TASMANIAN FREIGHT EQUALISATION SCHEME

SUBMISSION TO SECOND ROUND

Summary

(A) The Draft Report by the Productivity Commission (PC) is extremely disappointing, containing many contradictory and unsubstantiated claims. The report also lacks quantitative data to support many of its findings and provides little in the way of insight as to how the changes suggested within would benefit Australia. Whilst heavily criticising the TFES and previous reviews of the scheme for their lack of precision and poorly thought through recommendations this draft report does little to change the trend.

(B) The Commission has failed to establish that any changes to the TFES would result in a compensatory improvement elsewhere in Australia.

(C) There could be significant negative flow-on effects from any major changes to the TFES which have not been considered or have been ignored by the Commission.

(D) Any major changes in TFES are likely to result in substantial closure of businesses in Tasmania and substantial job losses

(E) The freight task across Bass Strait disadvantages Tasmanian businesses directly and indirectly. TFES enables Harvest Moon to compete in mainland markets. Without TFES or under a greatly reduced flat rate as proposed, the Company would eventually have to close its doors.

(F) Harvest Moon supports a more transparent scheme and in principal a flat rate provided that the rate reflects the freight task and is indexed. This is unlikely to be covered by a single rate but may require at least three to reflect the different freight tasks involved across Bass Strait.

Preamble

In reading the draft report from the Productivity Commission it is at times difficult to accept that the Commission is working from the same Issues Paper that was provided with the initial call for submissions.

In being asked to *"report on the merits and weaknesses of current arrangements…."* The Productivity Commission (PC) has clearly focussed on the weaknesses. There was little or no attempt to look at the positive attributes that may exist in or flow from TFES. This is perhaps not surprising given the following quotations:
"There is no economic rationale for providing freight assistance to Tasmanian firms simply to equalise their freight costs with mainland producers."

"If a broader objective of regional development is intended, a sea freight subsidy is unlikely to be the most economically efficient way of meeting this." (Draft Report, p XII)

The draft report contains errors of fact, inaccuracies, contradictions and fails in large part to address at least three of the four specific matters covered under the Inquiry's scope. The Commission was also asked "….to consider possible alternative interventions, notwithstanding that they will, of course, have advantages and disadvantages of their own." The Commission has largely ignored this request. Nevertheless, the Commission has felt free, whenever it needed to support a finding, to comment on areas outside the scope of the current Inquiry.

Many of the recommendations are flawed and contrary to various findings within the report. The Report is also short of substantive and quantitative evidence to suggest that the PC recommendations will produce any better outcome than the current scheme.

This submission by Harvest Moon considers the arguments and findings of the Commission and will also re-iterate our earlier points from our first submission providing more detail than that already submitted.

The Findings

The PC findings can be distilled into the following key points:

Shippers from Tasmania are disadvantaged by the cost of sea freight across Bass Strait, and that even with the existing scheme they are still paying more than mainland competitors when it comes to freight, (ch.3),

That the contribution by the Commonwealth to Tasmania provides a small gain for Tasmania at the expense of the rest of Australia, (ch.4),

The existing scheme has a number of flaws due to the difficulties of trying to fit a relatively simple scheme around a fairly complex freight task, (ch.5),

That under the current scheme there is scope for over-claiming, (ch.5),

That there is no economic rationale for freight assistance and that there are no clear underlying objectives for the scheme, (ch.6), That the loss of the scheme would have little impact upon Tasmania, especially through the development of a brand identity that would render extra freight charges sustainable, (ch.6),

The TFES

According to DOTARS, the TFES scheme is for the following purpose and it has operated against this background since its inception in July 1976.

"The Scheme assists in alleviating the comparative interstate freight cost disadvantage incurred by shippers of eligible non-bulk goods carried between Tasmania and the mainland. Its objective is to provide Tasmanian industries with equal opportunities to compete in mainland markets, recognising that, unlike their mainland counterparts, Tasmanian shippers do not have the option of transporting goods interstate by road or rail".

In compiling this submission Harvest Moon has framed its responses in accordance with the objective outlined by DOTARS. It was also against this background that Harvest Moon provided its first submission to the Inquiry.

This submission has followed a similar format to that of the PC report and each section is divided into two parts; the first examines the report by the Commission and the second part is a more detailed response from a Harvest Moon perspective.

Tasmania's Freight Task And Freight Cost Disadvantages. (Ch 3)

(i) Comments on the Draft Report

The PC makes the point that real freight rates for sea freight have declined more than those for road freight over the past 20yrs. The underlying suggestion being that perhaps the TFES is now overcompensating. This merits further comment.

