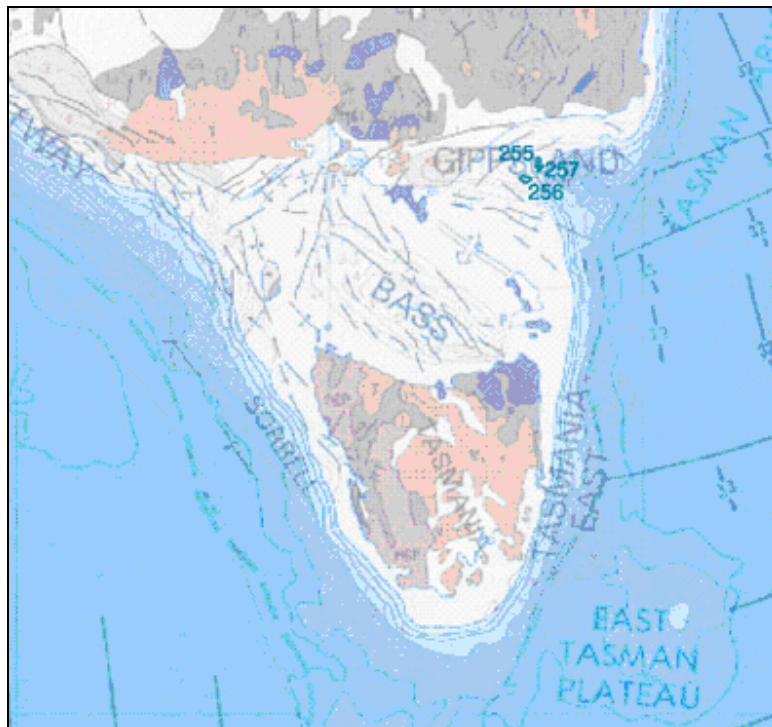


# TCCI Comment on TFES Draft Report

October 2006



**Tasmanian Chamber of Commerce and Industry**  
Providing effective leadership and a range of quality services to  
business and industry throughout the state of Tasmania.

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# 1.0 TCCI Profile

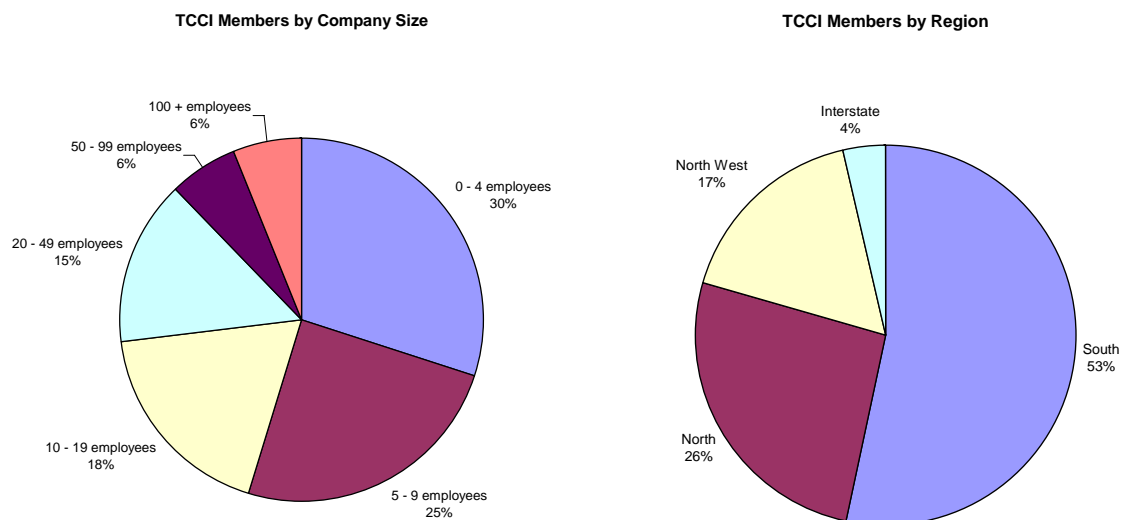
1.1 TCCI and its predecessors have been providing a broad range of high quality services and advice to the Tasmanian business community for over a century.

1.2 Building on this history, TCCI today is the state's peak employer body and is recognised as the voice of the Tasmanian business community.

