

**Tasmanian Government Final Submission  
to the  
Productivity Commission Inquiry into  
Tasmanian Freight Subsidy Arrangements**

**Introduction**

The Tasmanian Government welcomes and supports the Prime Minister's announcement on 7 September 2006 that the Australian Government would not be phasing out the Tasmanian freight equalisation scheme and will not be abolishing the Tasmanian Wheat Subsidy Scheme.

The Tasmanian Government is also mindful of the need to respond to key issues in the Commission's draft report prior to the Commission finalising its report. The Government is also keen to ensure that the arrangements for the delivery of freight assistance operate as intended.

This submission addresses the rationale for the scheme its importance to certainty of investment Tasmania and the design and administration of the scheme.

**Rationale for assistance**

In its draft report, the Productivity Commission states "there is no clear statement of the underlying objectives for the scheme".

At the Commission's recent hearings, the Tasmanian Treasurer presented a comprehensive case to show that freight assistance to overcome a disadvantage resulting from the absence of land transport across Bass Strait is based on the principles of federation and the practice of the Australian Parliament.

The evidence included the 1976 *Report of the Commission of Inquiry into Transport to and From Tasmania*, which first recommended the implementation of a freight equalisation scheme. In that report, Commissioner Nimmo stated:

"In agreeing to federate, the Australian States implicitly agreed to accept some sharing of their resources. This principle has long been accepted by the Australian Parliament."

Importantly, the Nimmo report also stated that the "sharing of resources between states has gone further than merely providing approximately similar standards of government services."

The provision of funds by the Commonwealth to construct the Ord River Dam and the recurrent provision of funds to construct "beef cattle roads" in Queensland and Western Australia were two significant examples used in the Nimmo report.

These examples demonstrate the principle of assisting the economic development of disadvantaged regions of Australia.

There are many more recent examples, such as the Australian Government's contribution of over 190 million dollars to the construction of the Adelaide to Darwin railway.

The Nimmo report subsequently concluded:

"...in federating, if a relatively poor State is making reasonable efforts to encourage investment and if these efforts are being frustrated by, for example, its physical separation, it should expect to be entitled to receive financial assistance from the Commonwealth Government."

The principle of sharing of resources amongst States continues today. It underpins the notion of horizontal fiscal equalisation, where the Australian Government, through the Commonwealth Grants Commission, distributes revenue in a manner that ensures all Australian citizens have access to equal standards of government services.

Without horizontal fiscal equalisation, Tasmania would be significantly disadvantaged due to unavoidable demographic, geographic and economic causes. For example, Tasmania receives higher GST revenue than it would if GST revenue were distributed on an equal per capita basis.

The principle of resource sharing, based on the principles and practice of federation, justifies the need for the Tasmanian Freight Equalisation Scheme to overcome the absence of land transport across Bass Strait.

The Prime Minister clearly recognised these principles in his response to the Commission's draft report on the TFES. The Prime Minister stated: "the Scheme remains an important element of Australian government programs that equalise cost disadvantages between the States and Territories."

This answers the Commission's call in its draft report for a clear statement of the underlying objectives for the schemes. There should now be no ambiguity about whether or not there should be such a Scheme. The Scheme should continue, and largely in its current form.

## **Investment and productivity**

Tasmanian industries have made significant investments since 1976, on the expectation that freight scheme assistance would continue. This investment by recipients of TFES has enabled them to remain globally competitive.

Any material changes in the rules increases the risk that investments will not earn expected returns. Certainty over the future of the scheme and the rules is therefore important to retaining existing operations and the future investment plans of industry in Tasmania. Some of the largest recipients of freight assistance are Norske Skog, Cadbury Schweppes, Simplot Australia, J Boag and Son, Australian Paper and Cascade.

### ***Norske Skog<sup>1</sup>***

Over 350 million dollars has been invested in Norske Skog's Boyer Mill since the late 1980's. The productivity, efficiency and environmental gains from these investments have been impressive. Annual paper production has lifted to around 233,000 tonnes per annum in 1989 to 295,000 tonnes per year.

The availability of assistance through the Tasmanian Freight Equalisation Scheme supported the revitalisation of this business by providing the mill's then owners with the confidence to invest. This, in turn, has provided a foundation for ongoing investment, including the current 5.9 million dollar bleach plant upgrade.

Without TFES, this investment would not have occurred and the Boyer Mill would not be delivering its strong contribution to the Tasmanian and Australian economies.

Norske Skog received 11.4 million dollars in TFES assistance in 2004-05.

### ***Cadbury Schweppes<sup>2</sup>***

Cadbury Schweppes undertook a 25 million dollar expansion in 2001 to secure the future of the plant in Tasmania and substantially increase production.

The company is currently investing a further 25 million dollars in additional chocolate making capacity and new moulding, wrapping and packing equipment to position the Tasmanian operations as a major supplier for the Asia Pacific region.

Owen Davies, Operations Manager for Tasmania, noted that: "Many of our major investments would not have come our way had our directors been uncertain about the continuation of the freight scheme."

Cadbury Schweppes received 5.1 million dollars in TFES assistance in 2004-05.

