THE TASMANIAN GOVERNMENT SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY OF CONTAINERISED AND BULK SHIPPING BETWEEN THE MAINLAND AND TASMANIA

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As Australia's only island State, Tasmania is in a unique position, with no land bridge between Tasmania and the mainland, all inter-state and international transport must utilise either sea or air to gain access to and from Tasmania.

In the absence of Government intervention, this relative isolation poses a barrier to the successful retention, expansion of existing industries and introduction of new industries and business into Tasmania, especially where they require access to mainland markets.

The issue of isolation and access should not be understated. Regular air and sea services across Bass Strait provide business with the physical access necessary to source materials and place products in the mainland markets in a timely manner, but not at the same level of service in terms of speed, convenience and reduced stock levels enjoyed by mainland enterprises. This means that investment in Tasmania does not have the same attraction to mainland and overseas investors as the mainland unless the raw material inputs in Tasmania are more competitive in value or availability.

SEA SERVICES AND ACCESS TO THE MAINLAND

Container and wheeled traffic shipping services operate across Bass Strait with Toll, Patrick and TT-Line providing a daily service between Tasmania and the mainland in both directions. ANL provides an alternate day three times weekly service to Melbourne as does TT-Line with the *Spirit of Tasmania III* to Sydney for the majority of the year. These services arguably provide shippers with the necessary degree of reliability and frequency to effectively plan individual supply and delivery requirements. They also provide a high degree of competition both in service schedules and pricing for shippers. However they also represent a significant capital investment in ships, equipment and facilities for both private and government entities, not needed or provided in the AusLink National Corridors between any of the other States.

In addition to frequency and reliability, the capacity of Bass Strait services has, over recent years, increased with larger ships and modifications to increase capacity. Together, service reliability, capacity, and frequency provide a significant component of access to mainland markets, that is, the physical infrastructure that is capable of meeting the needs of the market place.

However, even with an appropriate level of capacity, reliability and frequency, Tasmanian shippers, as distinct from their mainland competitors, are subject to the additional discipline of conforming to these scheduled daily services. Unlike mainland competitors they are unable to transport goods door to door at any hour of the day or night. They must organise their operations to meet the schedule set by the shipping services. Along with the necessity of shipping goods by sea comes the delay and cost of double-handling cargo from land to sea and visa versa. For Tasmanian shippers it is a case of conforming to the constraints of modal change and the service providers schedule rather than the opposite way round.

Finally, there is the purely economic aspect of access. Tasmanian shippers suffer a comparative freight cost disadvantage when shipping raw materials, equipment and processed goods across Bass Strait by sea. The disadvantage arises from the absence of a land bridge with the mainland, and accordingly, the necessity of relying upon the relatively more costly sea freight to transport large quantities of cargo between Tasmania and the mainland. Generally, land transport modes offer lower freight rates for most commodities. In a competitive market, where the freight rate can mean the difference between capturing and losing business, the freight cost disadvantage associated with Bass Strait may be critical to the success of many Tasmanian businesses. Unlike the equivalent mainland service Tasmanian shippers have to be far more disciplined to meet service schedules, have less access to stock quickly and have to carry larger inventories because of the complexity of the logistic supply chain to and from Tasmania. Shipping services also require significantly more capital invested than comparable road and rail links on the mainland, in both vessels, port infrastructure and their associated support infrastructure, with higher on going operating costs than comparable transport modes due to the harsh marine environment.

In order to overcome the absence of land based infrastructure and the costs of sea-based access to mainland markets the Commonwealth Government has, for the past 30 years, provided disadvantaged shippers with financial assistance under the Tasmanian Freight Equalisation Scheme (TFES) and initially since 1953 as part of the Australian Wheat Marketing Legislation and subsequently as the Tasmanian Wheat Freight Subsidy (TWFS).

INFRASTRUCTURE SUBSTITUTION

In effect the TFES and TWFS aim to provide a form of infrastructure substitution for disadvantaged shippers. An important point to note is that financial assistance under the Schemes is directed to those suffering a comparative freight cost disadvantage due to the need to rely upon sea freight for the movement of raw materials, equipment, and product. This necessarily removes any notion of assistance for bulk shipments in the case of TFES and supports bulk shipments in the case of TWFS. Large bulk shipments are most economically transported by sea. Accordingly, it is argued that even if the land transport option were available, Tasmanian shippers of bulk cargo would continue to utilise shipping as the primary mode of transport.