1.3 TCCI is a non-profit organisation that is funded by members for members.

1.4 TCCI directly represents in excess of 2,490 businesses employing over 78,000 Tasmanians.

The diversification of TCCI's membership is illustrated in the following charts:



## 2.0 TFES Rationale

- 2.1 The Tasmanian Freight Equalisation 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.”<sup>1</sup>
- 2.2 The purpose of the Tasmanian Wheat Freight Scheme is less clearly defined as being “...established to subsidise the cost of bulk shipments of wheat from the mainland to Tasmania by sea.”<sup>2</sup>
- 2.3 The Tasmanian Freight Equalisation Scheme was instituted as a tool of economic development in response to the underlying trade barrier that Bass Strait presents. While the genesis of the Tasmanian Wheat Freight Scheme was as part of a marketing arrangement to ensure that the administered price for wheat was the same for mainland Australian and Tasmanian users, implicit in this is the recognition of the same underlying trade barrier that is Bass Strait.
- 2.4 **The rationale for both schemes is equitable treatment of industry with respect interstate trade and specifically, access to production inputs, and the markets for goods produced. To achieve this, neutrality in terms of access to transport infrastructure is essential.**
- 2.5 The Australian Government has been actively engaged in pursuing this equity between mainland states on a number of fronts. These include identification and improvement of national highway infrastructure and the removal of barriers to trade such as the conflicts in rail gauge that existed at the time of federation. In Tasmania’s case, the barrier to trade is Bass Strait and without the equity provided through TFES and TWFS, access to Tasmanian markets by mainland producers and the reciprocal access to mainland markets by Tasmanian producers would be severely compromised.
- 2.6 **The rationale for the Schemes’ existence is as pertinent today as it was at their inception.**
- 2.7 However, it is observed that 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. Specifically these investments are improving the distribution efficiencies of importers in the Australian market and progressively eroding the competitive advantage of production and manufacturing facilities located in Tasmania.

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<sup>1</sup> Department of Transport and Regional Services, <http://www.dotars.gov.au/transport/programs/maritime/tasmanian/index.aspx>, 9 June 2006

<sup>2</sup> Department of Transport and Regional Services, Tasmanian Wheat Freight Scheme, April 2005

## 3.0 The Case for TFES

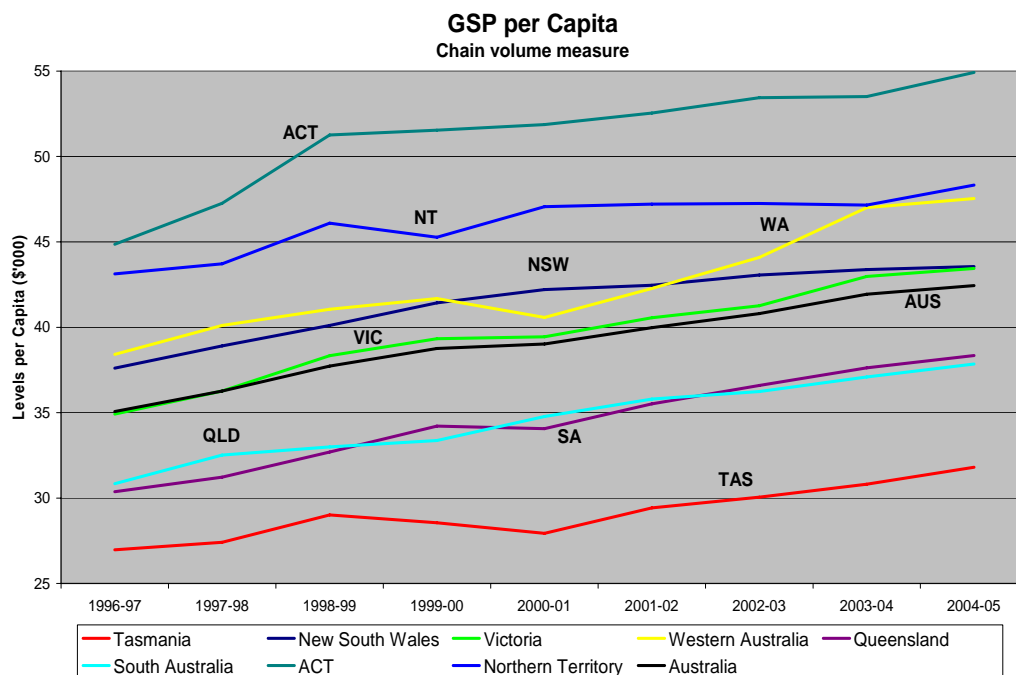
- 3.1 The TFES is not a regional development or assistance initiative. It is an equity measure to ensure that one state of the federation is able to compete with other states and is not disadvantaged because it is an island. Without the TFES, Tasmanian industry and businesses could not compete with other states.
- 3.2 Investment decisions by major companies with operations in Tasmania are not just about whether to invest in Tasmania or another state. Increasingly, these decisions are about whether to invest in Tasmania or overseas. The loss of the TFES and consequent lost investment in Tasmania will undoubtedly lead to lost investment in Australia.
- 3.3 Tasmania's economy is already in a weak position relative to other states. The diminution or loss of the TFES would have enormous implications for the Tasmanian economy.
- 3.4 The TFES is a very efficient way to ensure Tasmanian business and industry competes on a level playing field as it only assists those businesses which send their product to other states. It is difficult to envisage a more efficient method to ensure equity.

