



**Australian Government**  
**Productivity Commission**

# Tasmanian Shipping and Freight

Productivity Commission  
Inquiry Report

No. 69, 7 March 2014

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**Publications Inquiries:**

Media and Publications  
Productivity Commission  
Locked Bag 2 Collins Street East  
Melbourne VIC 8003

Tel: (03) 9653 2244  
Fax: (03) 9653 2303  
Email: [maps@pc.gov.au](mailto:maps@pc.gov.au)

**General Inquiries:**

Tel: (03) 9653 2100 or (02) 6240 3200

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**Australian Government**  
**Productivity Commission**

***Canberra Office***

Level 2, 15 Moore Street  
Canberra City ACT 2600

GPO Box 1428  
Canberra City ACT 2601

Telephone 02 6240 3200

***Melbourne Office***

Telephone 03 9653 2100  
[www.pc.gov.au](http://www.pc.gov.au)

7 March 2014

The Hon Joe Hockey MP  
Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's final report into Tasmania's shipping costs and competitiveness of Tasmania's freight industry.

Yours sincerely

Karen Chester  
Presiding Commissioner



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# Terms of reference

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby request that the Productivity Commission undertake an inquiry into the current arrangements for supporting freight and passenger services between the mainland and Tasmania.

## **Background**

Tasmania is a small economy that relies heavily on sea trade. The shipping costs associated with getting goods to market are a concern for Tasmanian businesses and consumers. These transport costs create an additional cost burden for Tasmanian businesses compared to businesses on the mainland, which may be placing them at a disadvantage. While the Government operates three schemes to address the freight cost disadvantage, there is a concern that these are not delivering an efficient outcome or achieving the stated objectives.

## **Scope of Inquiry**

1. Examine shipping costs, competition and shipping industry competitive structures across Bass Strait.
2. Identify the factors inhibiting the provision of international shipping services to Tasmania.
3. Examine the competitiveness of Tasmania's freight industry, economic infrastructure and possible reforms that would assist in enhancing effective competition, investment and productivity growth.
4. Assess the merits and weaknesses of the current arrangements for supporting freight and passenger services between the mainland and Tasmania and provide recommendations on an appropriate future approach and/or arrangements.
5. In making assessments in relation to matters in paragraph 4, the inquiry should:
  - a. report on the freight and passenger tasks and their costs between Tasmania, Flinders and King Islands and the mainland of Australia; and between Tasmania and international ports;

- 
- b. quantify any freight cost disadvantages for goods eligible under the Tasmanian Freight Equalisation Scheme and the Tasmanian Wheat Freight Scheme, identify their primary causes and assess the impact of that disadvantage on Tasmanian business;
  - c. quantify any cost disadvantages for passengers travelling to Tasmania who are currently eligible for support through the Bass Strait Passenger Vehicle Equalisation Scheme;
  - d. assess the effectiveness of the current schemes as a mechanism for addressing cost disadvantages, including identification of the costs and benefits, the impact on stakeholders, and any unintended consequences or distortionary effects of the current arrangements; and
  - e. identify any alternative mechanisms that could more effectively address cost disadvantages, including assessing the full economic costs and benefits of any alternative mechanism.

## **Process**

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report to the public.

The inquiry will inform the broader ‘root and branch’ review of Australia’s competition laws and competition framework and will provide broad scope to identify areas where further competitive reforms of particular benefit to Tasmania could be introduced.

The Commission will conduct the inquiry in consultation with the Australian Competition and Consumer Commission.

The final report should be provided by 7 March 2014.

**J. B. HOCKEY**

Treasurer

[Received 29 November 2013]

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# Abbreviations

|        |  |
|--------|--|
| ABS    | Australian Bureau of Statistics                                  |
| ACCC   | Australian Competition and Consumer Commission                   |
| ANAO   | Australian National Audit Office                                 |
| ANZSIC | Australian and New Zealand Standard Industry Classification      |
| BITRE  | Bureau of Infrastructure, Transport and Regional Economics       |
| BSPVES | Bass Strait Passenger Vehicle Equalisation Scheme                |
| CPI    | consumer price index   |
| DHS    | Department of Human Services (Australian Government)             |
| DIER   | Department of Infrastructure, Energy and Resources<br>(Tasmania) |
| DIRD   | Department of Infrastructure and Regional Development            |
| FCL    | full container load  |
| FLCT   | Freight Logistics Coordination Team                              |
| GTE    | Government Trading Enterprise                                    |
| HPV    | high productivity vehicle  |
| LCL    | less than full container load                                    |
| MFP    | multifactor productivity   |
| OECD   | Organisation for Economic Cooperation and Development            |
| PC     | Productivity Commission  |
| PLF    | port licence fee   |
| PoMC   | Port of Melbourne Corporation                                    |
| RFE    | road freight equivalent  |
| RORO   | roll-on roll-off   |
| TEU    | twenty foot equivalent unit                                      |
| TFES   | Tasmanian Freight Equalisation Scheme                            |
| TWFS   | Tasmanian Wheat Freight Scheme                                   |



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# OVERVIEW

## Key points

- Tasmania, like mainland Australia, is an island economy. It is serviced by high quality but relatively high cost containerised domestic shipping services. The viability of direct international shipping services is affected by the cost of coastal shipping. Given its reliance on sea transport, Tasmania is particularly affected by inefficiencies embedded in coastal shipping regulation. This regulation should be reviewed and reformed as a matter of priority.
- Tasmania uniquely receives (Federally) subsidised freight services via longstanding arrangements in recognition of the relative cost 'disadvantage' of Bass Strait transit. The Tasmanian Freight Equalisation Scheme (TFES), Tasmanian Wheat Freight Scheme (TWFS), and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) were designed to partially offset these costs. The term equalisation misleadingly implies 'full' compensation for the cost disadvantage but that is not inherent in the design and operation of the schemes. Further, securing 'true' equalisation is inevitably a policy chimera.
- The Australian Government has outlaid more than \$2 billion since the inception of the schemes, and without change a further \$2 billion can be expected over the next 15 years. In 2011-12 total outlays for the schemes were \$128 million.
- There is no coherent economic rationale for the TFES and it falls well short of what is needed to improve the lagging competitiveness of the Tasmanian economy — which the Commission considers should be the policy imperative. It has a high fiscal cost, eligibility is arbitrary; and the direct recipients are concentrated notwithstanding the unclear incidence of the subsidy. Further, the TFES is inherently complex and leads to unintended consequences.
- There is no clearly articulated objective for the BSPVES. At least some of the subsidy is being captured by the Tasmanian Government-owned and sole provider of Bass Strait passenger and vehicle shipping services — TT-Line.
- The Australian Government has stated its current intention to retain the TFES and the BSPVES. The recommendations related to the schemes in this report are made on that basis.
- A flat rate of subsidy per container (adjusted for King Island and the Furneaux Group of islands) would offer significant advantages over the current parameter-based regime — increasing incentives to minimise transport costs, improving transparency and simplifying administration.
- The Tasmanian Government has initiated a process to secure the return of a commercially viable direct international container service, albeit involving some transitional assistance. This raises an intractable sequencing obstacle for considering the relative merit of moving now to extend the scope of the TFES to all eligible northbound commodities transhipped through the Port of Melbourne.
- Several efficiency issues relating to Tasmania's shipping and freight are the responsibility of the Tasmanian Government. These include: rationalising infrastructure assets such as ports and rail; private operation and ownership of freight infrastructure assets where this would improve their efficiency; and developing a sustainable integrated freight strategy.
- Tasmania faces broader economic and social challenges and the Australian Government should put less emphasis on freight subsidy schemes in favour of reforms that have national and Tasmanian benefits (such as coastal shipping reform) and those that directly enhance the competitiveness and productivity of the Tasmanian economy.

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# Overview

## The broader context

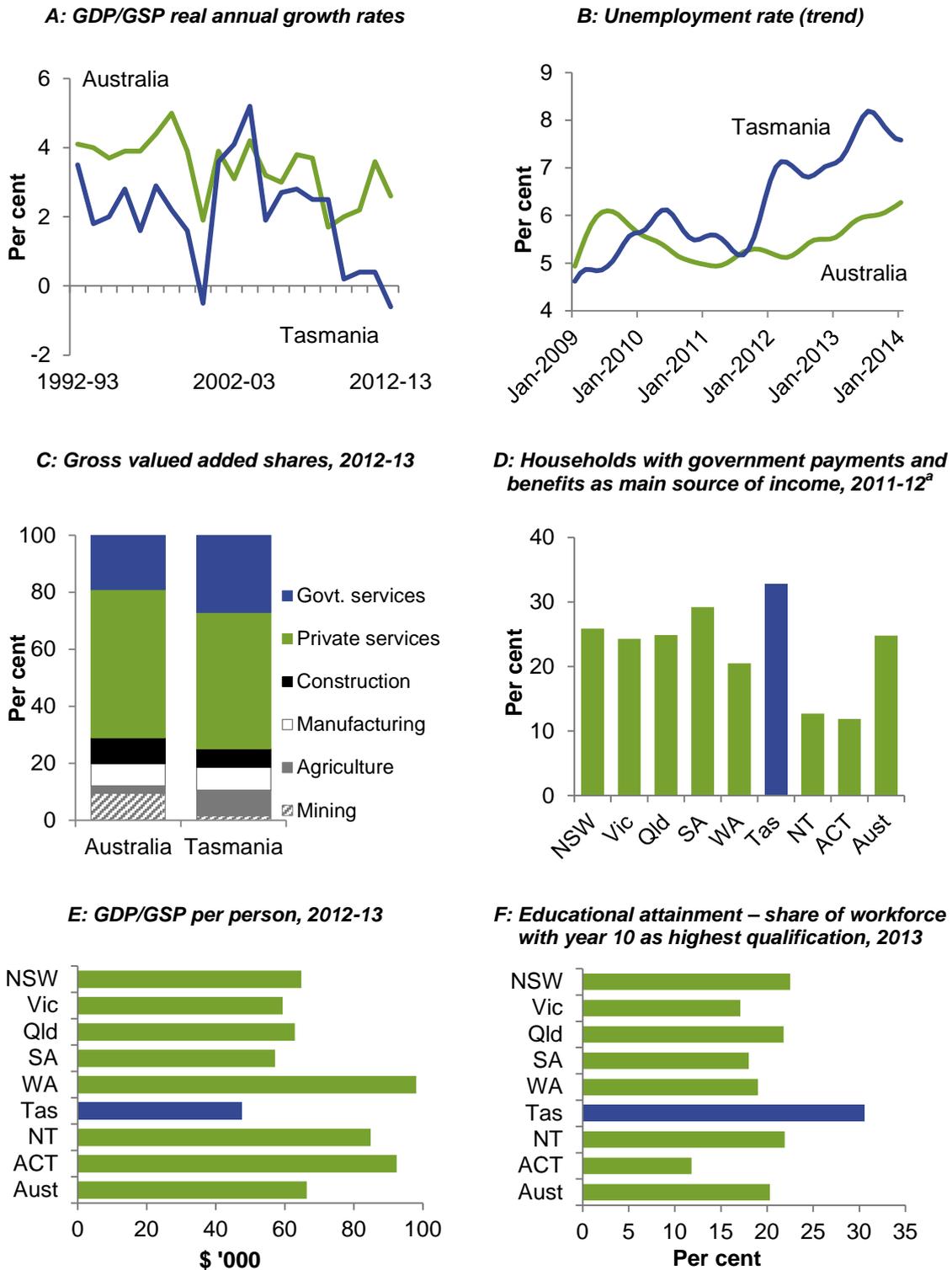
Tasmania is an island state, home to around half a million people. It has a host of natural advantages compared to many regional areas of Australia, but also shares the difficulties of many regional and remote Australian communities in accessing markets and services. It accounts for less than 2 per cent of Australia's gross domestic product, with a small 'domestic' market for producers who must look to mainland and overseas markets.

Tasmania has consistently lagged other states and territories on most economic indicators including income and employment, as well as social metrics such as educational attainment and welfare dependency (figure 1). These factors have contributed to the current net outward migration from Tasmania, exacerbating the small and steadily ageing nature of its population. Recent projections suggest that Tasmania is likely to have the lowest population growth to 2040 and remain the jurisdiction with the oldest population.

A number of interconnected drivers influence the performance of Tasmania's economy. Some are a matter of geography — natural resource endowments, distance from key markets, and small and dispersed population settlement. Others have more to do with the policy environment within which Tasmanian businesses operate. A key feature is the pervasive involvement of government in the Tasmanian economy (figure 1). This is particularly evident in the freight industry where the Tasmanian Government owns and operates major freight infrastructure assets including shipping, ports, roads, and rail. A key issue is whether these settings stifle innovation and private sector involvement. The Commission heard evidence that supported this concern. In particular, the issue of Local Government scale and structure was raised by several inquiry participants as a cost impost on business.

Tasmania has received substantial support through a wide array of Australian Government policy measures over the years. These have included subsidy schemes specifically designed to alleviate the costs faced by Tasmanian businesses and residents in accessing the Australian mainland.

**Figure 1 Tasmania's relative economic performance, selected indicators**



<sup>a</sup> Households defined as 'very remote' (around 23 per cent of NT's population) are excluded from the NT estimate.

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However, the widening gap between Tasmania and mainland jurisdictions in terms of income growth and employment suggests these measures do not meaningfully address the fundamental issues underpinning Tasmania's competitiveness.

The Commission considers that the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) are not the best way to advance Tasmania's economic development. They fall well short of what is needed to improve the competitiveness of the Tasmanian economy:

- they have a high fiscal cost (collectively \$2 billion since inception and without change a further \$2 billion over the next 15 years)
- eligibility for the TFES is arbitrary and the direct recipients are concentrated, with 50 per cent of the total amount claimed going to 10 recipients
- the incidence of the subsidies (who actually benefits) is not clear given the involvement of a monopoly service provider (TT-Line for passenger vehicle transit) and concerns about the effectiveness of competition between the three shipping lines on the Bass Strait route (for non-bulk freight)
- as subsidies they have unintended consequences, including perversely increasing the costs of goods for Tasmanian consumers.

These raise the question of whether more of the same policy measures can be expected to deliver different outcomes and reverse a generational trend of disparate performance.

Further, Tasmania is an economy in transition. Largely in response to market forces, it is gradually moving away from traditional resource-based manufacturing industries to higher-value economic activities in agriculture, aquaculture, specialised manufacturing and tourism. As such, what may have been well-intended policy initiatives a few decades ago are unlikely to be the best policy settings today.

Against this backdrop, the Australian Government asked the Commission to:

- Examine shipping costs, competition and shipping industry competitive structures across Bass Strait;
- Identify the factors inhibiting the provision of international shipping services to Tasmania;
- Examine the competitiveness of Tasmania's freight industry, economic infrastructure and possible reforms that would assist in enhancing effective competition, investment and productivity growth; and

- 
- Assess the merits and weaknesses of the current arrangements for supporting freight and passenger services between the mainland and Tasmania and provide recommendations on an appropriate future approach and/or arrangements.

In responding to the terms of reference, the Commission has examined the issues affecting the competitiveness of Tasmanian business as they relate to shipping, port, road, and rail infrastructure and services. The Commission has examined how these may be addressed, noting that several of the potential policy responses are the responsibility of the Tasmanian Government.

This report also focuses on the effectiveness of the freight and passenger subsidy schemes and assesses the alignment of their objectives and outcomes. Acknowledging the Australian Government's stated intention to retain the schemes, the Commission has considered amendments within their current design. In light of the material anomalies inherent in the current schemes' design, the Commission has also canvassed other options to mitigate some of these anomalies.

Some stakeholders expressed their sensitivity to the schemes' payments being referred to as 'subsidies' which they believe has a pejorative connotation for a payment they consider to be a reasonable entitlement to offset their locational disadvantage within a Federation of states. The Commission, as conveyed during its public hearings, uses the term 'subsidy' in this report as a technically correct reference that does not prejudice the policy analysis and review.

Recognising the broader economic challenges faced by Tasmania, the Commission considers that simply addressing the anomalies in the subsidy schemes will not meaningfully improve the competitiveness of the Tasmanian economy — which the Commission considers should be the policy imperative. Successfully addressing the endemic problems of comparatively lower income growth, higher rates of unemployment, lower labour productivity and social disadvantage is likely to require policies and programs that better target the underlying impediments.

The key policy levers to increase the competitiveness of the Tasmanian economy revolve around: improved employment and educational outcomes; greater coherence in infrastructure provision; private operation and ownership of infrastructure assets where this is both feasible and would improve their efficiency; coastal shipping reforms that will have positive spillovers for an economy that is highly dependent on shipping; the removal of subsidies to inefficient industries; and more generally, a regulatory environment that lowers the cost of doing business in Tasmania.

The report therefore canvasses elements of an economic development approach as a future and better alternative to the subsidy schemes.

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Owing to the short timeframe for this inquiry, the Commission has not been in a position to examine all the issues within scope of the terms of reference with the same level of depth. Data limitations have also constrained the Commission's ability to review in detail issues such as the commercial aspects of Bass Strait shipping services and the commercial viability of direct international container shipping services to and from Tasmania.

As an important input to this inquiry, the Commission has drawn on the substantial body of work undertaken by the Freight Logistics Coordination Team (FLCT) — an independent advisory body set up in November 2012 and funded by the Australian Government to inform a long term freight strategy for Tasmania.

## **Shipping and freight**

Tasmania will always be reliant on shipping and air services. With over 99 per cent of freight volumes moving in and out of the State by sea, the Bass Strait shipping link and its connectivity with land freight infrastructure and logistics is vital. Personal and business travel to and from Tasmania is now overwhelmingly by air, with around 90 per cent of travellers choosing to fly. The cost and frequency of sea and air access are even more critical for the sustainability of regional communities on King Island and the Furneaux Group of islands.

The economics of shipping relative to other transport modes improve as the distance traversed increases. As such, shipping is typically not cost-effective relative to road transport for distances comparable to Bass Strait.

The efficiency of Tasmanian shipping and freight is driven by several direct and interrelated factors: limited competition; scale; and investment.

### **Coastal shipping reform can make a difference**

As an island state, Tasmania is especially vulnerable to regulation and regulatory change that increases the cost of engaging in coastal trade. Foreign flagged vessels currently servicing Tasmania predominantly transport dry and liquid bulk freight.

Most inquiry participants raised concerns about the anticompetitive effects of Australian cabotage regulation and its impacts on the costs of shipping borne by Tasmanian businesses. Various studies have concluded that cabotage restrictions are likely to have a greater effect on Tasmania than other Australian jurisdictions. Recent amendments to the Fair Work Regulations in 2009 and the introduction of

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the *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth) have added further restrictions.

The 2009 changes extended the application of the *Fair Work Act 2009* (Cwlth) to workers on foreign flagged vessels engaged in coastal shipping. The 2012 changes introduced new hiring, licensing and registration regimes, and tax concessions for certain ship operators.

The Regulatory Impact Statement (RIS) that found a net benefit from the 2012 changes (and informed the parliamentary consideration and decision to introduce them) appears flawed. It assumed substantial benefits from the productivity compact (not in existence for the RIS preparation) that appear unrealistic.

Overwhelmingly, inquiry participants agreed that coastal shipping regulation is an important factor in reducing competition and increasing shipping costs for Tasmanian business. Additional costs imposed on foreign flagged vessels discourage these vessels from competing in the market for Australian coastal shipping. Further, where domestic trade assists in defraying costs of international shipping — as was evident for the previous direct international container service to Tasmania by the AAA consortium — any additional costs or regulatory requirements for carrying such cargo adversely impact the viability of international shipping services, particularly to marginal ports such as those in Tasmania.

The existing regulatory framework clearly affects Australian coastal shipping more broadly. The cumulative effect of the 2009 and 2012 changes has been a reduced interest from international vessels engaging in the Australian coastal trade and, consequently, reduced shipping options for users of domestic and international shipping services. They also increase the costs of providing domestic coastal services, to which Tasmania remains especially exposed.

In view of the higher shipping costs evident in Tasmania, the evolving economics of international shipping, and the likely impacts on Australian business generally, the Commission recommended in its draft report that the foreshadowed Australian Government review of coastal shipping be expedited with the objective of increasing the competitiveness of Australia's coastal shipping. This draft recommendation received strong support by most inquiry participants throughout the public hearings and in supplementary submissions. The foreshadowed review should be broad in scope, and include an examination of cabotage. It should recommend the removal of any anticompetitive provisions from relevant legislation, unless a clear case publicly demonstrates that there is a net benefit to the community as a whole.

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## Competition in Bass Strait shipping

A defining feature of Tasmania's economic infrastructure is limited competition between transport service providers. This is not dissimilar to many regional and remote production and population centres in Australia. However, the greater operational engagement of government in Tasmania is a distinctive feature.

Tasmania has a comparable level of competition for air freight and passenger travel to regional areas on the mainland, with low cost carriers servicing Hobart and Launceston airports.

The characteristics of Bass Strait shipping constrain competition for container traffic and effectively isolate Tasmania from international container services. Bass Strait shipping faces no competition from road and rail alternatives. Air transport provides a potential substitute, but only for time-sensitive and/or high-value commodities in small consignments.

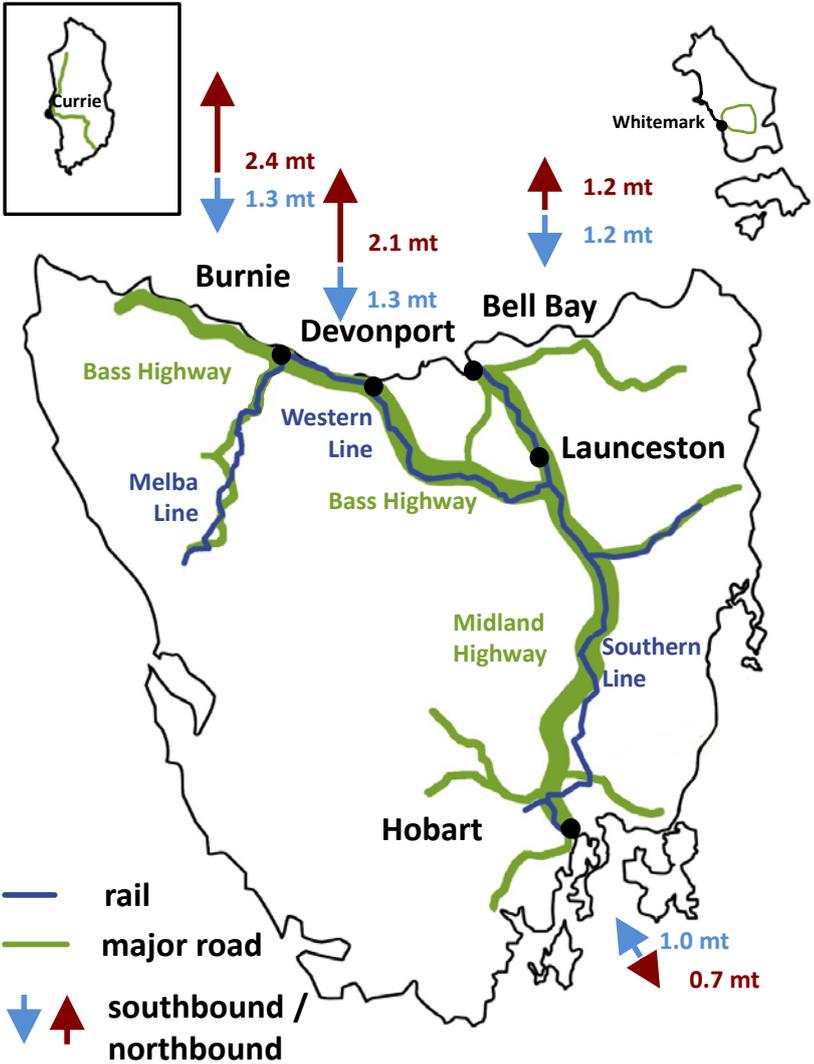
There are three shipping lines providing overnight daily services between Tasmania's northern ports and the Port of Melbourne: Toll ANL, SeaRoad Holdings, and the Tasmanian Government-owned TT-Line. Toll has over 50 per cent market share, with the other two providers holding roughly equal shares of the remainder. The later daily departure time and faster speed of the TT-Line service and its greater capacity for handling trailerised fresh freight means that it offers a distinct service. Notably, ANL also provides international shipping services. In the absence of a direct international container service, other international shipping lines servicing Tasmanian importers and exporters must utilise one of the three Bass Strait shipping lines.

Overall, and as supported by participants' submissions and evidence, the existing shipping lines provide high quality — but high cost — services to Tasmanian shippers (users of shipping services). While producers in Tasmania have diverse needs and many would prefer a lower-priced and less frequent service, they have mostly adapted their business operations to the current level and cost of service. Only 15 per cent of Tasmanian northbound products require an overnight service, yet up to half of all goods transported have logistic chains built around the immediate flow of product after production.

Whether the current shipping industry structure provides for effective competition and efficient shipping services is unclear. Some participants, primarily ship owners and larger shippers, consider that the three shipping lines compete for volume on price and service offerings. However, many of these same participants expressed concerns about 'excessive' Bass Strait shipping costs. Others, especially smaller shippers, also contended that there is an inherent lack of competition on what is

essentially a niche route. In their view, there are essentially the two commercial shipping firms operating with high levels of capacity utilisation and limited necessity to compete aggressively on that route, with limited influence from the Tasmanian Government-operated TT-line.

**Figure 2 Tasmanian freight movements (major ports), 2012-13**  
 mt = million tonnes



Importantly, Commission estimates suggest that TT-Line has not earned a commercial rate of return over the past five years, which raises the substantive issue of whether the principles of competitive neutrality are being satisfied. A failure to satisfy these principles can result in a distorted market and potentially and perversely reduce the level of competition.

Benchmarking of shipping costs is intrinsically difficult and therefore typically subject to caveats. That said, benchmarking work by Aurecon (commissioned by the

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FLCT) suggests that Bass Strait shipping is 24 per cent more expensive than comparable European services, which it partly attributed to relatively higher input costs for Bass Strait providers (particularly labour and fuel).

The cost of container shipping across Bass Strait is also an issue for international shippers. Compared to direct international shipping from Bell Bay, transshipping through the Port of Melbourne adds additional costs of about \$800–\$1500 per container. For international shipping lines servicing this freight, this additional transshipment cost is largely a direct cost-pass-through to their shipper clients, albeit potentially less transparent for clients using an integrated service.

Scale is a major factor (figure 2). The total volume of Tasmanian freight shipped in 2011-12 (the latest available data at a disaggregated level) was just under 13 million tonnes. Non-bulk freight, which is the main freight task across Bass Strait, accounted for around 5 million tonnes or around 380 000 TEUs (twenty foot equivalent units). From a peak in 2003-04, total trade volumes across Bass Strait have fallen by around 22 per cent over the period to 2011-12, partly driven by declines in forestry and paper products. The relatively low volumes are compounded by the diverse and highly seasonal nature of the non-bulk freight task.

Nonetheless, all three existing shipping operators are understood to be considering new investments which would materially increase capacity.

The Commission does not have access to data on operating costs and revenues of the commercial shipping lines and, therefore, cannot reach an informed view about the effectiveness of competition on that route. Fixed costs for a new entrant would be high. In the event of coastal shipping reform, the Commission notes the possible provision of other service options for shippers who do not require an overnight service.

## **Investment**

Tasmania's economic performance is also impacted by its limited ability to attract private capital. There is a perception amongst stakeholders that government sector involvement, combined with unclear infrastructure strategies, has stifled private sector investment. The purported lack of capital is exacerbated by current and growing constraints on public sector budgets. Most freight-related assets in Tasmania are owned by the state government including TT-Line, TasPorts, TasRail and Tasmania's road authorities. None are earning a sustainable rate of return on assets, which constrains new investment.

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### *Tasmanian ports*

Ports are an integral link in supply chains and, in a capital constrained environment, it is critical that investment decisions are made commercially.

TasPorts, a state-owned enterprise established in 2006, is responsible for the management of 12 Tasmanian ports, including the four major ports: Burnie, Devonport, Bell Bay and Hobart. The majority of freight moves through the three northern ports.

For the three northern ports, the Tasmanian Government has a strategy of ‘one port, three locations’. In 2012-13, the total throughput (including empty containers) of Tasmania’s three northern ports was around 451 000 TEUs, of which Burnie and Devonport accounted for around 56 per cent and 43 per cent of container traffic respectively. Bell Bay is predominantly a bulk port.

However, there are competing perspectives on the future development of Tasmanian ports. TasPorts is currently in the process of developing a long term plan based largely on retaining the three ports through a strategy of port specialisation and incremental investment in infrastructure. A number of submissions argued that a focus on port rationalisation would allow greater economies of scale to be achieved through consolidation of the freight task, and greater certainty and potentially lower costs for users.

There was some evidence put forward by inquiry participants to suggest that TasPorts costs are high relative to other Australian ports. It is difficult to determine whether the cost differences are due to scale or to other factors such as ageing and inefficient infrastructure, or the exercise of strategic behaviour by TasPorts. The fact that TasPorts is not generating a commercial rate of return on its assets, as required in its statement of expectations, could be the legacy of leasing arrangements it inherited when it was established in 2006, or it could suggest that TasPorts is not charging users the full cost of the services it provides. The current approach to pricing adopted by TasPorts — statewide uniform pricing — is likely to reduce flexible cost management and investment and involve cross-subsidies across ports and port activities. The Commission did hear evidence from port users to this effect. Against this background, there is an urgent need to articulate and implement a clear port strategy for Tasmania.

The Commission considers that the Tasmanian Government, as an essential precursor to considering such a strategy, should direct the Office of the Tasmanian Economic Regulator (OTTER) to conduct an inquiry into the pricing policies of TasPorts. In carrying out the inquiry, OTTER should consider and make

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recommendations on the extent to which pricing at the three northern ports is efficient and, where appropriate, cost reflective of individual ports.