### ***Simplot Australia<sup>3</sup>***

Simplot Australia processes over 50 per cent of the frozen and dehydrated potatoes produced in Australia. In 2003, Simplot invested 35 million dollars to upgrade its Ulverstone potato processing plant, bringing total investment at Ulverstone to 80 million dollars during Simplot's eight-year ownership.

By investing in the Ulverstone plant, Simplot decided to close its Scottsdale plant, despite the loss of 110 direct jobs. Simplot made this decision to improve its long term efficiency and move to world's best practice.

This investment has boosted production by 35 per cent from 240,000 tonnes to 325,000 tonnes per year. This shows that the Tasmanian Freight Equalisation

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<sup>1</sup> Norske Skog

<sup>2</sup> Cadbury Schweppes

<sup>3</sup> Sourced from <http://www.simplot.com.au/Hosting/corp/SimSite.nsf/News?OpenForm&listing>

Scheme does not prevent beneficiaries from making hard financial decisions if the need arises. Rather, it facilitates the investment needed to make these firms competitive.

Managing Director of Simplot Australia, Terry O'Brien stated that:

“This drive to increase productivity and efficiency is essential for the success in keeping the Australian industry competitive with low cost exporters such as New Zealand.”

Simplot received 10.3 million dollars in TFES assistance in 2004-05.

### ***J. Boag & Son<sup>4</sup>***

J. Boag & Son has invested 34 million dollars in Tasmania since the year 2000. It also plans to invest a further 33 million dollars in its Launceston operations over the next five years.

A new 17 million dollar bottling line was completed in late 2004 and work is expected to commence on a new 20 million dollar brew house in 2007. In 2006, other capital projects totalling more than 7 million dollars will be completed.

The Tasmanian Freight Equalisation Scheme has been an important factor in the expansion of J Boag and Son. Production has risen from 25 million litres of beer in 1995 to 41.3 million litres in 2005 – a 65 per cent increase.

Boag's freight costs over Bass Strait are 65 per cent higher than its mainland competitors over the same distance, even after the assistance received from TFES. Certainty over the future of the scheme is important to current operations and future investment plans.

A reduction in the level of TFES assistance will also warrant a rethink by the company of its Tasmanian operations and place 30 million dollars of the planned 33 million dollars in future investment at risk.

J Boag and Son received 3.3 million dollars in TFES assistance in 2004-05.

### ***Australian Paper<sup>5</sup>***

TFES has been instrumental in decisions by Australian Paper to invest in improving machine productivity and in new product development.

In 1996 Australian Paper spent \$29 million at its Wesley Vale Mill to develop film coated offset paper. This product competes in the Australian market with light weight coated grades produced overseas. Between 1997 and 1999, the company spent \$27

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<sup>4</sup> J. Boag and Son

<sup>5</sup> Australian Paper

million on its coater at Wesley Vale to enable the production of "double coated" paper.

The upgrades would not have been undertaken without the support provided by TFES.

### ***Cascade***

Cascade Brewery has indicated in its 11 October 2006 final submission to the Commission's inquiry that "Without access to the TFES, our operating structure within Tasmania would need to be reviewed, putting in doubt the jobs of more than 100 employees and the \$15 million which our production activities contribute annually to the state economy."

Cascade generates significant flow-on economic benefits throughout the Tasmanian economy by purchasing 100 per cent of the state's blackcurrant crop and 95 per cent of the state's raspberries. It pays \$6 million in wages and incurs expenditure on road and rail transport services and makes payments to utilities and national state and local government. The company also supports further downstream activities including services from tradesmen and small businesses and contributes to community organisations across the state.

Cascade Brewery notes that it enjoys strong support from the Fosters Group and that the Tasmanian operation must also meet commercial benchmarks of the parent entity. The withdrawal or reduction of assistance would alter the situation and "...make doing business at all in this state increasingly difficult. Put quite simply, and as set out in our initial submission, our company relies on the TFES for its ongoing operations."

### ***Contribution to the economy***

In 2004-05, around 1,300 companies benefited from TFES payments that totalled 92 million dollars. Around half goes to just seven companies - Norske Skog, Simplot Australia, Australian Paper, McCain Foods (Aust), Cadbury Schweppes, J Boag and Son and Cascade.

The TFES has contributed significantly to the capacity of these seven businesses to invest and increase their scale, productivity and competitiveness. The economic benefit of these companies to Tasmania is significant and includes:

- 3,100 direct jobs;
- 9,600 indirect jobs;
- 195 million dollars in annual wages; and
- 530 million dollars in annual expenditure in the Tasmanian economy.

Additional information received from six of the above companies shows that Australia clearly benefits too, from both the economic activity and taxation revenue this activity generates, and also from their contribution to the balance of trade. Importantly, it is estimated that over 75 per cent of the output of the six companies would be sourced from overseas should the Tasmanian operations close. The

supplementary information on economic benefits received from six of the above companies is detailed below.

- 1,505 million dollars in value of output
- 35 million dollars in exports
- 133 million dollars in payments to the Australian government
- 10 million dollars in payments to the Tasmanian government
- 3 million dollars in payments to local government.

