiscal constraints (reflecting Tasmania's demographic and economic profile).

TasRail is currently not achieving a sustainable rate of return on its commercial operations. In 2012-13, its total loss for the year was about \$47 million (compared with \$37 million in the previous year). While this includes a \$45 million impairment expense associated with accounting treatment related to Australian Government funding of capital upgrades, total revenue also includes an operating subsidy from the Tasmanian Government of around \$16 million. Actual revenue from freight services (about \$33 million) was less than variable costs (including wages, maintenance, fuel and administration) (TasRail 2013).

For rail to be a viable long-term freight option in Tasmania it needs to operate on a full cost recovery basis, except to the extent that there are social benefits from railway activities that genuinely justify public subsidies.

Improving the financial position of TasRail can be achieved through either of two broad mechanisms, or a combination of the two. The commercial sustainability of TasRail could be increased by increasing its revenue base, either through higher freight charges and/or increased capacity utilisation. To the extent that capital improvements to the network increase the speed and capacity of rail travel, and there is efficient terminal infrastructure for transferring cargo to and from ships and trucks, there may be greater uptake of rail freight. Higher charges would inevitably lead to the loss of some business to road transport.

Alternatively, network rationalisation could provide an opportunity to reduce costs while maintaining the more profitable freight volumes. As noted above, the total

distance of operational track is around 600 kilometres, which is roughly twice the distance between Hobart and Burnie. In its October 2013 interim report, the FLCT made the finding on the Tasmanian rail network that rail investment should be prioritised to:

- a. Implementing Nation Building 2 outcomes which focus on the Burnie-Devonport to Hobart primary freight corridor, a link in the National Freight Network; and
- b. Maintain and enhance other lines based on their relative potential to operate on a full cost recovery basis within a 10-year timeframe. (FLCT 2013b, p. 2)

Similarly, Juturna (2013), in its final report for the FLCT, highlighted that network rationalisation had not yet occurred. It also stated that this was difficult because there had not yet been a rationalisation of ports, making it challenging to prioritise rail investment strategies.

One particular issue with rail services is that they are dependent on relatively few customers, and so face considerable commercial risk that customers will withdraw their business, leading to underutilised or stranded assets. For example, Infrastructure Australia (2012b, p. 20) cites the case where:

... not long after TasRail opened its service to Bell Bay, customers Norske Skog and Nystar transferred their operations from Bell Bay to Burnie.

This shift was in response to changes caused by the withdrawal of shipping services at Bell Bay, rather than a commercial, standalone customer decision per se, but it nevertheless illustrates the risks associated with geographically fixed assets in a dispersed logistics system.

In its final report, the FLCT made the following recommendation about the Tasmanian rail network:

The role of rail in the Tasmanian transport system should be clearly articulated by Government and aim to –

- a. Ensure that above rail operations operate on a commercial basis within five years, where revenue from freight is sufficient to cover operating costs and to provide for future investment in above rail assets.
- b. Ensure that public investment in below rail assets is based on defined network standards linked to freight demand.
- c. Be consistent with a long-term port strategy and consider the long-run adequacy of rail access to ports. (FLCT 2013a, p. 4)

The Tasmanian Government generally supported this recommendation, subject to more detailed consideration in its development of a Tasmanian freight strategy.

On available evidence, it appears that utilisation of Tasmanian rail will have to increase to improve its commercial performance. While the recent capital upgrades should make rail more attractive to freight users, it is not clear how substantial this scope is. Also, it appears likely that some network rationalisation will be warranted. This may involve rationalisation of connections to ports and sections of track where there is insufficient business to cover operating costs or justify capital upgrades. Such decisions need to be made in the context of an overarching strategy for freight infrastructure.

The Tasmanian Government has indicated that it will consider the case for privatising rail in the future. The FLCT, in its final report, has recommended, more generally, that the government consider ways to increase the scope for private investment in Tasmanian transport infrastructure. These avenues should be thoroughly explored, but the 1997 to 2009 experience of private ownership suggests this might only be possible on some risk sharing basis. In the long run, it seems likely that a State with a small tax base will have to confront the costs associated with largely duplicated road and rail networks and determine whether multiple networks or a more efficient transport system is the higher priority.

INFORMATION REQUEST

What scope is there for parts of the rail network in Tasmania to be rationalised?

What are the nature and extent of any positive spillover benefits from rail that justify continued public subsidisation of rail freight charges? If rail charges were to be increased to reflect the full cost of service provision, what would be the impacts on current users and on the commercial sustainability of TasRail?

What is the scope for some form of private investment or operational service provision in rail?

5.4 An integrated Tasmanian freight strategy

Discussions with stakeholders and submissions to this inquiry have highlighted the need for a specific long term strategy or ‘vision’ to guide the development of freight infrastructure in Tasmania. For instance, Regional Development Australia – Tasmania (RDAT) suggested examining the need to:

Develop a long term freight strategy for Tasmania that is supported by all key stakeholders which considers the longer term needs for Port infrastructure and Road and Rail networks ... (sub. 17, p. 2)

In a similar vein, the Cradle Coast Authority put forward the case for:

A long term logistics plan for Tasmania, covering Bass Strait and international shipping and the port, road and rail systems that support them, including road and rail corridors linking Burnie to the West Coast and Smithton, and a long term shipping solution for King Island ... (sub. 20, p 1)

And Engineers Australia submitted that state governments need to:

- Develop long-term infrastructure visions and plans that accommodate projected economic growth and population increases.
- Establish independent planning infrastructure advisory groups to provide advice on infrastructure priorities and provide infrastructure planning and funding advice. (sub. 36, p. 5)

The terms of reference establishing the FLCT stated that its primary purpose was to provide expert advice and guide the completion of a long term freight strategy. In its December 2013 final report, it recommended that:

1. The Tasmanian Government should complete a Tasmanian Freight Strategy by 30 June 2014.
2. The Tasmanian Government should adopt the FLCT's objective for the Tasmanian freight system as the objective for the Tasmanian Freight Strategy.
3. The Tasmanian Government should establish an ongoing high level, public-private freight advisory group. (FLCT 2013a, p. 4)

In finalising the strategy, the FLCT recommended that the Tasmanian Government should ensure that the strategy:

- Incorporates the objective for the Tasmanian Freight System;
- Is based on the outputs, particularly this final advisory report;
- Is based on long-term freight analysis;
- Directly involves industry participants from the freight market;
- Identifies key freight corridors and intermodal points for priority investment;
- Addresses the issue of duplicated port, road and rail infrastructure;
- Clearly articulates the role of, and target standards for, individual modes within the freight system;
- Those roles and targets should be reflected in the strategies of all government owned infrastructure providers and other key stakeholders;
- Proactively anticipates freight system issues by linking planning to current transport model data; and
- Is regularly updated. (2013a, p. 41)

Allied to the development of a long term strategy for freight infrastructure, potential benefits from better coordination in the freight logistics chain have also been raised.

For example, in Aurecon's August 2013 report to the FLCT, one of the recommendations was that:

Consideration should be given to the state wide planning of freight movements. Better planning offers the opportunity to reduce the carriage of empties on ships, reduce empty backhauls for trucks, intelligently route freight to rail, eliminate the stranding of freight and reduce the number of vehicles on roads. (2013a, p. 8)

Similarly, Infrastructure Australia (2012b, p. 2) suggested that:

... consideration be given to the creation of a freight logistics coordination team with an industry leadership group similar to the Hunter Valley Coal Chain logistics team.

In this regard, in its final report, the FLCT also recommended that the Tasmanian Government should test the viability of a market-based online trading portal to facilitate trade of freight capacity, investigate opportunities to promote industry collaboration, and that funding should be provided for an expert advisory panel to assist small to medium freight users to optimise their supply chains and reduce costs. The FLCT also recommended the development of a publically accessible freight model that:

- Provides data and information on freight supply and demand, including empty container movements.
- Allows users to alter key assumptions (for example sector growth rates) to test possible service offerings and demand aggregation opportunities.
- Transparently reports proposed major capital expenditure and maintenance costs across road, rail, port and shipping providers. (FLCT 2013a, p. 34)

A strategic and coordinated approach to Tasmania's freight future has the potential to reduce the costs of doing business in Tasmania, and thereby make a contribution to the State's economic development. In particular, this could lead to more efficient infrastructure investments that take into account a whole-of-Tasmania perspective. This could, in turn, lead to more efficient Tasmanian freight operations, including, for example, through faster freight journey times from better coordination between transport modes.

A more integrated and transparent approach to freight movements may also be beneficial in terms of addressing the flow of empty containers in the Tasmanian freight system. Repositioning containers is a substantial part of the freight task and imposes significant costs. Cost saving opportunities could be realised through the sharing of information that may assist in reducing the flow of empty containers. The Commission understands that this issue is relevant not just in Tasmania but one that has proved intractable on many trade routes.

The scope for improving freight *coordination* is primarily a matter for freight businesses. The role for government should be long term planning of infrastructure provision to facilitate improved efficiency in Tasmanian freight services.

In its response to the FLCT's report, the Tasmanian Government has committed to developing a Tasmanian Freight Strategy, with work having already commenced. The Tasmanian Government has submitted that the strategy will deal with issues including:

- Consideration of a long-term ports strategy that clarifies the future roles and functions of each of Tasmania's northern ports, taking into account their relationship with key road and rail links and specific freight needs;
- The ongoing strategic prioritisation of road infrastructure investment around a high standard, principal freight corridor and the development of a high-productivity vehicle access policy;
- The need for greater clarity on the role of rail in the context of Tasmania's contestable freight task; and
- A clear plan to better focus infrastructure investment on the optimal modal mix across both road and rail to meet Tasmania's future freight needs. (sub. 43, p. 7)

The lack of an integrated freight strategy across all components of the supply chain increases the risk of inefficient decision making in relation to road and rail corridors, their connectivity to ports and duplicated infrastructure. In this context, the Commission supports the development of a long term integrated freight strategy for Tasmania which addresses the fundamental issues of productivity and effective capital allocation. A jurisdiction with a small tax base is unlikely to be able to maintain a full and duplicated array of transport assets. The development of such a strategy will help to ensure that developments in freight infrastructure are supportive of Tasmania's long term economic growth prospects and cognisant of the fiscal position of the Tasmanian Government, now and in the future.

