

# **Tasmanian Freight Subsidy Arrangements**

## **Productivity Commission Draft Report**

### **Net Sea Freight - Tasmania Response**

#### **1 INTRODUCTION**

1.1 Net Sea Freight - Tasmania expresses the view that the Productivity Commission's Draft Report on Tasmanian Freight Subsidy Arrangements is excellent in its comprehensiveness and clarity. However, we are not in agreement with some of the conclusions of the Commission, in particular, that the Tasmanian Freight Equalisation Scheme (TFES) be abolished, or failing that, the current (Nixon) assistance method be replaced by a uniform \$ 400 per TEU. As well, we believe there are several assertions in the Draft Report that are not sustainable and need further examination.

1.2 We note that the Federal Government has made a decision to retain the TFES, so that this rejoinder will in the main examine the Commission's proposal to adopt a flat-rate subsidy, but will also consider several other matters which we feel need to be examined further.

1.3 The point should be made at the outset that the present scheme provides only a partial offset to higher costs. There is not, except at very low sea freight costs, a complete rebating of what is determined by the computational process as a net wharf-to-wharf cost disadvantage. Hence shippers have to meet at least some part of the cost of sea freight which is judged to be more expensive than a road freighting exercise. Any reduction in the level of assistance per TEU will exacerbate this under-compensation.

#### **2 GAMING AND THE PRESENT ASSISTANCE DETERMINATION METHOD**

2.1 The Commission refers several times to the incentive to maximise the rebate which the present Nixon system of determining the assistance payment gives to claimants. This is an expected response to a situation where claimants have an option of choosing alternative ways of obtaining assistance. There is no wrong-doing in such practices. However, it should be recognised that once a shipper has established a wharf-to-wharf (WW) rate it becomes the constant basis of claim and the door-to-door (DD) option is no longer available. In other words, a shipper cannot oscillate between the two bases in order to seek the greater benefit.

2.2 There may be some incentive on the part of shippers to use the system to claim legitimate expenses (i.e. relating to a sea freight cost disadvantage) because the unchanged Nixon parameters have left un-recompensed additional expenses which are not recognised. For example, Net Sea Freight has already argued that the intermodal allowance is insufficient for many freight tasks - there are often necessary, and expensive, measures that shippers must take that are peculiar to a sea-freighting exercise, that do not apply to a land-based freight job, and for which an expense in excess of \$ 100 per trip is incurred.

2.3 The \$ 460 combined DW and WD allowance can in some cases be too high, and might be read as applying to a road-freight exercise, whereas the TFES is intended to remove disadvantages flowing from a shipping exercise being more costly than a land operation. Consider a Northern Tasmania - Melbourne freight operation with an invoiced DD charge of \$ 1800 for a dry TEU. Irrespective of what the actual WW and DW and WD charges are, the shipper is entitled to deduct \$ 460 to determine a notional WW charge of \$ 1340. The RFE of \$ 281 is deducted to produce a notional WW cost disadvantage of \$ 1059. It is irrelevant, for the purpose of determining the amount of subsidy assistance, what the actual land freight costs are.

2.4 If alternatively, there had been charges of say \$ 80 for the DW, and \$ 130 for the WD sections of the freight operation, the actual WW charge would have been \$ 1590, for an actual WW cost disadvantage of \$ 1309. In this case, the shipper would choose to present a TFES claim based on a WW charge of \$ 1309, rather than a DD charge of \$ 1800.

2.5 The shipper is doing no more than homo economicus would do, faced with the alternatives available. It would not be classed as "rorting" the system, as might have been implied by one participant's submission. (Warwick Counsell, Sub 18). No evidence is adduced by this participant to support the claim of "agents" rorting the system.

2.6 This same participant has also, perhaps unwittingly, thrown the spotlight on the quality of statistics produced by Centrelink by using them to illustrate his assertion that there is misuse of TFES procedures. His submission claimed that

(i) average assistance per tonne of timber shipped northbound rose by 27 % for the two years to June 2005, and

(ii) by contrast, the assistance for newsprint has fallen by 16.5 %.

He asserts that this information is supported by Centrelink statistics, upon which he bases the propositions of questionable behaviour.

2.7 These conclusions are not supported by the data Net Sea Freight has accessed from published Centrelink TFES Statistics for the years ended June 30, 2004 - 2005. The following table transcribes the data necessary for the calculations.