## 4.0 Scheme Contribution

- 4.1 The contribution of the scheme is substantial and widespread. It has been well documented in the previous TCCI written submission that there exists a host of tangible benefits associated with the scheme. Whilst the majority of the schemes funds are directed to a handful of Tasmanian employers, the effects of abolishing the scheme would be disastrous.
- 4.2 The scheme in its current state provides much needed assistance to Tasmanian businesses that are faced with an imposing cost disadvantage associated with the Bass Strait shipping channel. Along with the monetary value of the scheme which ensures competitiveness on the mainland and reinforces employment in Tasmania there are a number of other benefits which integral to the Tasmanian economy.
- 4.3 One of the major benefits of the scheme is the certainty which is built into business planning models. This enquiry comes at a time in Tasmania's economic history where there exist a number of uncertain variables which will directly affect the level of investment in Tasmania. From Tasmania's telecommunications market to the pricing of electricity and the standard of public infrastructure there a number of issues which increase uncertainty in the future of Tasmania's economic performance.
- 4.4 Certainty in future economic conditions is essential for investment, productivity and business confidence. Tasmania in recent times has struggled to attract major foreign investment however the State government has been working hard to place Tasmania as an ideal location for business investment. If the TFES was abolished or phased out it would be a major detriment to attracting investment in Tasmania. Investments would move to the mainland and the gap between Tasmania and the national economy would once again begin to widen.

### ***Productivity***

- 4.5 Tasmania has the lowest productivity of any state in Australia, where productivity is measured as Gross State Product per capita. Productivity is the prime determinant in the long run of a nation's standard of living, because it is the root cause of per capita national income. Increases in productivity are also central to the process of generating economic growth and capital accumulation.



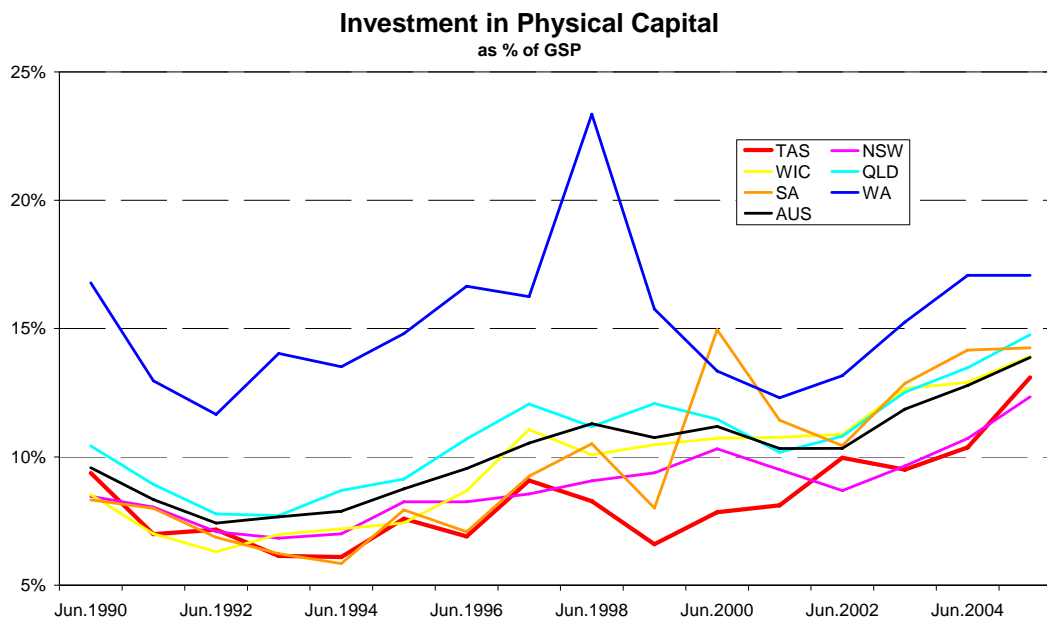
Source: Australian National Accounts: State Accounts, 2004-05 ABS Cat No. 5220.0