While governments should play a key role in developing a long term integrated plan for the state and the Tasmanian Government is currently undertaking such a process, it needs to be transparent, evidence based and include wide consultations with industry and the community at large, and provide opportunities for private sector investment and operations. As the Australian Government provides significant funding for Tasmanian infrastructure it should have a role in development of the strategy. The strategy should then form part of the assessment processes by the Australian Government and Infrastructure Australia for the allocation of funds to Tasmanian transport infrastructure.

DRAFT RECOMMENDATION

The Commission endorses the need for a comprehensive, long term integrated freight strategy for Tasmania. As the Australian Government will retain a role in funding Tasmanian infrastructure investments, it is appropriate that it (including through Infrastructure Australia) have a role in developing that strategy.

In developing the strategy, there should be broad consultation between industry, all levels of government, and the community more generally. A benefit-cost framework should be applied that identifies the most efficient use of investment capital and which clearly identifies the net benefits or trade-offs arising from community service initiatives or region-specific development objectives. As a matter of urgency, the strategy should:

- *identify Tasmania's likely future freight infrastructure requirements across all modes — sea, road, rail and air*
- *address port developments, including specialisation or rationalisation of existing infrastructure*
- *address the long term role of rail in Tasmania given the high degree of substitutability with road transport*
- *ensure that the objectives of government business enterprises for ports, sea freight and rail are consistent with commercial sustainability.*

6 An economic development approach

Key points

- The economic problems facing Tasmania require policy responses that directly target their underlying causes. A primary goal of the Australian and Tasmanian Governments should be to ensure that policy and regulatory settings lead to a more flexible and competitive state economy.
- Although popular with Tasmanian stakeholders, collectively the TFES, TWFS and BSPVES are not able to meaningfully promote Tasmania's economic growth, given the broader economic challenges the state faces.
- All levels of government should work towards making Tasmania more attractive to private sector investment by:
 - improving employment outcomes through skilling and training
 - creating an environment for more private sector involvement in infrastructure provision and operation
 - improving coherence in the provision of infrastructure
 - creating a regulatory environment that reduces the cost of doing business in Tasmania.
- A stocktake of existing economic development policies, programs, projects and bodies should be undertaken, with the results used to refine and develop a single integrated economic development strategy for Tasmania. The recently formed *Joint Commonwealth and Tasmanian Economic Council* is well placed to undertake or commission this work.

Although the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) are popular with many Tasmanian stakeholders, the schemes are not the most efficient or effective way to promote Tasmania's economic development, or to deal with the economic and social challenges the state faces.

Tasmania's broader economic problems — comparatively low rates of private investment and economic growth, and comparatively high rates of unemployment and social disadvantage — require policy responses that better target the underlying causes.

The de-facto goal of the TFES, TWFS and BSPVES has become to provide broader economic assistance to the state of Tasmania, and it is reasonable to use this as a ‘benchmark’ to assess the efficacy of the Schemes. In its submission to this inquiry, the Department of Infrastructure and Regional Development stated:

... through their actions, successive governments have accepted the rationale for TFES support has effectively expanded beyond a simple equalisation of transport costs to the provision of assistance that recognises Tasmania’s need for economic support ... (sub. 42, p. 26)

The Tasmanian Government submission also noted the link between the existing freight and passenger vehicle assistance schemes and general economic conditions in the state:

There is no doubt that the abolition of, or a significant reduction in assistance under, these schemes would be extremely damaging to the Tasmanian economy, particularly at this time. (sub. 43, p. 4)

And that:

The Tasmanian Government’s overriding concern is that this inquiry supports the growth of the Tasmanian economy, with the potential to lessen overall the dependence on Australian Government funding in the long term. This objective needs to be kept in mind in examining the current TFES, BSPVES and TWFS arrangements. A strategic and long-term view is required. (sub. 43, p. 16)

6.1 A better way to support economic and social development

As articulated in its draft report on geographic labour mobility, the Commission sees merit in policies that encourage people to move in response to changing economic conditions (PC 2013a). However, where governments seek to sustain population in a particular region, approaches that are designed to make the region concerned more attractive to business generally — such as improving selected infrastructure, upgrading labour force skills, removing inefficient taxes and improving administrative efficiency — are preferable to sponsoring selected firms or encouraging businesses to locate (or remain) there through subsidies. Importantly, such a strategy should be aligned with an overarching strategy that is consistent with a realistic assessment of the region’s comparative advantages.

In light of this, the Commission considers that the Australian Government should change the focus from freight and passenger vehicle support schemes, to policy reforms that have national and Tasmanian benefits (such as coastal shipping reform)

and those that directly enhance the competitiveness and productivity of the Tasmanian economy.

Where governments nevertheless pursue direct expenditure-based programs, the costs and benefits of a range of options should be assessed. For example, funding of the existing schemes could require more than \$2 billion in net present value terms over the next 15 years. Redirected effectively, this funding could provide the basis for more cost-effective policies and programs within an overarching economic development strategy.

Core elements of successful economic development strategies

The Commission considers that successful economic development strategies require the active involvement of all levels of government in a number of key areas, including:

- improving employment outcomes through skilling and training
- creating an environment for more private sector involvement in infrastructure provision and operation
- improving coherence in the provision of infrastructure
- creating a regulatory environment that reduces the cost of doing business.

Improving outcomes through skilling and training

The Commission notes that employment and labour market issues are a particular concern for Tasmania. A recent Commission draft report into labour mobility found low levels of labour mobility in Tasmania, unemployment levels that are consistently higher than the national average, and lower than average educational attainment (PC 2013a, pp. 96, 203). High wages, combined with low skill levels, were also identified as a possible cause of persistently high unemployment levels in Tasmania (PC 2013a, p. 233).

Improved education and training programs can redress limitations in the skills base of workers, and help to increase employment opportunities. More generally, policies that reduce barriers to employment and increase labour mobility are particularly important for geographically remote economies.

The Australian Government has foreshadowed an inquiry into the Fair Work Act and Australian labour markets. This inquiry has seen indications that regional factors should be examined in that inquiry.

Creating an environment for more private sector involvement in infrastructure provision

Like many remote regions of Australia, the need for efficient movement of people and goods into and out of Tasmania is important to the competitiveness of the local economy and its future growth path.

Ensuring that transport markets are effective and efficient is a high priority, and governments should reduce regulatory barriers and increase competition wherever this is feasible.

Launceston Airport (sub. 25) has argued that the TFES itself, by subsidising the cost of sea freight, is acting as a barrier to greater private investment in air freight capacity and improved air services, including in relation to air connections to King Island and the Furneaux Group of islands. A similar argument was made by Hobart Airport:

Hobart Airport is prepared to invest in growing the Airport's freight handling infrastructure to service Southern Tasmania's freight sector, improving access to markets and driving positive economic outcomes for Tasmania. However, the current freight subsidy arrangements inhibit private investment in this area. (sub. 46, p. 2)

Greater private sector involvement in Tasmania's shipping and land freight systems should also be considered. As JBS Australian Pty Limited (a meat processing firm) stated:

We also see scope for greater investment in infrastructure by the private sector in Tasmania as seen in other mainland states. (sub. 49, p. 2)

Greater private sector ownership and/or control of freight infrastructure, particularly port and shipping infrastructure, should be considered as part of the longer term economic development of Tasmania. State government ownership and operation of a commercial shipping business (TT-Line) and Tasmanian ports should be subject to periodic and transparent review.

As noted in chapter 4, restrictions on coastal shipping appear to have led to higher shipping costs between Tasmania and the mainland than would otherwise be the case. The Australian Government's foreshadowed review of coastal shipping regulation should examine the impact of the current regulations on shipping

competition and costs, and identify scope for reforms that might increase competition and lower shipping costs, not least for Tasmanian businesses.

Improving coherence in the provision of infrastructure

The availability and pricing of infrastructure can exert substantial influence on the location decisions of industries and households. In particular, some types of developments may be hindered by inadequate provision of infrastructure, while other regions may experience problems with excess capacity.

This inquiry has not found strong evidence of a major deficiency in the quantity of physical transport infrastructure in Tasmania, but it has found evidence that there is a need for better longer-term planning of infrastructure funding decisions and more effective use of capital (as discussed in chapter 5). Future fiscal pressures and sustainable policy responses will require greater attention to relative returns in allocating scarce capital.

An integrated transport strategy should be one component of the broader economic development strategy for the state as a whole. The Australian Government should also ensure that funding it provides for Tasmanian transport infrastructure is consistent with the goals and objectives of a freight strategy that convincingly addresses the concerns outlined in this report and evident in the commentary on improving Tasmania's economic performance.

Creating a regulatory environment that reduces the cost of doing business

The limited role of the private sector in Tasmania may indicate unusually large barriers to new investment in the state. To the extent this is caused by unnecessary or unnecessarily burdensome regulation, economic growth is compromised.

A recent Commission report into major project development assessment processes found that processes in Tasmania could be improved, but that the state approached leading practice in some aspects (PC 2013b, pp. 90, 133, 162). Good practices in Tasmania include the use of an independent regulatory assessment agency — the Tasmanian Planning Commission — to conduct integrated assessments of projects of state significance.

In contrast, a study by the Australian Innovation Research Centre (AIRC) into ways to diversify the Tasmanian economy found that environmental regulations and approval processes for new projects were, 'uncertain, risky, expensive and lengthy' (AIRC 2012, p. 10). Moreover, the authors found that approvals processes were,

‘overseen by government agencies whose task is to ensure regulatory enforcement with a mandate not to take into account economic concerns’ (AIRC 2012, p. 10).