To ensure that Tasmanian ports have access to adequate capital to enhance efficiency and competitiveness, opportunities and other models for private sector involvement should be considered by the Tasmanian Government. Privatisation and long term leasing of ports is a growing component of structural reform programs in most mainland jurisdictions, with the Port of Melbourne the only major capital city port on the east coast still owned/operated by a state government. The NSW Government is also further advancing the privatisation of regional ports. Such a move would provide an opportunity to reprioritise and redirect scarce public sector capital. It would also provide an opportunity to ensure that future capital investment decisions are underpinned by commercial imperatives. Further, it may be an opportune time for the Tasmanian Government to seek commercial third party advice on the merit of testing the market for interest in TasPorts.

#### *Tasmanian roads and rail*

Competitive and cost-effective freight connectivity between ports and land freight corridors is an essential enabler for the Tasmanian economy.

The road network in Tasmania accounts for the majority of the freight task to and from ports. As such, the efficiency of road freight networks has significant implications for other modes of freight infrastructure.

While Tasmania has an extensive road network, there are regulatory limitations on the use of high productivity vehicles such as B-Doubles. On balance though, road accessibility does not appear to be a significant constraint on the Tasmanian freight task. However, as is the case nationally, there is a disconnect between road funding and the pricing of, and demand for, road use services.

In its final report to the Tasmanian Government, the FLCT noted the need to prioritise road investment on the main freight corridor linking Hobart to Burnie-Devonport and on the key regional freight roads that connect to this corridor.

Road funding is provided by all three levels of government — Commonwealth, state and local. Over the period 1998-99 to 2011-12, the Australian Government's share of road funding in Tasmania averaged 43 per cent, significantly above the national average of 27 per cent. Australia's fragmented model for road funding leads to a less than optimal allocation of investment, with funding not necessarily targeted to where it would deliver the greatest net benefits.

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A notable feature of Tasmania's land freight infrastructure is the duplication of important elements of the road and rail networks — providing some substitutability between the two modes. Rail accounts for a small share of the Tasmanian land freight task (18 per cent on a tonne kilometre basis in 2011-12 compared to more than 50 per cent nationally in 2009-10), with cement, coal and mineral ores accounting for the bulk of rail freight.

Rail has had a chequered history in Tasmania under Tasmanian and Australian Government ownership, and part-private operation. The rail network returned to full Tasmanian Government ownership in 2009, and has continued to operate at a loss. Rail is generally profitable for long-distance routes, which do not exist in Tasmania.

A key issue for the Tasmanian Government to consider is the long term viability of its rail network. While substantial upgrades to tracks and rolling stock have recently been funded by the Australian and Tasmanian Governments, it is unclear whether these are justified on the basis of the expected rate of return on invested capital. The net benefits of rail investment and ongoing financial support for moving freight need to be judiciously considered from a long term and whole-of-Tasmania perspective, given the possible alternative use of these funds at a time when meeting other demands for infrastructure services is increasingly difficult. This is particularly pertinent in the context of TasRail's poor financial performance.

The commercial sustainability of TasRail could be improved by increasing its revenue base, either through increased capacity utilisation and/or higher freight charges (although higher charges could reduce usage). There may also be some scope for rationalising those sections of the network where there is insufficient demand to cover operating costs or to justify capital upgrades.

Capital constraints and the importance of freight costs to Tasmanian businesses make rigorous comparative analysis of alternative future investment options imperative, including for recent funding commitments. The funds used for the recent rail investment are likely to have delivered a higher return if they had been directed to other Tasmanian transport infrastructure. The proposed Tasmanian Freight Strategy provides an avenue to establish a framework for such assessment.

### *An integrated freight strategy*

Tasmania suffers from a lack of an integrated freight strategy. This increases the risk of inefficient decision making in relation to road and rail corridors, connectivity to ports and duplicated infrastructure. In this context, the Commission supports the development of a long term integrated freight strategy for Tasmania which addresses the fundamental issues of productivity and effective capital allocation. A

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jurisdiction with a small population and tax base is unlikely to be able to maintain a full and duplicated array of transport assets. The development of such a strategy will help to ensure that developments in freight infrastructure are supportive of Tasmania's long term economic growth. While governments should play a key role in developing a long term integrated plan for the State, and the Tasmanian Government is currently undertaking such a process, the plan needs to be transparent and evidence-based, include wide consultations with industry and the community at large, and provide opportunities for private sector investment and operations.

As the Australian Government will retain a key role in funding Tasmanian infrastructure investments, the Commission views it as appropriate that the Australian Government (including through Infrastructure Australia) be consulted in the development of that strategy.

## **Offsetting a cost 'disadvantage'?**

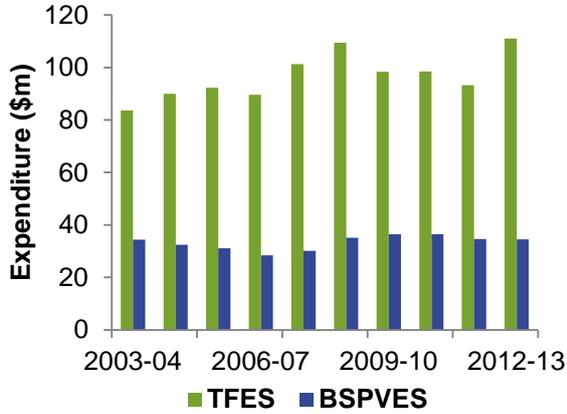
Concerns about the costs incurred by Tasmanian business and residents for Bass Strait transit have been the basis for longstanding subsidies for sea freight and passenger-accompanied vehicle travel. The Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) were designed to partly offset these costs (figure 3). The reference to equalisation in two of the schemes misleadingly implies 'full' compensation for the cost 'disadvantage', which is not inherent in the design and operation of the schemes.

The current arrangements (which have been in place since the inception of the schemes) are selective in nature and involve paying subsidies to particular recipients on the basis of eligibility criteria that appear arbitrary. In addition, and by design, recipients are paid a per unit amount that is not intended to secure consistency between each recipient's actual sea freight cost and the cost that would have applied if there were actually a road bridge across Bass Strait.

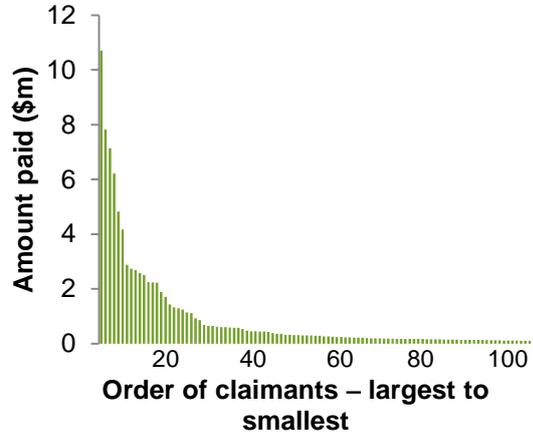
A genuine equalisation scheme on the grounds of a notional 'land bridge' would entail a significant widening of the scope, scale and cost of the current arrangements and exponentially increase not only the fiscal cost but also the cost to Tasmanian consumers and the Australian economy (as detailed in chapter 3). It would involve paying assistance to all freight and passengers transported by sea across Bass Strait — encompassing inter alia additional volumes of around 250 000 TEUs for non-bulk freight and over 40 000 additional passengers in 2011-12.

**Figure 3 TFES, TWFS and BSPVES — key indicators**

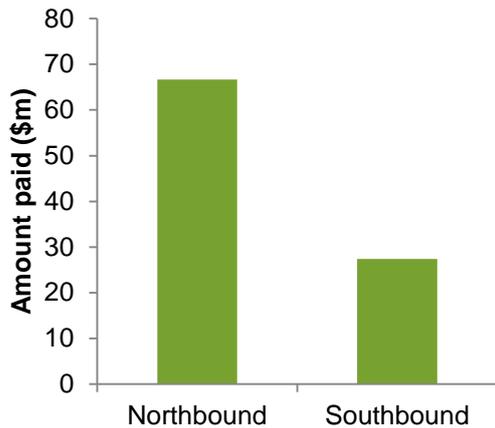
**A: TFES and BSPVES funding**



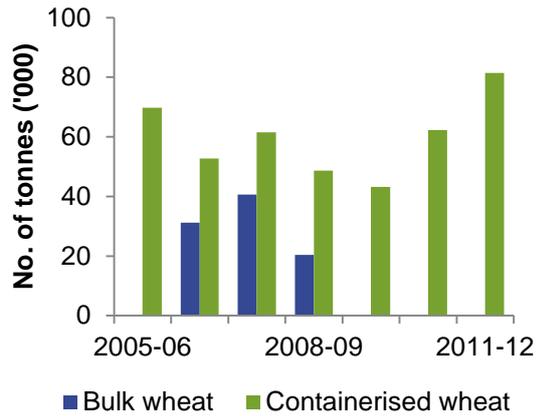
**B: TFES assistance paid to the top 100 claimants, 2011-12**



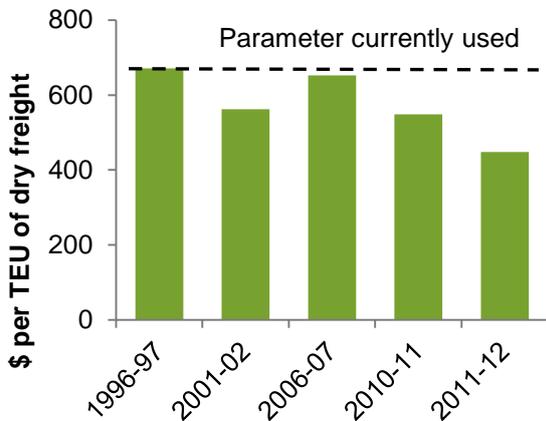
**C: TFES assistance paid by direction, 2011-12**



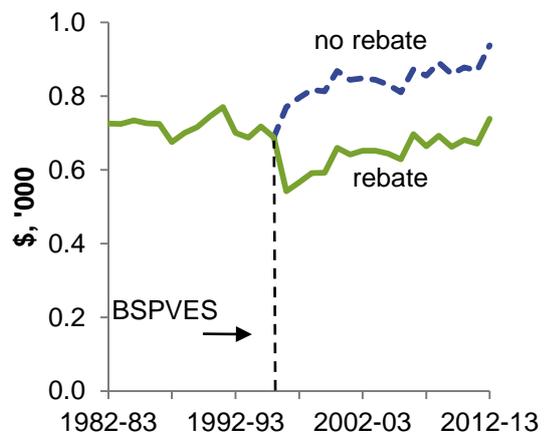
**D: Wheat shipped to Tasmania**



**E: TFES – sea freight cost disadvantage**



**F: BSPVES – real sea package prices**



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Many participants to this inquiry have highlighted the significance of the current subsidies for the viability of their Tasmanian business, albeit with limited and non-definitive evidence. A number of manufacturing enterprises, in particular, pointed out that their competitiveness against alternative production and investment locations is under regular review and that the TFES provides important assistance at the margin.

For a range of reasons, including higher labour and fuel costs, low and volatile freight volumes and limited competition, Bass Strait shipping is more costly relative to similar services in the North Sea in Europe. Many businesses claim that it is the single largest transport cost in their supply chain, even for products subsequently sent to distant markets.

Further, the recent imposition of a Port Licence Fee by the Port of Melbourne (\$75 million per year and indexed) as a revenue raising measure for the Victorian Government has added to the cost of the Bass Strait shipping task by around \$20 million per year. Taxes on business inputs are generally inefficient. It also negatively affects businesses in non-Victorian jurisdictions. Importantly, it effectively embodies a revenue transfer from the Federal Government to the Victorian State Government, at the expense of Tasmanian business through its effective and material dilution of the benefit of the TFES.

It is clear that the purpose of the TFES is misunderstood by many participants as offsetting increasing or absolute freight costs, rather than mitigating the *relative* and notional cost ‘disadvantage’ of moving freight by sea. The concept of a cost ‘disadvantage’ that can be measured and offset is in itself problematic. Similarly, the methodology used by the Bureau of Infrastructure, Transport and Regional Economics (BITRE) to calculate a cost ‘disadvantage’ is not intended to reflect the (widely disparate) experiences of individual firms. The design of the scheme is such that the parameter based calculation of the cost ‘disadvantage’ is based on median market benchmarks to avoid outcomes that are highly skewed by a few very large shippers.

The TFES treats the freight cost ‘disadvantage’ as the difference between:

- the costs incurred by shippers for moving freight across Bass Strait; and
- the notional cost incurred by moving freight an equivalent distance (approximately 420 kilometres) on the mainland by road.

Inherent in this formula is the perverse outcome that, as the movement of freight on the mainland becomes more efficient, the cost ‘disadvantage’ is estimated to increase, leading to an increase in the rate of the subsidy, which dilutes the incentive to increase the efficiency of freight movements across Bass Strait to some extent. Conversely, if

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road freight costs increase more than shipping, the relative ‘disadvantage’ is reduced. However, the scheme is structured so that it does not fully compensate all shippers for their notional ‘sea freight disadvantage’. The scheme phases out payments as the level of disadvantage increases to encourage shippers to seek lower freight costs, and therefore does not fully compensate all shippers for their parameter-determined ‘sea freight disadvantage’. This has been a design feature of the scheme since its inception, although not clearly articulated and not widely acknowledged by stakeholders.

Further, this calculation is by no means straightforward. Freight rates can differ for a number of reasons — the nature and volume of the product, the source and destination of the freight task, the direction of travel, the timing and frequency of the service, and the degree of competition in the provision of freight services. It remains unrealistic to suggest that any one ‘road freight equivalent’ is truly representative of a comparable freight task.

Measuring the precise freight cost disadvantage at a particular point in time is therefore challenging, if not elusive. This reality, coupled with the misperception that the scheme is designed to fully offset the notional cost ‘disadvantage’ faced by all shippers and the lack of stakeholder engagement in the parameter review process, underpinned recipients’ contested response to the Commission’s draft recommendation that the TFES subsidy rate be adjusted (down) in accordance with the latest parameter review undertaken by BITRE. The 2011-12 parameter review undertaken by BITRE suggests that the current subsidy rate — which has not been updated since 1998 — is higher than the current notional cost ‘disadvantage’.

While the methodology adopted by BITRE in estimating and updating the TFES parameters appears sound and transparent overall, the Commission is of the view that the process for undertaking rate reviews by BITRE would be improved by the release of a draft report and a public submission process prior to the release of a final report.

Transparency about the scheme would be further improved by more comprehensive public reporting of administrative data, including assistance paid to individual recipients. This would build on BITRE’s publication of information currently covered in its parameter reviews.

More fundamentally, the schemes create a myriad of distortions and anomalies. They are only available to some firms, and generate entrenched reliance on government support, which may of itself be having an adverse impact on the long term growth potential of the Tasmanian economy.

Further, the practical outcome of a subsidy (in terms of who actually benefits) depends on the relative responsiveness of supply and demand to a change in price.

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If supply is less responsive than demand, then suppliers will get relatively more of the subsidy than users or consumers — who in many cases are the intended beneficiaries.

In light of the lack of information about the incidence of the TFES, the Commission considers that BITRE should, as part of its rate review process, seek agreement with relevant shipping lines to provide their pricing and cost data.

## **Removing some anomalies but others remain**

### **The TFES**

The Australian Government's stated intention is to retain the TFES. As requested by the terms of reference, this report canvasses possible improvements to the scheme that would go some way to correcting the identified deficiencies. These are largely focused on addressing some of the perverse incentives created by the scheme while reducing complexity, and thereby lowering the compliance burden on businesses and administrative costs to government.

In particular, the Commission recommends that payments under the TFES should be made on the basis of a flat rate per TEU shipped. This would have significant advantages over the current parameter-based arrangements. It would provide increased incentives for businesses to minimise transport costs, make the scheme much simpler to administer, and increase transparency. Inquiry participants were generally supportive of a flat rate provided that the rate was set at the 'right' level. The Commission recommends that the flat rate of assistance be determined by BITRE, informed by a public consultation process and taking into account:

- the different circumstances pertinent to the Tasmanian mainland, King Island, and the Furneaux Group of islands
- a reasonable amount to partially offset the freight cost disadvantage associated with Bass Strait shipping and informed by the Government's overall budget commitment to the scheme
- a level of assistance that is compatible with the incentive to seek the lowest shipping cost
- an appropriate transition period.

The Commission's view on the appropriate quantum of assistance under the TFES is discussed further below in the context of the scope of eligibility for northbound commodities under the scheme.

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However, some of the inherent deficiencies associated with the scheme do not lend themselves to mitigation or removal through redesigning the scheme. It is evident that the schemes are having a number of unintended consequences in terms of their effects on incentives. Despite past reviews recommending changes to address some of these problems, the freight subsidy scheme remains largely unchanged since its inception.

A subsidy inevitably induces behavioural change, albeit at the margin, to access the subsidy and maximise its value. Evidence provided by participants highlighted how the TFES is influencing firm behaviour in terms of the location of processing activities (perversely and notably in Victoria rather than in Tasmania), the way that goods are shipped (in containers or in bulk), or the way that businesses are structured (vertically integrated or separated).

The Commission heard anecdotal evidence that some Tasmanian businesses are offshoring ‘processing’ activities to the mainland, mainly to Victoria, to access the TFES. The Commission has not been in a position to ascertain the magnitude of this distortion. However, given that the northbound component of the TFES is only available for goods that are intended for use or further transformation on the mainland, there is a clear incentive for doing so for goods ultimately destined for export and otherwise not eligible for the subsidy. This is a rational commercial response to the existing incentives, but contrary to the outcome the scheme was designed to achieve.

A change in the eligibility criteria may mitigate current, material anomalies but would ultimately draw another ‘line in the sand’. There will always be winners and losers with any criteria changes, and anomalies and undesirable incentives will ultimately remain.

The TFES primarily benefits a small number of firms based in Tasmania, largely in the manufacturing sector (table 1). These firms are important to the Tasmanian economy, as large private sector employers. In 2011-12, the top 10 claimants (out of 1400 in total) received around half of the total payments. At the other end of the spectrum, the smallest 1000 claimants received 2.7 per cent of total assistance paid.

By value, the main commodities claimed under the northbound component were frozen and fresh vegetables, newsprint, wood products and beer. Under the southbound component, beer bottles and cans, wheat and animal feed were the main commodities claimed. The subsidy does not apply to goods intended for export.

The 1998 (Nixon) review of the TFES recommended against extending the subsidy to exports given the then availability of direct international shipping services. Since May 2011, Tasmania has been without a direct regular international container shipping service following the AAA consortium’s withdrawal of its weekly service

from Bell Bay (though Swire Shipping recently commenced a limited monthly service, albeit primarily bulk with some limited container capacity). The Commission understands that the AAA service, which commenced in the late 1990s, catered for between one third to two thirds of Tasmania’s international containerised trade over the life of the service.

**Table 1 TFES large claimants**  
Top 10 claimants for commodities shipped in 2011-12

| <i>Claimant</i>                  | <i>Main commodity claimed</i>             | <i>Amount paid (\$m)</i> |
|----------------------------------|---|--------------------------|
| Simplot Australia                | Frozen/processed/prepared vegetables      | 10.7                     |
| Norske Skog Boyer                | Newsprint                                 | 7.8                      |
| Net Sea Freight Tasmania Pty Ltd | Various (freight administration services) | 7.1                      |
| J Boag & Son                     | Beer                                      | 6.2                      |
| Cadbury Australia                | Confectionery and chocolate products      | 4.8                      |
| McCain                           | Frozen/processed/prepared vegetable       | 3.0                      |
| Monson Shipping Tasmania Pty Ltd | Processed wood                            | 2.9                      |
| Cascade Brewery Co               | Beer                                      | 2.7                      |
| Ertler Trading Pty Ltd           | Fresh vegetables                          | 2.6                      |
| Murray Goulburn Co-op Co Ltd     | Dairy                                     | 2.5                      |

Consequently, containerised exports and imports are now transhipped mainly through the Port of Melbourne. In light of the shifts in shipping market dynamics that are seeing international maritime traffic with larger and more specialised vessels increasingly bypass smaller and shallower ports such as those in Tasmania, Adelaide and Fremantle, the Commission sought feedback in the draft report on the potential impacts of extending the TFES to include all eligible goods shipped from Tasmania to the Port of Melbourne.

However, contemporaneous developments relating to the potential resumption of regular international container shipping to Tasmania raise a critical policy sequencing issue. The Tasmanian Government, following a competitive selection process, announced that it had chosen Swire Shipping (a provider of niche, regional, multipurpose shipping services which already has an established bulk shipping service to Tasmania) as the preferred carrier for an international container shipping service from Bell Bay. It is envisaged that the potential new service could provide an export/import service on a regular (14–21 day) basis with connections to Asian hubs and calls to ports on the Australian east coast. It is expected to service a significant proportion of Tasmania’s export task. However, it is premised on some level of ‘transitional’ assistance (reported to reside in a range of \$4 million to \$33 million) funded by the Tasmanian Government until commercially viable volumes are established. The Commission understands that the requisite international volumes to and from Tasmania are in the order of 20 000 to 25 000

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TEUs annually. However, the Commission notes a disparity between this view and that in the FLCT commissioned report by GPS Logistics which suggests materially higher minimum requisite volumes for a commercially viable regular direct service to Tasmania (a range with a minimum of 35 000 TEUs).

The commercial sustainability of a direct international container shipping service for Tasmania is not certain now or in the future given the characteristics of Tasmania's containerised export task and the global trend towards larger vessels, which are constrained in accessing Tasmanian ports. Further, the highly concentrated nature of the Tasmanian export task suggests that the commercial sustainability of such a service is contingent on the transfer and retention of a small number of large exporters through a coordinated approach. Also relevant is the potential for strategic market behaviour by incumbent Bass Strait domestic shipping line operators, including those providing international services, who would have a strong commercial incentive to compete in the near term to retain the transhipped export volumes they currently service across Bass Strait.

Nonetheless, the possible return of direct international shipping services to Tasmania raises an intractable sequencing obstacle for considering the relative merit of moving now to extend the scope of the TFES to all eligible northbound commodities transhipped through the Port of Melbourne or other mainland ports, and destined for export. First, such an extension of the TFES would inevitably compromise the viability of a materially more cost effective international shipping service that would benefit a range of, but clearly not all, exporters and importers (and thereby Tasmanian consumers), and which arguably is in the best long term interest of Tasmania. Second, such a service would also add competitive pressure to the domestic Bass Strait route. Third, an extension of the TFES to exports at this point in time would also introduce the prospect of two subsidies (the Australian Government through an expanded TFES and the Tasmanian Government through the mooted transitional assistance) working at cross purposes. There will be some shippers who favour the status quo (and therefore an extension of the TFES to exports transhipped through the Port of Melbourne), and those who favour the direct international shipping option.

Importantly, and looking further ahead, comprehensive coastal shipping reform is likely to have a material impact on Tasmanian international shipping costs. The economics of a direct international service, given the commercially requisite adjunct of complementary coastal shipping revenues, are significantly enhanced in the absence of the additional cost burden imposed by coastal shipping regulation.

The Commission considers that in the absence of a regular direct international container service to Tasmania, there is a case for extending the TFES to all eligible

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commodities, including those transhipped through the Port of Melbourne or other mainland ports, and ultimately to export markets. The merit of this case is premised on no net increase in the overall quantum of assistance under the scheme. Broadening the scheme in such a way should improve allocative efficiency in Tasmania at least between producers that export internationally and those that sell to the Australian mainland. However, such an extension would not mitigate the negative impact of the current scheme on Tasmanian consumers more broadly.

Given the sequencing obstacles associated with recent and anticipated developments, the Commission recommends that the Australian Government should determine the merit and timing of such an extension following:

- discussion with the Tasmanian Government to ensure a mutually consistent policy approach
- the extent to which the potential resumption of a commercially viable direct service would be compromised by such an extension of the scheme, and advanced by potential coastal shipping reform
- agreement having been secured with the relevant shipping lines to provide pricing and cost data to BITRE (as per recommendation 3).

The Commission considers that such a determination would need to be made by the Australian Government in 2014 given the anticipated timing of related processes.

The decision on the total quantum of assistance under the TFES is ultimately one for the Australian Government. The Commission views the appropriate and overall quantum of assistance afforded under the TFES with the aforementioned scope extension, to be initially around the current and anticipated total payments and then subject to review in four years. This view is premised on containing the negative economic impact of the scheme on Tasmanian consumers and the Australian economy more broadly whilst securing a modicum of allocative efficiency by broadening eligibility in a cost neutral way. A review at that time will also be informed by anticipated developments, both policy and investment decisions influencing shipping capacity, that will likely impact the cost of Bass Strait shipping.

The implied average flat rate of assistance under such an extension to the scheme is a function of the quantum of overall assistance and the number of eligible recipients and their volumes. As such, the implied average flat rate assistance could be around \$735 per TEU (including intermodal costs) if the scheme is not extended to all eligible commodities transhipped through the Port of Melbourne, and within a range of \$470–\$570 per TEU (depending on export volumes) if the scheme is extended. Importantly, these figures are purely indicative given the paucity of export data

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from Tasmania and the uncertainty surrounding the dynamic impacts of any changes, and would be subject to zonal arrangements and TEU equivalent calculations by BITRE informed by a public consultation process. There would inevitably be winners and losers across the existing and potentially new TFES recipients under such an extension of the scheme, which is further addressed in chapter 3.

### *King Island and the Furneaux Group of islands*

By virtue of their size, population density and remoteness, the specific economic circumstances of the Bass Strait islands have been raised in submissions and through public hearings. Their economic sustainability is critically dependent on access to larger processing and end-product markets. In the area of transport logistics, they are clearly more exposed than the main island due to smaller volumes, high seasonality and both limited and tenuous shipping services.

Conversely, the islands' remoteness provides niche market appeal as reflected in their brand image — which creates a platform for high-value low-volume products in agriculture, and to a lesser extent, tourism.

The economic viability of the communities on these islands is largely a matter for the Tasmanian Government, within the broader context of market drivers. The Australian Government, through the TFES, provides explicit and additional support to alleviate freight costs between King Island and the Furneaux Group of islands, and the main island of Tasmania.

The Commission considers that the continuation of a zone based approach to the TFES — reflected in differential flat rates of subsidy — would ensure that the relative freight cost disadvantage of the Bass Strait islands is appropriately considered and reflected in the future rates.

## **The TWFS**

Wheat is the only bulk commodity that is eligible for a specific subsidy under the TWFS. The scheme dates back to the 1950s when the price of bread affected the determination of the basic wage and it was thought that, as a basic commodity, bread should be available to all Australians at the same price. Over time, the policy objective appears to have evolved to provide support to Tasmania's agri-businesses that use wheat as a feedstock. Expenditure on the TWFS has never reached its \$1.05 million cap and there have been no claims since 2009. This reflects the

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incentive to ship wheat in containers to access a higher level of subsidy through the TFES. This highlights yet another distortion created by the TFES.

Given its original purpose, the scheme is now redundant and the Commission recommends that the TWFS be terminated. This has been supported by most relevant inquiry participants. That said, the Commission notes that shipping wheat to Tasmania in containers may not be the most efficient process available, highlighting how these schemes have over time encouraged less efficient practices. In this context, the Commission recommends that the calculation of assistance for wheat and other grains shipped in containers under the TFES be based on the lowest feasible cost option for transporting grains to Tasmania.

## **The BSPVES**

The Australian Government has stated its current intention to retain the BSPVES. The scheme is designed to alleviate the cost of sea travel across Bass Strait for passengers accompanying an eligible vehicle. The scheme provides support to what is perceived by many inquiry participants to be its intended primary beneficiaries — Australian residents travelling between the mainland and Tasmania with their vehicle. From their perspective, the promotion of Tasmanian tourism is only an ancillary benefit of the scheme. However, there were other inquiry participants who viewed the scheme primarily through a tourism lens. That said, the Commission views the materially lower air fares to Tasmania as the single most important development to advance Tasmanian tourism.

The confusion around the purpose of the scheme suggests that there is merit in the Australian Government clearly articulating the scheme's objective so that any future evaluation of the scheme can be assessed against that objective.

Irrespective of the intended primary beneficiaries of the BSPVES, the scheme provides only diluted support to them. Some of the BSPVES subsidy is inevitably captured by TT-Line as the main (virtually sole) carrier of passenger vehicles across Bass Strait.

The extent of this 'leakage' is difficult to assess without detailed modelling and access to commercial cost data. However, the characteristics of this specific market, combined with the pricing of this service over time (see figure 3F), suggest that TT-Line ultimately receives at least part of the subsidy through higher fares.

Further, given the operation of the schemes, and that TT-Line competes with commercial operators in the freight market, and the passenger and vehicle market is

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contestable, there is an imperative to ensure that TT-Line fully satisfies the principles of competitive neutrality across these services.

The Australian Government should also undertake discussions with the Tasmanian Government on a joint approach to ensuring greater transparency around TT-Line's pricing, and an assessment of the extent to which the subsidy offered by the BSPVES is passed on to the intended recipients.

## **Tackling the fundamentals**

The TFES and the BSPVES are understandably popular with many recipients and Tasmanian stakeholders. Many submissions to this inquiry have stressed that the TFES in particular is important to the economic viability of individual businesses, at least in the short term. The Tasmanian Government has linked the TFES to the broader economic health of the State.

On the other hand, the vast majority of Tasmanian businesses do not receive TFES payments, including many in the growing services sector that also have to operate within a high cost setting.

While clearly of significant benefit to recipient businesses, the TFES is not a meaningful instrument to address the economic and social challenges facing Tasmania, of which geography is just one. Policies and programs that directly target the causes of the underlying problems are likely to be more effective and efficient than narrowly focused freight subsidy schemes like the TFES.

As articulated in its draft report on geographic labour mobility, the Commission sees merit in policies which remove impediments to people moving in response to changing economic conditions. Where governments seek to sustain population in a particular region, approaches to make the region concerned more attractive to capital generally — such as improving infrastructure, upgrading labour force skills, removing inefficient taxes and improving administrative efficiency — are preferable to sponsoring selected firms or incentivising businesses to locate (or remain) there through subsidies. Importantly, such a strategy should be aligned with an overarching approach that is consistent with comparative advantages.

