

**SUBMISSION TO THE INQUIRY INTO REGULATION OF AUSTRALIAN
AGRICULTURE – DRAFT REPORT JULY 2016**

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In its consideration of transport, the Commission finds that current coastal shipping regulations which give preference to Australian-flagged ships for transporting domestic cargo between Australian ports increase costs for farm businesses reliant on sea freight. It recommends that, to improve the efficiency of coastal shipping services, barriers to entry for foreign vessels should be removed to allow greater competition.

Australian coastal shipping policy settings have two distinct parts, one favouring Australian ships and the other – more dynamic and apparently growing – favouring foreign ones. This submission considers that policy bifurcation, not industry inefficiency, is the central problem to be addressed and that the Commission's preferred policy of 'removal of cabotage restrictions' overlooks the importance of achieving a consistent level playing field among all ships eligible to participate in coastal trading. This is needed not only to ensure cost-effective services to agricultural and other shippers, but also for the survival of a materially-sized industry, on which several other domestic marine-related sectors rely for qualified personnel.

This submission:

- Provides a brief history of Australia's 'two-track' coastal shipping policy
- Overviews Australian policy settings in comparison to those of some other countries
- Offers some information on the technical and cost efficiency of Australian shipping
- Reviews long-term trends in the coastal shipping task
- Discusses the relationship between shipping and other marine-related areas
- Outlines possible alternative policy settings that might offer an efficient cost of service to shippers, while maintaining and growing an Australian shipping industry and providing regulatory certainty and simplicity.

The submission draws on a forthcoming paper for the November 2016 Australasian Transport Research Forum, which is based on documentary research, statistical analysis and interviews.¹ In the interest of brevity, the extensive referencing provided in that paper is limited in this submission.

A recent history of coastal shipping policy

During the 1980s, the Hawke Labor Government implemented a strategy to improve industry efficiency that had been recommended by Sir John Crawford and his committee in a report commissioned by the preceding Fraser Coalition Government. The strategy centred on government tax incentives and investment funding, to modernise the coastal and international shipping fleets, conditional on union cooperation and workplace reform.

In 1989, in order to help 'lock in' these efficiency reforms, the Hawke Labor Government decided to draw on the foreign vessel voyage permit arrangements of the Navigation Act 1912, under which coastal shipping was regulated. This involved accessing the evolving global shipping market place, where so-called 'flags of convenience' and European nation 'second registries' were now offering services backed by low-rate taxation regimes and low-cost, developing country labour. The Act gave priority to Australian crewed vessels, but provision also existed for issue of single and continuous permits to foreign vessels, if no licensed vessel was available and if considered in the public interest. The government's aim was to increase competitive pressure on the Australian industry and ensure that the benefits of crew reductions from the efficiency reforms were passed on to shippers. As well as single voyage permits, continuous voyage permits, not issued for the previous 20 years, were now allowed. Permits were to be used by 'small, irregular shippers', or to help with 'the risks associated with new trades', or with 'an upsurge in demand' for raw materials processing. The government stated that, if it became clear that shippers were

¹ Potterton, P, *Australian maritime transport policy: what drives or constrains success?* Forum papers are available subsequently at <http://atrf.info/papers/>.

not benefitting from reform through lower freight rates, it would consider including price as a criterion when assessing permit applications.²

By 1994-95, the last full financial year of the Keating Labor Government, 3.4 million tonnes (seven per cent of the task) were being carried in permit vessels. Then in 1998, the Howard Coalition Government announced that continuing voyage permits, previously issued for a total period no longer than three years, could be renewed indefinitely. Permit use continued to increase such that, in 2006-07, 16.7 million tonnes (28 per cent of the task) was shipped in permit vessels. Many of the larger bulk routes, such as between Port Hedland and Port Kembla and from Gladstone to Newcastle, were using a mix of licensed vessels and permit vessels, thereby reducing their average freight costs.

In several instances over these years, the permit process involved reflagging of an Australian bulk vessel to an overseas registry, redundancy of the Australian crew and its replacement with a foreign crew on foreign conditions, with the vessel continuing to trade on the Australian coast.³ In effect, ship owners on interstate coastal routes could move, at choice, from the 'preferencing Australian flag' policy and regulatory track, to the 'preferencing foreign flag' one.