A commitment to reduce or remove unnecessary regulatory barriers to greater private sector business investment in Tasmania should be a central objective of the state’s economic development strategy. Of particular concern are barriers associated with changing land use (for example, limits on minimum sub-division sizes in rural areas, and constraints on previously cleared land that hinder conversion back to farming) that may be adversely affecting new investment in potential growth industries for Tasmania, including dairy farming, viticulture and horticulture.

A general focus on administrative efficiency (delivering efficient public services that make a lesser call on taxes and charges to fund them) and maximising the scope for private sector investment and expansion through competitive tax regimes (local, state and national), should also be high priorities for the Australian and Tasmanian Governments.

King Island and the Furneaux Group of islands

By virtue of their size, population density and remoteness, the specific economic geography of the Bass Strait islands has been raised in submissions. Their economic sustainability is critically dependent on access to larger processing and end-product markets. In the area of transport logistics, they are clearly more exposed compared to the main island due to smaller volumes, high seasonality and very limited choice in transport services.

In many respects, the economic and social challenges (including high transport costs) of residents and businesses on King Island and the Furneaux Group of islands are more magnified versions of the challenges faced by residents and businesses of mainland Tasmania.

The economic viability of the communities on these islands is largely a matter for the Tasmanian Government, within the broader context of market drivers. For example, the partnership agreements between the Tasmania Government and the King Island and Flinders Councils, both of which are aimed at promoting sustainable economic activity and building economic resilience, directly address these concerns.

To the extent possible, policies and programs designed to support economic development on the islands (such as the partnership agreements) should ideally be consistent with, or form part of, the broader economic development strategy for Tasmania as a whole.

6.2 Meshing with existing plans and programs

There is already an assortment of economic and regional development plans and strategies for Tasmania. Examples include high-level programs and policies such as the Australian Government's *Economic Growth Plan for Tasmania*, and the Tasmanian Government's *Economic Development Plan*. Other Australian Government initiatives include *Regional Development Tasmania*, the *Forest Industry Structural Adjustment Package*, and the recently announced *Tasmanian Jobs and Growth Plan*.

More generally, a range of initiatives has been developed and funded by all levels of government over time, covering a range of geographical areas, industries and activities. However it is not clear that these initiatives are collectively coherent and optimal for Tasmania as a whole. In particular, are they consistent and complementary in their design and intent?

In the limited time made available to this inquiry, it appears that many of these programs are individually aimed at limiting (or responding to) some aspect of disadvantage. They do not appear to be informed by any genuine questioning of the retention of structures and processes that have failed to deliver improved outcomes for Tasmania over long periods.

The Commission considers that an important first step in improving the existing approach to economic development in Tasmania is to conduct a stocktake of existing initiatives (policies, programs, development bodies and agencies, plans and strategies) to clarify their nature, intent, timing, coverage, and any areas of potential or actual duplication. A good starting point is the collection of policies and programs identified by the AIRC in its report to the Department of Infrastructure and Regional Development on ways to diversify the Tasmanian economy.

The Australian and Tasmanian Governments should jointly undertake the stocktake and review with a view to having a publicly available report by the end of 2015. The results should be used by the Australian and Tasmanian Governments to inform a fundamental and comprehensive policy strategy to enhance the economic development of Tasmania, and ensure related policies and programs generate the greatest net benefit to the state as a whole.

The Commission notes that a new body — the Joint Commonwealth and Tasmanian Economic Council — has recently been established under the Australian Government's *Economic Growth Plan for Tasmania*. This body will consider competitive reforms to enhance Tasmania's long term economic growth prospects.

The council is well placed to undertake or commission the proposed policy and program stocktake as part of its initial work program.

6.3 Review and evaluation

A dilemma for the Australian Government is that if assistance made available under an economic development strategy does not improve the underlying competitiveness (attractiveness to investors) of Tasmania, or facilitate the mobility of its inhabitants, there will inevitably be pressures from recipients for the assistance to become permanent. This would not only be likely to reduce the productiveness of the Tasmanian economy more generally, but also involve substantial transfers from the wider community.

For this reason the Commission considers that the commitment of Australian Government funds to broader economic development objectives in Tasmania should be subject to periodic review, with the assessments conducted by an appropriate independent body. Such reviews would complement the need for periodic reviews of the transport support schemes.

DRAFT RECOMMENDATION

The Joint Commonwealth and Tasmanian Economic Council should undertake or commission a stocktake and review of existing policies and agencies associated with the pursuit of economic development in Tasmania as part of its initial work program. The review should:

- ***cover initiatives established by all levels of government***
- ***clarify their nature, intent, timing, scope, governance arrangements and any areas of duplication***
- ***assess whether the suite of initiatives represents a coordinated, consistent, targeted, and efficient approach to Tasmania's economic development***
- ***include the release of a public report by the end of 2015.***

The results of the stocktake and review should contribute to and inform the development of an integrated economic development strategy for Tasmania.

DRAFT RECOMMENDATION

The Australian Government should review and evaluate its programs for Tasmania after a reasonable length of time. Such reviews should be transparent, be conducted by an appropriate independent body and should comprise an ex-post assessment of the aggregate benefits and costs of the strategy to date and an assessment of the benefits and costs of any continued Australian Government financial contribution to these programs.

Draft

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the inquiry report.

Draft

A Conduct of the inquiry

The Commission received the terms of reference for this inquiry on 29 November 2013. Notices were placed in the media and on the Commission's website inviting public participation. Information about the inquiry was also circulated to parties identified as likely to have an interest.

The Commission initially hosted two roundtables in Tasmania to discuss key issues and to assist inquiry participants in preparing their submissions. The Commission also separately held informal consultations with relevant regulatory bodies, government agencies and companies.

Details of the organisations that were consulted are included in table A.2.

Sixty-one submissions were received prior to publication of this draft report. A list of these submissions is provided in table A.1.

The Commission would like to thank all those who have contributed to the inquiry so far.

Table A.1 Submissions received

<i>Participant</i>	<i>Submission No</i>
ANL Container Line Pty Ltd	33
Australian Aluminium Council	10
Australian Competition and Consumer Commission	28
Australian Pacific Touring	11
Australian Shipowners Association	29
Australian Trade Commission	41
Bell Bay Aluminium	12
Boating Industry Association of Victoria	13
Brohier, Peter	59
Business Council of Australia	47
Burnie Chamber of Commerce and Industry	57
Confidential	31
Cooper, Cherie Joy	58
Cooper, Patricia	60
Corporate Financial Consulting Pty Ltd	6
Cradle Coast Authority	20
Cuthbertson Bros Pty Ltd	3
Department of Infrastructure and Regional Development	42
Engineers Australia	36
Flinders Council	23
Forestry Tasmania	37
GA Cossar and Co Pty Ltd	7
Harvest Moon	21
Hobart Airport	46
JBS Australia Pty Ltd	49
John Barker and Associates	44
Kelp Industries Pty Ltd	4
King Island Beef Producers Group	15
King Island Shipping Group	19
Launceston Airport	25
Lindblad Expeditions	1
Maritime Union of Australia	32
Mondelez Australia Pty Ltd	24
na Champassak, Phil	51
Napier, Don	61
National Public Lobby	2, 52
National Sea Highway	54
National Sea Highway Coalition – Tasmanian Division	34
Net Sea Freight – Tasmania Pty Ltd	26
Norske Skog Boyer	39
Northern Tasmania Development	27
North West Primary Industry Branch of the Liberal Party	5
Regional Development Australia – Tasmania	17

(Continued next page)

Table A.1 (continued)

<i>Participant</i>	<i>Submission No</i>
SeaRoad Holdings Pty Ltd	35
Shipping Australia Limited	53
Simplot Australia	50
Tarlinton, Trish and John	56
Tasmanian Exporters Group	14
Tasmanian Farmers and Graziers Association	45
Tasmanian Farmers and Graziers Association, King Island Branch	8
Tasmanian Government	43
Tasmanian Ports Corporation	30
TasRail	22
Toll Group	55
Tourism Industry Council Tasmania, Tourism and Transport Forum, and Cradle Coast Tourism Executive	48
TT-Line Company Pty Ltd	9
Veolia Environmental Services	38
Viewbanks Pty Ltd	16
Webster Limited	40
Wise, Grant	18

Table A.2 Meetings and roundtables*Participants***Tasmania**

Bartholomew, Quinn and Associates
 Bell Bay Aluminium
 Cuthbertson Bros
 Department of Economic Development, Tourism and the Arts (Tas)
 Department of Infrastructure, Energy and Resources (Tas)
 Flinders Island Council
 Forestry Tasmania
 Fresh Freight Tasmania
 Harvest Moon
 King Island Council
 Killara Pastoral
 Lion
 Launceston City Council
 Markarna Grazing Company
 Mondelez Australia
 Net Sea Freight - Tasmania
 Norske Skog Boyer
 Northern Tasmania Development
 Nyrstar Hobart
 Petuna Group
 Regional Development Australia - Tasmania
 Simplot Australia
 TT-Line
 Tasmanian Chamber of Commerce and Industry
 Tasmanian Exporters Group
 Tasmanian Farmers and Graziers Association
 Tasmanian Minerals Council
 TasPorts
 TasRail
 Tourism Tasmania
 Webster Limited

Victoria

Australian Shipowners Association
 Department of Transport, Planning and Local Infrastructure (Vic)
 Port of Melbourne Corporation
 SeaRoad
 Toll Group

Australian Government

Australian Competition and Consumer Commission
 Department of Human Services
 Department of Infrastructure and Regional Development
 Infrastructure Australia

B Recommendations of the PC 2006 inquiry into Tasmanian freight subsidy arrangements

Box B.1 The Commission's 2006 inquiry recommendations

Recommendation 1

The basis for claiming TFES payments should be restructured to minimise the adverse incentives that the current scheme generates.