The draft report on geographic labour mobility also commented on labour market issues in Tasmania specifically. It identified high wages, combined with low skill levels, as a possible cause of persistently high unemployment levels in Tasmania.

In light of this, the Commission considers that the Australian Government should change its focus from freight subsidy schemes to policy reforms which have

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national and Tasmanian benefits (such as coastal shipping reform) and those that directly enhance the competitiveness and productivity of the Tasmanian economy.

Where governments nevertheless pursue direct expenditure-based programs, the costs and benefits of a range of options should be assessed. For example, funding of the existing freight and passenger schemes could require more than \$2 billion in net present value terms over the next 15 years. Redirected effectively, this funding could provide the fiscal basis for more cost-effective policies and programs to form an overarching economic development strategy for Tasmania.

The Australian Government should work with the Tasmanian Government and other stakeholders to establish and implement an economic development strategy that maximises the long-term economic prospects of Tasmanian businesses and residents. This should address the underlying competitiveness and efficiency of the Tasmanian economy.

Successful economic development strategies give priority to policies and other initiatives (including targeted assistance measures) that remove impediments to industry and regional adjustment, and improve the productivity and underlying cost structure of each region. This is the most effective way of achieving positive outcomes for states or regions like Tasmania. It requires the active involvement of all levels of government in a number of key areas, including:

- improving employment outcomes, for example, through appropriate skilling and training
- improving coherence in infrastructure provision — by developing and implementing an integrated long term strategy for investment based on economic returns
- creating an environment for more private sector involvement in infrastructure provision and operation
- removing subsidies to inefficient industries
- creating a regulatory environment that reduces the cost of doing business in Tasmania and delivering efficient public services that make a lesser call on taxes and charges to fund them.

It is also clear that some regional economies experience very different labour market issues relative to the national economy generally. The Australian Government has foreshadowed an inquiry into the Fair Work Act and Australian labour markets. This inquiry has seen indications that regional factors should be examined as part of that inquiry.

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## **Meshing with existing plans and programs**

There is array of economic development plans and strategies for Tasmania. These include initiatives developed and funded by all levels of government and covering a range of industries and activities. It is not clear that the existing suite of initiatives is collectively coherent and optimal for Tasmania as a whole. In particular, are the various plans consistent and complementary in their design and intent?

In the limited time and evidence made available for this inquiry, it appears that most strategies are individually aimed at addressing some aspects of ‘disadvantage’. They do not appear informed by any genuine questioning of the value of retaining structures and measures that have not delivered improved outcomes for Tasmania over long periods.

The Commission considers that an important first step in improving the existing approach to economic development in Tasmania is to conduct a stocktake of existing programs specific to Tasmania in order to clarify their nature, intent, timing, coverage, governance arrangements, and any areas of duplication.

The Australian and Tasmanian Governments should jointly undertake the stocktake with a view to having a publicly available report in 2015. The results should be used by the Australian and Tasmanian Governments to inform a fundamental and comprehensive policy strategy, to enhance structural reform and the economic development of Tasmania, and ensure related policies and programs generate the greatest net benefit to the State as a whole.

The Commission notes that a Joint Commonwealth and Tasmanian Economic Council has recently been established to consider competitive reforms to enhance Tasmania’s long term economic growth prospects. This Council is well placed to initiate such a stocktake as part of its initial work program.

## **Review and evaluation**

One of the deficiencies of the existing freight and passenger vehicle subsidy schemes has been the lack of evaluation of their impacts over time.

The Commission considers that programs, including those that are specific to Tasmania, should be reviewed and evaluated periodically and transparently. Such reviews should be conducted by an appropriate independent body and, apart from an ex-post assessment of the aggregate benefits and costs of the strategy to date, should also include an assessment of the benefits and costs of any continued Australian Government financial contribution to the strategy.

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# Findings and recommendations

## Reforms with national and Tasmanian benefits

### RECOMMENDATION 1

(CHAPTER 4)

*The Australian Government should proceed with the foreshadowed review of coastal shipping regulation (including cabotage) as a matter of priority. The objective of the review should be to achieve the most efficient coastal shipping services feasible for Australia.*

### FINDING

*The Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) are not the best way to advance Tasmania's economic development. They fall well short of what is needed to improve the competitiveness of the Tasmanian economy:*

- *they have a high fiscal cost (collectively \$2 billion since inception and without change a further \$2 billion over the next 15 years)*
- *eligibility of the TFES is arbitrary and the direct recipients are concentrated, with 50 per cent of the total amount claimed going to 10 recipients*
- *the incidence of the subsidies (who actually benefits) is not clear given the involvement of a monopoly service provider (TT-Line for passenger vehicle transit) and concerns about the effectiveness of competition between the three shipping lines on the Bass Strait route (for non-bulk freight)*
- *as subsidies they have a number of unintended consequences, including perversely increasing the costs of goods for Tasmanian consumers.*

*It is disappointing that to date the policy focus remains on these schemes and not on more fundamental policy levers — such as coastal shipping regulation, the overall size and breadth of government in Tasmania including the direct involvement of the Tasmanian Government in commercial enterprises, labour market skills and mobility — to meaningfully improve the overall competitiveness of the Tasmanian economy. Notably, and refreshingly, the Commission did receive some evidence from Tasmanian businesses to support policy initiatives in this vein, and widespread support for coastal shipping regulatory reform.*

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## The TFES

### RECOMMENDATION 2

(CHAPTER 3)

*The Australian Government should introduce payment of freight assistance as a flat rate of subsidy per TEU (twenty foot equivalent unit) shipped.*

*The Bureau of Infrastructure, Transport and Regional Economics should recommend separate dollar amounts per TEU of assistance for the Tasmanian mainland, King Island, and the Furneaux Group of islands, informed by a public consultation process, and taking the following into account:*

- *a reasonable amount to partially offset the freight cost disadvantage associated with Bass Strait shipping and informed by the Government's overall budget commitment to the scheme*
- *that the flat rate should include a zone structure for eligible shippers on King Island and the Furneaux Group of islands in recognition of their relatively greater shipping freight cost disadvantage and limited shipping service options*
- *that the flat rate should provide assistance that is compatible with the incentive to seek the lowest shipping cost and not a percentage of transport costs incurred*
- *an appropriate transition period to the new flat rates reflecting any quantum of change and the tenor of shipping contracts.*

*The commencement of this consultation process is contingent on the resolution of the issues related to recommendation 6.*

### RECOMMENDATION 3

(CHAPTER 2)

*Future Tasmanian Freight Equalisation Scheme (TFES) rate reviews should be undertaken every four years by the Bureau of Infrastructure, Transport and Regional Economics using a public multi-stage process, comprising:*

- *release of a draft report, containing the estimated rate updates and underlying assumptions and data*
- *a public submission process that allows interested parties sufficient time to provide input*
- *release of a final report that incorporates resulting feedback and evidence.*

*Further, to inform rate reviews and future assessment of the effectiveness of the TFES, the Bureau should seek agreement with the relevant shipping lines to provide pricing and cost data.*

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**RECOMMENDATION 4****(CHAPTER 2)**

*The Australian Government should respond publicly and in a timely manner to all Tasmanian Freight Equalisation Scheme rate reviews. All responses should be released with an appropriate lead time to provide certainty for recipients, and for any resulting revisions to payment rates to be incorporated into Commonwealth Budget processes.*

**RECOMMENDATION 5****(CHAPTER 3)**

*If the Australian Government chooses to retain the Tasmanian Freight Equalisation Scheme in its current form, the rate should be based on parameters recommended by the Bureau of Infrastructure, Transport and Regional Economics, informed by a public consultation process, and payable only on the basis of evidence of actual wharf-to-wharf costs.*

**RECOMMENDATION 6****(CHAPTER 3)**

*In the absence of a regular direct international container service (direct service) from Tasmania, there is a case to extend the Tasmanian Freight Equalisation Scheme to all eligible commodities (as specified in the Ministerial Directions) shipped to the Port of Melbourne or any other mainland ports and subject to no net increase in the overall assistance provided by the scheme. The Australian Government should determine the merit and timing of such an extension following:*

- *discussion with the Tasmanian Government to ensure a mutually consistent policy approach*
- *an assessment of the extent to which the potential resumption of a commercially viable direct service would be compromised by such an extension of the scheme, and advanced by potential coastal shipping reform*
- *agreement having been secured with the relevant shipping lines to provide pricing and cost data to the Bureau of Infrastructure, Transport and Regional Economics (as per recommendation 3).*

**RECOMMENDATION 7****(CHAPTER 3)**

*The Department of Infrastructure and Regional Development should provide more comprehensive public reporting of information under the Tasmanian Freight Equalisation Scheme, including annual payments to recipients.*

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RECOMMENDATION 8

(CHAPTER 3)

*The Australian Government Department of Human Services should examine the benefits and costs, including compliance costs for claimants, of upgrading its technology to provide greater access to online claims under the Tasmanian Freight Equalisation Scheme and improve internal claims processing.*

RECOMMENDATION 9

(CHAPTER 3)

*The Department of Infrastructure and Regional Development should examine the benefits and costs to claimants and the Australian Government of introducing a minimum value for:*

- *individual sea freight invoices*
- *a consolidated set of sea freight invoices over a 12-month period*

*that are eligible for assistance under the northbound component of the Tasmanian Freight Equalisation Scheme.*

RECOMMENDATION 10

(CHAPTER 3)

*The Department of Infrastructure and Regional Development should encourage and facilitate the take-up of the self-assessment facility under the Tasmanian Freight Equalisation Scheme where appropriate.*

RECOMMENDATION 11

(CHAPTER 3)

*The Department of Infrastructure and Regional Development should, subject to confirming feasibility, assess claimants under the southbound component of the Tasmanian Freight Equalisation Scheme on a basis that would avoid the need for claimants to establish a separate legal entity to qualify for assistance, taking into account the compliance costs for businesses and the administration costs to the Australian Government.*

## **The TWFS**

RECOMMENDATION 12

(CHAPTER 3)

*The Australian Government should terminate the Tasmanian Wheat Freight Scheme as its original policy rationale, and therefore the scheme itself, is redundant.*

*The calculation of assistance for wheat and other grains shipped in containers under the Tasmanian Freight Equalisation Scheme should be based on the lowest feasible cost option for transporting grains to Tasmania.*

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## **The BSPVES**

### **RECOMMENDATION 13**

**(CHAPTER 3)**

*The Australian Government should clearly articulate the objective of the Bass Strait Passenger Vehicle Equalisation Scheme, and any future evaluation of the scheme should be assessed against that objective.*

### **RECOMMENDATION 14**

**(CHAPTER 3)**

*The Australian Government should undertake discussions with the Tasmanian Government on a joint approach to ensuring greater transparency around TT-Line's pricing, and an assessment of the extent to which the subsidy offered by the Bass Strait Passenger Vehicle Equalisation Scheme is passed on to the intended recipients.*

### **RECOMMENDATION 15**

**(CHAPTER 3 AND CHAPTER 4)**

*The Tasmanian Government should:*

- *articulate its underlying objectives in owning and operating a freight and passenger/vehicle services business, and assess whether ownership of TT-Line is the most cost-effective way in which to achieve those objectives*
- *initiate an independent and public review of the extent to which TT-Line's freight and passenger/vehicle services business satisfies the principles of competitive neutrality.*

## **Improving the competitiveness of Tasmanian ports**

### **RECOMMENDATION 16**

**(CHAPTER 4)**

*The Tasmanian Government should direct the Office of the Tasmanian Economic Regulator to conduct an inquiry into the pricing policies of TasPorts. In carrying out the inquiry, the Tasmanian Economic Regulator should consider and make recommendations on the extent to which pricing at the three major northern ports is efficient and, where appropriate, cost reflective of individual ports.*

### **RECOMMENDATION 17**

**(CHAPTER 4)**

*The Tasmanian Government should assess the commercial viability of TasPorts and potential changes to enhance its operation. The assessment should include a consideration of alternative models for the provision of port infrastructure, including the feasibility of privatisation or long term leases to private operators and be informed by the findings of recommendation 16.*

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## Improving the coherence of infrastructure investment

RECOMMENDATION 18

(CHAPTER 5)

*The Commission endorses the need for a comprehensive, long term integrated freight strategy for Tasmania to be developed by the Tasmanian Government. As the Australian Government will retain a role in funding Tasmanian infrastructure investments, it is appropriate that it (including through Infrastructure Australia) be consulted in developing that strategy.*

*In developing the strategy, there should be broad consultation between industry, all levels of government, and the community more generally. A benefit-cost framework should be applied that identifies the most efficient use of investment capital and that clearly identifies the net benefits or trade-offs arising from community service initiatives or region-specific development objectives. As a matter of urgency, the strategy should:*

- *identify Tasmania's likely future freight infrastructure requirements across all modes — sea, road, rail and air*
- *address port developments, including specialisation or rationalisation of existing infrastructure and, informed by the Tasmanian Government's consideration and resolution of the issues in recommendations 16 and 17*
- *address the long term role of rail in Tasmania given the high degree of substitutability with road transport*
- *ensure that the objectives of government business enterprises for ports, shipping and rail are consistent with commercial sustainability.*

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## Improving Tasmania's future economic development

### RECOMMENDATION 19

(CHAPTER 6)

*The Joint Commonwealth and Tasmanian Economic Council should initiate a stocktake of existing programs specific to Tasmania as part of its initial work program. The stocktake should:*

- *cover initiatives established by all levels of government*
- *clarify their nature, intent, timing, scope, governance arrangements and any areas of duplication*
- *assess whether the suite of initiatives represents a coordinated, consistent, targeted, and efficient approach to Tasmania's economic development*
- *include the release of a public report in 2015.*

*The results of the stocktake should contribute to, and inform the development of, an integrated economic development strategy for Tasmania.*

### RECOMMENDATION 20

(CHAPTER 6)

*The Australian Government should review and evaluate its programs for Tasmania after a reasonable length of time. Such reviews should be transparent, be conducted by an appropriate independent body and should comprise an ex-post assessment of the aggregate benefits and costs of the strategy to date and an assessment of the benefits and costs of any continued Australian Government financial contribution to these programs.*



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# 1 Introduction and scope

## 1.1 A matter of geography

Tasmania is an island state and so the interstate and international movement of freight is heavily reliant on shipping services across Bass Strait. The cessation in 2011 of weekly direct international container shipping services to and from Tasmania has meant that most international container freight is currently transhipped through the Port of Melbourne, although there is now the potential prospect of the resumption of direct international shipping services to and from Tasmania.

Shipping tends to rely on long distances to realise its cost advantages and shipping goods across Bass Strait is generally more costly than transporting goods equivalent distances by road or rail. The costs of getting goods to mainland and overseas markets are an important consideration for Tasmanian businesses. Similarly, the cost of getting a passenger vehicle across Bass Strait is an important issue for Tasmanian and mainland residents who choose to do so.

Australian Governments have for many years operated subsidy schemes to help partially offset transit costs through the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES). Recent reviews have noted that the schemes do not achieve their stated objectives, or deliver efficient outcomes.<sup>1</sup> Real Australian Government outlays on the TFES have been around \$100 million per year for the past decade.

In a broader context, the Australian Government has noted:

Tasmania has the lowest gross state product per capita in Australia, the nation's highest unemployment rate, the nation's lowest life expectancy, the highest standardised death rate due to suicide, the lowest proportion of adults in the nation who have attained a

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<sup>1</sup> These include the Australian National Audit Office's 2011 assessment of the Tasmanian Freight Equalisation Scheme (ANAO 2011); Infrastructure Australia's Tasmanian ports and freight strategy report (Infrastructure Australia 2012b); and the Freight Logistics Coordination Team (established by the Australian and Tasmanian Governments in 2012 to provide expert advice on Tasmania's freight system) report on delivering improved freight outcomes for Tasmania (FLCT 2013a).

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year 12 qualification, one of the nation's lowest retention rates to year 12 and the highest proportion of people without superannuation coverage. (Coalition 2013, p. 2)

This stark backdrop suggests that the competitiveness of Tasmania's transport infrastructure and services, and indeed the overall Tasmanian economy, need to be viewed through a wider and longer term lens.

The longstanding lack of clarity about the objectives of the subsidy schemes identified in many reviews adds to the difficulty of determining whether these subsidies aim to offset a natural cost 'disadvantage', or address fundamental structural issues, or both. The schemes' reference to equalisation has also misleadingly implied 'full' compensation for the cost disadvantage which is not inherent in their design and operation. A central issue for this inquiry is whether (and to what extent) the subsidy schemes enhance the competitiveness of Tasmania's freight industry, or conversely, work against it by further entrenching reliance on government support.

It is for these reasons that the terms of reference go beyond an assessment of freight subsidies to also embrace matters of integrated supply chain logistics encompassing shipping, port, road, and rail services.

## **1.2 What the Commission has been asked to do**

The Government has asked the Commission to review shipping costs and the competitiveness of Tasmania's freight industry structure, and assess the current arrangements for supporting freight and passenger services between the mainland and Tasmania. The major issues under consideration are:

- Tasmania's freight task in the broader context of Tasmania's economy
- the drivers of freight costs in Tasmania, with a focus on the competitiveness of shipping, port, road and rail services, and possible reforms to enhance their efficiency
- the effectiveness of the current freight and passenger vehicle subsidy arrangements, and how these arrangements could be improved
- alternative approaches that could more effectively address Tasmania's economic challenges.

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In responding to these issues, the Commission has examined the underlying causes of the relatively high transport costs facing Tasmanian businesses and consumers and how these might be addressed. It has also focused on the alignment of the objectives and outcomes of the subsidy schemes. In examining some of these matters, the Commission has consulted with the Australian Competition and Consumer Commission.

## **The Commission's approach**

The Commission's approach is guided by the terms of reference and the policy guidelines in the *Productivity Commission Act 1998* (Cwlth). Guidelines of particular relevance to this inquiry are the requirements to encourage the development of efficient and internationally competitive Australian industries; to promote regional employment and development; and to improve the productivity and economic performance of the economy. As the Commission is required to recognise the interests of the community generally, it must look not only at the interests of Tasmania, but also the impacts of policies on the Australian community as a whole.

### **1.3 Conduct of the inquiry**

Public inquiries involve extensive consultation with all interested parties, participants preparing submissions, and the Commission undertaking policy analysis and developing a draft report. The Commission may conduct public hearings at several stages of the inquiry, including after receipt of further submissions from participants on the draft report prior to a final report being finalised.

The terms of reference for this inquiry were received on 29 November 2013, specifying a final reporting date of 7 March 2014. Given the limited time available, the Commission advertised the inquiry in newspapers, on its website and in a circular, and invited initial public submissions by 14 December 2013. A draft report for public comment was released on 24 January 2014, with a call for further submissions by 7 February. Public hearings were held in Canberra, Hobart, Melbourne and Launceston in early February. Over the course of this inquiry, the Commission also held roundtables and informal consultations with producers, shipping companies, government agencies and other interested parties (appendix A).

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The Commission received 113 written submissions in total (appendix A) which are available at [www.pc.gov.au/projects/inquiry/tasmanian-shipping](http://www.pc.gov.au/projects/inquiry/tasmanian-shipping). Appendix C on coastal trading regulation is an online appendix that can also be accessed on the inquiry web page.

The Commission thanks all those who contributed to the inquiry for their endeavours in meeting the short timeframe. The Commission also acknowledges the substantive body of work and report by the Tasmanian Freight Logistics Coordination Team in 2013 that the Commission was able to draw upon during this inquiry.

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## 2 Tasmania's freight in context

### Key points

- Tasmania faces a number of economic challenges. Relative to the national average, economic growth is slower, unemployment is higher, participation rates are lower and the private sector accounts for a smaller share of economic activity.
- As with businesses across Australia, the productivity and economic performance of many Tasmanian businesses is affected by their ability to move goods through supply chains to intra- and inter- state markets, as well as markets overseas.
- However, as an island state, Tasmania's reliance on shipping to transport its freight, as opposed to rail and road, means that Tasmanian producers face relatively high freight costs when competing in mainland and international markets.
- The Tasmanian Freight Equalisation Scheme (TFES) and the Tasmanian Wheat Freight Scheme (TWFS) were designed to partly offset these costs.
- Under the TFES, cost disadvantage is defined as the difference between the actual sea freight costs across Bass Strait, and the notional road freight costs of moving goods an equivalent distance on the mainland.
- The TFES is currently administered on the basis of 1996-97 parameter estimates. While costs for Tasmanian sea freight have risen in the period since, mainland road freight costs have risen at a faster rate.
- Latest Bureau of Infrastructure, Transport and Regional Economics (BITRE) estimates indicate that if TFES parameters were updated to reflect these changes the estimated freight cost disadvantage, as defined by the TFES, would fall substantially — with a commensurate reduction in overall payments.
- Many other Australian regions face significant costs to transport goods to markets due to their remoteness or the absence of a rail link or all-weather roads. However, businesses in such regions have established there in response to other locational advantages and seldom receive explicit government freight or passenger subsidies.
- The Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) is designed to assist in alleviating the cost of sea travel across Bass Strait for passengers accompanying an eligible passenger vehicle.
- Quantification of any cost disadvantage associated with the movement of accompanied passenger vehicles across Bass Strait is problematic.
- While the BSPVES led to an initial reduction in real after-subsidy fares, this has been steadily eroded in the decade and a half since the scheme's introduction.
- The total number of passengers travelling across Bass Strait has doubled over the past decade, driven by rising numbers of air passengers following the entry of low cost airlines and discount air fares — whilst the total number of passengers travelling by sea has fallen by one third over the same period and despite the BSPVES.
- Around 90 per cent of passengers travelling across Bass Strait now travel by air.

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## 2.1 Tasmania's economy at a glance

Tasmania is an island state, home to around half a million people. It is endowed with many natural assets — high rainfall, fertile soils, large fish stocks, substantial forestry resources and an attractive natural environment. These features, combined with a relatively low cost of living, low traffic density and a range of cultural attractions contribute to a unique lifestyle enjoyed by Tasmanians.

Despite the host of positive attributes that provide the foundation for Tasmania's comparative advantages, Tasmania's economic performance has persistently been below trend relative to the rest of Australia. This is reflected in a range of economic indicators including income, employment, investment and productivity, as well as in terms of social metrics such as education and health outcomes.

Over the past decade, the Tasmanian economy, measured by gross state product (GSP), has grown more slowly than the Australian economy overall (figure 2.1, A). In 2012-13, Tasmania recorded the lowest average annual GSP growth of all Australian states and territories. In the same year, Tasmania's labour productivity (output per hour worked) was around 15 per cent below the national average. In addition, estimates of multifactor productivity growth (MFP) by state and territory indicate that over the past two decades Tasmanian MFP growth was the lowest of all jurisdictions with the exception of the Northern Territory (Cunningham and Harb 2012).

The widening gap between Tasmanian and national employment outcomes evident over the past five years, including lower aggregate hours worked and higher rates of unemployment (figure 2.1, B), has spurred an increase in migration from Tasmania to mainland states, mainly among younger workers. An inflow of interstate migrants in the older demographic bracket has partly offset this trend, exacerbating the small and steadily ageing nature of Tasmania's population. Recent projections suggest that Tasmania is likely to have the lowest rate of population growth over the period to 2040 and remain the jurisdiction with the oldest population — with the average-age gap between Tasmania and the rest of Australia projected to widen in coming decades (ABS 2013c).

Tasmania's industry structure has undergone significant structural change in recent decades (Department of Treasury and Finance (Tasmania) 2013). Once known as the 'Apple Isle', Tasmania's economy has traditionally been based on natural resources — either as primary products or as resource-based manufactures. The Agriculture, forestry, and fishing sector accounts for a larger share of output than for the Australian economy overall (figure 2.1, C). While its share has remained relatively stable in terms of gross value added, significant diversification has taken

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place within the sector, with a shift from traditional products (apples and pears) to higher value products such as processed vegetables, stone fruit and salmonids.

In the last decade, there has been a notable decline in Tasmania's manufacturing output. This sector had for many years accounted for a larger share of Tasmania's output compared to its share for Australia overall. This decline, driven largely by contractions in Food and beverages, Wood and paper products, and Textiles, clothing and footwear, has seen manufacturing's share of gross value added fall to around the national economy average (around 8 per cent).

Structural changes have reinforced the demand for high frequency shipping services across Bass Strait for a number of industries, although only 15 per cent of Tasmanian shippers require an overnight service (FLCT 2013a). The high cost of Bass Strait shipping services (for reasons discussed later) is felt most keenly by producers who mainly supply interstate and international markets.

Like most advanced economies, growth has typically been in service industries — notably health care, construction and tourism. Within the services sector, the contribution of private services has increased relative to public services. However, Tasmania still retains a large public sector relative to the rest of Australia (around 27 per cent of gross value added compared to a national average of around 19 per cent, figure 2.1, C).<sup>2</sup> Expenditure on health care and community services is expected to continue to increase in line with Tasmania's ageing demographic profile.

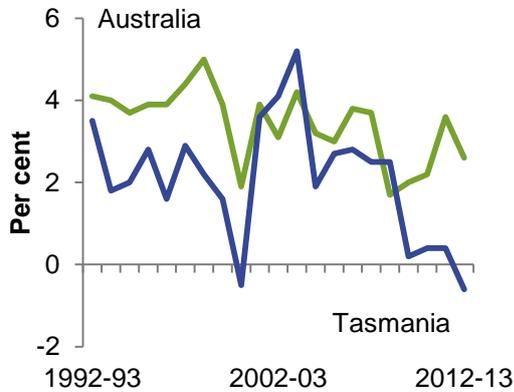
Tasmania's small, dispersed and slow growing domestic market means that for its industries to grow, they must export their products and services, either to markets on the mainland or overseas — or, in the case of tourism, attract visitors from outside Tasmania. For example, around 75 per cent of Tasmania's total food production is currently sold in interstate (50 per cent) or in international markets (25 per cent) (sub. 43). This means the efficient and cost-effective movement of freight, and people, to and from Tasmania is integral to overall economic performance.

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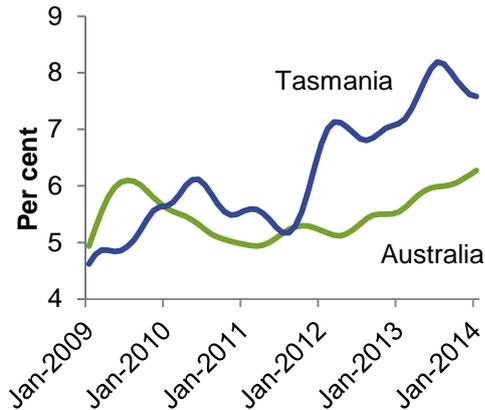
<sup>2</sup> In addition, direct employment by all three levels of government as a share of total employment was over 5 percentage points higher in Tasmania than for Australia as a whole in 2013.

**Figure 2.1 Tasmania's relative economic performance, selected indicators**

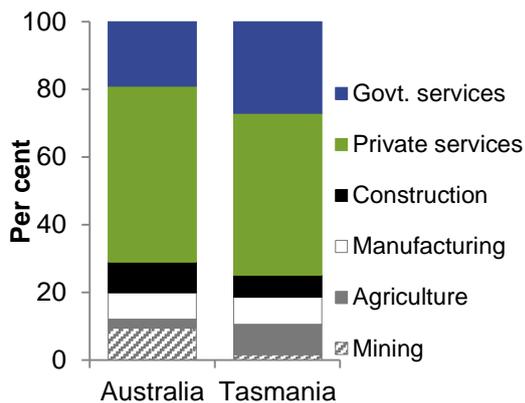
**A: GDP/GSP real annual growth rates**



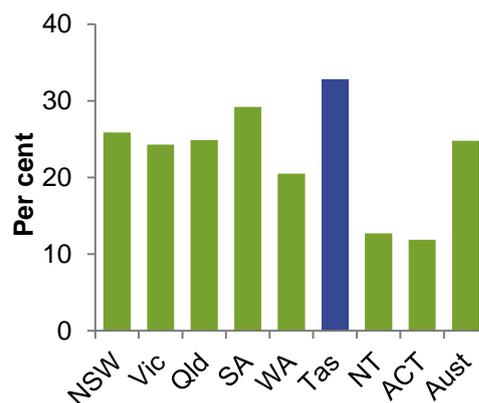
**B: Unemployment rates (trend)**



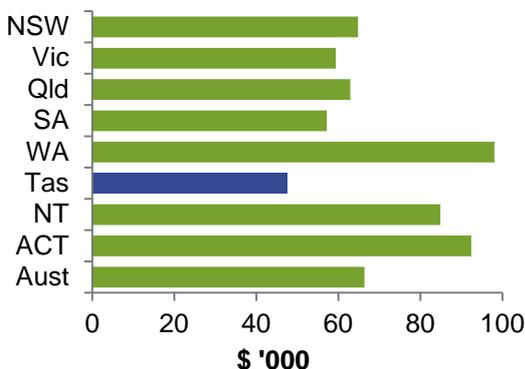
**C: Gross valued added shares, 2012-13<sup>a</sup>**



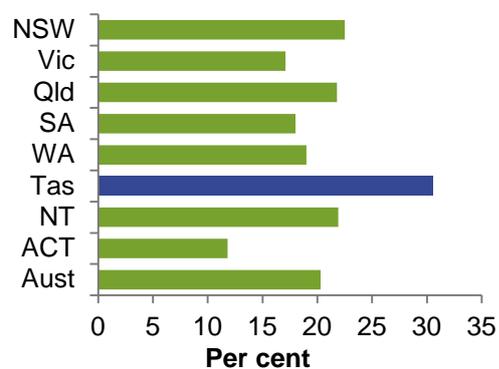
**D: Households with government payments and benefits as main source of income, 2011-12<sup>b</sup>**



**E: GDP/GSP per person, 2012-13**



**F: Educational attainment — share of workforce with year 10 as highest qualification, 2013**



<sup>a</sup> Following Department of Treasury and Finance (Tasmania) (2013), public expenditure is approximated by divisions O, P, Q, and private expenditure covers divisions D, F to N, R and S. Excludes ownership of dwellings. <sup>b</sup> Households defined as very remote were excluded from the Northern Territory estimate, accounting for around 23 per cent of the Territory's population.