With a liberal voyage permit regime, with many Australian flag vessels nearing the end of their economic life and with earlier fiscal investment incentives having been discontinued, the Australian registered coastal fleet declined in the 2000s, from 41 in 1999 to 28 in 2008, while average vessel size reduced from 38,000 deadweight tonnes to 25,000.

In 2008, the Rudd Labor Government, having stated an intention, prior to election the previous year, to end 'abuse of the permit system and to review shipping policy', issued revised ministerial guidelines for granting licences and permits. Permit applications were to be made available to all licensed ship operators, the better to establish whether an Australian ship was available.

In 2010, all permit vessels operating inside Australia's Exclusive Economic Zone became subject, from the third voyage onwards, to the Fair Work Act 2009, via the Seagoing Industry Award. This extended workplace laws including wage awards to permit vessels, with minimum wage, hours of work and rest period requirements, while the ship was in Australian waters. Whereas a foreign (non-officer, or rating) seafarer might earn, under International Transport Federation rates, not more than 30 per cent of the pay including overtime of an Australian equivalent, minimum award rates are higher, at around 60 per cent of equivalent Australian enterprise bargain agreement rates.

In 2013, the Coastal Trading Act 2012 came into effect, giving priority to Australian flag vessels. Australian registration (the new 'general licence' regime) was now restricted to Australian owned ships, with transitional arrangements for foreign owned ones.⁴ Complex contestability procedures were introduced in applying for the renewable 'temporary licences' that replaced the voyage permit arrangements. The new arrangements increased both costs and uncertainty, at least temporarily, for bulk shippers in particular,⁵ as described in the draft report.

² Willis, R 1989, *Reforming Shipping and the Waterfront*, Minister for Transport and Communications Statement, 1 June

³ See Australian Institute of Marine and Power Engineers 2008, Submission to House of Representatives Standing Committee on Infrastructure, Transport, Regional Development and Local Government Inquiry into Australian Coastal Shipping, Appendix A.

⁴ Under the predecessor Navigation Act, licensing was available to foreign ships, provided they met all registration requirements, including compliance with employment law and use of crews comprising Australian citizens or residents.

⁵ Non-bulk services do not appear to have been significantly affected. This is perhaps because the application requirements for temporary licences, involving advance specification of voyage dates in blocks of five or more, align better with the public schedules that are a feature of non-bulk and passenger services, than they do with bulk services, where changing demand and supply conditions and individual customer requirements can complicate

However, the changes barely reduced participation of foreign flag ships on the coast. In 2013-14, the most recent year for which data is available, temporary licence vessels carried 13.5 million tonnes, 26 per cent of the task, much as in the 2000s. The temporary licence share is thought to be higher now, with 'flagging out' of petroleum tanker and other vessels over the last two years.⁶

As in the earlier period, the total number of Australian registered ships continued to decline, from 28 in 2007-08 to 21 in 2013-14. Average vessel size declined from 27,000 deadweight tonnes to 12,000 deadweight tonnes, while that of Australian owned, overseas registered vessels increased from 42,000 to 62,000 deadweight tonnes. And, as in the earlier period, there have been instances of Australian crews being made redundant, to make way (forcibly, according to reports) for foreign crewed vessels on temporary licences.⁷

In June 2015, the Abbott Coalition Government proposed legislative amendments involving a new two-tier permit system. Ships trading on the coast for less than 183 days in a year would no longer attract payment of minimum award wages – in effect, raising substantially the existing two voyage threshold. Ships trading for more than 183 days would need to meet minimum Australian crewing requirements, mirroring those for ships on the Australian International Shipping Register, as established by the Gillard Labor Government. These comprised at least two Australian officers, with other positions eligible to be foreign-crewed and paid at minimum award wages.

Despite support from shipper representatives, the proposals were criticised for the potential for maritime industry job losses and for not offering a competitive level playing field for Australian shipping. There were fears that the 183 day rule would provide an opportunity for ship owners to offer a continuing coastal service by rotating foreign vessels through. The Senate rejected the amendment bill in November 2015.