The figures supplied to the Commission by Harvest Moon in its first submission and repeated below suggest that current level of Equalisation is appropriate for the fresh vegetable sector.

Secondly the PC makes the point that most of the decline in sea freight happened over 15yrs ago and since that time declines in land and sea freight rates have been of more or less similar magnitude. This suggests that if the current scheme is now delivering what it intended, then it was not 15yrs ago.

Thirdly the PC makes much of the fact that finding an average or typical freight rate is very difficult and uses this argument as part of its platform that the TFES should be abolished. This is disingenuous at the very least. It is hard to justify that the variability on data is such as to make compilation of benchmarks too difficult and then smooth the same data to suggest that there are changes occurring in the relativity between freight rates. The data is either useful or not.

Fourthly unless the freight to Perth is a significant component of TFES claims it is hard to see the relevance of arguments on changes in sea freight between SE Australia and Perth (p 28).

When considering the cost of shipping across Bass Strait the PC notes that the weighted mean average cost of a TEU in 2004/05 was $1106 with a standard deviation (sd) of $486 and the median cost was $1076. With only a slight difference between the mean and median the distribution of costs about the mean would appear to be normal. Thus there is no evidence for a skewing of costs toward the high end of claims. The standard deviation (sd) is relatively high but given that all types of cargo and shipping methods are included this is to be expected. Nonetheless two thirds of shipper costs fall between $620 and $1592.

The PC also notes that beside Bass Strait there is a high variability in freight rates everywhere in the country. Quite what this is meant to illustrate apart from the obvious is hard to fathom, other than to suggest a single rate as a form of offset is inappropriate. Unfortunately the PC makes no attempt to come up with anything constructive on this point. Furthermore part of the PC draft finding 3.1 is clearly contradicting the data presented. Compare these two statements *"However over the last several; decades, the real cost of Bass Strait shipping has fallen significantly relative to road costs"* (p 35) and "..*the difference between the two freight rates has declined over time, with most of this decline occurring during the 1980's". (p 26)*
As pointed out earlier the data show that the between 1989/90 and 2000/01 there has in fact been very little overall change.

Lastly in Ch 3 the PC notes a number of reforms that it claims have lead to a claimed reduction in freight. One of these reforms is the use of single and continuing voyage permits (Box 3.7, p38). Unfortunately on p21 the PC notes that *"However despite the recent increase in the use of permits, most coastal trade is still carried on Australian –licensed vessels".* It is worth noting that there is even less on Bass Strait! Clearly the contribution of the reforms is perhaps not what we are being asked to believe. In fact the PC has produced little real evidence that since the 1980's there has been very much in the way of further reform with any meaningful impact upon shipping rates.

As noted above there is still a substantial disadvantage to Tasmania through its reliance on sea freight. There is also no escaping the fact that there is no alternative to sea or air freight and on this basis alone Tasmania is differentiated from the rest of Australia where there is choice. Governments have built bridges across rivers and harbours to improve infra-structure. This also provides benefits at the expense of others. Were the logic of the PC followed through then we would suggest that there should be no infra-structure improvements performed anywhere unless they are entirely non-discriminatory. This would rule out nearly all transport improvements in the country. A bridge across Bass Strait would be an entirely appropriate replacement for the TFES!

(ii) Harvest Moon And The Freight Cost Disadvantage
Harvest Moon is no different to other companies quoted in the draft report in that the freight cost disadvantage is real and substantial.

In its original submission, Harvest Moon noted that with TFES the freight comparison between Devonport and Melbourne was comparable to that between Melbourne and other regional centres in Victoria of similar distance. Figures to illustrate this fact were supplied and they are repeated below. There has been no change in the situation since these figures were compiled.

Mildura (540km)	- $87 per pallet space,
Robinvale (465km)	- $79
Orbost (370km)	- $66
Devonport (420km)	- $75 (with TFES)
Devonport	-$140 (without TFES)

Other disadvantages associated with being solely reliant on shipping include:
- a lack of flexibility in dispatch and delivery times (ie the ship leaves at 3pm),
- a delay of up to 24hr in delivery time,
- increased warehousing due to the need to store product on site rather than dispatch as produced. This is a considerable cost as most produce is highly perishable and thus requires coolstorage,
- increased response time to customer requests
- a negative cash flow between time of payment for freight and receipt of TFES payments,
- an administrative cost in managing claims.

In summary there is no doubt that Harvest Moon and other Tasmanian shippers suffer considerable extra expenditure through the reliance on sea freight.

Air freight is not a viable alternative.