SCOPE OF THE TFES

The Scheme is directed towards offsetting the inter-state freight cost disadvantage incurred in shipping eligible non-bulk goods across Bass Strait by sea. Eligibility under the Scheme is restricted to goods produced or manufactured in Tasmania for use or sale on the mainland and non-consumer raw materials, machinery or equipment, imported for use in manufacturing, mining, agriculture, forestry or fishing industries in Tasmania. The Scheme therefore directly assists only Tasmanian industry rather than the retail and services sector.

The northbound component of the Scheme accounts for the vast majority of assistance provided to shippers. In the 2004/2005 financial year some \$89.1 million was paid to shippers, of which \$69.7 million (or approx. 80%) was paid in respect of goods produced or manufactured in Tasmania for use or sale on the mainland. The balance, \$19.4 million, was paid for the importation of inputs to manufacture in Tasmania.

Goods not eligible for assistance:

- are bulk shipments;
- exports and goods imported from overseas which have not undergone some form of manufacturing process on the mainland prior to shipment to Tasmania; and
- goods shipped by airfreight.

The southbound component of the Scheme (directed at raw materials, machinery and equipment) also excludes:

- fuels and lubricants;
- goods of Tasmanian origin;
- building and construction materials; and
- motor vehicles for manufacturing and mining industries, which will be registered for, use on public roads.

The exclusion of certain goods (e.g. consumer goods) and transport modes (e.g. bulk shipments) is undertaken on the basis that such goods/modes are either not disadvantaged compared to the mainland and/or the inclusion of such goods would provide an unworkable level of administrative complexity in ensuring that the disadvantaged party benefited from the Scheme. It is important to the success of the Scheme, involving as it does many millions of taxpayer dollars, that the Government be assured that the benefit flows directly to those disadvantaged.

In terms of consumer goods insuring the benefits flow directly to those disadvantaged would be administratively too complex. The Scheme is therefore directed towards offsetting the disadvantage incurred by Tasmanian industry.

SCOPE OF THE TWFS

The Tasmanian Wheat Freight Scheme (TWFS) provides assistance to shippers of bulk wheat transported by sea to Tasmania from the Australian mainland. The aim of the Scheme is to ensure that businesses in Tasmania relying on bulk wheat shipments are not unduly disadvantaged, by paying a rebate against the sea freight costs associated with the Bass Strait crossing.

The original scheme, the Tasmanian Wheat Freight Subsidy Scheme, was introduced in 1989, replacing the 30-year-old Tasmanian Wheat Freight Levy (TWFL), which subsidised wheat freight costs to Tasmania. Centrelink assumed responsibility for administering the Scheme in July 2004 when containerised wheat became included in the Tasmanian Freight Equalisation Scheme (TFES) and a reconstituted Tasmanian Wheat Freight Scheme (TWFS) was established to cover bulk wheat shipments.

The Scheme operates under a set of Directions approved by the Minister for Transport and Regional Services on 7 June 2005. Tasmanian Assistance Services administers the Scheme, from Centrelink's Hobart office, on behalf of the Department of Transport and Regional Services.

BACKGROUND TO TFES

The freight disadvantage suffered by Tasmania was widely discussed but not well understood in the late sixties and early seventies. At one point in time, ANL, the Government owned shipping line, was paid a subsidy to offset their costs on Bass Strait, this was despite it being one of three shipping line in the Bass Strait trade. The Federal Member, the Hon Peter Nixon, first raised the idea for a TFES during the 1974 election campaign. It was taken up as official Liberal Party policy during the election, which was lost to the Labor Party. Once in office, the Labor Party tasked Commissioner Nimmo to review Bass Strait shipping arrangements and report back to the Commonwealth. At the 1975 election campaign, the Liberal Party campaigned on the basis of a TFES for Tasmania and won the election. Once in office, the Hon Peter Nixon as Minister for Transport, announced the setting up of the TFES. The Nimmo Review in its report made a wider set of recommendations, which were not implemented at the time. All political parties have since its inception supported and continue to support the TFES because of its essential fairness and targeting of Tasmanian industries freight disadvantage.

When the TFES scheme was implemented, its intention was to assist economic growth in Tasmania, by reducing the freight cost disadvantage caused by Tasmania’s physical separation from the mainland.

> For 30 years the Commonwealth Government has accepted its responsibilities to make financial assistance available to offset the disadvantage caused by Tasmania’s physical separation from the mainland. This Commonwealth assistance has been based on the following assumptions;
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> - Tasmania is a sovereign State;
> - In federating, the States in effect agreed to share resources;
> - Tasmania is at a disadvantage;
> - The excess transport and associated costs have mitigated against development of industry in Tasmania. (Nimmo, 1976, p168).