Australian policy settings in international context

Australia's shipping policy settings share a lineage with those of New Zealand and Canada, all one-time British Commonwealth 'dominions'. In each country, domestic shipping was previously closed to other than 'British' ships, with this nomenclature continuing until at least the 1980s. Legacy legislation of each country allows or allowed permits to be granted to unlicensed, i.e. foreign, ships, in particular, where no licensed ship is or was available. Today, Australia's settings are the most liberal of the three, allowing 'stand-alone' coastal services by foreign flag vessels, whereas New Zealand permits foreign flag access only as part of continuing international voyages. Canada's policy settings are more closed.

Liberalisation of cabotage – understood as access by foreign flag ships to coastal trade – is yet to gain standing in negotiations in the World Trade Organization and the General Agreement on Trade in Services

forecasting of future service needs. ANL, carrying a large share of the coastal container traffic between east coast ports and Fremantle, under temporary licence arrangements, has found the temporary licence regime workable and provided evidence to a parliamentary committee of falling freight rates in recent years. See Submission to the Senate Rural and Regional Affairs and Transport Committee Inquiry into the Shipping Legislation Amendment Bill, p. 5 and 'Farmers' coastal shipping criticism wide of the mark, says ANL chief', *Lloyds List Australia*, 5 August 2016. It should be noted that many agricultural and other non-bulk shippers were adversely impacted by cessation of international container services through the port of Bell Bay in May 2011. Non-policy related factors appear to have contributed to this outcome, as discussed by the Commission in its 2014 inquiry report (*Tasmanian Shipping and Freight*, pp. 129-131). However, debate has persisted on whether the extension of minimum award coverage to foreign flag ships, introduced the previous year, was a factor as well. See Shipping Legislation Amendment Bill 2015 Second Reading Speech, Senator Richard Colbeck, Senate Hansard, pp. 9116-9117.

⁶ See Strategic Marine Group, "Coastal shipping temporary licence use on the rise", *Lloyds List Australia*, 17 June 2016.

⁷ See "Guerrilla raid: Security guards force Australian crew off Alcoa ship MV Portland", *The Age*, January 13, 2016 and "Armed ships remove ship's Australian crew, escort replacements aboard", *Sydney Morning Herald*, February 5, 2016

and cabotage restriction remains widespread.⁸ Notably, the United States limits foreign ownership of its domestic shipping to 25 per cent equity participation and requires ships to be built in the country, as well as mandating crewing by United States nationals or residents.

The 28-member European Union, where access to each country's coast is available on a mutual reciprocity basis and with a single labour market, is a prominent, if partial, exception to this restrictive approach. Wage levels of east European nations, which are below those prevailing in western Europe, but above those in the global shipping industry, are understood to predominate.⁹

Finally, at least three European countries, the UK, Iceland and Ireland have an 'open coast' policy, with essentially unrestricted access available for foreign ships. As a country with both a sizeable coastline, as has Australia and with the world's fifteenth largest fleet, in terms of deadweight tonnage (Australia's is the fifty-third largest), the UK's policy approach merits attention.

Under the UK flag, there are no nationality restrictions on officers or crew sailing on UK vessels, other than for masters of so-called strategic vessels, which include larger passenger ships and product tankers. Secondly, under the UK's tonnage tax regime, ship owners access low and stable tax arrangements, with the rate based on gross ship tonnage rather than income and UK seafarers are eligible for income tax rebates, regardless of the flag of the vessels on which they are employed. This lowers seafarers' gross employment costs for ship operators, improving seafarer competitiveness. With the country's open and level playing field policy settings, the size of the UK fleet has increased over the past decade. Moreover, ratings comprise over 40 per cent of the UK's seafarer workforce, with most employed in the ferry and cruise liner sectors, rather than in the freight sector.¹⁰

Is Australian coastal shipping inefficient?

The need to improve maritime labour efficiency was a national policy preoccupation in the 1980s and early 1990s. Over this period, average crew sizes per vessel fell by nearly 50 per cent from the low 30s to 18 in 1996. This remains the norm and is regarded as an internationally competitive level, with some bulk ships operating with crews as small as 16. However, industry considers that outstanding issues remain, including work practices with regard to crew multi-tasking and use of riding gangs for maintenance work during voyages. Other issues go beyond the maritime sector and relate to the international competitiveness of general Australian employment law and practices on matters such as worker's compensation and dismissal.