Impact on Tasmania and Australia (Ch 4)

(i) Productivity Commission Report

The PC notes that most submissions predicted fairly severe consequences should the TFES be lost or significantly reduced. Harvest Moon is no exception and the ramifications at the company level are explored in more detail later.

In attempting to cast doubt on the suggested impacts and therefore suggest that effects will be relatively small, the PC claims that TFES payments are equivalent to 0.9% of total costs for the agriculture, mining and manufacturing sector. This does not make sense or is disingenuous. With a total GSP in 2004/05 of $16,114m and total TFES receipts of $89.1m the contribution of TFES to GSP is 0.55%. In 2003/04, Agriculture, manufacturing and mining contributed 30% to GSP based on factor incomes (Tas. Govt figures). . If the figures being quoted are comparable then it is difficult to see how a figure of 0.9% could be derived (0.55/0.3 = 1.83). It is probably closer to 2%. If the figures are not comparable then why they are used at all?

The PC draft report goes on to suggest that Tasmanian producers enjoy other non-price benefits *"And* (sic) *while price is always a factor, the competitive position of many Tasmanian products is also due, in part, to some non-price factors."*(p 45). Whilst this is undoubtedly true for some niche producers the majority of payments are going to shippers who are producing product for which 'state of origin' is entirely irrelevant (Draft Report, box on pXVI). It is hard to find much in the way of 'state of origin' as a focus on labels of chocolate bars or newsprint for example. Frozen vegetables are also branded with private label or existing icon labels neither of which have much to do with Tasmania. Furthermore, those shippers who may enjoy a benefit from state of origin and thus enjoy a price premium are also those who will potentially suffer the most from a withdrawal or substantial reduction in TFES. Typically such shippers produce small volumes of product and thus are paying freight at the upper rather than lower end of the scale.

Other examples provided by the PC are equally misleading and illogical. Examples of the reduction in newsprint costs, potential developments in fruit production and dairying are irrelevant. These plans have been developed based on current cost structures and a major perturbation such as a doubling of freight rates is likely to have a significant negative impact on such potential developments.

It is very difficult to follow the reasoning (or lack of) in the sections 4.2 and 4.3 of the report and what it is trying to demonstrate. It certainly provides no evidence for the assertions made in draft finding 4.1.

It is suggested that there has been no improvement in Tasmanian welfare as a result of the scheme (p50). This statement is not explained, referenced or supported and there has been no attempt to place it into a relative context by comparing Tasmania with other states or Australia as a whole. Presumably the claim comes from the Monash University study commissioned by the Department of Infrastructure, Energy and Resources. The Commission also fail to point out that this same study noted that without the TFES there would be a reduction in Tasmanian welfare of 5% (Monash Study p13).

The general conclusion by the PC is that the TFES benefits Tasmania but has an overall slight negative impact upon Australia although where and how it came to the figure of 0.05% is unreferenced. There is also the underlying assumption that a loss in economic activity would be replaced by a commensurate increase in activity elsewhere in Australia. The PC has made no attempt to verify this assumption. A breakdown of the TFES into various commodities for 2004/05 (TFES Statistics, Centrelink) show the following contributions of assistance in the major recipient industries :

Frozen vegetables	16%
Fresh vegetables	3%
Manufacturing and mining	43%
Wood and Paper	21%

In the case of horticultural activity two points have been ignored by the PC. Activity by the two major vegetable processing companies is already under extreme cost pressure. The current cost pressures in the industry are already extreme and threatening to overwhelm it. Loss of this industry would be off-shore not to elsewhere in Australia. This would add to Australia's balance of payments debt.

Apart from the loss to Tasmania of this production the loss of the vegetable processing industry would also have a significant effect upon fresh market producers. The ability to place lower grade product for processing helps offset the current high cost of distribution to interstate markets.

As indicated, by Harvest Moon and other fresh market vegetable producers in their submissions, the loss of TFES would close these industries down or reduce them very significantly. In addition to the direct loss to the Tasmanian economy there are flow on consequences of national significance. To service the Australian market fresh vegetable production will need to be increased elsewhere in Australia. This will mean a further increase in demand for water from irrigation schemes that are already stressed and at a time of year when demand is highest. With the aim of the Federal Government being to reduce rather than increase water demand such an outcome would appear to be counter-productive to Federal water policy.

Similarly the question needs to be asked as to how much of the manufacturing, mining and newsprint business would flow back to other states or be lost offshore?

A far more detailed appraisal needs to be made of the cost/benefits of the TFES than the cursory attempts in the Draft Report.

(ii) Impact Upon Harvest Moon

Harvest Moon's sales and financial records over the past five years show that the Company made a profit in 4 out of those 5 years and that interstate sales comprise about 40% of annual vegetable sales that last year totalled $27m.