4.6 One of the main drivers of productivity growth is investment in physical capital buildings and structures, plant and equipment, and information technology and software. The other key driver of productivity growth is investment in human capital.

4.7 The State's productivity levels are the result of a number of contributing factors; poor investment in physical capital, low levels of business investment in research and development and a very poor level of education. These factors are the main drivers of economic growth and improvements in these areas will increase productivity.

## Physical Capital

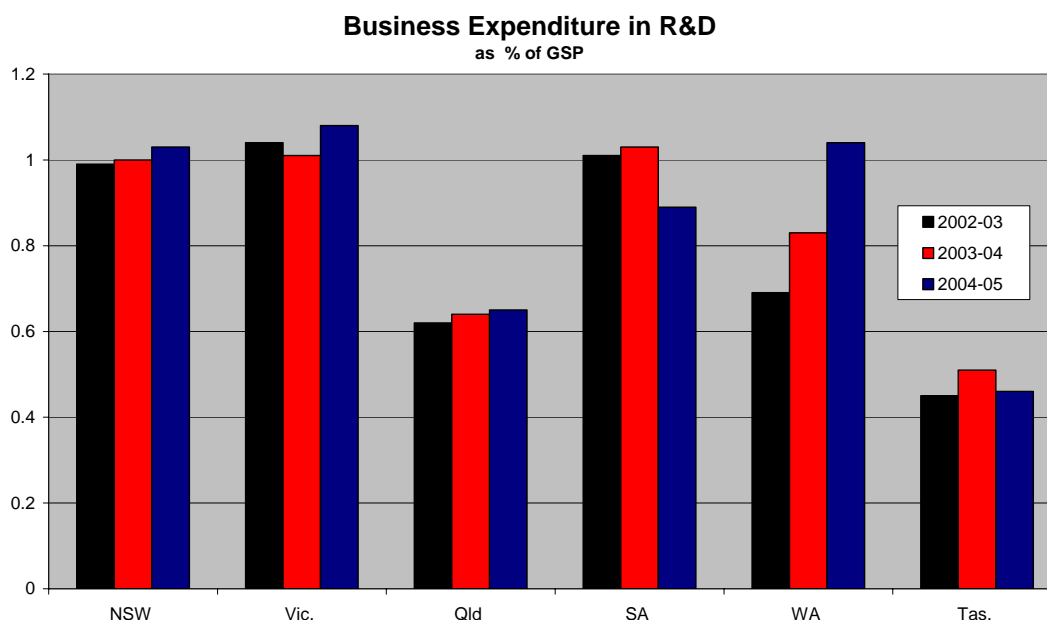
4.8 Tasmania's level of investment in physical capital has historically been far below national levels. The graph below depicts the investment in physical capital as a percentage of GSP. Clearly Tasmania is lacking in this area.



Source: Australian National Accounts: State Accounts, 2004-05 ABS Cat No. 5220.0

## Technology

4.9 The level of technological advancement is dependant on R&D. Tasmania experiences a poor level of business investment in R&D and this has become a major contributor to our unfortunate productivity levels. The graph below portrays the environment that our business R&D exists.