Recommendation 2

Assistance under the TFES should only be payable on the basis of evidence of actual wharf-to-wharf costs:

- Centrelink should specify the documentary evidence that it will accept as proof of wharf-to-wharf costs. As far as practicable, this should be based on original carrier wharf-to-wharf invoices.
- Parameter adjustments of \$230 per TEU for door-to-wharf and wharf-to-door costs would no longer apply. Other parameter adjustments would continue to be used.

Recommendation 3

The administration and auditing of the TFES should focus more intensively on the verification of wharf to wharf costs:

- The systems required to administer the scheme should be updated in the light of the more detailed evidence and data processing needed to verify wharf-to-wharf costs.
- There should be more comprehensive public reporting of information, including the annual payments to recipients.

Recommendation 4

DOTARS and the BTRE should revise the methodology for setting and updating the remaining parameters, and review them every three years. In particular, they should review how wharf-to-wharf costs should be defined. The results of parameter reviews should be published.

Box B.1 continued

Recommendation 5

DOTARS should monitor the operation of the revised scheme to investigate whether there is evidence of ongoing gaming and overcompensation of wharf-to-wharf costs. It should report to Government on this matter during 2009.

The report should also examine:

- the effectiveness of administration and audit controls;
- the role of all actual and potential claimants who are not producers and shippers of goods assisted under the TFES; and
- any aspects of the Ministerial Directions judged to be causing difficulty at that time.

If the Government concludes that gaming and overcompensation of freight cost disadvantage remain significant issues, it should introduce a flat rate of assistance per TEU as per finding 7.1, to operate from 1 July 2010.

Recommendation 6

The TWFS should pay the same level of assistance per tonne to wheat shipped in containers and in bulk:

- Payments under the TWFS should not be capped.
- Wheat should no longer be eligible for assistance under the TFES.

The level of assistance should be based on the least cost method of shipping wheat across Bass Strait and a rail freight equivalent cost:

- Given the lack of recent data on these measures, the Bass Strait wharf-to-wharf container rate and the TFES road freight equivalent should be used in the interim. As such, for three years, the TWFS should pay assistance of \$23.12 per tonne, or the shipper's actual wharf-to-wharf cost, whichever is the lesser.
- In concert with the first three-year parameter and operational review of the TFES, the BTRE should estimate the cost of bulk shipments of wheat and the rail freight equivalent, to update the rate of subsidy from that time.

Source: (PC 2006c).

References

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C Coastal trading regulation

Key points

- Recent changes to Australian coastal trading regulation have been: in 2009, changes to workplace relations were passed, and when combined with awards modernisation processes, in 2011 Australian wage rates were extended to workers on foreign flagged vessels inside Australia's Exclusive Economic Zone; in 2012, hiring, licensing, and vessel registration requirements changed; and tax exemptions applied to certain Australian ship operators.
- The cumulative effects of the changes are likely to decrease the desirability of engaging in Australia's coastal trade for international vessels; increase the costs of providing domestic coastal trading services; and reduce the level of competition in Australia's coastal trading network.
 - These changes are likely to have a substantial impact on Australia's shipping industry, and also those Australian businesses who rely on shipping services to transport their goods to market.
- Tasmania, as an island state, is particularly vulnerable to regulatory reforms which affect the desirability of engaging in the coastal trades. A number of participants to this inquiry have stated that shipping costs have risen over the past few years, and that the increased costs are attributable to the recent regulatory reforms. Tasmania's markets are likely to be affected as follows:
 - *Dry and liquid bulk* —Tasmania's bulk (dry and liquid) market that utilises temporary licenced vessels must hire Australian workers in senior positions and pay Australian wages for foreign flagged vessels engaged in their third and subsequent coastal trading voyages in a 12 month period, increasing shipping costs.
 - *Containerised and other cargo* — the Bass Strait route is served by Australian-owned vessels for containerised cargo, and therefore the hiring and wage reforms have not directly affected the market. It is unclear whether the tax reforms will reduce shipping costs, but they are relevant to current plans for new ship investments.
 - *Tourist numbers* — tourist numbers from Victoria to Tasmania are lower than they could be as the reforms adversely affect the appeal of the Bass Strait route. Elsewhere throughout Australia, large cruise vessels compete on an open coast basis, with the potential for lower fares for tourists.
- Removing these reforms will be of some benefit to Tasmania, however, removing them will not fully ameliorate the relatively high costs of shipping across Bass Strait.

C.1 Introduction

Coastal shipping can be broadly defined as the interstate carriage of cargo or passengers from a state/territory to another state/territory via water. Whilst common for a vessel to undertake intrastate and/or international legs along with an interstate leg during any single voyage, intrastate and international legs are not coastal trading. This appendix outlines some of the recent legislative changes to Australia's coastal trading network, and the impact of those changes on Tasmania.

Section C.2 covers the 2009 amendments to the Fair Work Regulations 2009 (Cwlth), and the award modernisation process under the *Fair Work Act 2009* (Cwlth), whereby foreign flagged vessels which engage in Australian coastal trading are obliged to pay Australian seafaring wages to their workers.

Sections C.3 to C.5 discuss the coastal trading reforms introduced in 2012. The three main 'reforms' were to: vessel registration requirements; licensing vessels to engage in coastal trading; and a range of tax exemptions for vessels and ship operators.

Section C.6 outlines the likely impacts of the recent reforms on coastal trading in Tasmania.

C.2 Amendments to workplace relations legislation

Under the previous award system, unlicensed (permit) vessels were not engaging in 'coastal trading' (see section C.4) and, therefore, these vessels were permitted to pay the International Transport Workers' Federation (ITF) prevailing wage rate.

From 1 January 2010, amendments to the Fair Work Regulations 2009 (Cwlth) extended the application of the *Fair Work Act 2009* (Cwlth) to all workers engaged in coastal trading. From 1 January 2011, vessels that were licensed or under permit (see section C.4), as well as majority Australian-crewed vessels, were required to pay prescribed wage rates.

Following a process of award modernisation, the Maritime Industry Seagoing Award 1999 was replaced by the Seagoing Industry Award (SIA). On 1 January 2010, Part A of the SIA applied to vessels covered by the *Fair Work Act 2009* (Cwlth), except unlicensed (permit) vessels. From 1 January 2011, SIA Part B applied to unlicensed vessels, and for the first time, required employers of workers on those vessels to provide their workers with certain minimum conditions of employment such as including wage rates, hours of work, and allowances.

Table C.1 illustrates the changes in the prevailing wage rates for different vessel licences before and after the amendments.

Table C.1 Workplace relations amendments to prevailing wages in the seagoing industry^a

<i>Vessel ownership</i>	<i>License type</i>	<i>Old wage rate determined by:</i>	<i>New wage rate determined by:</i>
Australian-owned vessel	Licensed	MISA 1999	SIA 2010 Part A, plus EBA negotiated additions
	Unlicensed (permit)	ITF market rate	SIA 2010 Part B
Foreign flagged vessel	Licensed	MISA 1999	SIA 2010 Part A, plus EBA negotiated additions
	Unlicensed (permit)	ITF market rate	SIA 2010 Part B

^a The SIA applied to licensed vessels on 1 January 2010, and to unlicensed vessels on 1 January 2011. EBA = Enterprise Bargaining Agreement. ITF = International Transport Workers' Federation. MISA = Maritime Industry Seagoing Award 1999. SIA = Seagoing Industry Award 2010.

Sources: (Australian Industrial Relations Commission 1999; Fair Work Commission 2010).

The SIA Part B wages were around twice the amount of the ITF market rates that prevailed previously (Deloitte 2012). Labour costs account for around 10-15 per cent of total voyage costs (chapter 4), and therefore an effective doubling of labour costs has the potential to change the profitability of some foreign flagged vessels engaging in coastal trading in Australia.

Further, the amendments ensure that any vessels entering Australia's Exclusive Economic Zone — which are majority Australian-crewed — are required to pay their workers SIA Part A wages. This requires foreign flagged vessels (which are majority Australian-crewed) operating on international routes to/from Australia to pay SIA Part A wages. Prior to the changes, these vessels would have paid their workers ITF market rates. The Commission estimates that solely based on the leave accrual provisions, the labour costs associated with remunerating workers at the SIA Part A rate, is more than 80 per cent above the SIA Part B rate. The Commission has not analysed other provisions that exist in SIA Part A which do not exist in SIA Part B such as allowances for: handling and securing cargo; disturbances of sleep; study; living away from home; and meals and accommodation. The true labour costs of remunerating a worker under SIA Part A could potentially be twice as much as they are for SIA Part B.

C.3 Coastal trading reforms: vessel registration

Prior to 2012, coastal trading was regulated by Part VI of the *Navigation Act 1912* (Cwlth). The *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth)

(“the Coastal Trading Act”) and consequential amendments Act¹ established the new regulatory framework on 1 July 2012.

The objectives of the changes are to provide a regulatory framework that:

- (a) promotes a viable shipping industry that contributes to the broader Australian economy
- (b) facilitates the long term growth of the Australian shipping industry
- (c) enhances the efficiency and reliability of Australian shipping as part of the national transport system
- (d) maximises the use of vessels registered in the Australian General Shipping Register in coastal trading
- (e) promotes competition in coastal trading
- (f) ensures efficient movement of passengers and cargo between Australian ports. (Coastal Trading Act s 3)

The new regulatory framework introduced three main changes. The changes affected vessel registration requirements (see below); licensing requirements to engage in coastal trading (section C.4); and certain tax exemptions for vessels and ship operators (section C.5).

Vessel registration

Vessel registration is fundamental to coastal shipping as the flag flown by a vessel determines the license types the vessel can operate under as established by the Coastal Trading Act. It is a requirement that every Australian-owned commercial vessel (with some exceptions — see below) be registered.