Data sources: ABS (2013a, 2013b, 2013c, 2013e).

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## Tasmania's geographic advantages and disadvantages

The economic performance of Tasmania reflects external influences from the national and global economies as well as internal drivers. Previous reviews (TFES Review Authority (Nixon) (1998), BITRE (2008b)) identified a number of factors affecting Tasmania's long term growth, some of which are natural endowments.

The island's identity and geography provide businesses with advantages in product branding — such as Cascade lager and King Island dairy products. Tasmania's niche appeal also provides a platform for investment in high-value low-volume products and services particularly in agriculture, aquaculture and tourism. Bass Strait provides some 'natural protection' to Tasmanian-based businesses in the form of a freight cost advantage over their counterparts on the mainland in supplying goods to consumers and businesses in the (albeit small) Tasmanian markets.

These advantages notwithstanding, Tasmania's remoteness and decentralised settlement patterns pose challenges. These include limiting the benefits available from specialisation, economies of scale and competition between producers and service providers.

All countries and regions are affected by economic geography. Indeed, research by the OECD and others has shown that Australia — as one of the most remote advanced economies in the world — has faced, and through sound overall policy settings, largely overcome, substantial disadvantages stemming from its remoteness from world markets (box 2.1).

While Tasmania's island status means that it faces particular transport challenges relative to other states and territories, many other regions of Australia also incur significant costs to transport goods to markets either because of their remoteness or the absence of a rail link, all-weather roads or, in the case of other islands including Kangaroo Island and the Torres Strait islands, low cost sea links. However, as the Commission noted in its previous inquiry on freight subsidy arrangements (PC 2006b), businesses in such regions have established there in response to other locational advantages and, with some notable exceptions, generally do not receive explicit government freight or passenger subsidies.

Australia's experience suggests that the capacity of businesses to exploit the geographic advantages or overcome geographic disadvantages they face is governed largely by the overall policy framework within which workers and individual firms operate. At the broadest level, this covers the extent to which policy settings promote productivity, innovation, efficient investment and flexible labour markets.

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### Box 2.1     **The economics of geography and remoteness**

Economic geography refers to the location, distribution and spatial organisation of economic activities. The spatial aspects of economic activity can be influenced by different elements of geography and history, including a country's natural resource endowments, location, climate, topography and population settlement patterns.

Research by the OECD and others confirms that differences in economic geography help explain differences in economic performance across countries. Countries that are geographically close to the centres of world economic activity tend to have higher incomes and higher productivity.

It has long been recognised that Australia's geography has at times played an important role in its economic performance (Blainey 1966; Caves 1984). Australia is (with New Zealand) one of the two most remote advanced economies in the world in terms of average distance from world economic activity. Australia's remoteness has imposed economic costs. Battersby and Ewing (2005), for example, found that if Australia was as close to world markets as the United Kingdom, its level of trade would be expected to be around 50 per cent higher.

However, while geographic disadvantage cannot be fully overcome, Australia's experience indicates that the consequences of remoteness can be ameliorated through sound policy settings. Research indicates that Australia has performed well above its predicted level of GDP per capita, given its degree of remoteness (and after accounting for its abundant natural resource endowments). Dolman, Parham and Zheng (2007, p. 36) conclude that 'less tangible differences between countries — such as their institutions, policies and culture — may be more important than remoteness', and have been crucial in Australia's ability to largely offset the 'tyranny of distance'.

*Sources:* OECD (2008); Dolman, Parham and Zheng (2007); Battersby and Ewing (2005); Caves (1984); Blainey (1966).

Sound transport policies are also critical. In all advanced economies, socioeconomic opportunities are closely related to the mobility of people, goods and services. Tasmania's geography renders it particularly dependent on sea and air transport for accessing mainland and international markets and value chains. With virtually all cargo (over 99 per cent by weight) across Bass Strait carried by sea, shipping links and the associated land side transport infrastructure are vital.

While geography is a significant factor affecting freight costs, other relevant factors are the intrinsic nature of the freight task and the degree of competition in the provision of shipping and land-based freight services. Government policy settings can also have a major bearing on costs either directly through measures such as cabotage regulation and freight subsidies, or indirectly, through public ownership and other policies that affect the level and nature of competition and investment across freight logistics chains.

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## 2.2 Tasmania's freight task

Tasmanians, like other users of freight transport across Australia, use a range of transport services depending on the freight task. Road and rail move goods to and from ports in Tasmania, and air transport is used for high value and perishable goods. However, unlike most producers on the mainland, Tasmanian producers have a unique reliance on sea freight.

### Bass Strait trade

Tasmanian sea freight accounts for 9.3 per cent of the total Australian coastal shipping tonnage, and constitutes over one-third of Australian non-bulk coastal shipping tonnage (BITRE 2013c). However, the short haul nature of Bass Strait shipping means that Tasmania's share of Australia's total coastal shipping task is considerably smaller (5.3 per cent) when measured on a net tonne kilometre basis.

The importance of non-bulk cargo to the Tasmanian coastal trade reflects the unavailability of road and rail freight options for interstate trade. In 2011-12, of all goods loaded and dispatched at Tasmanian ports (for coastal shipping to and from the mainland) over half were non-bulk, compared to 12 per cent of goods handled in all Australian ports.

Total Tasmanian freight shipped in 2011-12 was just under 13 million tonnes, of which an estimated 8.1 million tonnes was bulk trade (table 2.1). Just under half of Tasmanian trade in bulk freight was with the mainland. The main bulk commodities shipped from Tasmania to the mainland were cement and sulphuric acid, while the main commodities received were metallic concentrates and alumina.

International trade accounted for around 52 per cent of bulk trade and mainly comprised direct shipments, with only a small proportion of bulk trade transhipped through an Australian mainland port. Major commodities exported were iron ore and wood chips, while the major bulk commodities imported were petroleum oils and manganese ores (BITRE 2013c).

Non-bulk freight accounted for 4.9 million tonnes in 2011-12, with 79 per cent being coastal freight — that is, shipped to and from the Australian mainland — and the remaining 21 per cent comprising international trade. With the cessation of direct international container freight services to Tasmania in May 2011, the majority of Tasmania's containerised international exports and imports are now transhipped (mainly through the Port of Melbourne, see chapter 4).

**Table 2.1 Freight shipped to and from Tasmania, 2011-12**

mt = million tonnes, per cent <sup>a</sup>

|                      | <i>Non-bulk trade</i> <sup>b</sup> |                 | <i>Bulk trade</i> |            | <i>Total trade</i> |            |
|----------------------|------------------------------------|-----------------|-------------------|------------|--------------------|------------|
|                      | mt                                 | %               | mt                | %          | mt                 | %          |
| <i>International</i> |                                    |                 |                   |            |                    |            |
| Exports              | 0.8 <sup>c</sup>                   | 17 <sup>c</sup> | 3.8               | 47         | 4.6                | 36         |
| Imports              | 0.2 <sup>c</sup>                   | 4 <sup>c</sup>  | 0.4               | 4          | 0.5                | 4          |
| <i>Coastal</i>       |                                    |                 |                   |            |                    |            |
| Northbound           | 2.0                                | 40              | 1.9               | 24         | 3.9                | 30         |
| Southbound           | 1.9                                | 39              | 1.9               | 24         | 3.8                | 30         |
| <b>Total trade</b>   | <b>4.9</b>                         | <b>100</b>      | <b>8.1</b>        | <b>100</b> | <b>12.9</b>        | <b>100</b> |

<sup>a</sup> Totals may not sum due to rounding. <sup>b</sup> Excludes empty containers. <sup>c</sup> The majority of Tasmania's non-bulk international trade is transhipped through mainland Australian ports.

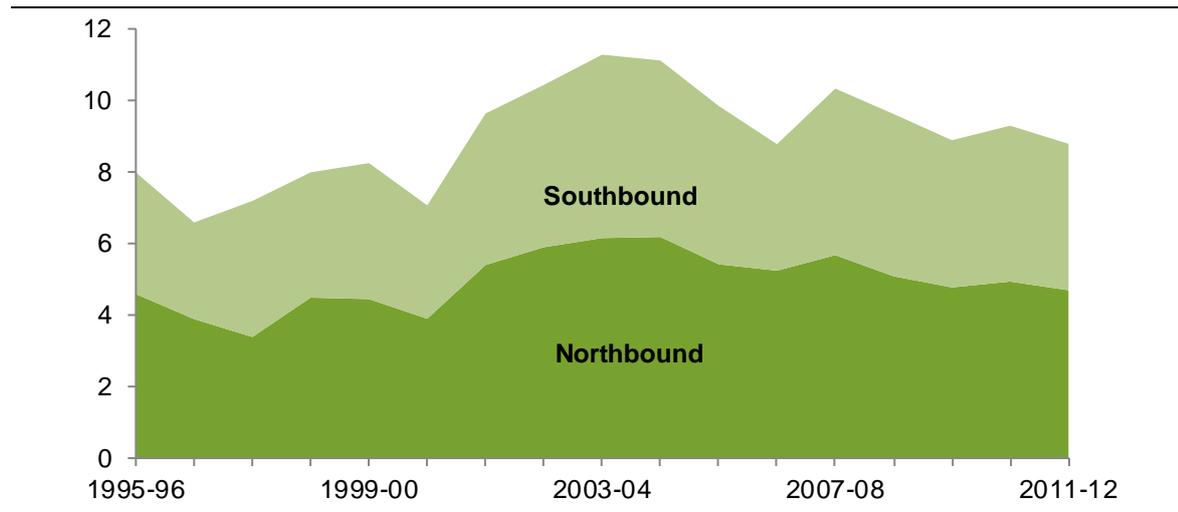
Source: BITRE (2013c).

### Trends in sea freight

Sea freight between Tasmania and the mainland grew by nearly 50 per cent between 1995-96 and 2003-04, to reach a peak of just over 11 million tonnes (figure 2.2). Growth during this period was driven by substantial increases in the transport of two significant commodity groups traded on Bass Strait: Metalliferous ores and metal scrap; and Wood and wood products.

**Figure 2.2 Coastal shipping between Tasmania and the mainland <sup>a</sup>**

Million tonnes



<sup>a</sup> Includes coastal freight loaded in Tasmania and shipped to mainland Australia ('northbound'), or shipped from mainland Australia to Tasmania ('southbound'). Coastal freight shipped within Tasmania is not included. Data are not directly comparable to that provided in table 2.1 due to inclusion of empty containers.

Data source: BITRE (2013a) (various years).

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From its peak in 2003-04, the total trade volume across Bass Strait has declined — down 22 per cent by 2011-12. Northbound freight makes up slightly more than half of the total tonnage and, in almost all years, changes in the amount of northbound freight were accompanied by broadly similar changes in southbound freight.

The overall decline in freight tonnages has been largely driven by falls in bulk freight. While time series data on freight trends measured in terms of twenty foot equivalent units (TEUs) is not available on a consistent basis, TasPorts data on total TEUs loaded and unloaded — including both domestic and international freight as well as empty containers — indicate that over the past five years or so the total number of TEUs moved through Tasmanian ports has remained relatively flat. Trends in container movements are discussed further in chapter 4.

### *Composition of sea freight*

The major commodity groups traded between Tasmania and the mainland are listed in figure 2.3. In 2011-12, the major commodity group shipped northwards was Manufactured goods chiefly classified by material, which largely comprised cement, zinc and zinc alloys, and newsprint. Crude materials, including iron ore pellets and sawn timber, were the next largest commodity group shipped to the mainland. The group, Commodities and transactions not elsewhere specified (nes) included large numbers of empty containers. It is estimated that empty containers account for around 33 per cent of outbound containers and 21 per cent of inbound containers (Aurecon 2013b). The other major commodity groups on the northbound route were Food and live animals; and Chemicals and related products. Significant quantities from these commodity groups were also shipped south to Tasmania, particularly other food preparations (such as frozen or processed foods), unmilled wheat and flours, and meat products. The other major commodity on the southbound route was fuel.

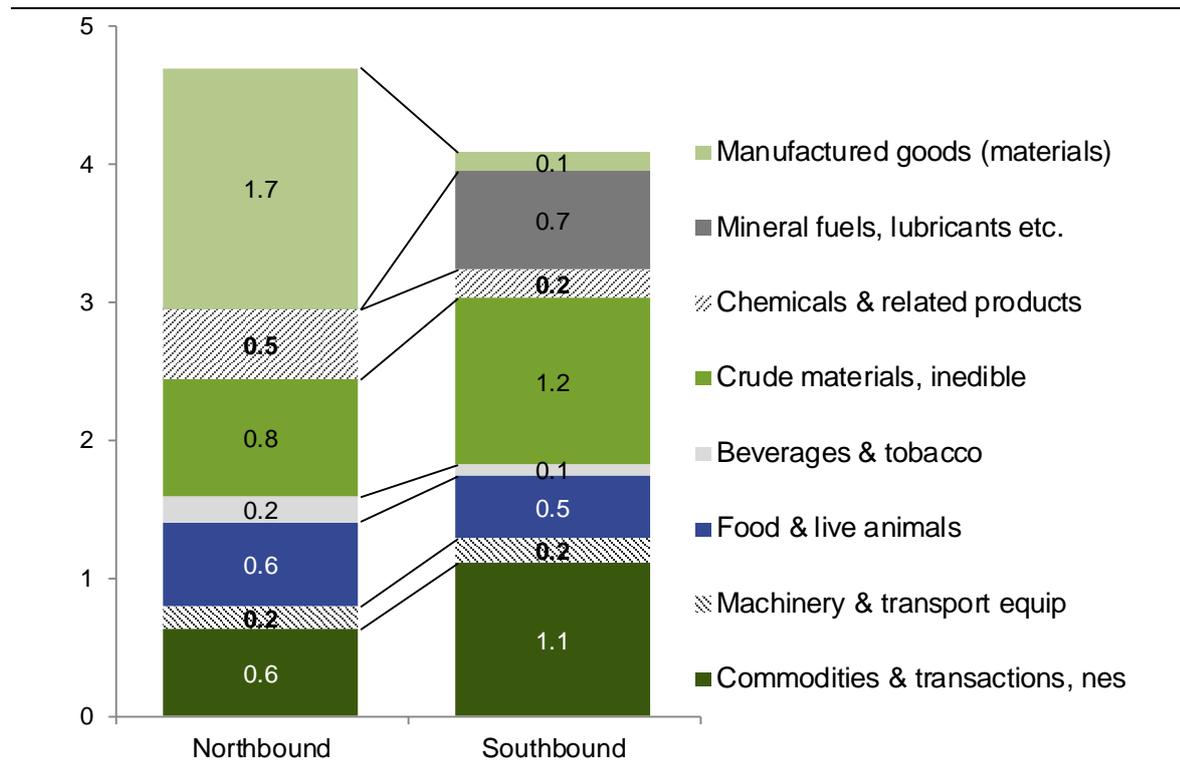
### *Bass Strait islands' freight task*

Industry on King Island and the Furneaux Group of islands (including Flinders Island) is dominated by livestock production. Consequently, the freight task chiefly comprises the export of live animals to markets in Tasmania and Victoria. The nature of the industry means that freight demand is highly seasonal. Key business inputs shipped to the Bass Strait islands include farming goods, machinery and fertiliser.

The King Island beef industry comprises 100 000 head of cattle, representing 22 per cent of Tasmanian beef production. The closure of the island's abattoir in

September 2012 saw the nature of the freight task change from refrigerated containerised meat to live shipments — with slaughter cattle now shipped live to Tasmania (and occasionally Victoria if a reverse sailing occurs) (TFGA — King Island Branch, sub. 8). In addition, Shipping Australia noted that King Island cattle are also carried on the return leg of a regular shipping service from New South Wales (Eden) to Bell Bay (sub. 53).

**Figure 2.3 Major commodities traded with Tasmania, 2011-12<sup>a</sup>**  
Million tonnes



<sup>a</sup> Includes coastal freight loaded in Tasmania and shipped to mainland Australia ('northbound'), or shipped from mainland Australia to Tasmania ('southbound'). Coastal freight shipped within Tasmania is not included. 'nes' = not elsewhere specified.

Data source: BITRE (2013a).

Because of their geographic isolation, businesses located on King Island and the Furneaux Group of islands are relatively more vulnerable to changes in the cost and reliability of shipping services. The Flinders Council noted:

As a remote island chain, the Furneaux Group has a critical need for timely, reliable and cost effective shipping and freight services to support the ongoing viability of the island's productive economic sectors and community at large. (sub. 23, pp. 3–4)

The major freight challenge for King Island is the availability of a suitable vessel. Also, restrictions to existing wharf infrastructure capabilities mean that access to the island is severely limited (King Island Shipping Group, sub. 19).

In addition, JBS Australia noted:

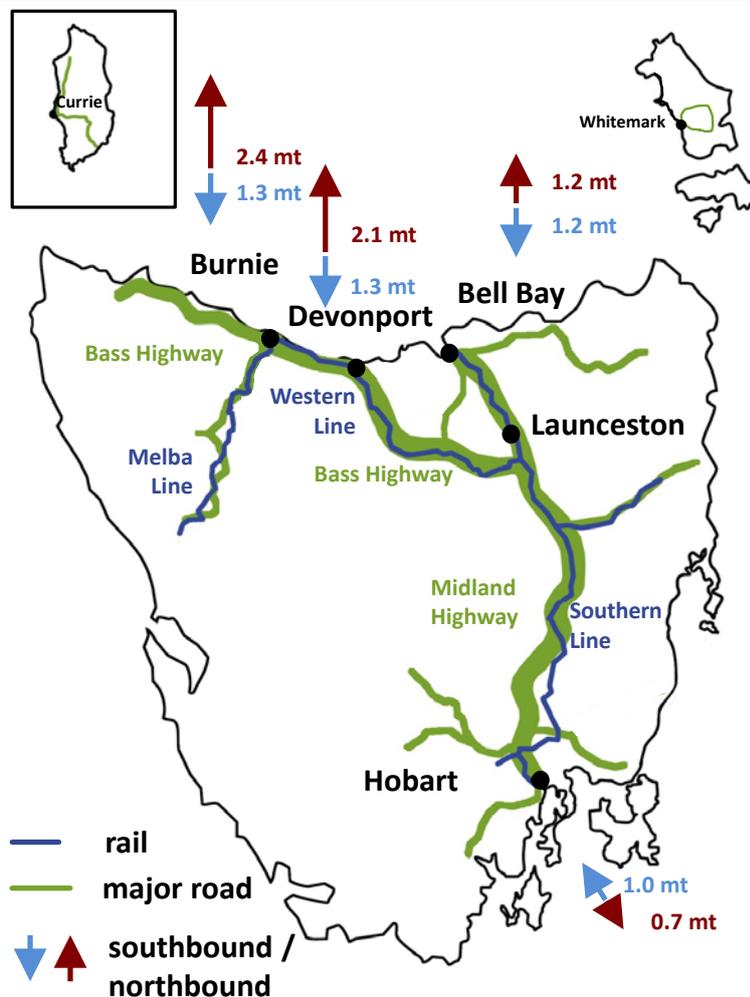
The cost of transporting livestock from locations such as King Island and Flinders Island to Tasmania for processing is expensive and on a cost per kilometre considerably greater than on mainland Australia. (sub. 49, p. 2)

## Other freight modes

Most of the freight shipped to and from Tasmania (around 80 per cent) is shipped through the three northern ports — Bell Bay, Burnie and Devonport (figure 2.4).

Figure 2.4 **Tasmanian freight movements (major ports), 2012-13**

mt = million tonnes



Data sources: Adapted from DIER (2013a) (figure 1). Southbound/northbound data from TasPorts (2013).

Tasmania's road transport network is chiefly responsible for moving freight to and from the ports. In 2011-12, Tasmania's total land freight task was 23 million tonnes, 82 per cent of which (on a tonne kilometres basis) was carried by road. Tasmania's

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National Network (the designated road network funded by the Australian Government) carries almost half of the land freight task. The Tasmanian Government funds the State Road network, which accounts for 28 per cent of the total land freight task (table 5.1, chapter 5). It is also the owner and operator of the State Rail network — which accounts for 18 per cent of total freight movements on a tonne kilometre basis. The extensive network of local government owned roads carry a smaller proportion of the state’s overall freight task, but are important for the ‘last mile’ of the overall freight task (DIER 2013a).

The heaviest freight volumes are carried through the Burnie-Devonport to Hobart corridor due to its linkages to major ports, key urban areas and industrial and processing areas in Burnie, Devonport, Launceston and Hobart (FLCT 2013a).

Air freight carries less than 1 per cent of freight (by volume) in Tasmania. Given its relatively higher costs, it is used for high value products including perishable, time sensitive products such as abalone, crayfish, cut flowers and berries.

A number of submissions raised the issue of widening eligibility under the Tasmanian Freight Equalisation Scheme (TFES) to also include air freight. Launceston Airport called for the subsidy for domestic freight to be applied to air freight as well as shipping and highlighted the potential role that air freight can play in helping Tasmanian businesses establish new markets:

... the Bruny Island Cheese Company in order to break into new markets, improve their profile and establish the business, used airfreight to get their product to mainland shelves and restaurants. At first they were air-freighting only a few 5kg boxes, but their reputation has grown, a cheese club has been established and shipments now are in the order of 1500 cartons being distributed all over Australia. Airfreight can provide the initial inroads to break into and establish new markets for niche Tasmanian products, until later in their growth cycle, when volumes will dictate that sea freight will come into its own again. (sub. 25, p. 2)

Hobart International Airport also called for the subsidy for domestic freight to be applied to air freight as well as shipping, noting:

Air freight is a crucial option for the future of Tasmania’s high value producers ... The fast developing, high quality fresh produce industry which is vital to the Tasmanian economy is ideal for air freight. (sub. 46, p. 2)

However, the Commission does not consider that there is a case for this extension of the TFES. Tasmania has access to low cost regional airline services comparable to that for other regional mainland communities. Further, reliance on air freight to access markets is a feature of many regional and remote communities and not unique to Tasmania. (The issue of scheme scope and coverage is discussed in chapter 3.)

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## 2.3 Freight cost disadvantage

The terms of reference for this inquiry require that the Commission quantify any comparative freight cost disadvantage for goods eligible under the TFES and the Tasmanian Wheat Freight Scheme (TWFS) — and identify its primary causes.

The cost of freight, across Bass Strait and for comparable tasks on land, and elements of Tasmania's interstate freight disadvantage are discussed below, drawing largely on published data on freight rates, information provided in submissions to this inquiry, and the TFES administrative database.

### Factors influencing the cost of freight

Participants to this inquiry raised a number of concerns about the high costs of freight to and from Tasmania. Some of these are included in box 2.2.

Similar concerns were raised in the Commission's 2006 inquiry into Tasmanian freight subsidy arrangements (PC 2006b).

A wide range of factors influence the cost of freight, including mode of transportation (road, sea, rail, air), cargo weight and volume, distance to destination, points of pickup and delivery, and the actual goods being shipped. Key factors affecting Tasmanian freight costs include:

- *mode of transportation* — for Tasmania, mode and distance factors are critical. A consequence of the short-haul nature of Bass Strait shipping is that it is unable to exploit the economics of sea transport, resulting in higher freight rates. As sea freight is characterised by higher fixed costs and lower marginal costs than land freight, it tends to be relatively cheaper over long distances, while land freight tends to be relatively cheaper over short distances (box 2.3).
- *intermodal costs* — the use of a combination of land and sea transport means that Tasmanian shippers incur costs of loading and unloading their cargoes. Unlike freight sent between mainland states and territories that can be transported by only one mode, freight sent between Tasmania and the mainland has to change mode at least twice. Intermodal transfers can also apply to land freight, particularly if rail transport is involved. Changing modes also adds to transit times and increases the likelihood of damage to goods.

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## Box 2.2 Participants' views on Tasmania's freight cost disadvantage

### Forth Farm Produce (trading as Harvest Moon)

A frequent, reliable and cost effective refrigerated transport service is absolutely fundamental to the business's supply chain and therefore viability ... With the TFES in place the cost per tonne to ship produce from Devonport to Melbourne is between \$75 and \$80/tonne. Road freight for the equivalent freight service ... from Melbourne to Bairnsdale is \$54/tonne and from Bairnsdale to Melbourne is \$64/tonne. The TFES does not provide Tasmanian based shippers with an unfair advantage versus mainland companies. It simply means we are only disadvantaged by \$15 to \$20/tonne rather than \$85 to \$90/tonne. (sub. 21, p. 2)

### Viewbanks

The cost component across Bass Strait equates to \$1450+, making these charges comparable with the longer Asia/Melbourne haul. Tasmanian business cannot afford the component cost of the Bass Strait haul. (sub. 16, p. 2)

### Bell Bay Aluminium

Shipping across Bass Strait is one of the most expensive components of freight export ... The factors affecting cost on Bass Strait are complex, and include shipper characteristics (volumes shipped, seasonal vs. regular shipper); high fixed costs associated with shipping (fuel, wages); and particularly cabotage legislation ... BBA's costs remain higher than comparable operations exporting goods from other Australian ports. For shipping providers, fixed costs are high. Benchmarking of shipping costs for users found Bass Strait shipping to be 24% more expensive than a similar European service, largely due to estimated input costs for Bass Strait providers (labour costs and fuel) to be 23% more expensive than in Europe. (sub. 12, p. 5)

### Mondelez

The current level of TFES assistance does not fully compensate Mondelez International's total level of disadvantage it experiences for manufacturing in Tasmania. The current level of assistance falls short by approximately 30% and places us in an uncompetitive position when compared with Swiss and German peer chocolate companies. Correcting the freight inequity is pivotal to future investment in our Tasmanian operations. (sub. 24, p. 3)

### Cuthbertson Bros

We suffered a 25% increase overnight on the Burnie leg to Melbourne. No warning, no discussion; pay or you don't ship, and when you have forward contracts, you pay ... Everyone will tell you [the Bass Strait] is the dearest freight crossing in the world. (sub. 3, pp. 1-2)

### TFGA — King Island Branch

When comparing to other freight movements across Bass Strait [rates] for livestock and fertiliser movements, appear to be extremely excessive. ... Freight costs on fertiliser in containers are hindering the ability of farmers to improve their production with freight rates 3 to 4 times that of shipping from Melbourne to Tasmania and in excess of double that of shipping from Bridport to Lady Barron (Flinders Island) ... There is a large differential in the diesel price on King Island versus the Victorian and Tasmanian regional price averages — in the order of 125%. The general differential between Terminal Gate Price vs. Regional Pricing is in the order of 4.5 – 12%, however on King Island it is in the order of 26%. (sub. 8, pp. 1-2)

### Kelp Industries

A major issue is the cost of shipping from King Island to Melbourne both for export and domestic sales ... It is often more cost effective for potential customers to import Irish or Canadian seaweed into Australia than it is for them to pay the freight from King Island to Melbourne ... freight to Melbourne or Devonport is not available on a weekly basis. There can be a wait of 1-5 weeks before the local agent sends a container of general freight. (sub. 4, p. 1)

### Box 2.3 Stylised cost structures of road and sea freight

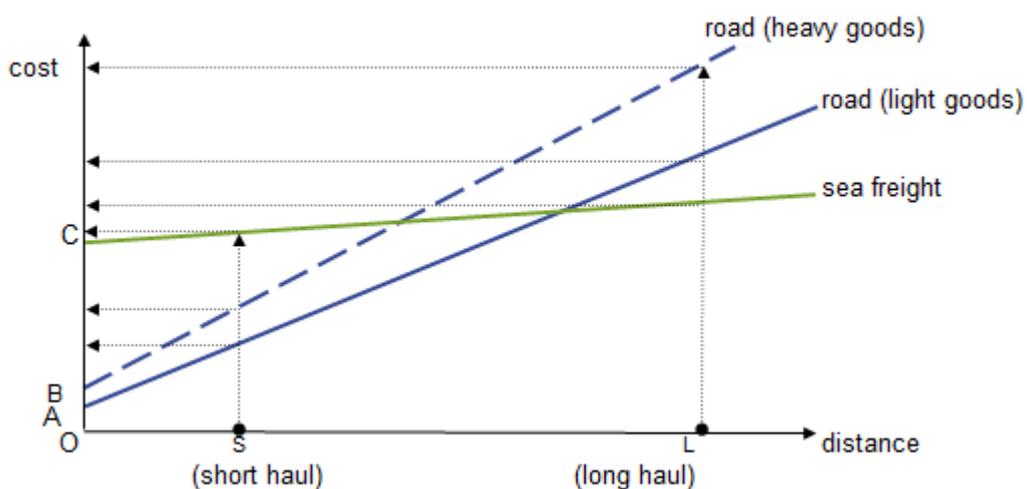
The figure below depicts different operating cost structures for road and sea freight as they relate to the distance involved in transporting a given volume of goods, such as a twenty foot equivalent unit (TEU).

Sea freight is characterised by large fixed costs (shown as OC on the cost axis) and relatively low marginal costs (represented by the gradient of the sea freight cost curve). The fixed costs include the overhead of owning or leasing vessels, crewing them and the port costs (such as wharfage) associated with loading and unloading the goods. Marginal costs relate to costs that vary with use of vessels over different distances such as fuel, wages and additional repairs and maintenance. For example, the fixed costs of 'getting the ship running' represent roughly 80 per cent of total costs of liner shipping (PC 2005, p. 281). As such, running a fully laden vessel costs little more than an empty one (or a vessel carrying empty containers).

By comparison, road freight has significantly lower fixed costs (OA), representing its relatively low overheads, and a higher degree of flexibility for loading and unloading cargoes. However, this greater flexibility is progressively offset by a steeper marginal cost curve as fuel and crew costs increase at a faster rate with distance. Additionally, as road transport is more weight constrained than sea freight (which is essentially volume constrained), high density cargoes are more costly per unit of capacity to transport by road.

As indicated, road transport is typically cheaper over a short haul (OS on the distance axis), while sea freight is cheaper over a long haul (OL). Rail freight tends to be intermediate between the two.