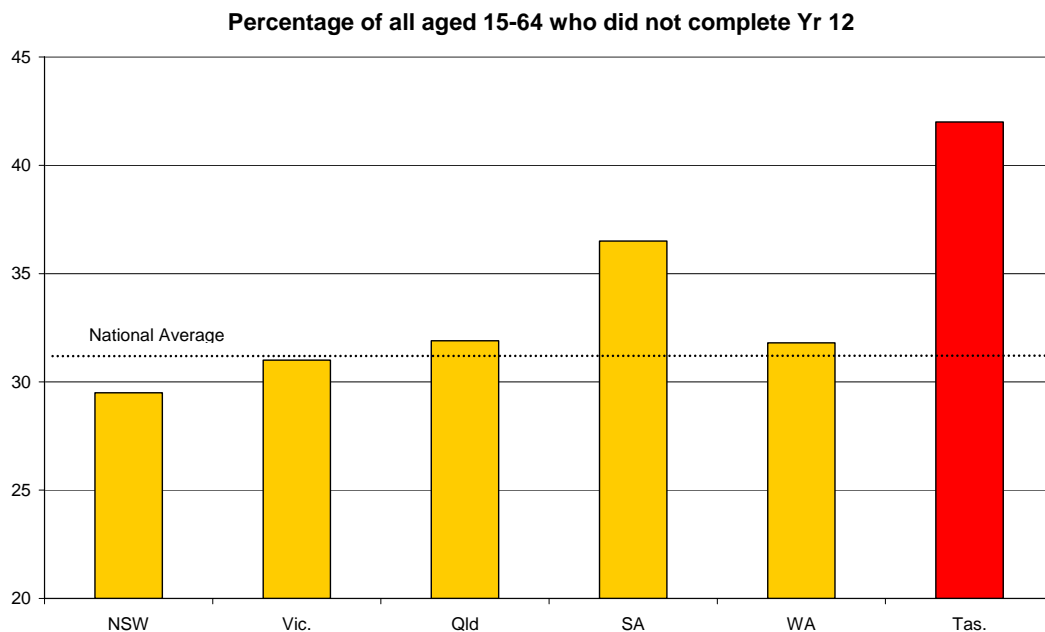


Source: Research and Experimental Development, Businesses, Australia, 2004-05 ABS Cat No. 8104.0

## Human Capital

4.10 The final factor of productivity is the investment in human capital. Tasmania ranks last in Training and Qualifications as per The Competition Index 2005. A number of Tasmanian firms have expressed difficulty in attracting and retaining people with high levels of educational attainment in the state. For 10 consecutive quarters the availability of suitably qualified workers has remained the number one constraint on business growth as evidenced by the Commonwealth Bank/TCCI Survey of Business Expectations.

4.11 Tasmania also has the lowest proportion of its population completing post school qualifications. This level of education will be a key determinate in Tasmania increasing its productivity levels and sustaining economic growth in the long term.



*Source: Australian Social Trends, 2006 ABS Cat No. 4102.0*

4.12 With Tasmania's economic climate outlined with the previous major issues included the outlook for the economy is somewhat subdued. The effect of altering the scheme can and will have far reaching effects. Reducing the scheme will also reduce business confidence which will incur a whole range of negative consequences.