The Nixon Report, “Tasmania into the 21st Century a Commonwealth State Inquiry into the Tasmanian Economy” by The Hon Peter Nixon AO, stated that continued uncertainty about the future of TFES impedes development in Tasmania. The Hon Peter Nixon stated publicly during and subsequently to the Nixon Report that it would be a huge economic blow to Tasmania if the scheme was wound down and the Nixon Report recommended it be continued.

On 1 July 1999, the Commonwealth implemented the current scheme, which gave effect to the TFES Review Authority's June 1998 advisory opinion.

The current Scheme recommended by the Review Authority provides a more transparent and appropriate basis of assistance than the previous form of the Scheme and clearly defines the basis of assistance. The Scheme has also removed a number of anomalies, including the arbitrary reduction in assistance for large volume shippers and the previous ability of some shippers to obtain assistance that was equal to their freight cost.

The intent of the Scheme is to place shippers in a position similar to that which may exist if a land bridge with the mainland existed. While a broad range of freight disadvantages can reasonably be identified with shipping goods and raw materials across Bass Strait by sea, the Scheme is designed to alleviate only the *inter-state freight cost disadvantage* as defined by the TFES Review Authority.

During the course of the Scheme's review, there were calls to expand eligibility to include bulk shipments, shipments by air, exports from Tasmania and extending the eligible southbound goods beyond raw material inputs for specified industries (manufacturing, mining, agriculture, forestry and fishing industries).

The Review Authority concluded that:

- In respect of bulk shipments, for the most part goods shipped in bulk form would continue to be shipped in this way even in the presence of a land bridge. Accordingly, it would be inappropriate to extend the Scheme to cover bulk shipments.
- The inclusion of exports would likely compromise Australia under its World Trade Organisation (WTO) obligations and also endanger the frequency of liner shipping calls to Tasmanian ports as more export freight was diverted to Melbourne for export. On balance it was thought that the inclusion of exports would represent a detriment to direct calls of international ships.
- The Scheme has at all times been directed towards the sea freight disadvantage and should therefore not be extended to include airfreight.
- An expansion of eligible southbound goods beyond raw materials inputs, for instance to service industries, would raise the risk of consumer goods receiving assistance. Such an extension was deemed to be beyond the scope of the Scheme.

Shippers also claimed that the disadvantage posed by Bass Strait goes some way beyond freight costs and includes:

- Higher cost of equipment and infrastructure associated with sea transport required over and above the road and rail assets employed at either end of the journey.
- The costs of handling due to increased intermodal changes for sea freight journeys.
- The costs to efficiency due to less frequent services, longer waiting times and conforming to scheduled service timetables.
- The costs of delays, damage, warehousing due to the need to change modes and adhere to shipping schedules.
- The cost of increased inventories or stock outs in the case of disruptions to schedules due to the increased complexity of the supply chain into and out of Tasmania.

The Authority recognised these factors represent a disadvantage associated with the necessity of transporting goods by sea for particular shippers but considered each to be inappropriate for inclusion as a basis for assistance under the scheme. Accommodating even an arbitrary measure for individual shippers would considerably add to the complexity and administrative cost of the Scheme and increase the risk of distortions between shippers. It should also be noted that elements of these additional costs are either partially or fully compensated by the inclusion of the fixed inter-modal cost component within the basis of assistance.

The major recipients account for a high per cent of total assistance, with the vast majority of assistance provided for the shipment of newsprint, fruit and vegetables, paper, confectionery, timber and beverages.

FEEDBACK ON CURRENT SCHEME

The feedback on the current Scheme continues to be very positive, largely due to the fact that most recipients have experienced an increase in assistance. Beyond this, the basis of assistance is now clearly defined and transparent, providing added certainty for shippers to make investment decisions. The removal of arbitrary measures of assistance under the previous Scheme has also provided a more appropriate and equitable basis for assistance under the scheme.

Questions over the exclusion of exports have continued to be raised along with the exclusion of intrastate trade. The Australian Government's response on both matters continues to reflect the opinion of the TFES Review Authority, that is:

<u>Intra-state Cargo</u>

The issue of intra-state cargo remains an issue for the Tasmanian Government. It should indeed be noted that the Tasmanian Government currently provides support for the movement of freight between Bass Strait islands and the Tasmanian mainland through support to or through the facilitation of or the contracting of shipping services.

Exports

A move towards including exports within TFES would not only place Australia in breach of its obligations to the WTO but would also have the effect of accelerating any move within the shipping sector to less frequent direct international shipping calls at Tasmanian ports. As the shipping economy moves towards larger containerised vessels, the costs of visiting smaller ports will increase. The quantity of cargo to be picked up at ports will arguably have a direct impact upon the viability of larger ships visiting Tasmanian ports. Inclusion of exports in TFES will hasten any trend towards less frequent direct calls.