At a high level, there are two sets of registers: national registers, and international and open registers. National registers enable domestically-owned vessels to register so they can engage in coastal trading within their territorial waters. Depending on how registers are established under domestic law, international registers may allow domestically-owned vessels to engage in both coastal and international trade. Similarly, open registers allow foreign-owned vessels to engage in both coastal and international trade in multiple countries, subject to domestic legislation of the coastal state.

¹ *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth). Collectively, these two Acts are referred to as ‘the Coastal Trading Acts’.

Registration requirements prior to the 2012 reforms

Prior to the shipping ‘reform’ package, ships were registered on the Australian register of ships under the *Shipping Registration Act 1981* (Cwlth). It was a requirement that every Australian-owned ship over 24 metres in tonnage length (excluding Government ships, fishing vessels and pleasure craft) be registered.

Foreign owned ships were not permitted to be registered on the Australian register of ships.

Under the *Navigation Act 1912* (Cwlth) (which was the relevant Act prior to the 2012 changes), whether a ship was registered in the Australian register of ships had little bearing on its ability — or licensing conditions — to engage in coastal trading (see section C.4).

Registration requirements after the 2012 reforms

The *Shipping Registration Amendment (Australian International Shipping Register) Act 2012* (Cwlth) amended the *Shipping Registration Act 1981* abolishing the Australian register of ships and creating two new registers:

- the Australian General Shipping Register (“the general register”)
- the Australian International Shipping Register (“the international register”).

The general register effectively replaced the Australian register of ships and has the same registration requirements as applied under the *Shipping Registration Act 1981* (Cwlth) prior to the commencement of the changes. One important point to note is that only ships registered on the general register are permitted to apply for general licences to engage in coastal trading (see section C.4).

The international register is a new register, and as stated in the Explanatory Memorandum:

International registers have been established by a number of traditional maritime countries to offer their ship owners an alternative to registering under open registers. International registers offer some of the advantages of open registers, such as the ability to use crew of different nationalities, while maintaining the link between ownership/management of the vessels and the national flag. Maintaining this link ensures that the maritime safety regulator and other regulators of the ‘flag state’ continue to have control of safety and environmental standards, enforcement and compliance, and other matters which underpin the reputation of the national ‘flag’. (Albanese 2012)

Ships that are permitted to be registered in the international register are:

- (a) trading ships that are Australian-owned ships;
- (b) trading ships that are wholly owned by Australian residents, or by Australian residents and Australian nationals;
- (c) trading ships that are operated solely by Australian residents, or by Australian nationals, or by both;
- (d) trading ships that are on a demise charter² to Australian-based operators. (s 15B)

A prerequisite for registering on the international register is that a collective agreement must exist between the ship owner and the seafarers' bargaining unit (that is, the relevant seafarer employee organisation).

The registrar must refuse to register the ship if the registrar is satisfied that 'the ship will not be predominantly used to engage in international trading': s 15F(3)(a). This ensures that those ships registered on the international register predominantly engage in international trade, potentially restricting the level of competition between those ships and those on the general register. Ships registered on the international register are not permitted to apply for a general licence to engage in coastal trading (see section C.4).

It is a condition of registration of a ship on the international register that, where possible, the following positions be filled with Australian nationals or Australian residents:

- master or chief mate; and
- chief engineer or first engineer.

The ship can be cancelled from the international register under a range of circumstances including that the ship has not been or will not be predominantly engaging in international trading, or that a collective agreement is not in force.

C.4 Coastal trading reforms: licensing requirements

Until the shipping changes commenced in 2012, coastal trading was regulated by Part VI of the *Navigation Act 1912* (Cwlth). Under that Act, coastal trading was governed by a licencing and permit regime covering both domestic and foreign flagged ships. After the reforms commenced, the licencing regime was amended to

² A demise charter is one where 'the charterer has whole possession and control of the ship (including the right to appoint the master and crew of the ship)': *Shipping Registration Act 1981* (Cwlth) s 3.

include additional classes of licences, which had differing regulatory obligations on ship owners depending on whether the vessel was Australian registered, internationally registered, or a foreign flagged vessel.

Coastal trading under the Navigation Act

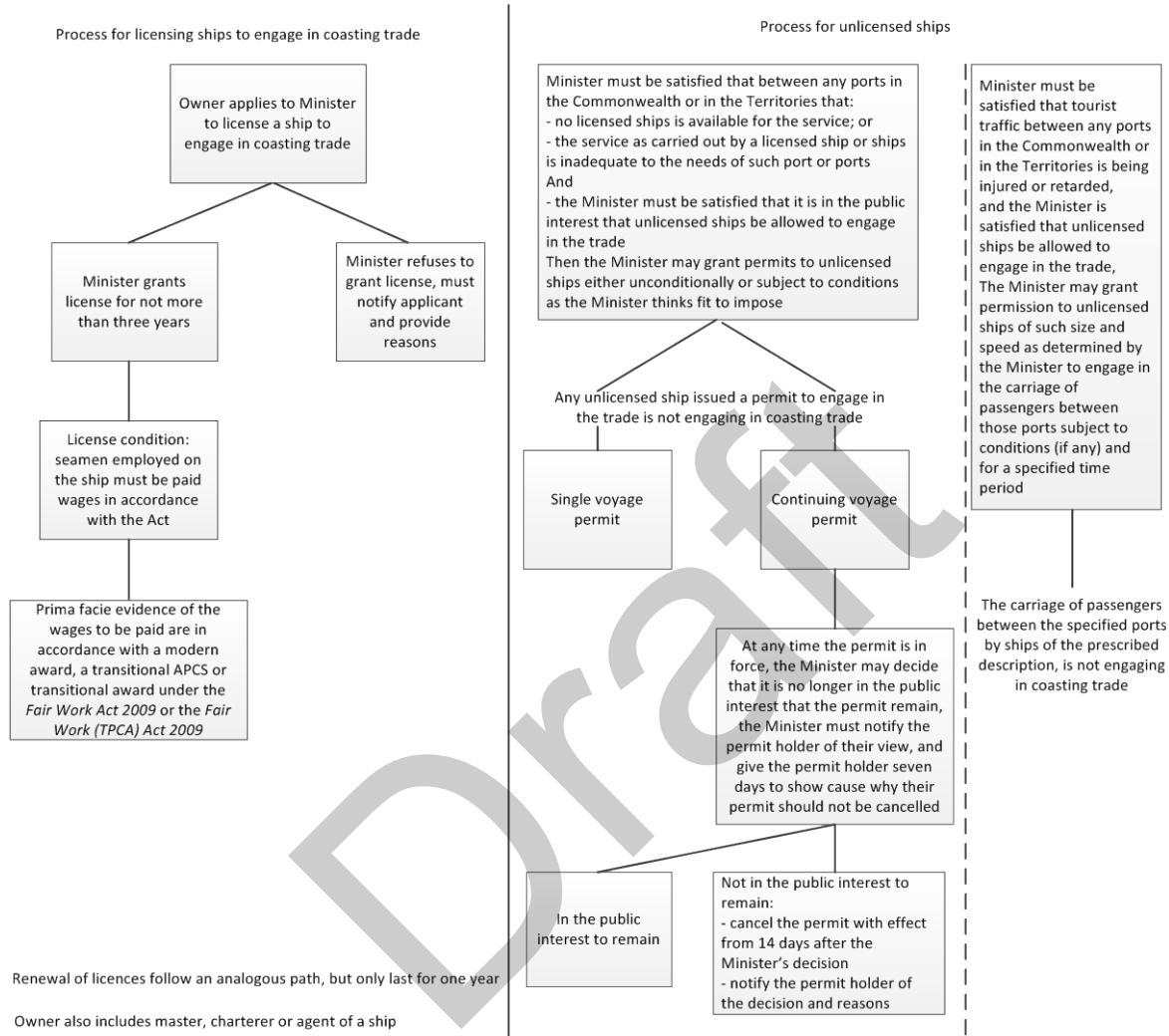
The previous licencing and permit regime under the *Navigation Act 1912* (Cwlth) is depicted in figure C.1.

In order for ships to be licensed under the Act, the owner was required to make an application to the Minister to engage in the ‘coasting trade’ (as it is referred to in that Act). There are no ownership restrictions on which ship owners may apply to be licenced to engage in the coasting trade. That is to say, both Australian and foreign flagged ships can apply to become a licenced ship. The major licence condition placed on ships when engaging in the coasting trade is that they must pay the seamen employed the prevailing Australian wage rate. It is not a licence condition that such seaman be Australian citizens.

A ship can alternatively apply for a permit as an unlicensed ship. There are two types of permit: single voyage permit (SVP) and continuing voyage permit (CVP). In order to obtain a permit, the Minister must be satisfied that there is a market gap, either because there is no licensed ship available for the service, or because the current level of service by licensed ships does not meet the needs of the port(s). The Minister must also consider that it is in the public interest that unlicensed ships be allowed to engage in the trade. If either a SVP or a CVP is issued, the ship is not engaging in the coasting trade for the purposes of the Act.

Under the Navigation Act there is no requirement to pay the seamen employed on these voyages Australian wage rates. However, following the commencement of amendments to the Fair Work Regulations on 1 January 2010 and the commencement of Parts A and B of the SIA (on 1 January 2010 and 1 January 2011, respectively), there is an obligation to pay seafarers Australian wages (see section C.2).

Figure C.1 The previous process for licensed ships to engage in the coasting trade and the process for unlicensed ships^a
Under the (repealed) *Navigation Act 1912* (Cwlth)



^a In addition to the legislated process illustrated, a series of Ministerial Guidelines were established to assist in the practical application of the regime, and these were largely codified when the package of shipping changes commenced on 1 July 2012. While notionally 'new regulation' therefore, the changes did not constitute new required practices or obligations on ship operators.

While a CVP is in force, the Minister may decide that it is no longer in the public interest that such trade be undertaken and can issue the ship owner a show cause notice as to why their permit should not be cancelled. The Minister must, after allowing the ship owner to make representations, then decide whether it is in the public interest for that permit to remain.