## **Business Confidence and Economic Outlook**

- 4.13 This inquiry is proposed at a time in Tasmania's economic history where the gap with the Australian economy is forecast to substantially widen.
- 4.14 The Tasmanian economy in recent times has performed well above most optimistic forecasts. The economy should have struggled given the strong appreciation of the Australian dollar and considering the substantial manufacturing component and little mining. Despite these facts, Tasmania was able to achieve strong growth in GSP and at one stage were the fastest growing state in Australia. The main driving force behind our recent economic success was the turnaround in net interstate migration. This was the result of a housing price boom on the mainland which began to make Tasmanian housing relatively attractive.
- 4.15 The outlook for the Tasmanian economy paints a more subdued picture. The flow-on effects to retail spending and jobs growth has been brought on by the migration of interstate home buyers. As our housing prices move more into line with other states, the once attractiveness of our houses is waning. While Tasmania is currently experiencing record levels of employment and participation, Access Economics are predicting a significant slowing of the economy which would see Tasmania once again widen the gap with the national economy.
- 4.16 The long term projections for the state will be a definite easing which would reverse much of the ground gained on the national economy in recent years. The key to sustaining economic growth is productivity. Tasmania continues to lag behind the rest of the country in terms of productivity which has resulted in less efficient workers who are currently earning wages well below national averages. For this reason Access Economics predicts Tasmania will get left behind the Australian economy as much of the recent economic success has been largely cyclical.
- 4.17 Business confidence in the Tasmanian economy has slipped considerably in the last quarter on the back of a few key factors. The Commonwealth Bank/TCCI Survey of Business Expectations for the September Quarter 2006 revealed that confidence in the Tasmanian economy is at its lowest level in over 5 years. This can be confirmed by the Sensis® Business Index of Small and Medium Enterprises who in their August 2006 issue indicated that Tasmanian business confidence is also at their lowest levels in over 4 years. Both of these indexes indicate a worrying trend for the Tasmanian economy with tough trading conditions predicted.
- 4.18 The key drivers of this decline in business confidence may be the realisation that the Tasmanian economy has passed its peak in the cycle and is heading for a downturn. This recognition is driven from the fact that petrol prices are beginning to wear down business profits. The TCCI/CBA survey indicated that businesses have for some time been absorbing the rising cost of fuel however expectations are for an increase in selling prices. Whilst both of these surveys were conducted prior to the Reserve Bank of Australia's announcement to lift the cash rate target, there was significant speculation that an imminent increase was unavoidable. The interest rise together with mounting fuel costs will change consumer spending patterns. This

would add weight to an economic downturn which is typified by a reduction in consumer spending.

- 4.19 A further decline in business confidence will see a reduction in training and skills. Many businesses in today's climate are increasing their training of staff due to the further globalisation of markets. The ability to export both domestically and internationally is becoming more attainable for business and as such businesses are up-skilling and retraining to ensure they keep up with demand. Abolishment of the 30 year scheme will see the freight cost disadvantage priced into Tasmanian goods and thus reduce profit margins and potentially any market edge for those businesses at the margin.

## 5.0 Response to the Major Proposals

### *DRAFT PROPOSAL 1*

***Given the lack of a whole-of-economy justification for a freight subsidy scheme, and acknowledging the benefits to Tasmania of Australia's broader reform program, the Australian Government should:***

- ***Phase out the Tasmanian Freight Equalisation Scheme from 1 July 2007, over a five year period. The subsidy should be four-fifths of the eligible amount in 2007-08 and be reduced by an additional one-fifth of the eligible amount for each subsequent transition year.***
- ***Provide for structural adjustment assistance of, say, up to \$20 million each year for five years, directed at alleviating social and economic hardship arising from abolition of the scheme.***

The TCCI rejects the proposal and urges the PC to look beyond economics as the sole reason for the existence of the TFES.

The proposed structural assistance package will be ineffective compared to the assistance to the Tasmanian community offered by the TFES as it currently stands.

### *DRAFT PROPOSAL 2*

***The Australian Government should abolish the Tasmanian Wheat Freight Scheme from 1 July 2007.***

The TCCI believes the issue warrants more detailed analysis than afforded in the Draft Report.

### *DRAFT PROPOSAL 3*

***If the Australian Government chooses to retain a freight subsidy scheme, it should be structured to avoid the distortions in the TFES. The Government should:***

- ***Introduce a flat rate subsidy of \$400 per TEU from 1 July 2007. The subsidy should be applied on a pro rata basis for other than full TEU loads. No other adjustments should apply.***
- ***Review the nominal level of the subsidy in 2011-12, to apply from 1 July 2012.***

- ***Provide for structural adjustment assistance of, say, up to \$10 million each year for three years, directed at alleviating social and economic hardship arising from the introduction of the flat rate subsidy.***

The TCCI rejects any move to a flat rate subsidy. A flat rate would disadvantage smaller, intermittent shippers who are not able to use economies of scale to negotiate more beneficial shipping rates. Moreover, a flat rate ignores the differing shipping charges for more specialised shipping containers eg refrigeration. Finally, the proposed amount of \$400 is inadequate assistance.