With regard to cost, all-Australian crews are by definition uncompetitive in comparison with open register crews that comprise, stereotypically, officers from 'first world' countries and ratings from 'third world' ones. Australian wages for ratings are typically three to four times those recommended by the International Labour Organization for international seafarers. Leave conditions for ratings that are well below the Australian level, i.e. three months rather than six months per year – although six months is an international norm for officers – add to the cost differential.

Such cost differences would be experienced in virtually all industries throughout the economy and are not unique to shipping. The difficulty for shipping policy arises from the generally homogenous character of the shipping service or 'product', on the one hand and the 'borderlessness' of the global shipping industry, on the other. The latter is more present for Australia than some other countries, as most of the continent's

⁸ See Brooks, M 2009, *Intermodal Transport & Supply Chains: Liberalization in Maritime Transport*, International Transport Forum, pp. 3-4.

⁹ "Commonly vessels in these trades employ east European crews whose wages are less than Australian but more than Asian wages" (Aurecon 2013, *Tasmanian Shipping and Ports*, Report for the Department of Industry, Energy and Resources, September).

¹⁰ Department for Transport (UK) 2015, *Seafarer Statistics, 2015*, p.5

coastline is accessible to ocean-going vessels. Thus, regardless of the level of technical efficiency of the Australian industry, the opportunity almost always exists to facilitate a lower cost service for shippers, if policy so chooses.

Why the stagnation in coastal shipping?

As in other countries (see Table 1 below), freight carried by coastal shipping has recorded only slow growth for several decades. This largely reflects a narrowing in domestic sea freight's role, which occurred progressively through the twentieth century. Tasmania and the islands and remote communities of northern Australia aside, sea freight became primarily confined to bulk commodities, with other freight, often inherently faster growing, accommodated by rail and road freight networks using new and upgraded infrastructure. Source industries such as cement, fertiliser and aluminium have also been subject to prolonged, competitive pressure from imports.

Table 1 Coastal freight growth (selected countries and periods)

Country	Period	Average annual growth rate
Australia	1992-2014	0.7%
	1990-1996	-3.5%
Canada	2001-2011	1.5%
European Union	2002-2010	-1.7%
Mexico	1990-1996	0.5%
United Kingdom	2004-2014	-3.9%
United States	1990-1996	-1.8%

Source: Various and author analysis

With regard to the impact of policy settings, introduction of the Coastal Trading Act would have had some negative impact on task growth, particularly in the short term, when uncertainty about regulatory outcomes was high, with the risk of challenge to temporary licence applications. It is understood this uncertainty has dissipated more recently, with few general licence ships remaining and with industry wariness about engaging in a potentially adversarial process, with the risk of damage to relationships between people and businesses. However, the more significant and longer term impact – and one that has been positive for task growth – has come from the policy of allowing (temporary licence and previously voyage permit) access by foreign vessels. This has helped keep costs down in both the domestic bulk and the east to west (transcontinental) non-bulk markets. Between 2000 and 2007, with a rapidly expanding voyage permit (foreign flag) task share and in a context of unusually strong economic growth, coastal shipping grew at an average of two per cent a year, compared with a twenty year annual average of 0.7 per cent.

Do shipping jobs matter?

The draft report argues that shipping industry jobs should not be preserved at the expense of job growth in other industries. However, it does not engage with the more complex impacts of Australia's two-track coastal shipping policy, as they relate to employment. These are that, while the 'Australian flag prioritisation' aspect of the recent policy settings will have harmed jobs growth in end-user industries including agriculture, the policy's long-standing and continuing 'foreign flag access' aspect, with its built-in 'flagging out' option for Australian coastal ship owners – is inimical to jobs growth in the shipping industry,

with the decline in ship numbers and vessel sizes proxy indicators of this impact. Thus the question of whether the apparent trend in shipping jobs matters and, if so, how, is an important one.