**Freight cost by mode of transport and distance travelled**



Sources: PC (2005, 2006b).

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- *direction of travel/trade flow imbalances* — can also affect the price of transport. Prices for ‘backhaul’ (freight travelling in the opposite direction to the main trade flow) can differ from, or even be included in, the price on the main trade leg of the journey. For Tasmania, an imbalance in trade flows necessitates the movement of large numbers of empty containers to and from the mainland, adding substantially to costs for some producers (Tasmanian Government, sub. 43).
  - *the impact of government policies* — a range of government policies affect freight costs including:
    - the extent of under- or over-recovery of costs for some road and rail infrastructure through registration fees, diesel excise, flagfall charges and other fees (discussed in chapter 5)
    - the effect of government ownership and operation of transport service businesses
    - the degree of compliance with competitive neutrality by government owned transport service businesses (such as TT-Line)
    - the efficiency of port freight facilities, in particular, Tasmania’s reliance on three principal ports (Burnie, Bell Bay and Devonport), which raises issues associated with scale economies (or lack of) and capacity to handle larger, more efficient vessels (discussed in chapter 4, along with the issue of port charges, including the levy imposed by the Victorian Government on freight movements through the Port of Melbourne)
    - coastal shipping regulations, including cabotage, which can reduce competition and increase costs (discussed in chapter 4 and appendix C).

The short haul nature of the Bass Strait route, combined with the seasonality of much of the Tasmanian freight task and the inherently high cost nature and use of roll-on roll-off (RORO) services all add to the costs of Tasmanian shipping.

## **Trends in freight rates**

Following the introduction of the TFES and changes to the arrangements for subsidised shipping services in the mid-1970s, Bass Strait freight rates increased rapidly in real terms to peak in the early 1980s (figure 2.5).<sup>3</sup> Rates then fell equally rapidly until the end of the decade before settling into a pattern of fluctuation around

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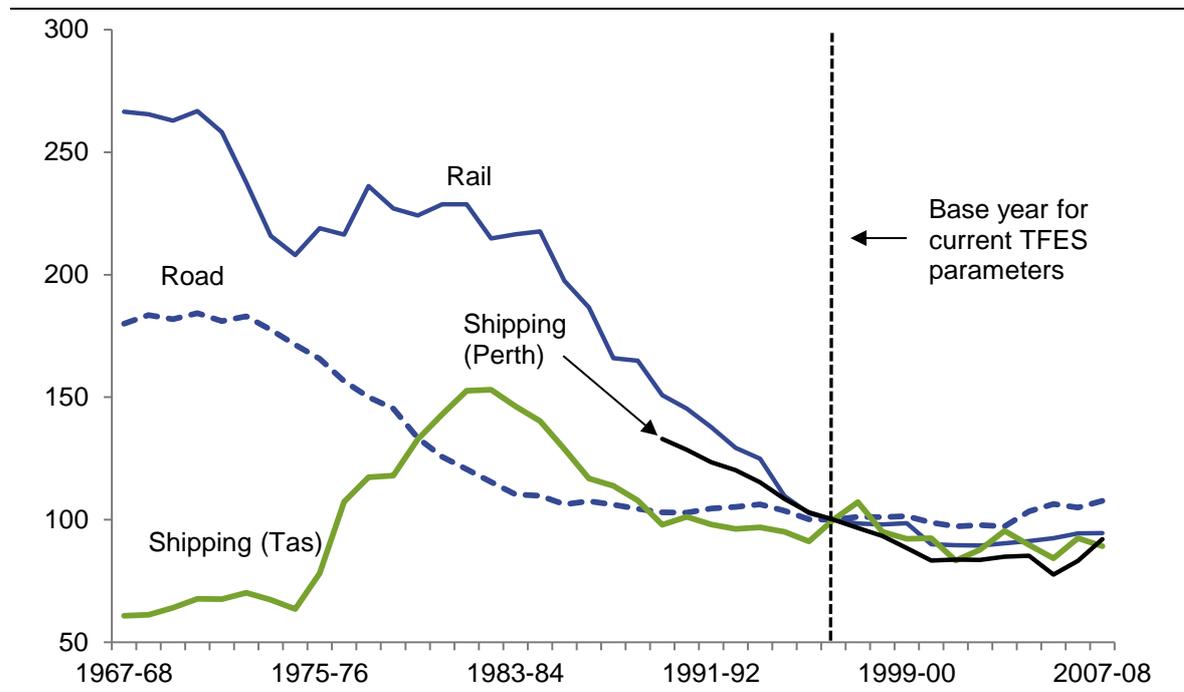
<sup>3</sup> These increases followed the decision to allow the (then) major carrier ANL to increase its rates after a period of almost five years without general rate increases, in response to cost pressures arising, in large part, from an increase of 82 per cent in waterside workers’ real earnings (ISC 1985a).

a slowly declining trend. Latest available data indicate that by 2007-08 the fall in real rates had levelled out, with real rates remaining above those available prior to the commencement of the subsidy.

Changes in Australia-wide transport more broadly differ markedly by sector. Sea freight rates between the east coast and Perth and Australia-wide rail freight rates experienced marked and sustained declines, before flattening from the start of the 2000s. The falls in sea rates correspond with the then increasing use of single and continuous voyage permits, in particular, international vessels carrying domestic cargo between the south-eastern ports and Western Australia (discussed in chapter 4).

**Figure 2.5 Real freight rates for land and sea based transport**

Real index (1996-97 = 100)



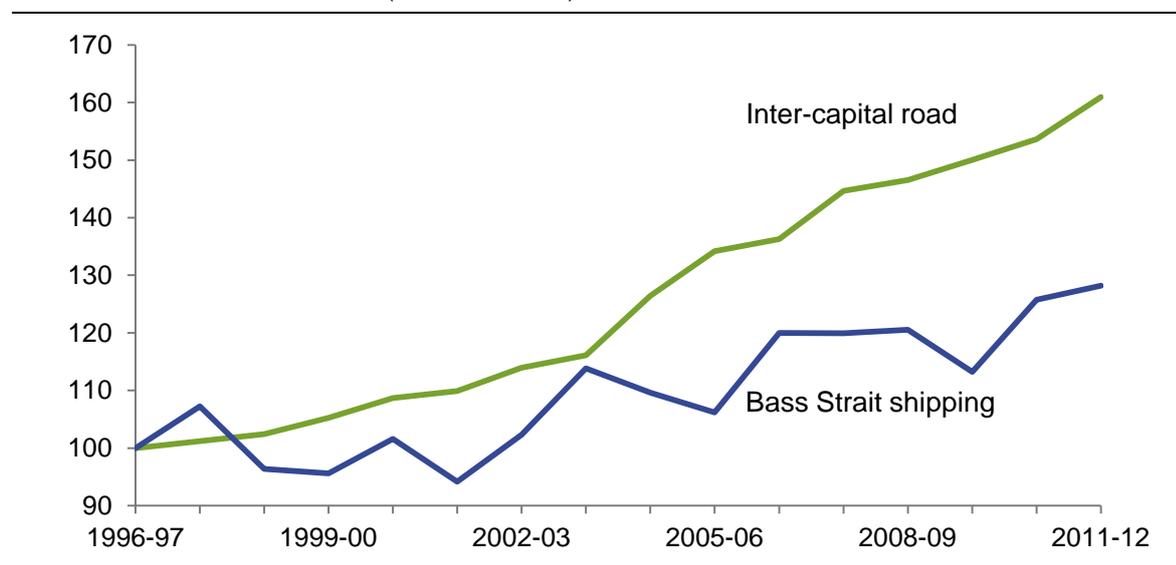
Data source: BITRE (2008a).

Real road freight rates, by contrast, fell rapidly in the decade to the early 1980s. Real road freight rates then levelled out, with only modest declines (of around 10 per cent) in the two decades to 2003-04, before increasing so that by 2007-08 they were back to almost the same level as they were in 1984-85.

The key trends in freight rates of interest for the purposes of this inquiry are changes in relative road and sea freight rates since 1996-97, as this was the base year used for the parameter-based estimation of the Bass Strait sea freight cost disadvantage for the purposes of the TFES.

While data on real rates are only available to 2007-08,<sup>4</sup> data on nominal freight rates prepared by SKM (2013) for BITRE are available to 2011-12 (figure 2.6).

**Figure 2.6 Nominal freight rate indices: road and Bass Strait shipping<sup>a</sup>**  
Nominal index (1996-97 = 100)



<sup>a</sup> Estimated Bass Strait freight rates are weighted average nominal freight rates per tonne for wharf-to-wharf full container loads in the TFES database. Inter-capital road rates assume zero empty running.

Data sources: BITRE (2013b); SKM (2013).

Figure 2.6 indicates that nominal freight rates for Bass Strait shipping increased between 1996-97 and 2011-12, by just under 30 per cent. Inter-capital road rates increased by around 60 per cent over the period, around double the rate of increase of Bass Strait sea freight rates between 1996-97 and 2011-12. The main factors influencing cost increases for road freight over the period were fuel and driver costs and increasing regulatory compliance costs (SKM 2013). An important conclusion from these data is that the gap between road freight rates and Bass Strait shipping freight rates — and hence the relative freight cost disadvantage for moving goods across Bass Strait — has narrowed since 1996-97. However, following the release of its draft report, the Commission received evidence (at the public hearings and in submissions) from a number of participants that questioned this conclusion based on their own experiences.

Comparing the changes in road transport costs it had experienced in moving newsprint between Albury and Melbourne with those used in the BITRE analysis (figure 2.6), Norske Skog noted that:

<sup>4</sup> The most comprehensive time series data on trends in real freight rates for Australian land and sea based transport are compiled by BITRE. The most recent update to this series, which includes data for the period 1964-65 to 2007-08, was provided in BITRE (2008a).

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... Norske Skog's real world experience diverges significantly from BITRE's analysis of costs. ... There is a significant difference in the rate of increase over this period. The actual Norske Skog Albury costs increase has been 40% less than that outlined in the BITRE report. It is our view that the BITRE data significantly overestimates the actual commercial increases that have occurred and that have been experienced by our Albury facility. (sub. DR67, pp. 3–4)

While the Commission accepts that Norske Skog's actual experiences of road freight rate changes differed substantially from that shown by the nominal freight rate indexes, the relevant question from a policy perspective is what happened to overall freight rates for all shippers. To form a view on overall freight rates requires the development and use of aggregate measures. As such, it is inevitable that experiences for some shippers, especially larger volume shippers, will differ from what the comprehensive data may suggest is the experience across all shippers. It is also inevitable that there will be areas of disagreement as to the best method, appropriate data and assumptions to use. Norske Skog identified a number of issues with the assumptions and underlying methodology that it saw as contributing to the marked difference between its own road freight rate changes and those shown in the BITRE analysis. These are discussed in more detail later in the chapter in the context of the other evidence the Commission received in relation to movements in relative road and sea freight rates.

Nevertheless, at the national level, Australian Bureau of Statistics (ABS) producer price index data lend support to the overall BITRE/SKM finding of a substantial growth in the costs of road freight over this period of time. These data indicate that Australian road freight transport prices increased at more than three times the rate of growth in prices for water freight transport (figure 2.7).

### **Freight costs for Tasmanian shippers**

The TFES database provides a measure of the freight costs paid by Tasmanian shippers that are recipients of payments under the scheme.<sup>5</sup> Using these data BITRE calculated median wharf-to-wharf freight rates paid by all wharf-to-wharf full container load shippers. For 2011-12, these were \$1098 for dry shipments, \$1130 for refrigerated shipments and \$1129 for all shipments.

An analysis of TFES data confirms that freight costs per TEU varied considerably for different shippers and commodities. An indication of the variation is provided

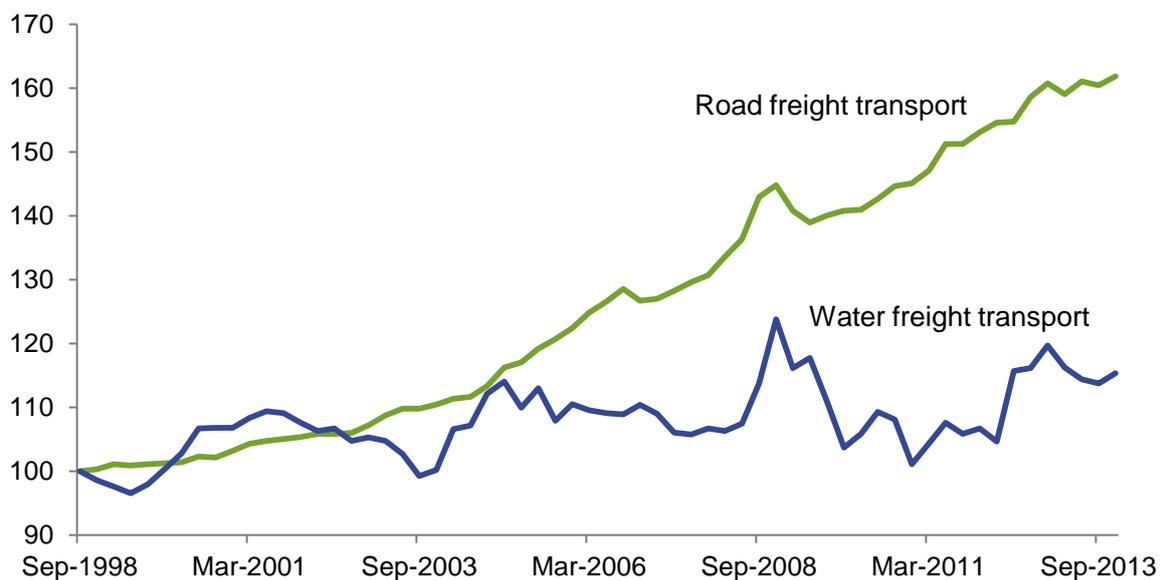
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<sup>5</sup> The TFES data set is administrative data used by the Australian Government Department of Human Services to administer claims. BITRE (2013b) advises that the structure of the database reflects how shippers arrange freight shipments and make claims and chosen claim method can affect the median calculation where a large quantity of freight and/or a large number of shipments are involved.

by estimates in table 2.2, which show freight rates per TEU for full container loads submitted with wharf-to-wharf invoices between northern Tasmania and Victoria. These indicate that there was substantial variation in costs per TEU, with most claims recording a Bass Strait equivalent cost of between \$600 and \$1400 per TEU. Similarly, rates varied by commodity. For example, fresh fish and fresh vegetables recorded higher average freight rates than commodities such as plastic products and processed wood.

**Figure 2.7 Producer price indexes: Australian road and water freight transport**

Index (September 1998 = 100)<sup>a</sup>



<sup>a</sup> Data have been indexed to September 1998 — the earliest year for which data for both series are available. Data source: ABS (2013d).

These differences are unsurprising. Differences in rates across commodities and routes are a feature of sea freight. Carriers may charge different rates for different commodities on the same voyage, different rates for similar commodities on different legs of a voyage, and different rates for similar commodities on the same voyage. More valuable cargoes tend to attract higher rates (PC 2005). In addition, ability to negotiate freight rates can be a significant factor in actual rates charged. Medium to large, frequent and fairly uniform shipments generally attract lower freight rates. Shippers of these goods can use their status as ‘anchor’ clients to negotiate more favourable rates with carriers.

However, care is needed in interpreting freight rate data based on TFES claims. The Commission noted in its 2006 inquiry into freight subsidies that the scaling factors and set allowances incorporated in the TFES to cater for the different eligible

freight tasks, types of packaging and methods of payment are likely to result in estimates of shippers' average Bass Strait sea freight costs being distorted due to shippers seeking to maximise the value of the subsidy received (PC 2006b).

**Table 2.2 Freight rates per TEU, 2011-12**  
Bass Strait shipments<sup>a</sup>

| <i>Freight rate per TEU</i>         | <i>Proportion of claimants<sup>b</sup></i> | <i>Proportion of TEUs shipped</i> |
|-------------------------------------|--|-----------------------------------|
|                                     | per cent                                   | per cent                          |
| Less than \$600                     | 1.9  | 0.3                               |
| \$600 to \$800                      | 7.3  | 20.8                              |
| \$800 to \$1000                     | 15.8                                       | 21.5                              |
| <b>\$1000 to \$1200<sup>c</sup></b> | <b>26.5</b>                                | <b>19.7</b>                       |
| \$1200 to \$1400                    | 31.1                                       | 35.9                              |
| \$1400 to \$1800                    | 16.9                                       | 1.6                               |
| Over \$1800                         | 0.4  | 0.1                               |

<sup>a</sup> Based on claims recorded as full container loads travelling northbound from Northern Tasmania to Victoria, and travelling southbound from Victoria to Northern Tasmania, on a wharf-to-wharf basis. In total, just over half of all full container loads for this route were submitted with wharf-to-wharf invoices. <sup>b</sup> Claimants may be charged differing freight rates and therefore may be included more than once. <sup>c</sup> Median.

Source: Estimates based on PC analysis of TFES claims database (accessed November 2013).

The Commission heard during the current inquiry that rising shipping costs for smaller volume shippers, coupled with the structure of the payment thresholds of the TFES, may be causing them to switch from making 'wharf to wharf' claims to making claims on a 'door to door' basis. Norske Skog raised concerns about whether this may be skewing the calculation of median shipping costs (sub. DR110) by the median not being representative of smaller shippers and their shipping costs. BITRE has undertaken some initial analysis on this issue and has advised that whilst there has been some volume shift from wharf to wharf to door to door claims over the past five years, there are also other material structural shifts in the profile of the recipient base informing the median calculation (pers. comm. BITRE, 28 February 2014).

The Commission considers that there is a case for reviewing these issues in the context of future rate reviews. Importantly, the recommended move to a flat rate of assistance under the TFES would go some way to addressing issues relating to the median calculation.

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## Estimating the sea freight cost disadvantage

The essential feature underpinning the levels of assistance provided under the TFES is an estimate of the cost disadvantage associated with moving goods across Bass Strait. For the purposes of the scheme, this is defined as the difference between the actual sea freight costs between northern Tasmanian and Victorian ports, and the notional road freight costs of moving goods an equivalent distance on the mainland (the ‘road freight equivalent’ or RFE).

Inherent in this formula is the perverse outcome that, as the movement of freight on the mainland becomes more efficient, the cost disadvantage is estimated to increase, leading to an increase in the rate of the subsidy, which dilutes the incentive to increase the efficiency of freight movements across Bass Strait. Conversely, if road freight costs increase more quickly (as has been the case recently), the disadvantage is reduced. However the TFES is structured so that it does not fully compensate all shippers for their notional ‘sea freight disadvantage.’ The scheme phases out payments as the level of disadvantage increases to provide some, albeit limited, incentive for shippers to seek lower freight costs.

### *Determining the road freight equivalent cost*

Estimating RFE costs is by no means straightforward, and a range of different considerations and key assumptions need to be made in determining RFE costs including:

- *road costs per kilometre* — including fuel consumption, tyres, driver costs, capital costs/depreciation, registration costs and capacity utilisation
- *shipper characteristics* — such as how regularly they use freight services/average monthly spend (as achieved freight rates are very sensitive to bargaining power)
- *commodity carried and level of urgency* — assumptions are generally for typical commodities carried in the typical way for the most common level of urgency
- *actual rates versus tendered prices* — the former are often slightly lower due to post-tender negotiation
- *choice of benchmark journey* — different interstate corridors have different costs (SKM 2013).

In addition, there will always be rates paid that are substantially more and substantially less than typical rates quoted. For example, on many Australian freight routes there is a lot more freight flowing in one direction than the other. In such instances the marginal costs of backhauling is low, offering shippers scope to

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transport their freight on those backhaul routes at much lower costs — sometimes less than half of forward rates.

### *Parameter estimates*

In its calculations of the RFE, BITRE uses a road benchmark of a B-Double heavy vehicle with a maximum payload of 39 tonnes and approximately one third empty running.<sup>6</sup> Based on this, BITRE's latest estimates (released in December 2013) of RFE costs are \$650 per TEU for dry freight and \$715 for refrigerated freight in 2011-12 (up from \$281 and \$309 respectively in the 1996-97 parameters, box 2.4).

These increases in the RFE have had a substantial impact on estimated sea freight cost disadvantage. In particular, they imply that the 1996-97 parameters currently in use significantly overstate the cost disadvantage for shipping freight across Bass Strait. For 2011-12, BITRE estimates show that shippers were receiving on average \$223 per TEU (\$671 minus \$448, see table 2.3) more than the estimated sea freight cost disadvantage for dry freight based on updated sea freight rates and road freight benchmarks and the scheme's established methodology. This payment is about 33 per cent more than is justified under the most recent parameter estimates.

Given the magnitude of the difference, updating TFES parameters would have substantial implications, both in terms of scheme funding costs and the payments to shippers. BITRE concluded that updating the TFES parameters to reflect 2011-12 values would significantly reduce payments to most shippers, noting that if the parameters were revised to reflect the latest estimates, compensation paid through the scheme may have fallen by around \$90 million for freight shipped between 1 July 2010 and 30 June 2012 (BITRE 2013b).

Commenting on these findings, the Commonwealth Department of Infrastructure and Regional Development (DIRD) noted:

While the sea freight disadvantage has declined, shipping costs have continued to rise and successive governments have chosen not to adjust TFES and TWFS parameters because such action would have reduced Australian government assistance to Tasmania at a time when Tasmanian producers were facing rising shipping costs and difficult economic conditions. (sub. 42, p. 24)

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<sup>6</sup> SKM (2010) suggested that approximately one third of potential carrying capacity on average may not be utilised for inter-capital long haul routes.

## Box 2.4 TFES parameter reviews

The level of assistance provided to shippers through the TFES is derived from calculations using a set of parameters which are unchanged since 1998 (and relate to freight costs in the year 1996-97). Regular reviews of the parameters were recommended by the Nixon Review in 1998 and the Commission in 2006.

Since 2006, BITRE has conducted periodic reviews, most recently in 2013. The latest BITRE modelling shows that the sea freight cost disadvantage as defined by the scheme has fallen (BITRE 2013b).

BITRE's latest updated parameters (relating to the year 2011-12) are shown in table 2.3, along with the 2006-07 estimates and the current parameters (1996-97).

Table 2.3 **Estimates of selected TFES parameters (\$), 1996-97, 2006-07 and 2011-12<sup>a</sup>**

|   | 1996-97    | 2006-07 | 2011-12 |
|---|------------|---------|---------|
| Road freight equivalent (dry freight)                                   | <b>281</b> | 507     | 650     |
| Road freight equivalent (refrigerated freight)                          | <b>309</b> | 558     | 715     |
| Wharf-to-wharf sea freight cost disadvantage (dry freight) <sup>b</sup> | <b>671</b> | 653     | 448     |
| Wharf-to-wharf sea freight cost disadvantage (refrigerated)             | <b>671</b> | 631     | 415     |
| Intermodal costs allowance  | <b>100</b> | 100     | 100     |

<sup>a</sup> Current parameters are shown in bold type. <sup>b</sup> For 2001-02 the estimated disadvantage was \$562 and in 2010-11 it was \$549.

Overall, the latest BITRE parameter review found that, based on updated RFE rates and the median wharf-to-wharf freight rates, the sea freight cost disadvantages for 2011-12 were:

- \$448 per TEU for dry freight (down from \$671)
- \$415 per TEU for refrigerated freight (down from \$671).

For the intra-state TFES (King Island and the Furneaux Group of islands) the sea freight cost disadvantages (which have not been updated since 2006-07) for 2011-12 were:

- \$350 per TEU for dry freight between King Island and Tasmania (up from \$275 per TEU in 2006-07)
- \$1226 per TEU for dry freight for the Furneaux Group of islands to Tasmania (down from \$1601 per TEU in 2006-07).

BITRE also recommended that the high density discount be reduced to 30 per cent (from 40 per cent in the 1996-97 parameters) and the stowage factors for high density freight be increased from 1.1 to 2.6 tonnes per cubic metre.

Source: BITRE (2013b).

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### *Concerns about the latest parameters*

The Commission received evidence at the public hearings and through submissions from a large number of participants that was critical of many aspects of the latest parameter review, including methodology, underlying assumptions and overall conclusions. While participants focused on different issues, a consistent theme was that the freight cost disadvantage faced by Tasmanian shippers was large and persisted even with TFES payment rates at current levels.

Two key sources of evidence provided to support these views were:

- estimates of freight costs prepared by Aurecon (2013a)
- data on individual shipping costs experienced by a number of companies.

### *Aurecon/Freight Logistics Coordination Team estimates of cost disadvantage*

Estimates of freight costs prepared by Aurecon for the Freight Logistics Coordination Team were cited in a number of submissions. A key finding of the Aurecon analysis is that even with the TFES at current rates there is a substantial cost disadvantage — of almost \$300 per TEU — for shippers moving a TEU from Hobart to Melbourne relative to shippers moving a TEU a similar distance on the mainland (box 2.5). Citing this analysis, the Tasmanian Government noted:

The benchmark Hobart to Melbourne shipping cost ... with the TFES applied ... is still more expensive than a comparable mainland freight journey. ... These estimates suggest that some form of indexation and/or benchmarking is required to ensure the TFES can fulfil its freight equalisation objective into the future. (sub. 43, p. 14)

The Commission notes that some differences between estimates of freight cost disadvantage are to be expected given the range of different approaches, assumptions and data sources that can be used. However, the magnitude of the difference between the Aurecon figures and those published by BITRE warranted further enquiry.

The Commission raised the issue with officials from DIRD and BITRE during the latter (Canberra) phase of the public hearings and following the release of the draft report and the receipt of earlier public hearing evidence from concerned shippers. The Department also provided additional more detailed evidence in a supplementary submission (sub. DR107). DIRD and BITRE identified a number of issues with the Aurecon analysis, including:

- incorrect treatment of ‘lift on lift off’ (intermodal) costs
- significant under-estimation (by around \$200 per TEU) of TFES assistance payable due to incorrect application of TFES methodology

- use of road freight benchmark costs that appear to reflect low spot rates which are not a representative market benchmark. In addition, the basis of the ‘industry sourced’ road freight rate for Aurecon’s benchmark is not stated<sup>7</sup> and there is no allowance for ‘operating empty’ in the road freight benchmark.<sup>8</sup>

### Box 2.5 Aurecon benchmarking of freight costs

Aurecon’s (2013a) study for the Freight Logistics Coordination Team benchmarked the cost of transporting a container originating in Tasmania against a road journey originating on the mainland. The costs of transporting a container (one TEU) from Hobart to Melbourne (733 km) were compared with the cost of transporting a container a similar distance on land only. A land journey between Adelaide and Melbourne was used to estimate road costs. This route was chosen as the distance is close to the distance between Hobart and Melbourne (table 2.4).

**Table 2.4 Transport cost comparison: Hobart–Melbourne versus Adelaide–Melbourne**

Comparison is for one TEU

|                  | <i>Export – Hobart to Melbourne</i> |             | <i>Domestic (TFES assisted) – Hobart to Melbourne</i> |            | <i>Land only – 19m Semi – 733km</i> |            | <i>Land only – 26m B-Double – 733km</i> |                  |
|------------------|-------------------------------------|-------------|---|------------|-------------------------------------|------------|---|------------------|
|                  | <i>Unit Cost (\$)</i>               |             | <i>Unit Cost (\$)</i>                                 |            | <i>Unit Cost (\$)</i>               |            | <i>Unit</i>                             | <i>Cost (\$)</i> |
| Road leg         | 278km at \$1.09/km                  | 303         | 278km at \$1.09/km                                    | 303        | 733km at \$1.09/km                  | 799        | 733km at \$0.77/km                      | 564              |
| Lift on          |                                     | 50          |   | 0          |                                     | -          |   | -                |
| Bass Strait      | Devonport – Melbourne               | 900         | Devonport – Melbourne                                 | 450        |                                     | -          |   | -                |
| Lift off         |                                     | 50          |   | 0          |                                     | -          |   | -                |
| Further road leg |                                     | 100         |   | 100        |                                     | -          |   | -                |
| <b>Total</b>     |                                     | <b>1403</b> |   | <b>853</b> |                                     | <b>799</b> |   | <b>564</b>       |

Source: Aurecon (2013a, table 36, p. 90).

These estimates indicate the cost to transport a container from Hobart to Melbourne was \$1403, compared with \$799 by semi-trailer and \$564 by B-Double. Aurecon (2013a, p. 81) notes that ‘the cost to move a container from Hobart to Melbourne is reduced by \$550 to a total cost of \$853 where the exporter is eligible for TFES assistance.’ However, this rate remains well above that for transporting a container a similar distance on land only – with a B-Double rate of \$564, which was \$289 cheaper than the TFES assisted Hobart to Melbourne journey.

Source: Aurecon (2013a).

<sup>7</sup> By contrast, data and assumptions underlying the BITRE per kilometre road freight rates are published in SKM (2013).

<sup>8</sup> However the Aurecon (2013a) study does acknowledge elsewhere that the cost of moving empty containers may be included in the freight rates for some shippers.

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More detail on the source of the difference between the Aurecon estimates, as well as a re-estimation of the Aurecon's calculations applying the correct TFES formula and using BITRE's estimated road freight equivalent rates is provided in DIRD's submission (sub. DR107).

Based on an assessment of the available evidence — including that provided by TFES parameter reviews and supporting material as well as evidence from other sources including ABS data and unpublished data from the TFES Database — the Commission's view is that the transport costs comparisons undertaken by Aurecon do not provide a case for setting aside the findings of the latest BITRE parameter analysis. Importantly, however, the Commission sees merit in a broader and ongoing process of consultation with key stakeholders and TFES recipients on future rate reviews undertaken by BITRE. (This issue is discussed further below.)

#### *Cost disadvantages faced by individual firms*

A number of participants stated that, even with the level of subsidy currently being provided through the TFES (using the parameters for 1996-97), their businesses continue to face an overall freight cost disadvantage and called for even greater support through the TFES to help defray the high shipping costs they faced (box 2.2). Similar views were provided in the Commission's 2006 inquiry, where the Commission heard that even after receiving the subsidy, there was still a disadvantage, varying generally from 3–20 per cent, with some goods facing higher disadvantages (PC 2006b).