The obligations on licensed and unlicensed ship owners are described in table C.2.

Table C.2 Eligibility and conditions imposed on licensed and unlicensed ships under the *Navigation Act 1912* (Cwlth)

Australian or foreign flagged ships

<i>Subject matter</i>	<i>Australian ship</i>	<i>Foreign flagged ship</i>
Eligibility to apply for:		
• licence	✓	✓
• single voyage permit	✓	✓
• continuing voyage permit	✓	✓
Is the ship engaging in the coasting trade?		
• licence	✓	✓
• single voyage permit	✗	✗
• continuing voyage permit	✗	✗
Conditions imposed on:		
• licence	seamen employed on the ship shall be paid Australian wages	seamen employed on the ship shall be paid Australian wages
• single voyage permit (prior to 1 January 2011)	no conditions, unless Minister prescribes conditions	no conditions, unless Minister prescribes conditions
• continuing voyage permit (prior to 1 January 2011)	no conditions, unless Minister prescribes conditions	no conditions, unless Minister prescribes conditions
• single voyage permit (after to 1 January 2011)	seamen employed on the ship shall be paid Australian wages	seamen employed on the ship shall be paid Australian wages
• continuing voyage permit (after to 1 January 2011)	seamen employed on the ship shall be paid Australian wages	seamen employed on the ship shall be paid Australian wages

Recent changes in coastal trading

In 2012, the Government introduced a range of measures that sought to ‘create a stable regulatory environment and provide internationally competitive fiscal incentives to encourage the revitalisation of the Australian shipping industry’ (Albanese 2012).

The two Coastal Trading Acts replaced Part VI of the *Navigation Act 1912* (Cwlth), creating a new licensing regime for vessels to engage in coastal trading. The Shipping Registration Amendment Act removed the pre-existing Australian register of ships, creating a general register and an international register (section C.3).

The effect of the Coastal Trading Acts is to replace the previous licensing and permit regime with a system of:

- general licences
- temporary licences
- transitional general licences
- emergency licences.

Emergency licences are only available in the event of natural disasters and are not discussed.

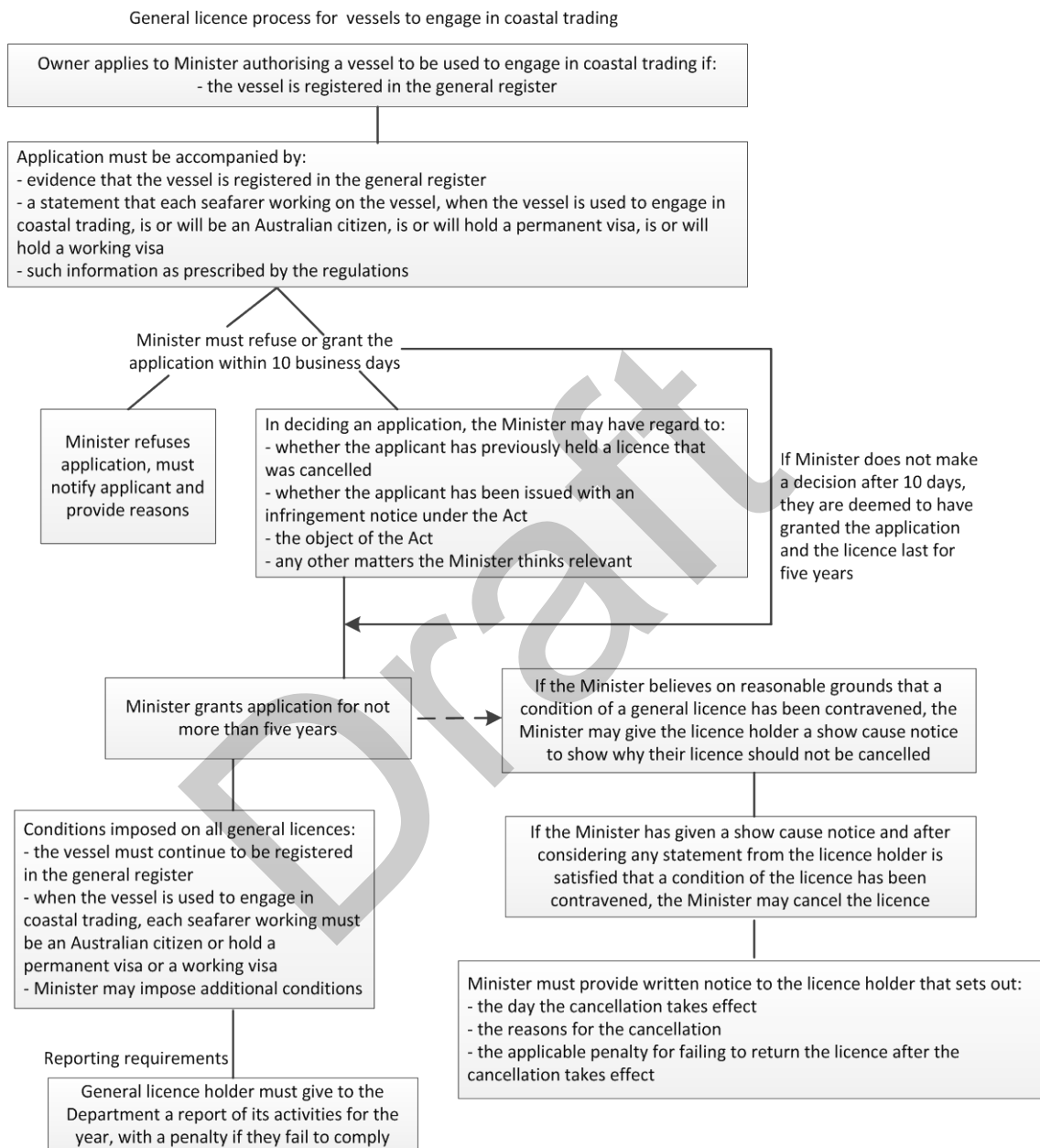
General licences

The process for general licences is depicted in figure C.2. The prerequisites for a general licence are that the vessel is registered in the general register (see section C.3), and that each seafarer working on the vessel (when engaged in coastal trading) is permitted to work in Australia. In effect, this license is the same as a license issued under the previous regime of the *Navigation Act 1912* (Cwlth).

General licences are granted to vessel owners for a period not exceeding five years. During the time that the licence is valid, the vessel has unrestricted access to Australian coastal waters, although there is no requirement that the vessel undertake any voyages. Shippers and the users of shipping services can only enter into contracts for the period that the general licence is in force.

Conditions placed on all general licences are that the vessel must remain registered in the general register, and that the seafarers employed during the times when the vessel is engaged in coastal trading must be permitted to work in Australia.

Figure C.2 The general licensing process for vessels registered in the general register to engage in coastal trading
Under the *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth)

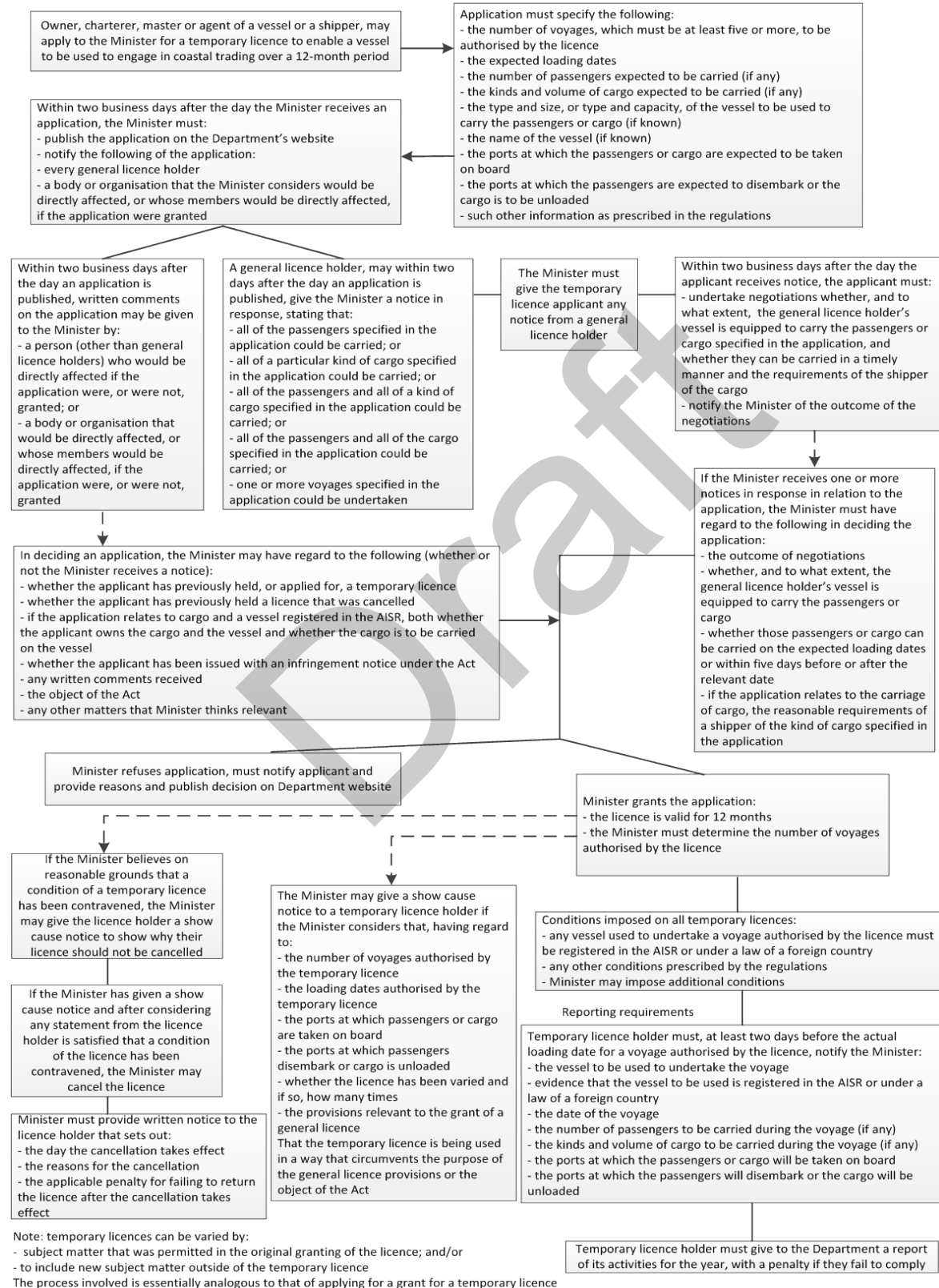


Owner also includes master, charterer or agent of a ship or a person of a kind prescribed by the regulations

Temporary licences

The process involved in applying for, and the granting of, a temporary licence is shown in figure C.3.