If implemented, the first recommendation from the PC to phase out the TFES, would have resulted in Harvest Moon recording a profit in only one out of the past five years and the Company would now no longer be in existence.

The second recommendation to reduce the TFES to a flat $400 would mean that Harvest Moon would have recorded a loss in three out of five years, a break even in one year and a profit in the other. The Company would still have gone broke.

Access to interstate markets is essential to Harvest Moon as it provides access to a large customer base thereby providing enough scale to justify ongoing capital investment. Without this investment Harvest Moon would not be able to remain competitive against larger companies based on the mainland and thus would lose its share of the Tasmanian market. Harvest Moon is responsible for the employment of 250 people. These employees are mostly women and it is difficult to see where they would find alternative employment.

There is no scope for further price increases in the market place for Harvest Moon produce. Fresh market produce is sold at a market price determined by supply and demand and quality. Harvest Moon is already at the upper end of the quality spectrum in order to obtain an acceptable return. The Company could in theory reduce the price it pays to growers for produce but this would only make their position untenable. Data from Davey & Maynard show that to remain competitive in mainland markets there would need to be a reduction in prices paid to growers of from between 6 to 39% with an average of 14% Currently Harvest Moon has a grower base of around 200 producers. Flow on effects would be considerable. The commonly accepted multiplier effect in Tasmanian agriculture is 3 (source DPWI and University of Tasmania). Thus the loss of Harvest Moon alone would take $90m out of the Tasmanian economy. How were these flow on effects considered by the PC in its draft report?

Assessment of Scheme Design (Ch 5)

(i) Productivity Commission findings

The issues raised by the PC in this chapter are important and do suggest that there are some limitations to the current scheme. Considerable discussion is devoted in this and other chapters of the role in freight forwarders and how they might manipulate the scheme. Once again it would perhaps have been helpful to the report if some quantitative data had been presented.

Given the complexity of the freight task it is however hardly surprising that a relatively simple scheme does not adequately meet all of the scenarios with which it is presented. Unfortunately apart from suggesting that there may be over-compensation and other rather vague comments the PC has provided little in the way of quantitative data to indicate how much distortions are costing the scheme. There has certainly been no attempt to suggest improvements or cost/benefit the various ways of tightening the scheme.

Significantly draft finding 5.3 would suggest that had various other route scaling factors been adopted from various past reviews then current TFES payments would be considerably higher.

There has also been no attempt by the PC to look at any positive attributes that may exist in the current scheme.

The real question to be addressed in this chapter which is entitled *“Assessment…”* is not only that the scheme has flaws but the extent to which those flaws impinge or distort the true value of freight equalisation to both the Tasmanian and Australian economy.

(ii) Harvest Moon perspective

Despite the criticisms of the TFES by the PC the current scheme adequately addresses the freight cost disadvantage faced by Harvest Moon. Importantly the scheme in its current form provides an indirect indexation which is vital. The figures on presented earlier on p 5 show that the TFES restores Harvest Moon’s freight component to approximate parity with mainland costs.

Recognizing that in any scheme there may be a degree of over-claiming Harvest Moon supports any move to make the scheme more transparent and also to have a fixed wharf-wharf arrangement.

Rationales for the Schemes (Ch 6)

(i) Comment On PC Draft

It is both unfair and also disingenuous for the PC to argue in finding 6.1 that because no satisfactory statement of the schemes underlying objectives was received there are none. Given the stated objective by DOTARS for the TFES it is hardly surprising that most submissions used that as the basis for their arguments. The initial Issues paper noted *"…a broader issue for the inquiry is to consider whether a subsidy on freight costs is an efficient or effective way of achieving the underlying regional development goal."* However nowhere in the Issues document is there a reference or request for submissions on what should be the objective of the schemes. Noting the PC's bias against the TFES (as stated in their key points on pxii of the Draft Report) it is unlikely that they would be able accept alternative argument in any case.

Within this chapter the PC suggests that broader measure of regional assistance may be more beneficial to Tasmania and cites a number of regional and government assistance programmes to Tasmania. Schemes quoted are part of those available to all areas of Australia and not part of a unique programme for Tasmania. It is hard to see how many of these will in any way be of benefit to Tasmania if the resultant final saleable goods are too expensive because of high freight costs. Direct spending by the Federal Government and its agencies in Tasmania, has actually fallen as a percentage of the states economy since the late 1980s and the share of Commonwealth payments to Tasmania has declined by nearly ½ percentage since the late 1990s (S Eastlake 2004).

It is hard to see how the PC can argue against TFES on a rationale economic basis and then promote regional assistance grants as an alternative. If the PC arguments are followed through to their logical conclusion then why is Australia paying any form of economic welfare at all?