Many participants to this inquiry underscored the significance of TFES subsidies for the viability of their Tasmanian business, albeit with limited and non-definitive evidence. In particular, a number of manufacturing enterprises pointed out that their competitiveness against alternative production and investment locations globally is under regular review and the assistance provided by the TFES is important in swaying the case in favour of their Tasmanian operations. For many businesses, Bass Strait shipping is the single largest transport cost in the supply chain, even for products sent to distant markets (FLCT 2013a).

The Commission received evidence from a number of participants on their shipping costs. For example, Mondelez stated that its operations in Tasmania faced considerable disadvantages relative to plants located in Victoria for similar products, noting:

... the current level of rates were designed in 1998 and this level has not been amended or adjusted for any of the changes that have taken place. The current level of rates appears to be about 30% lower than the required level.

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On basis of a direct comparison between the operation of a B-Double vehicle on the Hume Highway and the freight rates on the Bass Strait, the TFES maximum cap should be raised from \$855 to \$1150 at least. (sub. DR98, pp. 5–6)

Simplot noted:

With TFES equalisation it is 10.4% more expensive per tonne kilometre to freight between Ulverstone and Melbourne versus Simplot's average cost per tonne/kilometre between eastern seaboard states. (sub. DR96, p. 4)

Norske Skog Boyer stated that comparison of their freight costs paid (with supporting evidence provided to the Commission in a confidential submission), compared to similar transport tasks on the mainland:

... clearly show an ongoing freight cost disadvantage, notwithstanding all our efforts to contain costs in conjunction with our logistics suppliers. ... If there was a land bridge to the mainland, the Boyer Mill could transport paper to its Melbourne customers for approximately 27% less than the current cost including the benefit of TFES. This would be a much more significant impost, at around 57% if the current level of TFES assistance did not exist. It can therefore be concluded that while TFES payments meet part of the additional cost, they do not fully 'equalise' for the whole difference and the difference remains substantial. (sub. 39, p. 17)

In response to the Commission's proposal that TFES parameters reflect the latest estimates (which show a fall in the freight cost disadvantage), Norske Skog expressed strong concerns with a number of aspects of the latest BITRE parameter review methodology and assumptions, and provided additional supporting evidence. The materiality of these concerns prompted the Commission to make further enquiry of BITRE on the issues articulated by Norske Skog in public hearings and follow up submissions. Some of the key issues and questions raised by Norske Skog about the latest TFES parameter review along with some of the BITRE responses are provided in box 2.6.

A key element of BITRE's response was that while it did not dispute the evidence provided by Norske Skog of its experiences with freight costs, these were not necessarily representative of the broader experience across all shippers. Further, BITRE noted that many of Norske Skog's criticisms related to the design of the scheme, in particular the use of a median freight rate, the design of the incentive structure and the use of a market road freight benchmark.

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**Box 2.6 Concerns raised by Norske Skog in relation to latest TFES parameter estimates**

Norske Skog identified a number of significant concerns in relation to the methodology, assumptions and data used by BITRE in the calculation of the Bass Strait shipping cost, road freight equivalent cost (RFE) and intermodal costs.

*Bass Strait shipping cost*

Norske Skog stated that movements in median shipping costs listed in BITRE were not consistent with BITRE's own shipping data, noting:

We are obviously not privy to the underlying data but it is clear that the calculation of the 'median rates' does not reflect the real movement in shipping costs paid by Tasmanian shippers and in this case significantly understates the actual shipping rates by 15%. (sub. DR67, p. 3)

*Road freight equivalent costs*

Norske Skog stated that the RFE calculated by BITRE is significantly inflated due to a number of factors including: the assumption of 30 per cent empty running; low tare weights inflating the payload; and actual road rates — in particular, rates that Norske Skog (and others) have been able to achieve in the real world commercial environment. Norske Skog stated that:

... the current BITRE calculation of an RFE of \$650 is significantly inflated to what could actually be achieved and therefore results in a dramatic underestimation of the overall freight cost disadvantage. (sub. DR67, p. 4)

*Intermodal costs*

Intermodal costs were highlighted as a significant additional cost that Tasmanian shippers bear, with Norske Skog noting:

Since 1998, [intermodal cost] has been determined to be \$100 per TEU with no review or escalation. As Norske Skog has indicated in our confidential submission, intermodal costs have increased and are currently \$145/TEU. There is therefore a significant shortfall in the Scheme's assistance on this parameter. (sub. DR67, p. 5)

**BITRE responses to issues raised by Norske Skog**

In responding to the issues raised by Norske Skog, BITRE pointed out, however, that Norske Skog is a very large shipper with specialised freight requirements who:

... clearly differs from other shippers and their freight costs cannot be used as a market freight cost benchmark. Norske Skog is recommending as a benchmark for the Road Freight Equivalent, the use of road freight rates that are likely to be well below market rates paid by most shippers (sub. DR107, attachment A, p. 1).

BITRE also noted that with respect to Norske Skog's critique of key BITRE assumptions:

1. Road freight rates provided by SKM "are typical rates for large shippers, exclude backloading rates and do not allow for empty running." (SKM 2013, p. 3)
2. BITRE based its 30 per cent 'operating empty' assumption on actual truck weigh in motion data on inter-capital routes (BITRE 2011b, p. 21)
3. The 1.5 tonne/TEU tare is based on the tare weights for half a standard 40 foot dry shipping container (Rockwell International Pty Ltd, Container specifications, undated). (sub. DR107, attachment A, p. 1)

BITRE also provided a set of specific responses addressing a range of technical issues raised by Norske Skog (see sub. DR107, attachment A).

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BITRE noted that in suggesting updated parameters it had followed the TFES methodology as recommended by the TFES Review Authority, and noted that with respect to the design of the current TFES:

- The Scheme does not fully compensate all shippers for their ‘sea freight disadvantage’ — the TFES incentive structure phases out payments as the level of disadvantage increases to encourage shippers to seek lower freight costs.
- The use of a median sea freight rate was recommended by the TFES Review Authority (1998) to overcome what it stated was ‘the very heavy influence of a few very large shippers who enjoy low freight rates’. (DIRD, sub. DR107, attachment A, p. 1)

Information from participants that the Commission received during the course of the inquiry clearly showed that many misunderstood the purpose and parameter based operation of the schemes. Many participants considered the TFES was directed at offsetting increasing or absolute freight costs, whereas its actual purpose is partially offsetting (not eliminating) the relative and notional disadvantage of moving freight by sea.

Overall, while the Commission acknowledges that some costs shippers face can be higher than the rates used in the TFES parameters, the methodology and parameter estimates used by BITRE to calculate the cost disadvantage are based on assessments of average costs and rates and median shippers. As such, they inevitably cannot reflect the (widely disparate) experiences of individual firms. That said, the scheme provides incentives for shippers to move between wharf to wharf and door to door based assessment. As such the Commission acknowledges that the recipient base informing the median calculation (on actual recipient data wharf to wharf) will change with recipient freight experience and an election to shift between the two forms of assessment. As discussed above, the Commission considers that there is a case for reviewing these issues in the context of future rate reviews.

### *Intermodal allowance*

The high cost of intermodal transfers and the level of intermodal allowance was also identified as an issue by many participants. Mondelez, for example, noted:

The intermodal allowance must be increased with immediate effect to reflect the actual additional costs incurred ... Mondelez International recommends the annual review of the intermodal assistance to adequately compensate shippers for the annual rise in intermodal costs. (sub. 24, p. 3)

Net Sea Freight considered that the intermodal allowance is too low and, whilst acknowledging the difficulties in determining an intermodal allowance that better reflected actual shipper costs, called for a review:

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It may be that the task is too complex, in that there is likely to be a series of almost unique intermodal costs associated with each freighting exercise. Nevertheless, that fact that a one-size-fits-all value has been extant since 1998, and has been implicitly accepted as a necessary component in the freight-cost-alleviation procedure, suggests that the allowance be considered for revision. (sub. DR67, p. 4)

A number of other participants to the inquiry stated that their intermodal costs were higher than the intermodal allowance.

The use of a fixed intermodal rate dates back to the original scheme design. The Nixon (1998) review of TFES rates and assistance recommended that a fixed intermodal amount be provided, noting:

By fixing the amount, any unwanted incentives to shift activity inside or outside the wharf in response to assistance will be avoided. (p. 12)

Nixon also noted that it would be undesirable that a different audit trail be imposed on scheme administrators who would be charged with verifying claims for other than container hire, wharfage or sea transport if other eligible costs were made explicit, and that in most cases for goods shipped on a door to door basis no disaggregation of wharf to wharf costs is given.

That said, determining the appropriate level of the fixed rate is not straightforward. BITRE (2008b) stated that analysis of data provided by two large shippers indicated that the quantifiable, incremental costs that were attributable to the need for a sea journey was at least \$50 and \$86 per TEU respectively. In its latest parameter review, BITRE (2013b) stated that it was not known whether these levels were representative of the majority of shippers. It nevertheless recommended that the \$100 per TEU intermodal allowance be retained.

In the Commission's view, BITRE should seek evidence from shippers and other participants on intermodal costs as part of broader TFES rate review processes (discussed further below).

#### *Achieving reductions in payment rates over time*

Another concern raised by many participants was that any changes to payment rates could have substantial adverse impacts on the Tasmanian economy, particularly if they were implemented too quickly. The Tasmanian Government stated that:

... it is absolutely critical that the Commission recognises both the extent to which the equalisation schemes are embedded in the Tasmanian freight system and the current vulnerability of the Tasmanian economy, including the tourism sector, to the impact of further short-term shocks. In this context, even relatively minor changes to scheme parameters need to be carefully considered and introduced progressively. (sub. 43, p. 16)

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Similarly, a number of participants stated that a transition period of 2-3 years would be too short a time period to allow adjustment. Net Sea Freight noted:

Should there be envisaged a substantial reduction in TFES payments per TEU, there would need to be a transition period extending beyond the suggested 2-3 years. The reason for this proposal is that business models of those receiving assistance would be structured on the presumption of a medium to long-term continuance of existing arrangements, and it is possible that a decrease in TFES assistance received would make some operations marginal. (sub. DR75, p. 9)

In the Commission's view, because a move to updated payment rates has the potential to adversely affect some shippers substantially, that move should only be undertaken with appropriate transition arrangements. The details of those arrangements should be determined as part of the review process associated with the full suite of reforms to the Tasmanian freight schemes outlined in the following chapter.

#### *Ensuring TFES payment rates are soundly based, transparent and up-to-date*

The notion of a cost disadvantage that can be measured and compensated for is problematic and inherently difficult to measure. Regardless of the method employed, any calculation will be subject to challenge. As noted earlier, freight rates can differ for a number of reasons. In its 2006 inquiry, the Commission found that even for a given freight task there is considerable variation in the freight costs both within jurisdictions and between them. The additional information provided to the Commission during the course of this inquiry (both public and confidential) reinforces this conclusion.

Given this, determining with any confidence the absolute magnitude of sea freight cost disadvantage at a particular point in time has many problems, with methodology and assumptions open to dispute. The Commission noted in its 2006 inquiry that it was unrealistic to suggest that any one 'road freight equivalent' was truly representative of a comparable freight task. This remains the case.

Nevertheless, principles of sound public policy design indicate that for a program to be administered effectively, it requires clear, consistent and transparent rules. Such rules need to provide ongoing certainty to all affected parties, including recipients, those administering the scheme, and taxpayers who ultimately fund the scheme.

A consistent and transparent mechanism for determining TFES funding rates over time is therefore essential. Further, notwithstanding the problems in establishing a benchmark noted above, tracking changes in underlying costs for different freight

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modes over time is likely to involve fewer problems than establishing the initial benchmark.

The Commission considers that current arrangements for developing TFES parameters — which involve the preparation and public release of comprehensive parameter reviews undertaken by BITRE on a periodic basis — are soundly based, consistent and transparent. Further, in the Commission’s view, the BITRE review methodology and approach reflect the broad scheme objective of partially offsetting the relative cost disadvantage. Hence, if the Australian Government chooses to retain the TFES in essentially its current form, it should ensure that the payment rates are based on the findings of the latest available BITRE parameter estimates subject to a public consultation process as recommended below.

Updating TFES payment rates to reflect current parameter estimates would result in a saving to the Commonwealth Budget. However, a one-off and thereby substantial change from the 1996-97 to the 2011-12 parameters has the potential to create adjustment pressures for businesses as their planning is likely to have been undertaken on the basis of the current level of assistance. It is also likely to represent a material withdrawal of assistance to some firms, notably large claimants. Therefore, if this policy option were to be adopted, consideration should be given to appropriate transitional arrangements.

Further, the Commission notes that BITRE has been making available the results of its regular parameter reviews as well as underlying assumptions, cost estimates, methodology and other supporting information — most recently in BITRE (2013b) and SKM (2013). This approach is consistent with public policy principles of transparency and accountability.

However, the Commission acknowledges the range of views and evidence that has been provided to this inquiry about the level and underlying drivers of freight transport costs, estimated levels of cost disadvantage, including the assumptions that underpin them, and appropriate scheme payment rates.

It has also been apparent to the Commission during the course of this inquiry that, notwithstanding the publication of BITRE reviews, recipients’ awareness of those reports and their implications for payment rates was low. More broadly, it has also been evident that the level of understanding of the scheme among recipients and stakeholders varies greatly. This has led to a number of misperceptions about what the schemes are designed to do and how they work. This, combined with successive governments’ reluctance to adjust payment rates to reflect changes in scheme parameters has meant that recipients are less likely to factor possible future changes to payment rates into their future production and freight usage plans.

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In this regard, one area of potential improvement to scheme administration identified by the Commission during the course of this inquiry is to further strengthen the consultation processes used in rate reviews. Consistent with leading practice stakeholder consultation processes, rate reviews could be undertaken in several stages. This would involve the release of a draft report, containing the updated parameter estimates and underlying analysis and providing an opportunity for stakeholders to comment and provide any additional evidence through public submissions. Following this, a final report would be released that would include any changes or additional analysis stemming from the consultation process, as well as discussion of the outcomes of the consultation process, and how the resulting feedback and evidence were taken into account in the preparation of the final report.

Such a multi-stage process would allow for a public and transparent testing of the merits of different data, estimates and assumptions provided by stakeholders prior to the finalisation of updated parameters.

The process would also provide a mechanism for BITRE to access pricing and cost data from the relevant shipping lines to assist with the determination of the updated rates as well as assess the impacts and effectiveness of the TFES more broadly. This is particularly important given the substantial challenges in gaining a clear understanding of changes in Bass Strait shipping costs and prices identified in the Commission's 2006 inquiry and strongly evident during the course of the current inquiry. Without clear information in these areas, assessing the extent to which subsidies paid through the TFES are passed through to their intended recipients, and hence the overall effectiveness of the scheme in achieving its objectives, is unclear.

The Commission heard strong support for a multi-stage approach from a range of participants at the post-draft hearings and in submissions. The King Island Shipping Group stated:

We wholeheartedly support that review ... and especially the new objective around wider public stakeholder consultation in those processes. That is definitely the way forward in terms of how effective the scheme or the process is. (trans., p. 420)

Houston's Farm noted that while it agreed that future reviews should be through a public multi-stage process:

... there needs to be sufficient time for all parties concerned to deliberate, research, understand and study and provide feedback. (trans., p. 201)

Mondelez noted that it:

... welcomes the [public multi-stage] process for the reviews and would like to emphasise the importance of industry input into such a process carrying sufficient

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weight to ensure that the level of TFES is maintained at correct levels. (sub. DR98, p. 6)

In view of the potential substantial investment of time and resources, for government and business alike, that such a process is likely to involve, the current schedule of biennial parameter reviews is likely to be too frequent. Accordingly, the Commission considers a period of four years between reviews to be appropriate in terms of achieving a balance between currency and administrative burden while also reflecting an appreciation of the tenor of shipping line contracts.

#### RECOMMENDATION 3

***Future Tasmanian Freight Equalisation Scheme (TFES) rate reviews should be undertaken every four years by the Bureau of Infrastructure, Transport and Regional Economics using a public multi-stage process, comprising:***

- ***release of a draft report, containing the estimated rate updates and underlying assumptions and data***
- ***a public submission process that allows interested parties sufficient time to provide input***
- ***release of a final report that incorporates resulting feedback and evidence.***

***Further, to inform rate reviews and future assessment of the effectiveness of the TFES, the Bureau should seek agreement with the relevant shipping lines to provide pricing and cost data.***

The failure of successive Australian Governments to respond to the many parameter reviews that have been undertaken in past years has eroded the integrity of the TFES. As noted, strengthening the scheme's integrity, in its current form, will require substantial adjustments to bring payment rates in line with latest estimates. This situation should be avoided in the future with regular adjustments to payment rates being made as revised parameters become available.

#### RECOMMENDATION 4

***The Australian Government should respond publicly and in a timely manner to all Tasmanian Freight Equalisation Scheme rate reviews. All responses should be released with an appropriate lead time to provide certainty for recipients, and for any resulting revisions to payment rates to be incorporated into Commonwealth Budget processes.***

However, while these changes would improve scheme integrity, there are a number of additional problems with the scheme that would remain unaddressed, including administrative complexity and the potential for 'gaming' and associated weaker

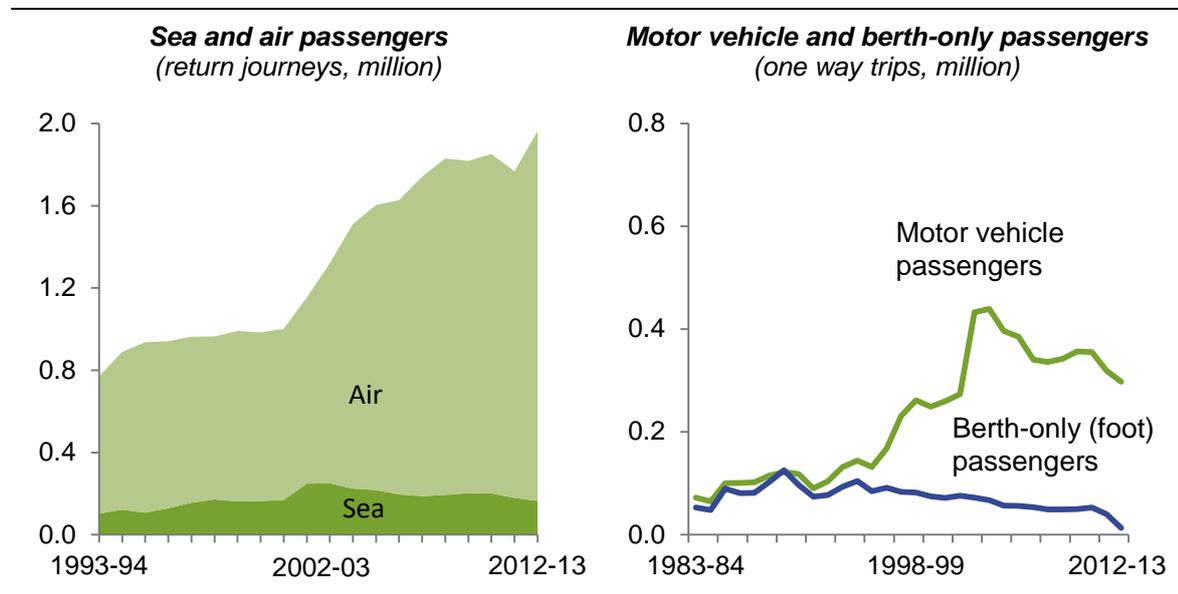
than normal commercial incentives for cost minimisation resulting from the scheme’s sliding scale. The Commission’s preferred approach for addressing these and other associated issues involves more substantial changes to the design and administration of the TFES. These issues are discussed in the following chapter.

## 2.4 Tasmania’s passenger vehicle task

The terms of reference of this inquiry require that the Commission quantify any cost disadvantage for passengers travelling to Tasmania who are currently eligible for support through the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES). The scheme provides a subsidy for passengers accompanying an eligible vehicle across Bass Strait. Eligible vehicles include cars, motor homes and buses.

In 2012-13, almost two million adult passengers travelled by air and sea across Bass Strait (figure 2.8, left panel). Air travel accounted for around 90 per cent of this total. After remaining flat during the second half of the 1990s, the total number of passengers travelling across Bass Strait increased sharply from the early 2000s, driven by a doubling in annual air passengers following the entry of low cost airlines into the Tasmanian market and the resulting marked fall in fares (BITRE 2014).<sup>9</sup>

Figure 2.8 Sea and air traffic across Bass Strait<sup>a</sup>



<sup>a</sup> Includes both visitors and Tasmanian residents.

Data source: BITRE (2014).

<sup>9</sup> BITRE notes that falls in discount airfares have been the driver of the rapid growth in the number of air passengers travelling across Bass Strait since 2003-04.

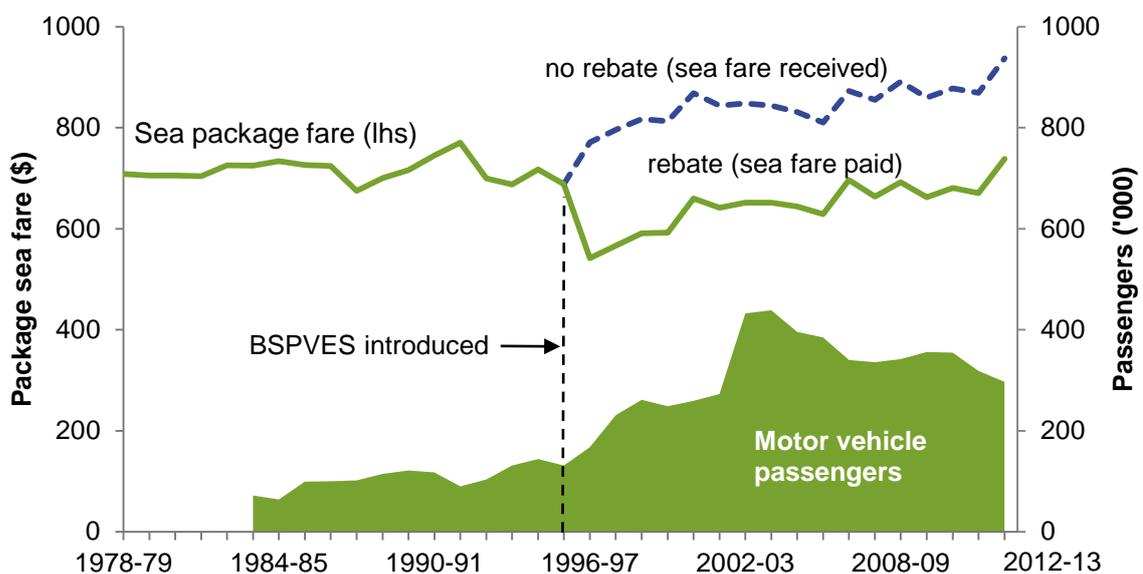
In contrast, the number of passengers accompanying an eligible motor vehicle has declined since the mid-2000s, with just under 300 000 people making the trip (with their vehicles) across Bass Strait in 2012-13 (figure 2.8, right panel). Given that there were 1.9 passengers per vehicle, this amounted to 152 000 eligible vehicles being shipped under the scheme in 2012-13.

## 2.5 The cost for passenger vehicles

On 30 June 2013, the fare for shipping a standard (accompanied) passenger car across Bass Strait was \$288, which, with a rebate of \$199, resulted in a net fare of \$89 (BITRE 2014). An indication of changes in pricing over time is provided by BITRE's benchmark one way sea fare provided in the most recent BSPVES Monitoring Report (figure 2.9).

Figure 2.9 **Real sea package prices and passengers accompanying an eligible motor vehicle, 1978-79 to 2012-13<sup>a, b, c</sup>**

Peak season, end June — real (CPI deflated) 2012-13 dollars



<sup>a</sup> BITRE advises that this fare series is indicative and should be treated with caution given changes in the characteristics of the ships used and the fact that passengers can choose different standards and prices of accommodation. <sup>b</sup> Series break from 2010-11 due to TT-Line fare restructure (on 17 May 2010). <sup>c</sup> Consistent data on motor vehicle passengers not available prior to 1983-84.

Data source: BITRE (2014).

The BITRE data presented in figure 2.9 indicate that prices did not increase in real terms in the decade and a half to the mid-1990s. Following the introduction of the BSPVES, real package sea fares (excluding rebate) increased to be around 25 per cent higher a decade later. However, with the rebate, the package sea fare paid by

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passengers remained at around the same level, or below the fare paid prior to the introduction of the scheme in real terms in most subsequent years. However, latest data provided to the Commission by DIRD indicate that:

- sea fares increased substantially in 2012-13. In real terms, BITRE's benchmark fare index fell 1.6 per cent in the year to June 2012, then increased sharply — by 10.1 per cent in the year to June 2013
- sea passenger numbers declined in both 2011-12 and 2012-13, to levels last seen in 2001-02, with the modal share of sea travel falling to 8 per cent. This contrasts with air travel, where passenger numbers decreased in 2011-12 then increased significantly in 2012-13
- the number of TT-Line voyages decreased from 827 in 2010-11 to 748 in 2012-13. Average passenger numbers per TT-Line voyage decreased from 493 in 2010-11 to 442 in 2012-13 (sub. 42, p. 15).

Overall, while the introduction of the BSPVES saw a sharp immediate reduction in real (CPI adjusted) fares paid, most of the real reductions were recouped by TT-Line through increases in real fares in the four subsequent years to 2000-01. In the decade to 2010-11 real fares paid (by passengers) increased slowly before the strong upswing in the most recent year.

A comparison of sea package fares reveals a stark difference in the rates of growth prior to, and following, the introduction of the BSPVES. Before the introduction of the BSPVES, the annual average change in real sea package fares in the 17 years between 1978-79 (earliest available year) and 1995-96 was -0.2 per cent. However, in the 17 years since then (1995-96 to 2012-13), the real annual average rate of growth in sea package prices (excluding the rebate) was 1.8 per cent. The nominal rate of growth in sea package fares (i.e. without adjusting for CPI) over the period was over 4 per cent a year.

By comparison, sea freight transport prices for Australia overall increased at only around 1 per cent a year in the decade and a half to 2013 (figure 2.7). Bass Strait freight rates increased more rapidly (figure 2.6) — 1.7 per cent a year between 1996-97 and 2011-12. This was still below CPI (which increased at an annual average rate of just over 2.5 per cent over the period).

However, these indicators, as industry and national averages, do not reflect the unique operating costs for TT-Line over the period. TT-Line states that the increased fares following the introduction of the BSPVES reflected increased costs, noting, 'Over the past five years, TT-Line's operational expenses have grown at a rate higher than CPI' (sub. DR84, p. 6).

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Further, in providing these data, BITRE noted that the real sea package price series should be treated with caution given:

- There have been major improvements in the ships used to provide the service, including changes in the on-board service offerings
- Passengers can choose different standards and prices of accommodation (including the option of no cabin upgrade)
- This comparison is for the peak season only (particularly as TT-Line dropped shoulder season fares on 14 September 2009). (2014, p. 16)

This raises a number of issues including: the extent to which the subsidy may have affected the quality of services provided to passengers taking eligible vehicles across Bass Strait; the appropriate tradeoff between cost and quality of services and how this has affected the range of choices available to passengers seeking access to cheaper sea transport packages; and the future commercial viability of TT-Line's passenger vehicle service. These issues are examined further in chapters 3 and 4.

### **Comparative cost disadvantage**

The transportation of passengers differs fundamentally from the transportation of freight. Each load of freight must be managed from its origin to its destination, loaded, unloaded and transferred. By contrast passengers are relatively autonomous and can board, exit and transfer without assistance, processing information and making choices between transport modes. Further, unlike freight, comfort and safety considerations are an important element of passenger travel (Rodrigue et al, 2013). The greater range of options and decisions that need to be taken into account makes assessing cost disadvantages challenging.

A number of interrelated factors are likely to have a bearing on decisions by people to travel with their vehicle across Bass Strait including: budget; vehicle shipping prices; the length of the stay; the purpose of the visit; vehicle type; preferred travel route; and accommodation needs. Travel mode preferences are also important. The actual process of travelling often constitutes a valued service in and of itself. Hence, unlike freight, people will have preferences for different modes of travel. Some enjoy flying, while others enjoy driving or travelling by train or ship.

These factors make assessments of passenger costs more complex than freight costs. A range of assumptions would need to be made including in relation to:

- *vehicle costs* — including fuel and other on-road costs, drawing on, for example, Australian Taxation Office allowable per kilometre claim rates for motor vehicles of different sizes

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- the 2012-13 rate of 74 cents per kilometre for cars up to 2.6 litres applied to the 420 km ‘straight line’ land bridge used in the TFES yields a vehicle cost of \$311. Similarly, the National Roads and Motorists’ Association (NRMA) estimate for the current running cost for an average family saloon (a standard Holden Commodore Sedan) in 2013 was 79 cents per kilometre (Tourism Industry Council Tasmania, sub. 48)
  - *accommodation costs* — this would depend on the number of people travelling as well as the length of the journey/point of origin
  - *time costs* — including the opportunity costs of time spent behind the wheel — including fatigue breaks and refuelling — time that could have been spent sightseeing and engaging in other leisure activities.

The resulting estimates could then be used as a basis for comparison with other costs such as travelling across Bass Strait either by sea, with a vehicle, or flying and hiring a passenger motor vehicle on arrival.

Such an approach would need to ‘assume away’ many factors to produce an estimate of cost disadvantage. This would potentially lead to a significant overestimate or underestimate of the cost disadvantage for any one individual. BITRE does not maintain a set of parameters for accompanied passenger vehicle disadvantage. In its first BSPVES monitoring report, the (then) Bureau of Transport and Communications Economics included an estimate of the passenger vehicle costs based on the notional cost of driving an equivalent distance on a highway using NRMA estimates of an average family saloon (40 cents per kilometre) (BTCE 1997). This provided an equivalent highway cost of \$170 for a one-way trip. However, in all subsequent monitoring reports this approach has not been used.