	Year Ended June 30					
	2004			2005		
	Tonnes	Cubic Metres	Assistance Paid, \$	Tonnes	Cubic Metres	Assistance Paid, \$
Newsprint	297 332	13 704	9 980 061	262 510	46 857	9 834 177
Timber	53 283	176 385	5 059 423	38 575	175 931	5 037 141

The values for assistance paid per tonne of timber shipped during the year ended June 2004 and 2005 are about \$ 95.00 and \$ 130.60, which indicate an increase of about 37 % over the two years.

For newsprint, the values are about \$ 33.60 and \$ 37.60, which indicate an increase of about 12 % over the two years.

These results do not accord with those forwarded by Mr Counsell.

### 3 CENTRELINK STATISTICS

3.1 Irrespective of the support the Centrelink statistics provide for the assertions levelled by the participant, the calculations point to a more important issue. The published statistics appear to be erroneous and further analysis of these and some others produce quite inconsistent outcomes. We note that Centrelink is reliant upon information supplied by claimants, whose data may not be as reliable as is desirable. In particular, use of these data as support for critical propositions can be fraught with possible policy error.

3.2 Consider the calculation of assistance per tonne of timber shipped for the year ended June 2005, i.e. about \$ 130 per tonne. Assume that the representative container holds 20 tonnes. Then the average assistance per TEU in the year ended June 2005 becomes about \$ 2600. Even if the representative container held 15 tonnes, if average assistance is \$ 130 per tonne, the numbers point to assistance of \$ 1950 per TEU.

It is known that the actual rate of assistance per tonne of timber shipped is much less than the Centrelink statistics suggest. In fact, the maximum assistance under the Nixon regime is \$ 855 per TEU.

3.3 Consider the Centrelink statistics relating to northbound tonnages and volume of Timber (Code 56N) and Wood and Cork (Code 62) for the years ended June 30, 2003, 2004 and 2005.

	2003		2004		2005	
	Tonnes	Cubic Metres	Tonnes	Cubic Metres	Tonnes	Cubic Metres
Timber	18 456	193 047	53 283	176 385	38 575	175 931
Wood & Cork	15 425	174 376	40 630	135 979	53 298	111 702

We understand that the products included in the Timber category includes green scantling, and dressed and dried timber, while the Wood and Cork category includes largely green pallet timber. The trend over recent years has been for the volume of green timber as a proportion of all timber to rise, and thus for the proportion of dry timber to fall. That would imply that the ratio of cubic metres per tonne of timber should fall. What the statistics reveal is the following :

	2003 cu m / t	2004 cu m / t	2005 cu m / t
Timber	10.5	3.3	4.6
Wood & Cork	11.3	3.3	2.1

It is uncertain whether these calculations represent the trend, or whether there are reporting errors. In any case the figures show inconsistency.

## 4 A UNIFORM ASSISTANCE RATE ?

4.1 The Commission cites simplicity, transparency, elimination of gaming, and reduced administration costs as major beneficial effects of adopting a uniform rate of assistance per TEU. These are likely outcomes, but there should still be an incentive for shippers to seek to minimise transport costs, as was previously argued by Net Sea Freight under the existing Scheme. With the exception of cases where the notional wharf-to-wharf disadvantage (NWW) is very low (up to a NWW of \$ 335.50) where all of the cost disadvantage is rebated, the present scheme does not fully rebate freight costs. For high WW rates, there is a zero marginal benefit paid to shippers, i.e. all of any marginal increase in NWW is met by shippers. We continue to maintain that there is more than adequate incentive for shippers to seek to minimise shipping costs.

Over the mid-range rates, within a half median of MWW, the marginal rate of assistance decreases from 75 ¢ per dollar of freight cost increase, to 50 ¢ per dollar of freight cost increase. It is asserted that these costs at the margin still provide a strong motivation for shippers to seek the best WW rates they can obtain. It should be emphasised that the current system does not fully compensate for freight cost disadvantages. Any reduction will exacerbate that condition.

4.2 There are several reasons why a uniform assistance rate of \$ 400 per TEU is a retrograde step if the intention is to equitably aid Bass Strait shippers. One possible outcome could be that shipping companies would prescribe a maximum weight that they would accept per TEU, e.g. 21 tonnes. Net Sea Freight has already argued that shipping companies are in a strong market position and have the ability to dictate terms of shipping and rates to the bulk of their clients. Such a prescription will lead to an increase in the number of containers to be shipped in order to move the same quantity of freight, and accordingly increase the overall cost of the assistance Scheme. Moreover, road freighters will then be able to transport two TEUs and still be road-legal, whereas it may have been possible to shift a certain tonnage by road with fewer trips of heavier containers. There will be a rise in road freight costs as well. It need not be emphasised that the burden of these cost increases will most likely fall upon those smaller-volume shippers who are unable to negotiate an attractive sea freight rate.