# 6.0 Response to the Major Findings

## Chapter 3 Tasmania's freight task and freight cost disadvantages

### DRAFT FINDING 3.1

*Compared with freight users on the mainland, Tasmanian shippers face a freight cost disadvantage when conducting interstate trade. However, over the last several decades, the real cost of Bass Strait shipping has fallen significantly relative to road freight costs.*

The TCCI applauds the acknowledgement that Tasmanian shippers face a freight cost disadvantage. However, the statement that real cost of Bass Strait shipping has fallen relative to road transport cannot go unchallenged. The PC's own data is clear that since 1990 there has been at best a marginal fall in sea transport costs and that there has been no relative reduction against road freight costs in that period.

### DRAFT FINDING 3.2

*Indirect freight cost disadvantages faced by Tasmanian shippers include the quality and reliability of services, and the impacts of government policies.*

The TCCI agrees with the finding.

## Chapter 4 Impact on Tasmania and Australia

### DRAFT FINDING 4.1

*The modelling commissioned by the Tasmanian Government suggests that there are output and employment benefits to the Tasmanian economy from the TFES. However:*

- *The modelled benefits are likely to be an 'upper estimate'.*
- *There is very little improvement in Tasmanian welfare in per capita terms, reflecting population growth from the extra economic activity of producers receiving the sea freight subsidy.*
- *The benefits to Tasmania come largely at the expense of economic activity elsewhere in Australia and at a small net cost to the Australian economy.*

The TCCI does not accept the finding. Any such finding needs to be based on detailed economic modelling – not speculation. The only modelling available is the Tasmanian Government modelling.

## Chapter 5 Assessment of scheme design

### DRAFT FINDING 5.1

*At the core of the TFES rebate calculation, a single estimate of the road freight equivalent cost is deducted from the varying sea freight costs of producers. However, those who incur higher sea freight costs would be likely to face higher land freight costs. In these circumstances, the underlying disadvantage is overestimated and a higher rebate than appropriate is paid.*

It is difficult to conceive of a realistic, alternative methodology that can be adopted other than the current single estimate method. In that sense, the TCCI agrees with the PC. However, it is just as likely that the single estimate method will underestimate land freight costs for some organisations. In such cases the underlying disadvantage is underestimated and a lower rebate than appropriate is paid.

### DRAFT FINDING 5.2

*Many TFES recipients expressed concern about the manipulation of subsidy claims through the ability to choose the method of claiming. Use of a fixed \$230 per TEU land freight cost estimate provides an incentive for those with higher land freight costs to claim on a total freight cost basis, thus including the land components.*

- *This overestimates the extent of wharf-to-wharf freight disadvantage and results in higher than appropriate rebates being paid.*
- *The scope for this cannot be eliminated within the current design of the TFES.*

The TCCI understands the criticism but argues that the issue of “wharf to wharf” compared to “door to door” methodologies needs detailed analysis before an informed judgement can be reached. At this stage, the criticism is speculation only.

The general issue of “routing” has been raised. The TCCI does not. However there is no evidence that this is occurring – quite the contrary.

### DRAFT FINDING 5.3

*The majority of route scaling factors, estimated in 1996-97, are higher than the estimates in subsequent parameter reviews. A higher estimate results in a lower TFES rebate.*

The TCCI supports a more detailed analysis of the route scaling factors.

### DRAFT FINDING 5.4

*The intermodal cost allowance provides an incentive for shippers to seek wharf-to-wharf invoices that include as many intermodal services as possible, to which the allowance is then added. This results in a higher TFES rebate.*

The TCCI does not accept the finding but does support a more detailed analysis of intermodal costs.

#### *DRAFT FINDING 5.5*

*The design of the class cut-offs (based on the median) and the associated sliding scale for rebate payments provide weak commercial incentives for cost minimisation for the majority of shipments. The use of the median exacerbates this.*

The TCCI believes that the issue requires more detailed analysis.

#### *DRAFT FINDING 5.6*

*If the Bass Strait freight market is not fully competitive, there may be some leakage of the subsidy away from intended beneficiaries to the shipping lines.*

The TCCI believes the issue of the competitiveness of the Bass Strait shipping market requires more detailed analysis.

#### *DRAFT FINDING 5.7*

*The current rules as to which freight is eligible for a rebate result in a number of anomalies, with ongoing calls for extension of eligibility to other classes of Bass Strait shipments.*

The TCCI supports a more detailed examination of the issue.