In summary, while the lack of an option to drive a vehicle to and from Tasmania can impose a cost disadvantage relative to travelling a similar distance on the mainland, as well as other indirect costs such as the loss of convenience for travellers unable to use their own vehicle, quantifying the extent of any disadvantage is likely to be even more problematic than that for freight.

That said, Tasmania’s overall geographic disadvantage for passenger travel has declined due to rapid falls in air fares across Bass Strait — for example, the Melbourne–Hobart Internet Discount Fare index was around 60 per cent lower in July 2013 compared to a decade earlier (BITRE 2014). The real costs of transport between the mainland and Tasmania — including the costs of flying and car rental — are much lower than at the time the subsidy was introduced.

Car rental rates have also been declining in relative terms for some time. ABS data indicate that between 2000 and 2012 the underlying producer prices for the

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Australian rental car industry increased at around half that of prices for the economy overall (ABS 2013d). These data do not provide a breakdown of prices for the Tasmanian car rental industry; however the declining long-term trends in the national data are likely to be broadly reflective of trends in passenger motor vehicle rental rates in Tasmania. A comparison of car rental rates between Hobart and other capital cities by Austrade (sub. 41) indicated that Hobart's rental rates were below those of the mainland capitals. Austrade noted that the competition provided by the BSPVES is likely to assist in keeping car rental rates down in Tasmania, although the extent to which the BSPVES has played a role is unclear. The broader question of the scheme's overall impacts, as well as those of the TFES, are discussed in the following chapter.



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## 3 Current and alternative arrangements

### Key points

- In their current form, the Tasmanian Freight Equalisation Scheme (TFES), the Tasmanian Wheat Freight Scheme (TWFS) and the Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) continue longstanding arrangements to partially offset the relatively higher cost of moving freight and passengers across Bass Strait by sea. The reference to equalisation misleadingly implies 'full' compensation for the cost disadvantage which is not inherent in the design and operation of the schemes.
- More than \$2 billion has been outlaid since the inception of the schemes and they are expected to cost more than \$2 billion in net present value terms over the next 15 years.
- The TFES, in attempting to measure a precise notional freight cost disadvantage, is complex and creates compliance costs for business and an administration burden for government, while a true measure of the recipient's actual cost disadvantage remains inevitably elusive.
- To improve incentives to seek lower shipping costs, the Commission recommends a flat rate of assistance. In the absence of a flat rate, payment should be based on actual wharf-to-wharf costs to restore integrity to the scheme.
- In the absence of a direct regular international container shipping service to Tasmania, the Commission considers that there is a case for extending the TFES to all eligible commodities shipped to the Port of Melbourne or other mainland ports subject to no net increase in the overall quantum of assistance under the scheme. Importantly, this should be sequenced to avoid compromising the potential resumption of a direct service and to take account of the benefits of potential coastal shipping reform.
- To lower the compliance burden of the TFES the Commission recommends improved claiming processes. There should also be more comprehensive public reporting of scheme data to improve transparency.
- The TWFS is redundant and should be terminated. However, the Commission also recommends that assistance under the TFES for wheat and other grains be based on the lowest feasible cost option for transporting grain to Tasmania.
- There remains confusion about the main purpose of the BSPVES and the Australian Government should clearly articulate the scheme's objectives. As some of the scheme's benefit is inevitably captured by TT-Line, the Australian and Tasmanian Governments should ensure transparency as to who ultimately benefits from the scheme. There is also an imperative, given the operation of the schemes and that TT-Line competes with commercial operators in the freight market and the passenger and vehicle market is contestable, to ensure that TT-Line fully satisfies the principles of competitive neutrality across these services.

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## 3.1 About the schemes

### A brief history

The Tasmanian Freight Equalisation Scheme (TFES), Tasmanian Wheat Freight Scheme (TWFS) and Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) continue longstanding arrangements to partially offset and thereby subsidise the relatively higher cost of moving freight and passenger vehicles across Bass Strait by sea (box 3.1). The reference to equalisation misleadingly implies ‘full’ compensation for the cost disadvantage which is not inherent in the design and operation of the schemes and has resulted in a widespread misunderstanding of the objective and scope of the schemes.

The basis for assisting freight and passenger movements across Bass Strait is that the transport cost by ship is greater than for a comparable journey by road or rail. However, the schemes have also assumed broader economic development objectives expressed in the reviews that led to their introduction (table 3.1) and in subsequent comprehension of their purpose.

In the case of the TFES and BSPVES, these broader objectives were to promote economic development and a better-functioning transport system in the context of developing transport markets in sea, road, rail and air. The TWFS reflected the need to address impediments to a nationally-consistent price for wheat, a staple commodity at the time, and then subsequently to provide transitional support to Tasmanian wheat users for the move away from an administered wheat price.

### A brief overview of the schemes

#### *Tasmanian Freight Equalisation Scheme*

Specified commodities, and commodities used by particular industries, shipped by container between Tasmania (including King Island and the Furneaux Group of islands) and the mainland can claim a rebate for the cost of transporting the goods by sea.

The northbound component of the TFES covers around 150 goods specified in schedule 1 of the Ministerial Directions for the scheme, which are produced or manufactured in Tasmania. A wide range of fresh, processed and manufactured goods, as well as ores and concentrates that are shipped northbound are eligible for assistance. As northbound goods must be intended for further processing or use on

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the mainland, goods for export are not included unless they are transformed on the mainland prior to export.

**Box 3.1 A brief history of the TFES, TWFS and BSPVES**

The TFES was introduced in 1976 following the 1976 Commission of Inquiry into Transport to and from Tasmania that found that the cost of freight was seen to be an obstacle to expanding existing Tasmanian industries and establishing new ones. The original stated policy objective was to make the costs of shipping eligible cargoes between Tasmania and the mainland approximate those moved over a similar distance by road or rail on the mainland. A 1998 review of the scheme's structure by the TFES Review Authority recommended defining the freight cost disadvantage by applying a number of parameters (box 3.2). The Australian Government adopted the Review Authority's recommendations and the scheme took its current form.

Under the TWFS, wheat is the only bulk commodity that receives specific financial assistance for shipment to Tasmania. The TWFS had its origins in the Tasmanian Wheat Freight Levy which aimed to ensure the administered price for wheat was the same for Tasmanian and mainland users. In 1989, coinciding with the deregulation of the Australian wheat market, the levy was replaced by the Tasmanian Wheat Freight Subsidy Scheme (TWFS) to address additional transport and handling costs for Tasmanian wheat users and provide transitional support to adjust to the removal of administered pricing for wheat. The TWFS was introduced in 2004 as an alternative to the TWFS. Containerised wheat was included in the TFES in the 2004-05 Budget.

The BSPVES was introduced in 1996, extending a longstanding subsidy for passenger travel across Bass Strait. The BSPVES had the broader aim to help the Tasmanian tourism sector in particular and the Tasmanian economy more broadly. In 2001 the scheme was extended to cover eligible vehicles transported between King Island and the mainland. In 2002, the rebate was extended to caravans, motor homes, vehicles of people with disabilities and bicycles and became a set rate for each category of eligible vehicle that has been indexed to the consumer price index since 2008.

*Sources:* CIE (2001); Department of Infrastructure and Regional Development (sub. 42); Nimmo (1976); Sharp (1996); TFES Review Authority (1998).

The southbound component covers non-consumer raw materials, machinery and equipment produced in Australia, or imports transformed on the mainland, for use in the manufacturing, mining, agriculture, forestry, and fishing industries in Tasmania. Eligibility is determined by the Australian and New Zealand Standard Industrial Classification (ANZSIC) division the business belongs to, as determined by their primary activity. ANZSIC is the industrial classification system underpinning Australian Bureau of Statistics and Statistics New Zealand industry statistics (ABS and Statistics NZ 2006).

The cost of shipping brood mares and equipment used by professional sportspersons and entertainers can also be claimed under the TFES.

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Imports, bulk freight and the back hauling of empty containers are not eligible for TFES assistance. Price equalised goods, where a vendor averages their mainland and Tasmanian transport costs and charges the same price free-into-store, are not eligible for assistance under the southbound component of the scheme.

The TFES subsidises the estimated and relative freight cost disadvantage, not the full freight costs. The cost disadvantage is calculated as the difference between:

- the costs incurred by shippers for moving freight across Bass Strait; and
- the notional cost incurred by moving freight an equivalent distance (approximately 420 kilometres) on the mainland by road.

This amount is adjusted according to the parameters used to estimate the cost disadvantage, including a sliding scale of benefit, that is, the percentage rate of compensation falls with increasing cost disadvantage above certain thresholds (box 3.2).

The scheme is administered by the Department of Human Services (DHS) in Tasmania. Claimants submit a claim form comprising claim line items (the details for each individual shipment) and evidence of shipment (box 3.6).

### *Tasmanian Wheat Freight Scheme*

The TWFS provides a flat rate of assistance of up to \$20.65 per tonne for bulk shipments of wheat from the mainland to Tasmania. Total payments are capped at \$1.05 million each financial year. Claimants submit claims to DHS in Tasmania accompanied by evidence of shipment. No claims have been made under the scheme since 2009.

### *Bass Strait Passenger Vehicle Equalisation Scheme*

Persons travelling across Bass Strait by sea accompanying an eligible passenger vehicle receive the BSPVES subsidy. Eligible vehicles include cars, motorhomes, buses, motorcycle and bicycles. For travellers with TT-Line, which carries more than 99 per cent of eligible vehicles, the subsidy is deducted from the passenger fare at the time of payment and claimed by TT-Line. The amount of the subsidy for a return journey ranges from up to \$58 (for a bicycle) to up to \$816 (for a car towing a caravan or motorhome).

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## Box 3.2 TFES parameters

### Road freight equivalent (RFE)

The cost of transporting goods a similar distance by road on the mainland is deducted from the claimant's wharf-to-wharf freight cost. Different RFEs are used for the scheme's intrastate component.

### Part container load

The TFES assistance is based on a standard 6.1 metre container known as a 'twenty foot equivalent unit' container, or TEU. Shipments that are less than a full container load are converted to a TEU-equivalent size/full container load basis.

### Intermodal costs

A fixed allowance of \$100 per TEU is added to the wharf-to-wharf freight cost for the cost of transferring goods between different modes of transport.

### Dry or refrigerated freight

Transporting refrigerated ('reefer') freight by road is more expensive than transporting dry freight. Thus the RFE is higher for refrigerated goods thereby lowering the TFES rebate available.

### Door-to-door billing

As the TFES is only intended to provide assistance for wharf-to-wharf costs, up to \$460 is deducted from freight costs billed on a door-to-door, wharf-to-door or door-to-wharf basis. For those with high land freight costs, this has the effect of increasing the rebate.

### Route

Freight shipments between different parts of Tasmania and different states are eligible for the TFES, but adjustments are made because sea freight is cheaper than road or rail over longer distances. The freight charge is divided by a scaling factor to achieve a Bass Strait equivalent. Longer distances therefore have a larger scaling factor and attract a lower rebate.

### Density

As high density or heavy cargo is cheaper to move by sea than by road or rail, it receives 60 per cent of the standard weight assistance.

### Median cost

The rebate reduces as the cost disadvantage increases to provide an incentive for shippers to seek lower freight rates. Per TEU, the subsidy is 100 per cent up to \$335.50, 75 per cent on amounts over \$335.50 and up to \$671, and 50 per cent on amounts over \$671 and up to \$1006.50. This caps the subsidy at \$855 per TEU including fixed intermodal costs of \$100. The thresholds are based on a 'median' cost disadvantage per TEU (\$671) as recommended by the TFES Review Authority (1998).

*Source:* DITRD LG (2013).

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## Scheme funding

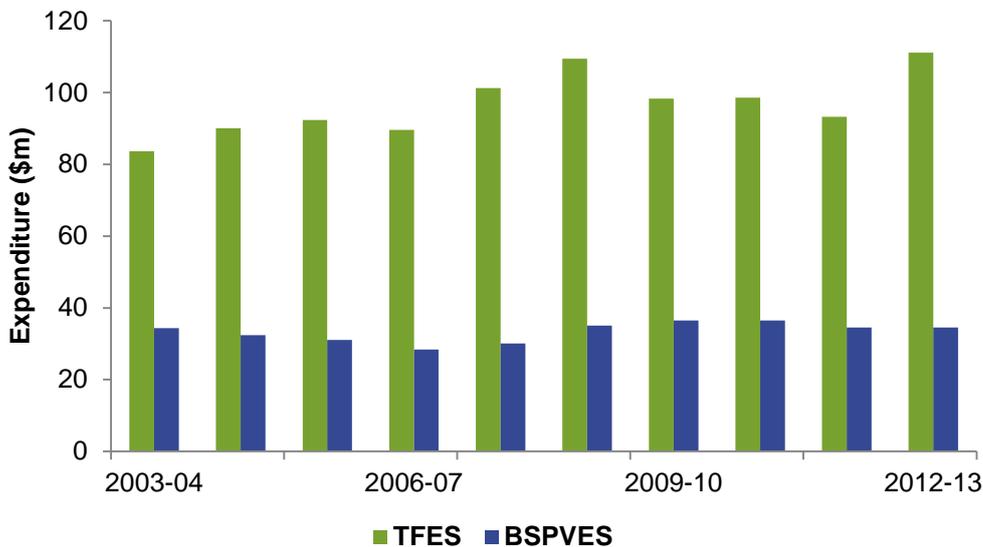
The TFES, TWFS and BSPVES receive appropriations across the forward estimates each year in the Commonwealth budget. More than \$2 billion has been outlaid under the three schemes since their inception, including more than \$400 million under the BSPVES since 1996. Over the next 15 years, the net present value of expenditure under all three schemes is estimated to be more than \$2 billion — including around \$500 million for the BSPVES — assuming the schemes continue to grow in line with trends over the past 10 years.

The \$111 million in funding assistance under the TFES in 2012-13 is the largest annual expenditure on that scheme (figure 3.1). This represented around 0.5 per cent of Tasmania’s gross state product in 2012-13, or around \$217 for each Tasmanian resident.

Expenditure on the TWFS has never reached the \$1.05 million cap and there have been no claims since 2009.

BSPVES expenditure grew rapidly in line with the strong take-up of the subsidy in the late 1990s and early 2000s, but has moderated over the past decade (figure 3.1).

Figure 3.1 **TFES and BSPVES annual expenditure**  
2003-04 to 2012-13



Source: Department of Infrastructure and Regional Development (annual reports).

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## **Previous reviews and monitoring of the schemes**

The schemes have been subject to review and monitoring over the past three decades with aspects of the schemes considered in some detail (table 3.1). In addition to these reviews, there have been a series of Bureau of Infrastructure, Transport and Regional Development (BITRE) reports on the TFES parameters and the BSPVES.

Despite most reviews recommending changes to address problems with the TFES and TWFS, these schemes, and the BSPVES, remain largely unchanged since their introduction. While the Australian Government agreed in 2007 to the recommendations of the Commission's inquiry into Tasmanian freight subsidy arrangements, and some minor changes to administration and scope were subsequently implemented, most of the changes to the TFES and TWFS that were recommended were not ultimately adopted. This decision was on the basis that the Global Financial Crisis warranted maintenance of the level of assistance to Tasmanian businesses (Albanese 2008).

The Commission's 2006 inquiry recommendations are at appendix B.

## **3.2 Impacts of the schemes**

### **The Tasmanian Freight Equalisation Scheme**

#### *Who benefits from the subsidy?*

In 2011-12, commodities shipped from Tasmania to the Australian mainland accounted for 71 per cent of the value of all claims. By value, the main commodities claimed for were frozen/processed/prepared vegetables, newsprint and fresh vegetables (table 3.2).

**Table 3.1 Reviews of Tasmania's freight subsidy schemes**

| <i>Review body/year</i>   | <i>Key recommendations</i>   | <i>Outcome</i>   |
|---|--|--|
| Commission of Inquiry into Transport to and from Tasmania (Nimmo inquiry), 1976 | Financial assistance for exporting goods for sale on the mainland <sup>a</sup><br>Increase passenger vehicle subsidy<br>Changes to vessels, scheduling and port operation<br>Government-owned services to charge economic freight rates  | The TFES was introduced in 1976  |
| Interstate Commission, 1985   | Replace the TFES with a Tasmanian Freight Compensation Scheme<br>Exclude bulk commodities and cargoes shipped by air<br>Continue the exclusion for exports<br>Specified eligibility for cargoes and compensation rates<br>Shippers pay a prescribed minimum of shipping costs<br>Payments to major recipients discounted above a minimum level<br>Ongoing monitoring and review of the scheme<br>Establish a Tasmanian Association for Interstate Shippers to address other coastal shipping matters<br>TFES and TWFS should be separate schemes as they have different objectives | All adopted, with the exception of changing the nature of the scheme from equalisation to compensation |
| Tasmanian Freight Equalisation Scheme Review Authority (Nixon inquiry), 1998    | Basis of assistance should be a defined sea freight cost disadvantage expressed on a dollar per TEU basis<br>Adjustments for freight density, export to states other than Victoria, door-to-door consignments, reefer freight<br>Assistance for intermodal costs<br>Increase in assistance as disadvantage increases up to a cap<br>Regular review of scheme/parameters  | Adopted  |
| Productivity Commission, 2006   | See appendix B for recommendations   | Accepted, but mostly not implemented   |
| Auditor-General (TFES performance audit), 2011                                  | Introduce arrangements to reduce the risk of incorrect payments<br>Strengthen quality assurance<br>Improve data entry and data integrity   | DIT and DHS agreed with the report   |
| DIT (Simplification Review), 2011   | Changes to simplify the scheme were recommended in the lead up to the 2011-12 Budget   | Not adopted  |
| National Infrastructure Coordinator (TFES, Tasmanian ports and shipping), 2012  | ACCC to review shipping costs and competition policy for sea freight and passenger services<br>Refer possible TFES fraud to the Australian Federal Police<br>Update BITRE examination of Tasmania's freight disadvantage<br>Consider including all non-bulk goods in scheme<br>Withdraw TFES funding and request Commonwealth Grants<br>Commission consider the scheme in distributing GST revenues<br>Create a freight logistics coordination team<br>Consider compensation for the withdrawal of international shipping only if there is a strong case                           | Mostly not accepted  |

<sup>a</sup> The Nimmo inquiry also recommended extending the scheme to southbound goods but had insufficient time to complete investigations into this element of the scheme. The Department of Transport conducted the investigations and the scheme was extended retrospectively to southbound commodities (ISC 1985b). DIT = Department of Infrastructure and Transport. DHS = Department of Human Services. Sources: Nimmo (1976); ISC (1985b); TFES Review Authority (1998); PC (2006b); ANAO (2011); Infrastructure Australia (2012b).

**Table 3.2 TFES top 10 commodities**

TFES paid for commodities shipped in 2011-12

| <i>Direction/commodity</i>               | <i>Amount paid (\$m)</i> | <i>Direction/commodity</i>              | <i>Amount paid (\$m)</i> |
|--|--------------------------|---|--------------------------|
| <b>Northbound</b>                        |                          | <b>Southbound</b>                       |                          |
| Frozen/processed/<br>prepared vegetables | 8.1                      | Beer bottles/cans                       | 3.0                      |
| Newsprint                                | 7.7                      | Wheat                                   | 2.9                      |
| Fresh vegetables                         | 6.8                      | Fodder/straw or pellets                 | 2.4                      |
| Processed wood                           | 5.5                      | Animal feed<br>preparations             | 1.8                      |
| Fresh/chilled fish                       | 3.7                      | Mixed or other cereals                  | 1.7                      |
| Processed milk                           | 3.6                      | Other paper<br>products/printed matter  | 1.4                      |
| Waste and scrap metal                    | 3.5                      | Cattle (adult)                          | 1.3                      |
| Confectionery and<br>chocolate products  | 3.4                      | Glass (other articles)                  | 1.2                      |
| Beer                                     | 3.1                      | Paper                                   | 1.1                      |
| Cheese and curd                          | 2.7                      | Sugar/molasses                          | 1.1                      |
| <b>Total (all commodity<br/>groups)</b>  | <b>66.7</b>              | <b>Total (all commodity<br/>groups)</b> | <b>27.4</b>              |

Source: TFES database (unpublished).

The impact of the subsidies can be assessed by examining the direct benefits they provide to recipient industries and firms.

By industry, a substantial amount of the subsidy was paid for commodities produced by the manufacturing sector. The top claimant industry in 2011-12 was the other food, beverages and tobacco industry which includes a range of processed foods and alcoholic beverages including vegetables, fish, confectionery, flour, oils, and beer (table 3.3).

**Table 3.3 TFES assistance by industry category**

For assistance paid in 2011-12

| <i>Category</i>                  | <i>Amount paid (\$m)</i> |
|----------------------------------|--------------------------|
| Other food, beverages & tobacco  | 29.4                     |
| Other agriculture                | 18.0                     |
| Paper & paper products           | 15.0                     |
| Wood & wood products             | 7.9                      |
| Dairy products                   | 6.8                      |
| Metal products                   | 3.5                      |
| Livestock                        | 3.4                      |
| Chemical products                | 2.4                      |
| Other non-metal mineral products | 1.7                      |
| Meat products                    | 1.6                      |
| Rubber & plastic products        | 1.4                      |
| Other categories                 | 1.8                      |

Source: TFES database (unpublished).

The subsidy is mostly paid to a small number of large firms. While the subsidy assisted around 1400 claimants in 2011-12, the top 10 claimants received around half of the total payments (table 3.4). At the other end of the scale, the smallest 1000 claimants received 2.7 per cent of total assistance paid in 2011-12.

**Table 3.4 TFES large claimants**

Top 10 claimants for commodities shipped in 2011-12

| <i>Claimant</i>                  | <i>Main commodity claimed</i>             | <i>Amount paid (\$m)<sup>a</sup></i> |
|----------------------------------|---|--------------------------------------|
| Simplot Australia <sup>b</sup>   | Frozen/processed/prepared vegetables      | 10.7                                 |
| Norske Skog Boyer                | Newsprint                                 | 7.8                                  |
| Net Sea Freight Tasmania Pty Ltd | Various (freight administration services) | 7.1                                  |
| J Boag & Son                     | Beer                                      | 6.2                                  |
| Cadbury Australia <sup>c</sup>   | Confectionery and chocolate products      | 4.8                                  |
| McCain                           | Frozen/processed/prepared vegetable       | 3.0                                  |
| Monson Shipping Tasmania Pty Ltd | Processed wood                            | 2.9                                  |
| Cascade Brewery Co               | Beer                                      | 2.7                                  |
| Ertler Trading Pty Ltd           | Fresh vegetables                          | 2.6                                  |
| Murray Goulburn Co-op Co Ltd     | Dairy                                     | 2.5                                  |

<sup>a</sup> Rounded to nearest \$ million. <sup>b</sup> Average 2010-11 and 2011-12. <sup>c</sup> Mondelez Australia Pty Ltd

Source: TFES database (unpublished).

The incentives built into the scheme, and its longevity, are likely to have had a significant impact on production, consumption and investment decisions by Tasmanian businesses and government over several decades.

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Many participants highlighted the important role the TFES played in reducing freight costs and making Tasmanian businesses competitive with those on the mainland and internationally (box 3.5). It is notable that a number of the main claimants mainly operate outside Australia and their alternative investment locations are not in Australia.

A common misconception is that all production and employment in those categories eligible for the TFES can be ascribed to the subsidy, when in fact it is the marginal or incremental effect of the subsidy that is relevant. Businesses consider a range of factors in making their choice of location, particularly inputs of labour and capital and the business environment. The availability of the freight subsidy would be one factor in determining the overall relative commercial merit in where to locate. The scheme's design is another factor, with uncertainty around eligibility favouring some investment on the mainland rather than in Tasmania (Houston's Farm, trans., p. 198).

However, in the long term, the availability of the subsidy is unlikely to be a sufficient determinant of location choice. The third-largest claimant in 2005-06, Australian Paper, which was paid \$6.3 million in that year, was sold in 2009 and its two Tasmanian plants subsequently closed (PaperlinX nd).

This would be consistent with the small contribution overall the scheme makes to firm costs. The scheme represents less than 1 per cent of total production costs in Tasmania's agriculture, manufacturing and mining sectors and a little over 2 per cent of industry value added (table 3.5).

### *Subsidy 'leakage'*

Even where claimants are eligible for the subsidy, the extent to which they benefit from it depends on the 'incidence' of the subsidy (box 3.3) — who ultimately 'captures' the subsidy. The incidence of a subsidy does not depend on who the subsidy is paid to — instead it is determined by the relative price responsiveness of producers and consumers and the level of competition in the market. Subsidy leakage dilutes the effectiveness of a subsidy.

In 2006, the Commission found that there was the potential for subsidy leakage to occur where shipping companies were able to increase their freight rates to capture some of the TFES assistance, that is, the incidence (benefit) of the subsidy could go to shipping companies.

As discussed in chapter 4, it is not clear whether the current shipping industry structure provides for effective competition and the Commission heard conflicting

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evidence. Ship owners and larger shippers consider the three shipping lines compete for volume on price and service offerings but other participants contend that there is a lack of competition. With few providers, and limited competition, the subsidy is inevitably shared with shipping companies — particularly for small shippers, who are likely to have less negotiating power than businesses that ship large regular volumes.

One of the shippers on the Bass Strait route, the Tasmanian Government-owned TT-Line, also provides passenger and vehicle services that are eligible for the BSPVES. The characteristics of that specific market combined with pricing over time suggests that TT-Line also receives at least some of the benefit of the BSPVES subsidy.

When real fares (including the subsidy) fall, consumers benefit from the subsidy. This occurred initially when the scheme was introduced. However, TT-Line's real fares grew sharply in the first four years after the BSPVES was introduced and have continued to increase over the last decade to reach levels similar to those before the subsidy was introduced (chapter 2, figure 2.9). As TT-Line is virtually the sole provider for the purposes of the subsidy, consumers have borne the increase in real fares.

To the extent that TT-Line benefits from the BSPVES, indexation creates less pressure on TT-Line to minimise its costs, as part of these may be able to be recouped through the subsidy. In its submission to the inquiry, TT-Line argued that indexation by the consumer price index (CPI) was inadequate as increases in maritime operating costs were significantly above the CPI (sub. 9).

The extent of subsidy 'leakage' is difficult to assess without detailed modelling and access to commercial cost data. Chapter 2 discusses the need for shipping lines to provide pricing and cost data to assess the effectiveness of the TFES. Commission estimates suggest that TT-Line has not earned a commercial rate of return over the past five years, as further discussed in chapter 4 of this report.

**Table 3.5 TFES assistance, industry costs and value added**  
By assistance paid in 2011-12

| <i>Industry</i>   | <i>Proportion of industry costs</i> |                        |
|---|-------------------------------------|------------------------|
|   | <i>Northbound TFES</i>              | <i>Southbound TFES</i> |
|   | per cent                            | per cent               |
| Livestock   | 0.9                                 | 0.7                    |
| Other agriculture                                       | 1.3                                 | 1.3                    |
| Fishing   | 0.0                                 | ..                     |
| Forestry  | ..                                  | 0.0                    |
| Coal mining   | n.r.                                | n.r.                   |
| Other metal ore mining                                  | 0.0                                 | n.a                    |
| Other mining  | 0.0                                 | 0.1                    |
| Meat products   | 0.4                                 | 0.0                    |
| Dairy products  | 1.3                                 | 0.0                    |
| Other food, beverages and tobacco                       | 1.4                                 | 0.3                    |
| Textiles, clothing and footwear                         | 0.3                                 | 0.1                    |
| Wood and wood products                                  | 1.0                                 | 0.1                    |
| Paper and paper products                                | 2.0                                 | 0.4                    |
| Other petroleum and coal products                       | ..                                  | n.r.                   |
| Chemical products                                       | 0.1                                 | 0.4                    |
| Rubber and plastic products                             | 0.4                                 | 0.4                    |
| Other non-metal mineral products                        | 0.3                                 | 0.7                    |
| Metal products  | 0.5                                 | 0.4                    |
| Other equipment   | 0.1                                 | 0.0                    |
| Other manufacturing                                     | 0.0                                 | 0.0                    |
| <b>Total costs (agriculture, mining, manufacturing)</b> | <b>0.6</b>                          | <b>0.2</b>             |
| <b>Value added (agriculture, mining, manufacturing)</b> | <b>1.7</b>                          | <b>0.6</b>             |

.. = not applicable. n.r. = not recorded as industry costs are unspecified.

Sources: TFES database (unpublished); ABS (2013a).

### *Impact of the scheme on the Bass Strait islands*

Intrastate claims are a very small proportion of overall claims, representing 0.4 per cent of the number of claim line items and 1.2 per cent of the total amount paid in 2011-12. By amount of assistance paid, the main commodities shipped were cattle and fertiliser. In 2011-12, around 85 per cent of the amount paid out under the intrastate component of the scheme was for southbound-shipped commodities.

Following the closure of King Island's abattoir in 2012, 97 per cent of the King Island area's product is shipped domestically to get product to market (King Island Shipping Group, trans., p. 416).

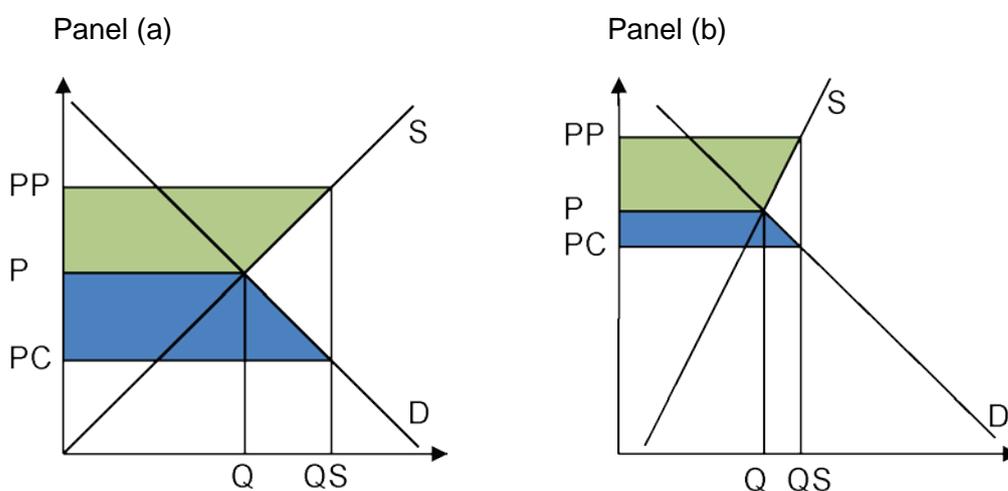
Despite the 2008 extension of the scheme to intrastate freight, inquiry participants said that freight cost disadvantages remain.