In 2012 the Maritime Workforce Development Forum found that there were around 1,000 qualified seafarers employed in 'blue water' (i.e. coastal and international) trading and observed:

There has been a shift in the balance of the Australian merchant marine industry over the last twenty years – from a primarily 'blue water' trading industry (19 per cent ... as compared with some 40 per cent of the industry in 1990) to an industry with a large presence in the off shore oil and gas sector (32 per cent ...), with key supports in towage (18 per cent), dredging (6 per cent), pilotage (5 per cent) and ports (3 per cent), reflecting the move to Australian mariners providing services to a growing number of foreign trading ships and off shore activities.¹¹

These various activities encompass both areas of national competitive advantage (off shore resources) and 'natural monopoly', or essential, marine infrastructure. While not an exhaustive list, other fields of marine-related activity include maritime education, shipping contract management and maritime safety administration. With regard to the latter, Australia possesses a high quality maritime safety regime, evidenced by the fact that many poorer quality international flag vessels choose not to visit Australian ports, in order to avoid receiving ship deficiency assessments and the attendant risk of ship detention.¹² Quality maritime safety administration underpins both Australia's international shipping task, comprising some 12 per cent of total global trade and a coastal shipping task that includes more than 1,800 annual voyages by foreign flag ships (2013-14).

Skilled migrants with seafaring expertise can help to underpin the future capability needs of these and other industries, where and as required. But it is difficult to see how a policy path that in future could imply almost total reliance on skilled migrants, to discharge the industries' seafaring-related functions, can reflect the long term national interest.

What policy options for Australian coastal shipping?

Current arrangements preferencing an 'Australian ownership only' Australian flag have proved problematic for the cost of bulk shipping services, at least in their initial impact and for regulatory certainty. They have also not revitalised the Australian shipping industry, due largely to the continuing option for owners and operators to 'flag out' and move from the first track of the policy settings to the second. But revitalisation still matters for a 'soft infrastructure' sector that is important to the functioning of the national economy.

This submission considers that policy should be assessed against three main objectives, with a recognition that trade-offs are required between them: regulatory certainty and simplicity; cost-competitiveness; and continuation of a viable Australian shipping industry. With regard to scheduled non-bulk and passenger services, service frequency and reliability is a fourth necessary objective. Two contrasting options could be considered, each centred on the principle of a level playing field between eligible operators.

The first is an 'open coast' regime, as applies in the United Kingdom. This is similar to the 'removal of cabotage restrictions', as advocated by the Commission, but with certain prerequisites. These prerequisites are, firstly, an internationally competitive shipping taxation regime and secondly, ship owners' essentially unrestricted access, as in the UK, to the international labour market.

When in government, Labor went some way towards the first requirement, with a zero rate of company tax for ship owners now in place. But a dividend withholding tax for non-resident shareholders and a lack of

¹¹ Maritime Workforce Development Forum 2013, *Australian Maritime Workforce Development Strategy*, p. 4

¹² Ship age is regarded as a reliable proxy indicator for quality. Whereas the average age of the world fleet in 2014 was 20.2 years, the average age of foreign ships visiting Australian ports was 8.4 years. Australian Maritime Safety Authority 2015, Submission to the Senate Rural and Regional Affairs and Transport References Committee Inquiry into the increasing use of so-called Flag of Convenience shipping in Australia, p. 5.

franking credits for domestic shareholders appears to have nullified the benefits for ship owners other than those in an investment phase – which, importantly, include SeaRoad, one of three shipping lines on the Bass Strait route. Also, in contrast to the UK and other European nations, the seafarer tax offset, which reduces the cost of employing Australian seafarers, is not available when working on overseas registered ships and so limits overall seafarer employment opportunities.

If all ship owners had unrestricted access to the international labour market, as well as a competitive tax regime, Australian coastal and international shipping sectors should each grow. But it seems likely that, due to the nature of the global marketplace, few if any ratings would be employed, while officers could fare better. Could the fast growing Australian cruise line sector provide an outlet for displaced ratings, newly supported with a seafarer tax offset that enabled them to accept a lower gross rate of pay on foreign flag cruise liners operating in Australia without loss of net income? Without an industry entry point at the rating level, how would even an officer workforce be sustained over time? The important point about these questions is that a strategy towards the re-employment and workforce implications of the policy would be needed.