Figure C.3 The temporary licensing process for eligible vessels to engage in coastal trading
Under the *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth)



Vessels registered in the general register are not permitted to apply for temporary licences. The only eligible vessels are those that are registered in the international register, and foreign flagged vessels.

A temporary licence is valid for 12 months. When applying for a temporary licence, the applicant must nominate at least five voyages to be authorised by the licence and information such as the expected loading dates, the number of passengers or cargo to be carried and the ports at which the passengers or cargo are to be loaded and unloaded.

After receiving an application for a temporary licence the Minister must notify all general and transitional general licence holders of the application, as well as bodies or organisations (or the members of either) that the Minister considers would be directly affected if the application were granted.

General licence holders are then given an opportunity to nominate one or more voyages that they could undertake under their general licence, and notify the Minister. If a general licence holder does nominate any voyage(s), the temporary licence applicant must negotiate with the general licence holder ‘whether, and to what extent, the vessel authorised by the holder’s general licence is equipped to carry the passengers or cargo specified in the application’: s 32(3)(a), and whether they can be carried in a timely manner. The Minister then makes a decision as to whether to grant or refuse the temporary licence application.

If the application is granted, conditions imposed on temporary licences are that the vessel be registered in the international register or be foreign flagged and that if any authorised voyage is not to be undertaken to inform the Department of Infrastructure and Regional Development. Temporary licences can be varied (eg where the number of passengers or cargo to be carried changes) or can be changed to include new matters (eg a further voyage). In both instances, general licence holders and bodies or organisations that would be directly affected by such changes are invited to make comments to the Minister, to assist the Minister in forming a decision as to whether the change should be permitted.

During the temporary licence period, the Minister may issue a show cause notice to the temporary licence holder if the Minister considers that ‘the temporary licence is being used in a way that circumvents the purpose of the general licence provisions or the object of this Act’: s 63(1).

Transitional general licences

Under the *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth), transitional general licences were created to transition those vessels which were granted a licence under s 288 of the *Navigation Act 1912* (Cwlth), immediately prior to its repeal. This was to ensure that there was a smooth transition to the new licensing scheme introduced by the shipping changes. In effect, transitional general licences guaranteed that foreign flagged vessels which were licensed would still be able to engage in coastal trading in an unrestricted manner. However, under the new regime, when foreign flagged vessels engage in coastal trading they are required to employ seafarers that are permitted to work in Australia and pay wages determined by the Minister for Infrastructure and Regional Development.

In deciding whether to grant a transitional general licence, the Minister may have regard to ‘whether the owner intends to register [the vessel] under the *Shipping Registration Act 1981*, but is unable to do so immediately because of commercial obligations or requirements under a foreign law’.³

Transitional general licences have the same conditions as those imposed on general licence holders (apart from the requirement to be registered in the general register). Transitional general licences are valid for no more than five years and can only be renewed once. In practice, vessels which currently have transitional general licences have a maximum 10 year period where they can engage in coastal trading, whilst being obliged to employ seafarers permitted to work in Australia. At the expiration of the transitional general licence (assuming the foreign flagged vessels wish to continue engaging in Australia’s coastal trading), they will have to either:

- transfer to a general licence (thus become an Australian vessel, hiring Australian workers and continue to pay them SIA Part A wages)
- apply for a temporary licence (while still permitted to be foreign flagged, the vessel has to hire prescribed Australian workers and pay SIA Part B wages for the third and subsequent voyages in a 12 month period).

Thus, if the foreign flagged vessel wants unfettered access to Australia’s coastal trading (as it has under the transitional general licence), it will have to become an Australian registered vessel. If the foreign flagged vessel seeks to only engage in coastal trading in a more ad hoc manner, then it can apply for a temporary licence (with the obligation to pay SIA Part B wages for the third and subsequent voyages

³ *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* Sch 2 Pt 3, item 12(2)(a).

in a 12 month period), where all general licence holders have a right to compete for the voyages in the temporary licence application.

C.5 Coastal trading changes: tax exemptions

In addition to the measures previously discussed, the shipping package introduced two tax Acts⁴ to provide a framework for tax incentives:

- (a) to encourage investment in the Australian shipping industry; and
- (b) to encourage the development of sustainable employment and skills opportunities for Australian seafarers (Tax Incentives Act s 3).

Briefly, the effects of the changes are to:

- exempt eligible ship operators from income tax on core shipping activities
- depreciate qualifying vessels over a shorter effective life than would ordinarily have prevailed
- postpone any tax liability arising from the disposal of a qualifying vessel for an additional 12 months than would ordinarily occur
- permit a refundable tax offset for the use of Australian resident seafarers
- exempt lease payments to foreign vessel owners being subject to the standard 30 per cent royalty withholding tax.

It was stated in the Explanatory Memorandum to the tax amendment Act that the proposed taxation ‘reforms’ would cost the Australian Government nearly \$50 million in foregone taxation revenue, in its first year of operation and would steadily increase (table C.3).

Table C.3 Financial impact as a result of the shipping taxation ‘reforms’
Over the forward estimates

	2012-13	2013-14	2014-15	2015-16	Total impact
Financial impact (\$m)	49	66.8	68.7	70	254.5

Source: Swan (2012)

The likely effects of the tax changes are twofold:

1. existing eligible vessels registered in either the general or international register (see section C.3) will be able to access the tax incentives

⁴ *Shipping Reform (Tax Incentives) Act 2012* (Cwlth) (“the tax incentives Act”) and *Tax Laws Amendment (Shipping Reform) Act 2012* (Cwlth) (“the tax amendment Act”).

2. foreign flagged vessels may be sufficiently incentivised to:

- (a) register in either the general or international register as part of becoming eligible for the tax incentives
- (b) lease their vessels to an Australian shipping operator due to the exemption from the requirement to pay royalty withholding tax.

For vessels registered in either the general or international register, the tax incentives represent a windfall gain to the vessel owners. These owners were previously required to pay company tax at the rate of 30 per cent on income from core shipping activities, and are now no longer required to do so.

The Commission has yet to receive any evidence to suggest that there has been any increase in the number of foreign flagged vessels registering in Australia, and therefore it is unclear whether the tax incentives have been accessed by what were previously foreign flagged ships.

The Maritime Union of Australia submitted that the income tax exemption might not be as effective as it could be, because the exemption did not extend to the distribution of profits via dividends to shareholders, thus lowering its overall appeal to shippers (sub. 32).

Foreign flagged vessels might lease their vessels to Australian operators on a bareboat charter basis because of the cessation of the requirement to pay the royalty withholding tax on bareboat chartered vessels. Prior to the change, the royalty withholding tax exemption only applied to Australian based operators who leased vessels on the basis of time or voyage charter arrangements (whereby a foreign flagged vessel would be leased with an existing and most likely foreign crew). As such, the change can be also viewed as addressing an anomaly. By exempting the bareboat charter vessels from the withholding tax requirement, more Australian operators (and seafarers) may be employed. However, the more foreign flagged vessels that lease their vessels to Australian operators, the greater the foregone taxation revenue from the loss of royalty withholding tax. Further, if by leasing these vessels, new Australian operators enter the shipping industry, they would be entitled to the tax incentives introduced as part of the shipping reforms. These new operators would enter the shipping industry and thereby redirect resources from other areas of the economy where the advantageous shipping tax incentives do not apply. That is to say, the further the policy intent is realised, the Australian Government can expect to forego additional taxation revenue.

C.6 Likely impacts of recent changes

Summary of changes

The shipping changes have significantly impacted Australia's coastal trading through material changes to the licence categories; application processes; and conditions attached to licences to engage in coastal trading in Australia (table C.4). Additionally, remuneration and hiring requirements have significantly changed.

Table C.4 Comparison of license categories and license conditions^a

Vessel registry	Navigation Act 1912						Coastal Trading Acts 2012 ^b		
	Prior to 1 January 2011			After 1 January 2011			General license	Temporary license	Transitional general license
	Licensed	Unlicensed (permit)		Licensed	Unlicensed (permit)				
	SVP	CVP		SVP	CVP				
Eligibility to apply for a licence:									
• general register ^c	✓	✓	✓	✓	✓	✓	✓	×	×
• international register	n/a	n/a	n/a	n/a	n/a	n/a	×	✓	×
• foreign flagged vessel	✓	✓	✓	✓	✓	✓	×	✓	✓
Is the vessel engaging in coastal trade?									
• general register	✓	×	×	✓	×	×	✓	n/a	n/a
• international register	n/a	n/a	n/a	n/a	n/a	n/a	n/a	✓	n/a
• foreign flagged vessel	✓	×	×	✓	×	×	n/a	✓	✓
Licence condition to pay Australian wages and/or to hire Australian workers:									
• general register	pay wages	×	×	pay wages	pay wages	pay wages	hire workers and pay wages	n/a	n/a
• international register	n/a	n/a	n/a	n/a	n/a	n/a	n/a	hire workers and pay wages ^d	n/a
• foreign flagged vessel	pay wages	×	×	pay wages	pay wages	pay wages	n/a	pay wages	hire workers and pay wages

^a Under the *Navigation Act 1912* (Cwlth), *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth) and *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth). ^b Emergency licenses excluded. ^c For the purposes of the table, it is assumed that the general register is the same as the Australian register of ships as was in force under the *Navigation Act 1912*. ^d Applies to the master or chief mate and to the chief engineer or first engineer of the vessel. SVP = single voyage permit. CVP = continuing voyage permit. n/a = not applicable.