4.3 By contrast, the present Nixon system retains the maximum flexibility for shippers to negotiate with forwarders and shipping companies mutually satisfactory freighting deals. The industry does not need any further non-essential constraints. The proposal could be described as a case of "one size fits none".

4.4 The impact of a uniform subsidy per TEU would not, as conceded by the Commission, be even across shippers. The data of Table 3.4 - Average Freight Rates, 2004-05 - indicate that there would be a varying gap remaining after a \$ 400 payment among shippers on the cross-Strait trade, ranging from fresh fish at over \$ 2100 per TEU (presumably only smaller quantities, given air freight is more suitable for such a product), to vegetables at nearly \$ 1200, to timber at about \$ 860. Clearly, such a flat rate regime is going to favour relatively more those whose product does not bear such a high freight rate, or those shippers who have been successful in negotiating very attractive rates. Given the price-cost disability arising from low-priced imports and expensive inputs, vegetable growers would not view a \$ 400 rebate per TEU with equanimity.

4.5 The above differentials are further illustrated by data in Table 3.3 - Estimated Bass Strait freight rates per TEU, 2004-05. This showed that more than 46 % of all claimants of TFES paid more than \$ 800 per TEU and shipped more than 45 % of all TEUs - not insignificant in the context of all shippers receiving a flat \$ 400 rebate. Consider the case where a shipper's WW rate is \$ 850 per TEU. The assistance received is \$ 611. The proposed \$ 400 flat rate thus represents about a one-third reduction in assistance. Such a reduction renders TFES-dependent operators unviable.

4.6 To add to the apparent inequity of the Commission's proposals, we note from Box 2.1 - Major recipients of assistance under TFES, 2004-05 - that less than one percent of all 1300 claimants received about \$ 45 m of the total cost of the scheme, or about one-half of the \$ 89 m total. These eight shippers accounted for about 50 % of all TEUs shipped. It is a fair assumption that these shippers received favourable rates, being base load, high-frequency shippers with some bargaining muscle power, as indeed they should. Hence, the proportion of their WW rates, after receiving a \$ 400 subsidy, which they will have to bear, is going to be relatively small. By contrast, the remaining 99 % plus of all shippers are not in a similar position but are very likely to have to bear a higher proportion of their WW charges after receipt of the proposed \$ 400 assistance.

## 5 IMPROVEMENTS TO PRESENT (NIXON) SYSTEM

5.1 Net Sea Freight - Tasmania reiterates its position that there should be adequate separation between the author of a freight invoice and the claimant. This would ensure a fair division between road freight and sea freight costs and not permit disguising the origin of the costs. We have already presented arguments that the parameters employed by the present procedures for determining assistance are in need of revision. It is submitted that of these, the intermodal expense allowance and the road freight equivalent cost are most in need of upward adjustment.

5.2 The allowance of \$ 100 per TEU per trip is quite inadequate for many sea freight operations. Its inadequacy may well account for much of the apparent cost shifting of expenses relating to land operations associated with a shipping exercise to DD (and thus to WW) charges.

5.3 To illustrate scenarios where intermodal costs occur, consider three ways in which freight may be loaded on a ship for a typical Bass Strait voyage.

A A tautliner, usually owned by a freight forwarder, may be used for which a charge is paid by the shipper, in addition to a strict sea freight charge. This is necessary because the tautliner's owner is deprived of the use of the equipment whilst on board the ship. A further expense of shipping will be a charge for space occupied by the trailer - this would normally appear as a WW charge.

B A base may be used for some goods. This is usually owned by a shipping company, and a charge would be made up of a volume charge for the product plus a hiring charge for the base. This charge would also appear as a WW expense.

C Containers are usually owned by shipping companies. The shipping cost will then be made up of a volume charge, a container hire charge, as well as DW and WD charges. Container hire is also a WW charge.

5.4 The notion of a wharf-to-wharf charge does not fully recognise expenses incurred outside wharf gates but which are necessarily incurred if shipping is used in conjunction with a land-based journey. A better concept would be the "cost of shipping" which enables the capture of all costs peculiarly involved in a shipping exercise. This would permit the recognition of the recent shift in shipping practice across Bass Strait whereby shipping equipment is now increasingly provided by a freight forwarder (tautliners, whose hire charge would not strictly be a WW expense) rather than a shipping company (containers, whose hire would be included in an invoiced WW charge). There has been a swing to use more tautliners and fewer containers, a tendency which has been facilitated by the two TT Line ships and the stretched Toll ships, all of which encourage RO-RO operation and tautliners.