The PC has been economical insofar as alternatives to TFES are concerned.

The recommendation of phasing out TFES over five years and providing assistance *"of say $20m"* is breathtakingly flippant in the extreme. There is no supporting data as to why it should be $20m, how it should be allocated and what should be done to provide for the 4,300 people who will be put out of work. This lack of detail places the Commission no better than any of the preceding inquiries for which it has felt free to criticise heavily for lack of detail and precision. It is also regrettable that with a recommendation containing significant ramifications the PC to has failed to come up with any form of socio-economic analysis and rationale on likely consequences.

The second or alternative recommendation on flat rate assistance is little better than the first and would only delay the inevitable decline of those companies that utilise the TFES. Once again there is no rationale for this figure and also no indexation. The $10m assistance presumably reflects that the PC thinks the consequences will be only half as bad as those from a complete phase out of TFES!

An examination of the PC flat rate proposal raises a number of issues. In determining an appropriate flat rate the Commission noted *“The rate payable should recognise that there is sea freight cost disadvantage, but not overcompensate for it or set in train any adverse incentives.”*
In setting a rate the Commission has made no attempt to quantify the “ *overstated freight cost disadvantage ”* nor has it provided much transparency in its analysis of data and submissions that were received. The PC has also felt free to utilise the same data which it so heavily criticised earlier in the report. The numerous flaws in the draft report also make any reliance upon the findings therein subject to question.

Despite acknowledging the wide disparity in assistance levels between differing commodities reflecting the wide variation in freight rates, the Commission has felt free to suggest a single rate of $400. The Commission notes that from a subset of data (not specified) that at this level the rebate would be at least half the cost of 60% of TEU’s shipped and cover 73% of the freight cost disadvantage. Seventy percent of TEU’s would receive less than currently (93% of claimants) and thirty percent would receive the same or more. This is intriguing as it suggests that data which the Commission felt free to criticise for its inadequacies in earlier chapters is now suitable for setting an alternative rate. It also acknowledges that companies deserve some compensation but they will be worse off than currently. No cost benefit analysis on the effect that such a change may have on the various industry sectors, other than to acknowledge fish and vegetable shippers will be substantially worse off, has been done. Is the saving of $23m commensurate with the likely impact on these two industry sectors? In Harvest Moon’s case it has already been shown that a reduction of this magnitude will cost the Tasmanian economy $90m.

The Commission has also ignored likely cost increases by providing no annual indexation.

(ii) Harvest Moon Submission
Harvest Moon supports a flat rate but suggests that it would be more appropriate to have several rates that reflect the big differences between various classes of commodities and that any such rates are indexed. The current rate that is claimed of approximately $800 per TEU is appropriate for fresh vegetables. Rates for other products should be based on the disadvantage appropriate to the industry sector. It is absurd to assume that minerals, paper and fresh vegetables all operate under similar freight paradigms.

Conclusions

(A) The Draft Report by the Productivity Commission is extremely disappointing with contradictory and unsubstantiated claims, a lack of quantitative data to support many of its findings. Furthermore the Report provides little in the way of insight as to how changes to the existing scheme would benefit Australia and perpetuates the same imprecision in both its thinking and recommendations that the PC has criticised in previous reports.

(B) The Commission has failed to establish that any changes to the TFES would result in a compensatory improvement elsewhere in Australia and that the negative impact in Tasmania will be addressed.

(C) There could be significant negative flow-on effects from any major changes to the TFES which have not been considered or have been ignored by the Commission.

(D) Any major changes in TFES are likely to result in substantial closure of businesses in Tasmania and substantial job losses

(E) The freight task across Bass Strait disadvantages Tasmanian businesses directly and indirectly. TFES enables Harvest Moon to compete in mainland markets and without TFES or under the proposed flat rate the Company would eventually have to close its doors.

(F) Harvest Moon supports a more transparent scheme and in principal a flat rate provided that the rate reflects the freight task and is indexed.

References Cited

Submission to Productivity Commission on Tasmanian Freight Equalisation Scheme, Harvest Moon

IRIS Tasmania, Economy, www.iris.tas.gov.au/activity

Tasmania's economic recovery: is it the 'Real McCoy', address to Tasmanian Economic Forum Dec 2004 by Saul Eslake, ANZ Chief Economist.

The Economic Effects of the Tasmanian Freight Equalisation Scheme, Monash University.

Impact of TFES Removal on Farm Price, L Davey, Davey & Maynard pers com..

Tasmanian Freight Equalisation Scheme Statistics 2004/05, Centrelink