Previously, Australian owned vessels could elect to have a general licence or a permit. Since the changes commenced, Australian owned vessels must obtain a general licence, they are not permitted to apply for either a temporary licence or a transitional general licence. This has reduced the flexibility available to Australian vessels to enter and exit the coastal trading market as they see fit. Further, it has the potential to allow Australian owned vessels which have a general licence to wait for internationally registered or foreign flagged vessels to make an application for a temporary licence, and then negotiate with the applicant to undertake those voyages (although there is no guarantee that negotiation would be successful or the voyages would be awarded to the Australian operator).

Likely effects of the tax changes

The likely effects of the tax changes on freight rates are explained in table C.5. The net effect of the changes is unclear as it is conditional upon shippers passing through any expected benefits of the reforms onto users of shipping services. Additionally, some tax of the changes (such as the accelerated depreciation) are not available for some time, so as to not have retrospective effect.

However, it is clear that the tax changes make investment decisions in new vessels more attractive to shippers. All three Bass Strait shipping operators are currently considering new vessel investments, and the commercial shippers have both indicated that the tax changes formed a part of their investment decisions.

Likely effects on dry and liquid bulk

In 2011-12, vessels operating under permit carried 21.8 per cent and 34.3 per cent of the dry and liquid bulk throughout Australia, respectively (BITRE 2013a). Therefore, to the extent that the reforms have increased the costs of these vessels in transporting bulk commodities throughout Australia, Tasmania is likely to be adversely affected.

A proportion of the total bulk freight task is still undertaken by foreign flagged vessels in Tasmania. As noted by the Department of Infrastructure and Regional Development:

Departmental records indicate that, since 1 July 2012, approximately 28 foreign flagged vessels have undertaken around 127 voyages under temporary licences between the Australian mainland and Tasmania, carrying cargoes ranging from petroleum and propane to gypsum, fertilisers and metals. (sub. 42, p. 38)

Table C.5 Expected changes to freight rates from tax reforms

<i>Explanation of tax measure</i>	<i>If tax measure is passed through to users of shipping services:^a</i>
Expected impact	
Company tax exemption - Exempt ship owners from 30 per cent company tax on income from core shipping activities	<ul style="list-style-type: none"> As all Australian shippers previously paid company tax on all assessable income, this represents a windfall gain. The reduction in tax payable means that shippers can reduce their freight rates and still be in the same financial position as they were prior to the tax exemption.
Accelerated depreciation - Depreciate qualifying vessels after 10 years	<ul style="list-style-type: none"> The effect of accelerated depreciation on freight rates is unclear given the assessable income exemption of income derived from core shipping activities for company tax purposes.
Rollover relief - Additional 12 months before liability arises in relation to disposal of a vessel	<ul style="list-style-type: none"> Since Australian shippers are liable to pay less company tax, the effect of rollover relief on freight rates is unclear.
Refundable tax offset – Increases amount of deductions for vessels which hire Australian seafarers	<ul style="list-style-type: none"> The refundable tax offset should reduce costs for eligible shipping vessels to the extent assessable income (for incidental shipping activities) remains subject to company tax.
Foreign withholding tax exemption - Vessels leased to Australian operators are exempt from 30 per cent tax rates	<ul style="list-style-type: none"> Should reduce leasing costs for international vessels leased to Australian operators under demise charter arrangements. It is unclear to what extent foreign flagged vessels were leased to Australian operators prior to the commencement of the reforms, particularly on the Bass Strait route. It is unclear to what extent the previous withholding tax was passed through to Australian operators, particularly in light of the global excess supply of foreign vessels. It is unclear whether the exemption from withholding tax is sufficient to induce vessels to be leased to Australian operators, given international tax regimes for shipping.

^a If the tax measures are fully appropriated by shippers then there will be no benefits from the reforms for the users of shipping services.

The 127 voyages undertaken were over an 18 month period, which equates to around 85 voyages per year. Prior to the reforms there were 134 voyages under single and continuing voyage permits in 2011-12 (BITRE 2012). There were a further 105 urgent single voyage permits (SVPs) issued in 2011-12. This suggests that, the number of permit voyages to/from Tasmania have reduced from 239 to 85 per year, although some of these voyages may now be carried out by ships operating under transitional general licences.

The Commission understands that a significant proportion of Tasmania's liquid bulk cargo is carried under temporary permit. Given the increase in costs associated with the Fair Work Regulation changes and the additional compliance costs

associated with the new licencing regime, it can be expected that freight rates for liquid bulk will increase in Tasmania.

Likely effects on containerised cargo

The three domestic operators across Bass Strait (TT-Line, ANL Toll, and SeaRoad Holdings) are all Australian owned. The recent (non-tax) changes will therefore not directly impact their costs. As before the regulation changes, the current Australian seafarer wage rates are in excess of those paid in other countries (Department of Infrastructure and Regional Development sub 42, p. 38), and to that extent they are adding pressures to the cost of transporting goods across Bass Strait. The regulation changes are likely to have a far more significant impact on international vessels.

Since 1 January 2011, international vessels are obliged to pay around twice the amount for labour than they had previously as a result of the awards modernisation (Deloitte 2012). If the international vessel was majority Australian-crewed, the vessel's labour costs would have increased around 200 per cent as a result of the changes. Despite evidence suggesting that labour costs represent only 10-15 per cent of total costs (see chapter 4), an increase in costs of this magnitude could have significant implications for the profitability of engaging in either coastal or international trading. This is further magnified given the global oversupply of international vessels.

Evidence suggests that only 15 per cent of Tasmanian northbound products require an overnight service, yet up to half of all goods transported have logistic chains built around the immediate flow of product after production (Aurecon 2013). This suggests an opportunity for foreign flagged vessels to collect containerised cargo from Tasmania. However, it is unclear whether the volume (approximately 110 000 TEUs per year) is sufficient to attract this service. An international service could provide an opportunity for some Tasmanian businesses to get their product to market, albeit on a more ad hoc basis, at less cost than the current overnight service. Given the small volume of containers, it is unclear what impact the recent increase in wages for workers on foreign flagged vessels will have on the barriers to international vessels calling at Tasmania.

Likely effects on Bass Strait passenger movements

Participants noted that voyages commencing in Victoria and terminating in Tasmania cannot be offered following the Ministerial exemption associated with the coastal trading reforms (Lindblad Expeditions sub. 1, Australian Pacific Touring sub. 11, Austrade sub. 41).

The Ministerial Exemption for large cruise vessels commenced on 1 January 2013 and states that vessels in excess of 5000 gross tonnes, capable of at least 15 knots, and carrying more than 100 passengers are exempted from the Coastal Trading Act. However, this exemption does not apply to the carriage of passengers between Victoria and Tasmania. The exemption is the same as the previous exemption first introduced in 1998.

The effect of the exemption is that ‘large cruise vessels’ (i.e. those in excess of 5000 gross tonnes that also meet the other requirements) can engage in ‘coastal trading’ throughout Australian ports — anywhere except between Victoria and Tasmania — and they can avoid the associated costs of complying with the Act.

It seems evident that this policy has the effect of deterring Victorians from visiting Tasmania since the costs of travelling across Bass Strait would be higher (because of the reforms to coastal trading — see section C.4), than they would be from travelling to Tasmania from anywhere else on the Australian mainland. The Commission understands that a significant proportion of visitors to Tasmania are domiciled in Victoria, so the exemption has the potential to materially curtail tourist traffic.

It is also important to note that Tasmanian tourists travelling to Victoria would be subject to the increased costs associated with the reforms.

What is perhaps more significant is that the exemption has the effect of ensuring that large cruise vessels can compete against each other on a completely open coast, with both domestic and foreign flagged vessels exempted from the application of the Coastal Trading Act. This in turn means that vessels travelling from one Australian mainland port to an interstate port (eg Darwin to Cairns, or from Darwin to Hobart) could do so on international vessels. Australian domestic vessels operating on these routes would need to price competitively with international vessels, or risk losing price sensitive tourists. Tourists would be able to access relatively cheaper interstate cruises than those offered between Victoria and Tasmania where the coastal trading reforms apply.

It is likely that the impact on Tasmania will be twofold:

1. Tourist numbers from Victoria to Tasmania would be less than they otherwise would be if the changes did not apply
2. Small cruise and expedition vessels would have to offer significantly higher fares as a result of the changes (since carrying passengers would amount to engaging in coastal trading, and thus increase costs), further reducing tourist numbers to Tasmania. Submissions indicated services have been withdrawn for this reason.

Conclusion

It is unclear as to the precise net effect of the tax and regulatory changes on freight rates for users of Tasmanian shipping services, but the likely direction of this effect is reasonably clear if there is one.

The Commission considers that the costs of transporting bulk commodities across Bass Strait will rise as a significant proportion of voyages were undertaken by foreign flagged vessels, which since 1 January 2011 are obliged to pay Australian wages to their workers. It appears that the containerised market will not be directly affected as a result of the reforms since at all relevant times the vessels servicing the market were Australian owned, operated, and crewed.

Tourist numbers from Victoria to Tasmania are likely to be lower than they otherwise would be if the route was exempted from the coastal trading reforms. It is unclear why this route is ‘protected’ whereas all other mainland Australian trips to Tasmania are not.

It is likely that the overall impact on Tasmania as a result of the changes is negative. Nevertheless, the removal of these reforms would not fully ameliorate the high costs associated with Bass Strait shipping. As detailed in the draft report, Bass Strait shipping costs are attributable to fundamental and broader economic drivers.