TASMANIAN GOVERNMENT EVALUATION OF TFES IN 2000 AND 2005

The Tasmanian Department of Infrastructure, Energy and Resources undertook an evaluation of the TFES in 2000. The evaluation showed that the TFES has an immensely positive impact upon the Tasmanian economy. The Department's survey of TFES recipients indicated that for the majority of those interviewed, TFES assistance is pivotal to the ongoing viability of operations in Tasmania.

The Department's evaluation indicated that the Scheme is of vital ongoing importance to the Tasmanian economy and is achieving its objective.

The evaluation found that TFES is a vital aid to continuing operations of a number of significant businesses in Tasmania. These businesses provided employment for over 4,700 people and also provided revenue for other smaller businesses (e.g. primary producers) and significant employment in the service sector. The loss of such businesses would have a major impact upon the Tasmanian economy.

The evaluation states that all businesses interviewed generally consider that TFES allows "the end price for products manufactured or grown in Tasmania to remain competitive with similar mainland and overseas sourced products thus achieving the aims of the TFES infrastructure concept".

Each of the 20 companies interviewed by the Department indicated that at the very least the loss of TFES would lead to downsizing and possible closure. There were a number of companies that would move immediately. Other companies with substantial capital invested in Tasmania would be reluctant to invest in new plant and equipment and would run down existing machinery and plant to the point of inefficiency with a long term view of closing or relocating to another global location. The evaluation also indicated the importance of the mainland market, and the need to grow the Tasmanian market and population.

The message from the evaluation is clear; shippers require the continued provision of TFES for their continued viability. Businesses surveyed regarded the modified Scheme more equitable, appropriate, and transparent.

Australia has gone through a period of economic reform and has improved the competitiveness of the economy. The TFES assisted Tasmania through this difficult phase. The TFES is indispensable to maintain Tasmania's competitiveness. In the global market, customers have increased their price and service sensitivity. The TFES allows Tasmanian goods to maintain and compete for their position in the Australian market and reduces the use of imported goods, keeping profit and employment in Australia.

The Department undertook a further study in 2005 into the affects of TFES on the Tasmanian economy through Monash University. A copy of the paper is attached at annex A. It can clearly be seen that this work supports the earlier work by the Department on the importance of TFES to the Tasmanian Economy and that any loss or reduction in TFES could have significant down sides to the Tasmanian economy. The model used by Monash in their study was a Computer General Equilibrium model. It showed that there were some 4,300 direct jobs attributable to TFES worth some $281 million to the Tasmanian economy annually. This is substantial in an economy the size of Tasmania.

With a full and part time employment of 224,000 (ABS Catalogue 6202.0 March 2006), this represents 2% of the Tasmanian workforce. Indirectly, the employment factor would increase this several times. At 6.7% Tasmania is the state with the highest unemployment rate in Australia. The impact of ceasing the TFES would be to substantially increase the unemployment rate. It is likely that this would significantly depress Tasmania's GSP. Commonwealth unemployment payments to Tasmania would substantially increase. There would be social impacts, including outward migration of skilled and younger staff, which would have long-term repercussions that would be hard to ameliorate.

BACKGROUND TO TWFS

The Tasmanian Wheat Freight Subsidy (TWFS) was initially introduced in 1953 as part of Australian wheat marketing legislation. A major revision of the TWFS took place in 1989 when wheat marketing was deregulated. Since 1989 the amount of assistance has been phased down from an initial level of $3.6 million (nominal 1989 value) to $1.2 million per annum at 2005-2006. The scheme provides financial assistance to importers of wheat into Tasmania to offset the cost disadvantages of having to import wheat via sea freight across Bass Strait.

In 2001 the TWFS was reviewed by the Centre for International Economics (CIE) engaged by the Australian Government Department of Agriculture, Fisheries and Forestry – Australia (AFFA.) The CIE report of the review recommended the establishment of the Tasmanian Grains Freight Scheme (TGFS), which would provide assistance to both wheat and other grains.

The recommendations of the report were not implemented.

In the Australian Government budget released of May 2003, it was announced that the TWFS was to be wound up with containerised wheat shipments to be covered by the Tasmanian Freight Equalisation Scheme (TFES). In response to lobbying from industry, the Tasmanian Government and Tasmanian Senators the Australian Government overturned the decision and the administration of the TWFS was transferred from The Tasmanian Department of Primary Industries, Water and the Environment (DPIWE) to Centrelink (which also administers the TFES) on 1 July 2004.

The TWFS always suffered from a number of problems principally that the fixed sum assistance provided by the TWFS causes assistance rates to vary from year to year depending on the level of wheat imports. Also the TWFS only supported wheat imports and not other grains.