In addition, under this option, a 'carve-out' for Tasmania shipping services could be considered, if necessary to prevent foreign ships being able to 'cherry pick' Tasmania services and undermine the capacity of operators to maintain a scheduled service pattern of the required frequency. In the aviation context, this was the argument used by Qantas and Virgin Airlines to oppose a proposal to allow foreign airlines cabotage access to air routes in northern Australia in 2015, a proposal that the government did not adopt. In the aviation case, the 'carrot' was a potential boost to northern Australia tourism, through increased direct services. Here also a policy trade-off could be involved, between some potential reduction in service cost on the one hand and assured service frequency and reliability on the other. If, on the other hand, there were judged to be no risk to desired service schedules, community acceptance of foreign crews could still be a matter to ponder, particularly perhaps with regard to passenger services.

The second option is a 'back to the future' one, where all ships on the coast would again come under the Australian flag. But the content of 'Australian flag' should be different from the past. Domestic shipping would be open to foreign ship owners, as it is in the domestic airline industry, internationally competitive arrangements would apply and there would be mixed nationality crews, resulting in a lower cost of service than if all-Australian crews were the norm. While this approach would be without known counterpart elsewhere, the 'hybrid' arrangements currently in place on Australia's largest coastal freight route, between Weipa and Gladstone in Queensland, i.e. foreign registered ships with fully Australian crews,¹³ offer a partial precedent.

In addition to concerns about increases in costs, shippers could fear that, however limited the initial Australian crewing share, it would increase over time, through union pressure and government or industry accommodation of it, eroding cost savings. Would it make sense to bring back the provision under the former Navigation Act for single and continuous voyage permits to be granted to foreign ships, for use if, in the future, costs increased at rates faster than those experienced in comparison sectors such as domestic aviation, road freight and rail freight? Aside from the risk of recreating the pattern of the past, involving incremental expansion of the role of foreign flag ships, benchmarking along these lines might well prove impractical. International bulk shipping markets are volatile, due to the interaction of often fast-changing resource commodity markets and shipping capacity that is largely fixed in the short term. So cost savings erosion remains a risk that would require some mitigation.

¹³ Operations on this route, an intrastate one, are not eligible for temporary licences. Four ships are licensed under Queensland's Restricted Use Flag arrangements, are registered in Singapore and use fully Australian crews (see Rio Tinto Bauxite and Alumina 2015, submission to the Senate Rural and Regional Affairs and Transport Committee Inquiry into the Shipping Legislation Amendment Bill, p. 2).

However, an exemption to allow foreign flag entry would be appropriate for cabotage services that are genuinely part of an international voyage, as these are likely to offer a cost and reliability of service that even a foreign flag domestic service could never meet. Today international liner vessels calling at east coast ports routinely pick up domestic containers and drop them off at Fremantle before continuing on their international voyage. These services, operating under temporary licence arrangements, are demonstrably cost-competitive, as they must compete for freight with domestic road freight and rail freight services. They are also additional to services that are provided by coastal shipping, or that potentially could be provided, given current shipping technology and Australia's economic geography. Whereas any domestic operator must cover the cost of the return 'west to east' leg, for which there is usually limited backhaul traffic, the international operator faces no such requirement.¹⁴

Such an exemption would, strictly, be a departure from the suggested 'level playing field for eligible operators' principle. The implied subsidiary principle here is one of seeking service additionality that does not undermine any functioning domestic shipping service network.

Conclusion

While more can always be done, today's Australian shipping industry is not inefficient, in contrast to the situation that prevailed in the 1980s and 1990s. But nor can it compete with foreign flag ships, accessing, comparatively, low wage international labour and more favourable shipping taxation regimes.

Policy options are needed that explicitly acknowledge and balance the key objectives of regulatory certainty and simplicity, cost-competitiveness for shippers and industry continuation. While not necessarily easy to achieve, a consistent level playing field between eligible operators should be a guiding principle. It stands in contrast to both current arrangements and those that have preceded them for more than 25 years.

¹⁴ In 2006 Pan Shipping attempted unsuccessfully to establish a domestic east to west shipping service. See Meyrick and Associates 2007, *International and Domestic Shipping and Ports Study*, Report for the Australian Maritime Group, pp. 108-109.