#### *DRAFT FINDING 5.8*

*The Bass Strait islands face particular freight cost disadvantages that are not fully dealt with in the current TFES design. Viable production rests on there being offsetting benefits for producers.*

The TCCI supports the finding.

#### *DRAFT FINDING 5.9*

*If the TFES is retained, administration of the scheme could be improved:*

- the published data could be more comprehensive and better aligned with the requirements of external analyses of the scheme;*
- annual payments to recipient companies should be publicly reported;*
- there is scope for reducing compliance costs via electronic lodgement; and*
- when parameter reviews are conducted, the results should be publicly released.*

The TCCI supports the finding in principle – subject to there being no added administrative or compliance cost.

#### *DRAFT FINDING 5.10*

*The Tasmanian Wheat Freight Scheme singles out the transport of wheat to Tasmania from all other bulk cargoes for subsidisation. The original purpose for such selective treatment — facilitating adjustment in Tasmania to a competitive domestic wheat market — has been fulfilled. The scheme is now unused.*

The TCCI believes the rationale for the Tasmanian Wheat Freight Scheme needs more detailed analysis.

## **Chapter 6      Rationales for the schemes**

### *DRAFT FINDING 6.1*

*While the operational rationale for the TFES is to alleviate individual shippers' sea freight cost disadvantages relative to a road freight equivalent, there is no clear statement of its underlying objectives. Consideration of those put forward finds that none is convincing and that there is no sound underlying economic rationale for freight assistance.*

The TCCI agrees that the objective of the TFES needs to be clearly articulated to avoid the current confusion. As stated earlier, we believe it is clear that the scheme's objective is to ensure equity for a full member of the Federation.

### *DRAFT FINDING 6.2*

*If the Australian Government sought to further assist Tasmania alleviate its disadvantage as a small regional economy, a more targeted approach would be to introduce an economic development program. The Government should clearly specify the objectives of any such scheme, be transparent as to the criteria for allocating funding, and publicly identify the beneficiaries. The efficiency and effectiveness of the program should be regularly assessed.*

The TCCI reiterates that the TFES is an equity measure – not a regional development initiative.

## 7.0 Final Comment

- 7.1 The Tasmanian Freight Equalisation Scheme has been in operation for 30 years and stands as an essential component of the Tasmanian business environment. The TCCI is a firm supporter of the scheme as it has helped strengthen the Tasmanian economy of a long period of time. The scheme has increased the competitiveness of a number of Tasmanian firms through alleviating the cost disadvantage of Bass Strait that Tasmania as a regional economy faces.
- 7.2 The TCCI believes that in its current state as an output based subsidy is one of the most efficient forms of subsidy. This is something a flat rate cannot ever achieve as there will always be a percentage of businesses disadvantaged.
- 7.3 However any attempt to further simplify and reduce the administrative costs associated with claiming the subsidy would be welcomed by industry.
- 7.4 The TCCI is aware that there are allegations of scheme rorting with subsidies undeservedly received. Industry is concerned at these damaging claims and would welcome any further transparency in the process. The actions of a minority should not cause the abolishment of the scheme. Industry welcomes random audits of recipient businesses; this would only serve to strengthen the scheme.
- 7.5 The TCCI is aware of economic modelling which has placed the net cost of the scheme to the Australian economy at \$5 million. The value achieved through the scheme is a very cost effective way of stimulating the Tasmanian economy and at a net cost of \$5 million should not have built the concern that it has.
- 7.6 The Prime Minister's statement of 7 September 2006 that the TFES would not be scrapped was welcomed by Tasmanians – particularly the business community. Given that there will be a TFES the TCCI urges the Productivity Commission to work with the business community of Tasmania to better understand the importance of the TFES to Tasmania. We specifically recommend:
- 7.7 The PC visits the major recipients to better understand how they use the TFES and the impact that its diminution would have on those businesses.
- 7.8 The PC examines in far greater detail the issues that have been raised in the course of the Inquiry. In particular, the reasons for the growth of the TFES need to be analysed and understood. If there are anomalies or rorting then they need to be exposed and addressed.
- 7.9 The end result of the Inquiry should be a clearer, more transparent TFES that as far as reasonably possibly ensures that businesses with operations in Tasmania are not disadvantaged by virtue of being based in an island state.