5.5 This concept of a broader base for recognising shipping costs can be illustrated by examining the requirements of freighting, by container, a shipment of goods from Hobart to Karratha (WA), which would otherwise be transported entirely by land. Some parts of the exercise are peculiar to a sea freight operation.

	Road Expense	Shipping Expense
1 Deposit container at shipper's premises		**
2 Transport container from shipper's premises to port of Tasmanian export	**	
3 Wharfage expenses		**
4 Ship container to Melbourne		**
5 Wharfage expense		**
6 Transfer container to WA-bound ship		**
7 Wharfage expense		**
8 Collect container from Fremantle wharf, de-stuff, load goods on truck		**
9 De-hire container		**
10 Freight goods Fremantle to Karratha	**	

It appears that the "off-water" operations, which are potentially quite expensive, are necessarily to be met from an intermodal allowance.



6.1 The Commission concluded (Draft Finding 6.1) that, " . . .there is no sound underlying economic rationale for freight assistance". While economic theory suggests that there may be negative welfare consequences attached to any intervention in a free market (where there has been no market failure), Net Sea Freight - Tasmania maintains that there is a limited economic case, based on the economics of the second best, for subsidy assistance, but its importance is overshadowed by other justifications. We are pleased that the Commission has recognised under the Compensatory category that there might be a case. We feel the Commission has erroneously dismissed too readily the facts of the Tasmanian case for continued assistance based on social and regional sustenance grounds; such a dismissive view is difficult to sell to a single-activity region.

6.2 The existence of a strong China in the global economic system imposes a ceiling on prices (referred to as the "China Price") and constrains the freedom of competing enterprises. It makes market conditions difficult in the context of Australian producers' existing cost structures, as the Chinese market power permeates through the Australian economy far beyond directly competing producers. As a recent example, the closure of the Caroma plant in Victoria and the shifting of ceramics production to China has led to a cessation of demand for pallets for transporting those products, which were previously produced from Tasmanian timbers. Electrolux in Adelaide have closed two of their three plants whose production is to be moved to China, with a similar impact on demand for packaging products. These are examples where there is a curtailment of scope for economic activity in Tasmania. Further impediments to economic and social advancement are not desirable.

6.3 There is a relatively small economic cost associated with assisting production of many of the goods whose production is supported by the TFES. That is, the resource-shifting effect of a subsidy is not likely to be deleterious to alternative users of those resources. In many smaller towns and non-urban regions, there is a reliance on one or very few employers, so that the question of resource diversion becomes non-relevant.

6.4 One major economic advantage which seems to have been down-played in the Commission's overview is the very real one of promoting production, employment and income generation through a continuation of economic activity where otherwise there may be none. This is being done in many cases at a cost which is small in terms of the incomes generated. The value of assistance by commodity in most cases appears to be very small - Table 4.2 - but that may be all that is necessary to sustain the producers. We note that many participants' submissions emphasised the crucial nature of freight assistance in the continuance of their enterprise. Indeed the Commission has acknowledged that many businesses have been structured around the continuance of the TFES in its current form.

6.5 We disagree with the Commission's view that freight subsidies are not cost effective, by noting that the complete Scheme has a current annual cost of about \$ 90 m, a very small outlay. To the suggestion that a more cost-effective alternative would be a broad economic development program, we note that there is a significant regional dispersion of the benefits of the Scheme; it is no less beneficial to many regional communities than those examples of regional assistance cited in Box 6.2 by the Commission.



6.6 It should be noted that the Tasmanian Country Sawmills Assistance Program, cited in Box 6.2 as providing a \$ 250 m package from the Federal and State governments, provides little specifically for country sawmillers. Of the \$ 250 m, \$ 46 m is to be applied to "help the industry adjust to changes in the public forest reserve" and only \$ 4 m has been quarantined to assist country sawmills, although they are eligible to apply for some of the remaining \$ 42 m.

## 7 CONCLUSIONS

7.1 Net Sea Freight proposes the following:

- A. The present "Nixon" scheme be retained with modification to the intermodal allowance and the road freight equivalent, which we suggest should be reviewed at the earliest opportunity.
- B. The proposal for a flat rate \$ 400 rebate not be proceeded with because of its inherent inequity, its potential to increase the cost of the Scheme and its "one size fits none " characteristic.
- C. Assistance continue to be paid to shippers, with supporting claim documentation to originate from a source divorced from the claimant.

## REFERENCES

Department of Transport and Regional Services: TFES statistics twelve months ending 30 June 2003,2004,2005

Productivity Commission Draft Report September 2006