Confidence that the freight scheme will continue is necessary for these, and other firms, to fully develop the competitive advantages of being located in Tasmania, given the freight cost disadvantages they face.

### ***Productivity***

Improving productivity is a key objective for Tasmania. There has been a long term and pronounced decline in Tasmania's productivity performance relative to Australia.

This has led to Tasmania's real income and living standards being lower than the national average. Furthermore, low productivity is a constraint on the State's capacity to attract investment.

As future productivity levels are influenced by the quantity and quality of capital, the Tasmanian economy would enjoy significant gains if it can move towards a cycle of high productivity growth and high investment.

To compound matters, Tasmania's population is ageing more rapidly than other states. In the 2006-07 Budget, the Tasmanian Treasurer announced the establishment of the Demographic Change Advisory Council to address Tasmania's productivity and demographic challenges.

The importance of productivity improvements to Tasmania's economic future is highlighted by an Australian Treasury paper released in April this year, titled '*Does Distance Matter? The Effect of Geographic Isolation on Productivity Levels*'.

The study found that Australia's isolation from world economic activity accounts for around 45 per cent of the gap in labour productivity between Australia and the United States.

The research uses a proximity indicator for the states and territories of Australia and the United States. The indicator is intended to capture the proximity of each state and territory to world output.

Closeness to output is found to present scale opportunities and positive spillovers for firms. This, in turn, stimulates higher productivity.

Out of a total of 59 jurisdictions in Australia and the United States, the research showed that Tasmania was ranked last, with the lowest proximity indicator of all

jurisdictions. The Australian Treasury research shows that distance from markets, or the high cost of gaining access to markets, is an impediment to labour productivity.

Removing the Tasmanian Freight Equalisation Scheme would have the effect of increasing Tasmania's isolation from mainland markets. This will constrain Tasmania's capacity to improve labour productivity. Given the importance of lifting productivity to drive Tasmania's future growth, removal of the scheme would be a devastating blow to Tasmania's economy.

## **Design and administration of TFES**

The objective of the Tasmanian Freight Equalisation Scheme is to remove the sea freight cost disadvantage for eligible non-bulk goods relative to the cost of land transport over the same distance as Bass Strait.

Modelling by the Centre of Policy Studies at Monash University shows that the freight scheme is an efficient method of removing freight cost disadvantages. The Centre showed that the effect of the Scheme is to increase real Gross State Product in Tasmania by around 2 per cent or 300 million dollars, and increase employment by 4 300 jobs.

The rest of Australia experiences decreased output of 317 million dollars and decreased employment of around 4 600 people. These results illustrate a near one for one transfer of activity from the mainland to Tasmania. This shows that the net cost of the TFES is very low, given the very significant advantages it provides to Tasmania.

The Commission has proposed a flat rate of assistance. Flat rates of assistance will not reflect the actual cost disadvantage to producers with different wharf-to-wharf costs reflecting the scale, frequency and density of shipments. Assistance should be based on the sea freight cost disadvantage of the wharf-to-wharf component of a freight journey.

Flat rates will impact most severely on manufacturers who are the largest beneficiaries of the freight assistance.

J. Boag and Son's post TFES assistance freight costs over Bass Strait are 65 per cent higher than its mainland competitors over the same distance. The company estimates that the Commission's proposal of a flat rate \$400 per container held for 5 years would reduce the current level of assistance by approximately \$1.2 - \$1.5 million in today's dollars.

Companies not in the top eight recipients of TFES assistance will also be adversely affected by introducing the flat rate proposed by the Commission.

Harvest Moon is a leading Tasmanian fresh vegetable grower, packer, wholesaler and exporter with annual sales of around \$27 million of which 40 per cent is destined for interstate markets. The company reports that withdrawal of assistance or introduction of a flat \$400 rate of assistance would have resulted in

a financial loss for the company in three out of the past five years and break even in one other year effectively closing the business down. Harvest Moon draws on a grower base of around 200 producers.

Flat rates of assistance may reduce compliance and administration costs, but these costs do not impede large companies such as those that receive almost half the assistance. The integrity of the current scheme and any perceived rorting can be addressed through measures such as the application of stringent risk management by the administrator and better auditing by an independent body.

The Australian Government has a responsibility to ensure confidence in the administration of the scheme. The Tasmanian Government and industry supports measures which would increase transparency of the Scheme's arrangements.

The Tasmanian Government also supports regular reviews of the operation and administration of the Tasmanian Freight Equalisation Scheme. It is vital that industry actively participates in any review to ensure parameters reflect actual practice and compensate fully for the Bass Strait sea freight cost disadvantage.

Consideration of eligibility criteria should also be reviewed to address issues such as the movement of recyclable empty containers, which currently do not attract assistance. However, Tasmania's support of regular reviews of the scheme is premised on avoiding radical changes to long-held arrangements.

## **Conclusion**

Tasmanian producers are at a significant freight cost disadvantage relative to producers in other states with access to land transport.

The Tasmanian Freight Equalisation Scheme is vital to Tasmanian export businesses and to continued economic growth.

The Scheme has had strong bipartisan support for over thirty years in recognition of its importance.

The Tasmanian Government strongly supports its continued operation.