The CIE report utilised the ‘cost disadvantage’ principle in calculating the Tasmanian Grains Freight Scheme (TGFS). There were no concerns with the principles and concepts of the recommended TGFS scheme. The main issue was the determination of the level of assistance under the TGFS.

Despite the initial policy change in 2004 both federal parties position has been to support the scheme that meets the true cost disadvantage of Tasmanian users of wheat and other grains having to ship those goods into the State using the Bass Strait sea route and its associated high cost supply chain infrastructure.

THE FUTURE OF TFES

The current Scheme has been well received by shippers. Beyond annual reviews of the key parameters, the focus of the Commonwealth has been to further improve the already high level of service delivery that shippers receive.

THE FUTURE OF TWFS

During the financial year 2004-05, funding for the Scheme was capped at $1.05 million. A shipper may be eligible for a rebate set at the rate of $20.65 per tonne, provided that the amount of the payment does not exceed the shipper's freight costs.

Any payment under the TWFS is discretionary and dependent on the level of annual funding available for the scheme in the financial year in which a subsidy is paid. If the annual funding is fully expended in a financial year, where possible, payments may be made in the following financial year from that year's annual funding.

The available funding provides for some 58,111 tonnes of bulk wheat to be shipped to Tasmania this provides adequate cover for Tasmanian users of wheat.

SCHEME'S SUCCESS

The doubling of the TFES since the introduction of the current arrangements in the late 1990's (Productivity Commission Issues paper Page 15) highlights several success points. These include:

- Increased movement of products into and out of the State by container;
- Increased attractiveness of Tasmania to new investment;
- More jobs in and for Tasmanians;
- Growth in the Tasmanian economy;
- Encouragement to Tasmanian producers to enter new markets in Australia and overseas;
- An increase in the number of claimants in the Less than Container Load category caused by demand for Tasmanian products and administrative improvements in the claims mechanism; and
- The flow on effect to general well being of the Tasmanian economy and the attractiveness of the State for inward migration.

The turn around in the Tasmanian economy and the reversal of the population drain is at least partly attributable to the success of the TFES.

ADMINISTRATION OF THE SCHEMES

Centrelink's Tasmanian Assistance Team, on behalf of the Department of Transport and Regional Services, currently now administers both Schemes. Recipients are overwhelmingly supportive of the quality of services currently being provided by Centrelink's Tasmanian Assistance Team.

However, there have been ongoing comments that administrative changes to the way the TFES is looked after has allowed anomalies to appear in the payments made through non -direct claimants. The Tasmanian Government seeks to have all such anomalies removed and the essential fairness of the scheme returned to that applying prior to the administrative changes. The details of this are no doubt well known and understood by the Department of Transport and Regional Services. The Tasmania Government looks to the Australian Government and in support of Tasmania industry to ensure this vital program is not affected or compromised by this administrative issue.

CONCLUSION

The provision of TFES and TWFS has enabled a number of significant Tasmanian businesses to operate on a viable basis and compete equally with mainland competitors. Based upon the Tasmanian Government's figures the continued provision of TFES for 20 major recipients alone is providing employment for around 4,300 people. The major shippers in receipt of TFES continue to invest large sums in the continued viability of their operations and, on an annual basis, are responsible for a significant proportion of expenditure in the Tasmanian economy.

The Schemes are now established with a well-defined, transparent and ‘live’ basis of assistance, which has been roundly accepted, as appropriate and equitable. The Commonwealth has continued its commitment to TFES for 30 years and TWFS since 1953. Any changes to the scheme will need to ensure that employment in the state is not adversely affected. Any changes need to consider all the costs and benefits of the change, including the effect on business confidence and therefore investment.

Many of the recipients are part of large companies with multi-state and multi-national plants. For them a change of location or manufacturing base is far less problematical now in the era of globalisation than was previously the case, as witnessed by the move of significant potato contracts now being sourced out of New Zealand to the detriment of potato growers on the North West Coast of Tasmania. For producers involved in the supply of primary inputs to much of the agri-manufacturing industries changes to the schemes could have a double disadvantage to them with significant flow on affects to the Tasmanian economy as forecast in the Monash papers.

The information to hand currently indicates that, as presently designed, TFES and TWFS are meeting their objectives of removing the inter-state freight cost disadvantage associated with Bass Strait transport, and are benefiting Tasmanian Industry and shippers to compete successfully with mainland and in many cases overseas competitors for mainland markets. They are also providing inputs to mainland industries restricting the import of overseas goods to the benefit of the balance of payments and the boarder national economy.