### Box 3.3 The incidence of a subsidy

The economic rationale for a subsidy is to increase the production and consumption of the subsidised good or service. The subsidy increases the quantity produced and consumed from  $Q$ , without the subsidy, to  $Q_S$  (panel (a) and panel (b) in figure 3.2). Producers receive a higher price for their goods (an increase from  $P$ , the price without the subsidy to  $PP$ , the price with the subsidy) and consumers pay a lower price (a decrease from  $P$  to  $PC$ , the price with the subsidy). The amount of the subsidy is the difference between the price paid by consumers and the price received by producers.

Where producers and consumers respond in a similar way to the change in price, the benefit is shared fairly evenly between them. Panel (a) shows the benefit to producers (shaded green) and consumers (shaded blue) to be similar. However, where a producer or consumer is less sensitive to price changes they will receive a greater benefit from the subsidy. This is because the subsidy is less effective at changing behaviour making it more likely that they receive a 'windfall' gain. Panel (b) shows that the benefit to producers (shaded green), who are less responsive to the price change than consumers, is larger than that for consumers (shaded blue).

Figure 3.2 The effect of a subsidy



This means that while the benefit of the subsidy is shared between producers and consumers, the extent to which they benefit (the incidence of the subsidy) depends on their relative responsiveness to the price change. In turn, this responsiveness depends on factors including the ability to substitute one set of goods or services for another set of goods and services.

Flinders Council said that air freight as well as sea freight was considered critical to ensure sustainable access for the region (sub. 23). Air transport is eligible for the subsidy in very limited circumstances such as when a shipping service is not available due to industrial dispute, mechanical failure or vessel maintenance.

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The Commission notes that adopting a level of assistance reflecting BITRE's 2013 estimation of the freight cost disadvantage for the Bass Strait islands would increase the subsidy to King Island and reduce it for the Furneaux Group of islands. This reflects changes in the sea freight cost and road freight equivalent cost per TEU. As noted in chapter 2, payment rates should be determined following rate reviews, informed by a public process, and with appropriate transitional arrangements determined as part of the review process.

### **Bass Strait Passenger Vehicle Equalisation Scheme**

The Tasmanian Government-owned TT-Line dominates the Bass Strait passenger vehicle transport market carrying more than 99 per cent of passengers accompanying eligible motor vehicles in 2011-12 and 2012-13 (BITRE 2014). SeaRoad Holdings was the only other operator providing (very limited vehicle only) Bass Strait services. TT-Line's ships are licensed to carry up to 1400 people and 500 vehicles and have a freight capacity of 160 TEUs per vessel. TT-Line provides travel options for those wishing to cross Bass Strait with their vehicle on day trips, or on overnight crossings with accommodation and entertainment options.

#### *Who benefits from the subsidy?*

Around 330 700 passengers travelled on TT-Line in 2012-13 with reimbursements that year for around 151 900 eligible vehicles (TT-Line 2013, BITRE 2014). The number of people travelling by sea in 2012-13 was 9.3 per cent lower than in 2011-12, and fell to levels not seen since 2000-01 following a decrease of more than 17 per cent in 2011-12 (BITRE 2014).

According to the Tourism Industry Council Tasmania (TICT), 40 per cent of the scheme's beneficiaries are Tasmanian outbound motorists (trans., p. 96), that is, Tasmanian residents travelling to the mainland with their vehicle.

BITRE data indicate that the main growth areas for vehicles using the subsidy has been vehicles with caravans or motor homes. Participants at the December inquiry roundtables and the Tasmanian Government advised that the passengers of these vehicles were likely to be 'grey nomads' (sub. DR85). Between 2002 when these vehicles became eligible for the subsidy and 2012-13, vehicles with caravans had grown by 42 per cent, and motor homes had grown by 34 per cent, to comprise 7 per cent and 5 per cent of eligible vehicles respectively (BITRE 2014). As such the 'grey nomads' represent a growing but minority share of the eligible vehicle scheme recipients. By contrast, the number of motor cars fell by 37 per cent over the same period (BITRE 2014).

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TICT, Tourism and Transport Forum, and Cradle Coast Tourism Executive stated that the traditional touring market remains critically important to Tasmania's tourism industry and economy (sub. 48). Tourism Research Australia indicates that there were around 1.3 million visitors to areas in Tasmania outside Hobart in 2012-13, generating 48 per cent of total domestic overnight visitor expenditure in Tasmania, excluding airfares and long distance transport costs (Tourism Research Australia 2013). To provide a sense of contribution, some 18 000 vehicles with caravans or motor homes were eligible vehicles transported by TT-Line to Tasmania in 2012-13 (BITRE 2014).

One unintended consequence of the scheme, suggested by Austrade, was that passengers travelling with their own vehicles provide competition for hire car companies which put downward pressure on hire car prices (sub. 41).

A further unintended consequence of the subsidy could be that part of the benefit of the subsidy is inevitably captured by TT-Line (as previously discussed) thereby diluting the subsidy's effectiveness.

### **3.3 Effectiveness of the schemes**

There is no coherent economic rationale for the TFES. The reference to equalisation in the TFES and BSPVES misleadingly implies 'full' compensation for the cost disadvantage which is not inherent in the design and operation of the schemes. The TFES phases out payments as the level of disadvantage increases to encourage shippers to seek lower freight costs, and therefore does not fully compensate all shippers for their parameter-determined 'sea freight disadvantage'. As such, the schemes as designed and administered are not consistent with an objective of full equalisation which is arguably unattainable.

The purpose of the scheme was misunderstood by many participants as offsetting increasing or absolute freight costs, rather than mitigating the relative and notional cost disadvantage of moving freight by sea (box 3.5).

The Australian Government's stated current intention is to retain the TFES and BSPVES. The terms of reference request that the Commission assess the effectiveness of the current schemes and recommend appropriate future approaches. As requested by the terms of reference, this report canvasses possible improvements to the schemes that would go some way to correcting the identified deficiencies. These are largely focused on addressing some of the perverse incentives created by the scheme while reducing complexity, and thereby lowering the compliance burden on businesses and administrative costs to government.

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Some of the inherent deficiencies associated with the schemes will not be eradicated. In relation to the TFES, the scheme design relies on eligibility criteria that appear arbitrary. Any eligibility rules place limits on the extent to which changing the scheme design can address these issues.

## **Tasmanian Freight Equalisation Scheme**

### *Scheme incentives*

Inherent in the scheme is the perverse incentive that as the movement of freight on the mainland becomes more efficient, the cost disadvantage is estimated to increase leading to an increase in the rate of the subsidy. This dilutes the incentive to increase the efficiency of freight movements across Bass Strait.

Businesses also change their behaviour to access and maximise the value of assistance under the scheme — an incentive created by the ‘dividing lines’ for eligibility through:

- the exclusion for exports — the Commission heard anecdotal evidence that this encourages manufacturing processes on the mainland prior to export to access the subsidy
- the scheme’s coverage for bulk and non-bulk goods under the southbound component of the scheme — wheat and other bulk goods have been shipped in containers to be eligible for the subsidy
- rules under the southbound component of the scheme, which are based on the ANZSIC division a business belongs to — evidence was presented that this discourages vertically integrated business structures.

These boundaries are creating perverse incentives and distortions in economic activity and business inefficiencies.

### *Incentives to minimise shipping costs*

In 2006, the Commission found that the use of a sliding scale, around a median, creates weaker than normal commercial incentives for cost minimisation, or incentives to maximise claims. The Commission at that time recommended a single flat rate of assistance to improve the commercial incentives for Tasmanian producers to minimise transport costs and address the in-built incentives to overestimate the sea freight cost disadvantage.

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It would also remove the incentive for claimants to structure freight bills in a way that maximises the value of the subsidy. A particular concern raised by the Commission in 2006 is the potential for door-to-door, door-to-wharf and wharf-to-door claims to provide this opportunity. While the TFES provides assistance for the notional wharf-to-wharf freight cost disadvantage, claimants can also claim on a door-to-door, door-to-wharf or wharf-to-door basis and deduct \$230 for each land-side component.

In 2006, the Commission found that where the door-to-wharf or wharf-to-door cost component is more than \$230, it provides an incentive to claim using a door-to-door invoice which would provide a higher rebate.

Analysis of the TFES database suggests that most claim line items are still presented on a basis other than wharf-to-wharf costs.

While moving to a flat rate of assistance would create ‘winners’ and ‘losers’ compared to the current scheme parameters, a number of participants acknowledged the benefits of a flat rate such as certainty, transparency for applicants in understanding how it impacts their freight costs and lowering the claims burden for government. The Tasmanian Government said that:

... the adoption of a flat rate of assistance applied on a per-TEU basis has the potential to reduce administrative costs for both the Australian Government and shippers, improve incentives for shippers to seek out the lowest freight rates and address ongoing perceptions about alleged ‘gaming’ of the Scheme. (sub. DR85, p. 9)

Houston’s Farm suggested that a flat rate would go some way to addressing the complexity in the southbound component of the scheme (trans., p. 207).

Veolia Environmental Services agreed with a flat rate on the basis that they were not disadvantaged in comparison with the current scheme, adding that:

... by having a single flat rate subsidy it would take out a major variable component when tendering for long term contracts (between 7 and 9 years). (sub. DR103, p. 7)

Net Sea Freight did not support a flat rate on the basis that it would disadvantage less frequent shippers and it commented that in any case was not needed as the current scheme already provided an incentive to seek lower freight rates (sub. DR75). However, a flat rate would improve commercial incentives to minimise shipping costs as producers would retain the full benefit of any transport cost savings and bear the full cost of any increase.

Net Sea Freight also challenged the view that it would reduce compliance costs to recipients as information currently required would still need to be submitted to DHS (box 3.6). GA Cossar and Co commented that a flat rate would still mean

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converting non-containerised freight (livestock and farm equipment) to a container equivalent (sub. DR82). However, a flat rate would still reduce the number of parameters and the requirement for supporting evidence and this would benefit claimants.

A further consideration for some participants in relation to the flat rate was the amount of the subsidy.

The King Island Shipping Group suggested a zone based approach for a flat rate that would accommodate the different costs faced by island shippers (trans., p. 421). Similarly, the Tasmanian Farmers and Graziers Association (TFGA) King Island Branch sought for King Island's unique costs associated with their freight task to King Island to be considered:

We are open to price gouging through imperfect competition. The reality is that the volume of freight will never be enough to create true competition. (sub. DR79, p. 1)

Continuing a zone based approach to the TFES as reflected in a different flat rate for the subsidy would ensure the freight cost disadvantage of the Bass Strait islands is appropriately considered.

While not supporting the introduction of a flat rate, Mondelez said there could be a case for a simplified calculated percentage rate compensation, based on a comparison of mainland freight rates and Bass Strait sea freight rates (sub. 24) and GA Cossar & Co also suggested a percentage subsidy (subs. 7 and DR82). The Commission does not support a percentage rate form of assistance — it is not a flat rate and it would not have the same incentive effect as a flat rate in terms of minimising shipping costs as it would reward shippers who sought higher costs by providing a larger rebate.

The Department of Infrastructure and Regional Development (DIRD) stated that further work would be required to assess the dollar amount of a flat rate that would provide reasonable assistance without diluting the commercial incentive to find the cheapest shipping cost (sub. 42). A public process would be required to determine the rate to take shippers' costs into account, including the particular freight cost disadvantage faced by the Bass Strait islands. The quantum of assistance that would form the basis of the flat rate 'funding envelope' also needs to be addressed in the context of the scope of eligibility of northbound commodities (discussed below). The Commission considers that such a determination would need to be made by the Australian Government in 2014 given the anticipated timing of related processes.

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## RECOMMENDATION 2

*The Australian Government should introduce payment of freight assistance as a flat rate of subsidy per TEU (twenty foot equivalent unit) shipped.*

*The Bureau of Infrastructure, Transport and Regional Economics should recommend separate dollar amounts per TEU of assistance for the Tasmanian mainland, King Island, and the Furneaux Group of islands, informed by a public consultation process, and taking the following into account:*

- *a reasonable amount to partially offset the freight cost disadvantage associated with Bass Strait shipping and informed by the Government's overall budget commitment to the scheme*
- *that the flat rate should include a zone structure for eligible shippers on King Island and the Furneaux Group of islands in recognition of their relatively greater shipping freight cost disadvantage and limited shipping service options*
- *that the flat rate should provide assistance that is compatible with the incentive to seek the lowest shipping cost and not a percentage of transport costs incurred*
- *an appropriate transition period to the new flat rates reflecting any quantum of change and the tenor of shipping contracts.*

*The commencement of this consultation process is contingent on the resolution of the issues related to recommendation 6.*

If the Government chooses to retain the existing arrangements, in the absence of a flat rate, paying assistance based on actual wharf-to-wharf costs would restore some integrity to the scheme by removing the incentive to over claim embodied in the door-to-door parameter adjustment. To the extent claimants will need to provide additional information, as stated by Net Sea Freight (sub. DR75), the Commission acknowledges that this is needed to restore the intent and integrity of the scheme.

While the Commission considers that BITRE's methodology in estimating and updating the TFES parameters appears sound and transparent, the Commission is of the view that the process for undertaking rate reviews would be improved by the release of a draft report and a public submission process prior to the release of a final report.

To the extent that this results in a significant reduction of TFES assistance, a transition period would assist business planning. The Commission considers it would be appropriate for the Government to determine a transition period having regard to the updated parameters and therefore the required adjustment.

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## RECOMMENDATION 5

***If the Australian Government chooses to retain the Tasmanian Freight Equalisation Scheme in its current form, the rate should be based on parameters recommended by the Bureau of Infrastructure, Transport and Regional Economics, informed by a public consultation process, and payable only on the basis of evidence of actual wharf-to-wharf costs.***

### *Changes to the northbound component of the scheme*

The exclusion of exports from the TFES was the main policy issue raised by participants (box 3.5). The TFES Review Authority (1998) recommended against providing the subsidy to exports because of its potential to undermine direct international shipping services. Since May 2011, Tasmania has been without a direct international container shipping service following the AAA consortium's withdrawal of its weekly service from Bell Bay. Consequently, non-bulk shipping exports have to tranship through the Port of Melbourne to access international markets.

In light of issues raised with the northbound component of the scheme, the Commission sought feedback in the draft report on the potential impact on businesses, industries and the economy of extending payments under the TFES to all eligible commodities shipped to the Port of Melbourne.

A number of participants including Harvest Moon, Net Sea Freight, Norske Skog and Fruit Growers Tasmania supported the extension of the TFES. Norske Skog said that the following factors meant a single direct service would limit Tasmania's linkage to overseas markets:

No single freight provider services all destination ports currently used by Tasmanian exporters, requiring trans-shipment arrangements and associated costs for many/most ... No single freight provider offers the most competitive rate into all destination ports that they do service ... No single freight provider will be able to offer the intervals of service required by many of our exporters to satisfy their need to be responsive to market expectations ... A single freight provider would not provide a sound basis for ongoing competition on those routes, increasing the potential for longer term rate escalation. (sub. DR110, p. 6)

Other participants, including Veolia Environmental Services, Cuthbertson Bros and the Tasmanian Exporters Group preferred a direct international service. The Tasmanian Exporters Group said that it was:

... far better to have a long-lasting solution and it introduces competition ... and it will be a lesser freight cost than what is currently the case. (trans., p. 138).

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Veolia Environmental Services said that:

... the introduction of an international shipping line with no cabotage restrictions, would provide the most competitive pressure on rates. (sub. DR103, p. 11)

The Commission considers that in the absence of a regular direct international container service to Tasmania, there is a case for extending the TFES to all eligible commodities, including those transhipped through the Port of Melbourne or other mainland ports, and ultimately to export markets, subject to no net increase in the overall quantum of assistance under the scheme.

However, after the release of the Commission's draft report, the Tasmanian Government announced that it had selected Swire Shipping as the preferred carrier for an international container shipping service from Bell Bay. This follows a competitive selection process, facilitated with the advice and involvement of consultants Thompson Clarke. This development raises a number of difficult sequencing obstacles that inevitably require deferral of the Australian Government's consideration of extending the TFES to exports.

First, although the long term commercial sustainability of a direct international service is not certain now or in the future, extending the TFES would inevitably compromise the viability of a (more cost effective) international shipping service. Second, a direct international shipping service would add competitive pressure to the domestic Bass Strait route. Third, it would also introduce the prospect of two subsidies (through the TFES and Tasmanian Government assistance to transition to the new international service) working at cross purposes.

Reforms to coastal shipping would also have some impact on competition and Tasmanian shipping costs (chapter 4).

Given the sequencing obstacles associated with recent and anticipated developments, the Commission recommends that the Australian Government should determine the merit and timing of such an extension following:

- discussion with the Tasmanian Government to ensure a mutually consistent policy approach
- the extent to which the potential resumption of a commercially viable direct service would be compromised by such an extension of the scheme, and advanced by potential coastal shipping reform
- agreement having been secured with relevant shipping lines to provide pricing and cost data to BITRE (as discussed in chapter 2).

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The merit of this case is also premised on no net increase in the overall quantum of assistance under the scheme.

As with all subsidies, extending the TFES would have efficiency and distributional effects through its impact on input and output markets. Broadening the scheme by extending payments to more goods should improve allocative efficiency in Tasmania, at least between producers that export internationally and those that sell to the Australian mainland. However, over time, if the overall quantum of assistance materially increases, this will be to the further detriment of Tasmanian consumers, who are already adversely affected by the scheme. To the extent that some resources shift into industries and firms that supply exports at the expense of firms that trade domestically, the supply to domestic consumers would be reduced and they will face a higher price for Tasmanian produced goods (box 3.4).

If such an extension resulted in a corollary increase in the quantum of assistance under the TFES, those benefits would be more than offset by the negative impact of a material increase in the overall subsidy on Tasmanian consumers and the Australian economy more broadly (box 3.4).

The decision on the total quantum of assistance under the TFES is ultimately one for the Australian Government. The Commission, for the reasons outlined above, views the appropriate and overall quantum of assistance afforded under the TFES with the aforementioned scope extension, to be initially around the current and anticipated total payments and then subject to review in four years. This view is premised on containing the negative economic impact of the scheme on Tasmanian consumers and the Australian economy more broadly whilst securing a modicum of allocative efficiency by broadening eligibility in a cost neutral way. A review at that time will also be informed by anticipated developments, both policy and investment decisions influencing shipping capacity, that will likely impact the cost of Bass Strait shipping.

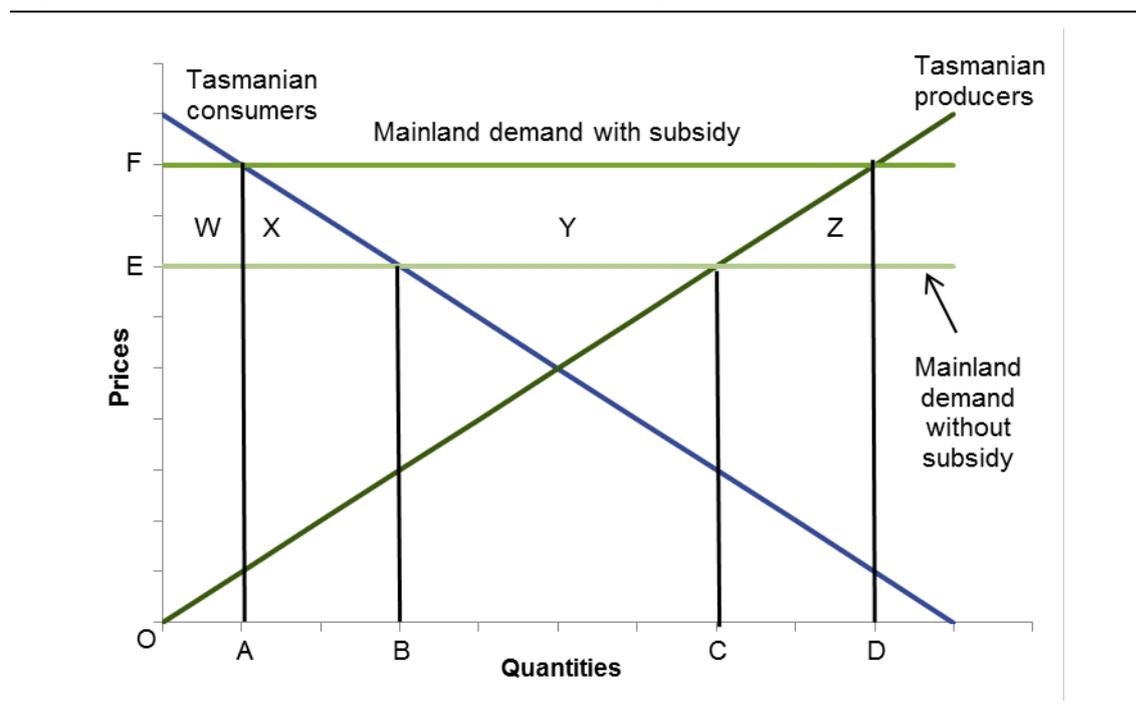
The implied average flat rate of assistance under such an extension to the scheme is a function of the quantum of overall assistance and the number of eligible recipients and their volumes. As such, the implied average flat rate assistance could be around \$735 per TEU (including intermodal costs) if the scheme is not extended to all eligible commodities transhipped through the Port of Melbourne or other mainland ports, and within a range of \$470–\$570 per TEU (depending on export volumes) if the scheme is extended. Importantly, these figures are purely indicative given the paucity of export data from Tasmania and the uncertainty surrounding the dynamic impacts of any changes, and would be subject to zonal arrangements and TEU equivalent calculations by BITRE informed by a public consultation process.

### Box 3.4 The distributional effects of the TFES subsidy

The TFES reduces Australia-wide welfare, as any gains to Tasmania are more than offset by a corresponding reduction in welfare for the rest of Australia. If it is assumed that Tasmanian producers are small in the mainland market and do not affect mainland prices, then the TFES (for northbound freight) can be illustrated as follows.

In the absence of the TFES, Tasmanian consumers purchase OB units of Tasmanian produced goods, at a price of OE, with BC freighted to the mainland. The TFES increases the price Tasmanian producers receive (by reducing their freight costs) from OE to OF. Producers prefer to sell to the mainland to receive a higher price, which also increases the price to Tasmanian consumers (from OE to OF). This causes the quantity demanded by Tasmanian consumers to contract to OA. Overall Tasmanian production expands from OC to OD with AD shipped to the mainland with a subsidy of EF.

Figure 3.3 Effect of the northbound component of the TFES



As a result, the subsidy:

- increases profits for eligible Tasmanian firms (W+X+Y)
- reduces welfare for Tasmanian consumers (W+X)
- adds costs for taxpayers who fund the subsidy (X+Y+Z)
- reduces Australian welfare (X+Z).

(Continued next page)

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Box 3.4 (continued)

To the extent that mainland prices are affected by the quantity shipped (that is the mainland demand curve slopes downwards), the benefits of the subsidy will be shared between Tasmanian producers and mainland consumers. However, Australia will still have a net welfare loss.

If the TFES is extended (but in a cost neutral way by reducing the rate), the net welfare effects will depend on the relative slopes of the demand curves of Tasmanian, mainland and international consumers. While the welfare effects of extending the TFES is an empirical question, Tasmanian producers are likely to be the main beneficiaries with Tasmanian consumers likely to bear additional welfare costs.

While those receiving assistance under the TFES are likely to be the main beneficiaries of an extension to the TFES, the impact on particular businesses would depend on their individual business model, the quantum of the TFES rate and the final destination of their goods:

- businesses shipping mainly to overseas destinations would benefit although the benefit to those preferring a direct service would be diminished where extending the TFES compromised the future viability of a more cost-effective direct international container service
- the benefits to businesses who ship to both mainland and overseas destinations would depend on the overall net impact of the extension of TFES eligibility to exports relative to the rate reduction on current eligible volumes
- businesses shipping primarily to and from the mainland would receive a lower level of assistance per TEU.

A deferred policy decision on this issue would also provide some lead time to address the paucity of data to inform the Government's consideration of future rate reviews and the overall effectiveness of the TFES.

RECOMMENDATION 6

*In the absence of a regular direct international container service (direct service) from Tasmania, there is a case to extend the Tasmanian Freight Equalisation Scheme to all eligible commodities (as specified in the Ministerial Directions) shipped to the Port of Melbourne or any other mainland ports and subject to no net increase in the overall assistance provided by the scheme. The Australian Government should determine the merit and timing of such an extension following:*

- *discussion with the Tasmanian Government to ensure a mutually consistent policy approach*

- 
- *an assessment of the extent to which the potential resumption of a commercially viable direct service would be compromised by such an extension of the scheme, and advanced by potential coastal shipping reform*
  - *agreement having been secured with the relevant shipping lines to provide pricing and cost data to the Bureau of Infrastructure, Transport and Regional Economics (as per recommendation 3).*

#### *Changes to the southbound component of the scheme*

The TFES provides assistance for some commodities that would otherwise be shipped in bulk. Wheat shipments under the TFES are a particular beneficiary with wheat the second largest southbound claim by value in 2011-12 (table 3.2). Since 2004-05, the TFES has provided a subsidy for containerised wheat in addition to the TWFS which provides a subsidy for bulk-shipped wheat.

This duplication arose in the 2004-05 Budget when the Australian Government ceased the bulk wheat freight subsidy and provided additional funds to the TFES to pay the TFES subsidy for containerised wheat. The bulk wheat freight subsidy was subsequently reinstated but the additional assistance under the TFES remained. The Commission notes that shipping wheat in containers may not be the most efficient process available.

Claims for wheat under the southbound component of the TFES have increased significantly in recent years, as shippers moved from bulk shipping to containers to access the higher TFES subsidy. Figure 3.4 shows that the number of tonnes shipped and the subsidy paid per tonne were higher for the TFES than for the TWFS and there were no claims under the TWFS in 2005-06, and there have been none since August 2009. For wheat shipped in containers, the number of tonnes increased by 17 per cent and the subsidy paid per tonne increased by 19 per cent between 2005-06 and 2011-12.

There is likely to have been a loss of efficiency in the move to containerised wheat transport. GA Cossar and Co. noted that the substitution from bulk to containers could have scheme cost, as well as efficiency effects. Under the scheme road-making material was put in bags to be made eligible under the TFES, which, while saving money for the claimant, meant that:

... the federal government has paid for a freight subsidy scheme and they may have paid \$20 a tonne [of] which \$19 a tonne has gone to putting stuff in bags in Tasmania and taking it out of bags and providing bags. (trans., p. 282).

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GA Cossar and Co. also described the exclusion of goods shipped in bulk as a distortion (sub. DR82). The exclusion was recommended by the TFES Review Authority which considered that most goods shipped in bulk form would continue to be shipped that way in the presence of a land bridge (TFES Review Authority 1998).

To be eligible to claim under the southbound component of the scheme, a person must be engaged in one or more of the following industries — manufacturing, mining, agriculture, forestry or fishing. However, eligibility is determined by ANZSIC division. Where an applicant is involved in activities that cover more than one ANZSIC division, DHS decides in which ANZSIC division the business belongs and therefore whether it is eligible for TFES assistance.

Participants advised that this discourages efficient business structures as the design of the scheme requires separate entities to claim for commodities for use in different ANZSIC classified business activities covered under the scheme, that would otherwise be claimed by one vertically integrated entity.

There was evidence that this disadvantages some businesses. Vos Construction and Joinery said that:

... we are eligible to receive around \$40,000 to \$50,000 per year in subsidies. However, due to a technicality with the freight equalisation legislation, we are unable to claim the Southbound subsidy due to our joinery business not being our main business activity ... (sub. 62, p. 1)

Given the eligibility requirements for the southbound component of the TFES provide incentives for inefficient business structures, the Commission considers that DIRD should examine whether alternative arrangements could be made for assessing eligibility.

#### RECOMMENDATION 11

***The Department of Infrastructure and Regional Development should, subject to confirming feasibility, assess claimants under the southbound component of the Tasmanian Freight Equalisation Scheme on a basis that would avoid the need for claimants to establish a separate legal entity to qualify for assistance, taking into account the compliance costs for businesses and the administration costs to the Australian Government.***

The Commission's draft report sought information on the potential impacts on firms and industries of extending the northbound component of the scheme and removing the southbound component of the scheme for all goods shipped from the Australian mainland to Tasmania.

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While there was general support for including exports, participants said this should not be at the expense of removing the southbound component of the TFES. Around 600 claimants made claims only under the southbound component in 2011-12 with total claims paid of around \$10 million.

Participants highlighted the importance of the southbound component to many industries and firms.

Net Sea Freight argued that industries that were reliant on inputs sourced from the mainland, such as mining, bore high input costs relative to their mainland competitors due to the cost of shipping across Bass Strait (sub. DR75). Further, they would not benefit from an extension of the subsidy to exports as they shipped in bulk (Net Sea Freight, sub. DR75). The Commission heard that high value agriculture, aquaculture and viticulture firms would have their operations severely affected by removal of the southbound component of the scheme (Net Sea Freight, sub. DR75).

Participants from the Bass Strait islands, in particular, were concerned at the impact on businesses' viability if southbound assistance were to be removed. Both the King Island Shipping Group and the TFGA (King Island Branch) emphasised the importance of the southbound component to the viability of the islands' livestock industry. The TFGA (King Island Branch) commented that:

If TFES is removed from King Island for southbound freight, the ramifications to an already weak farming business community will have a strong negative effect on the Island economy and a reduction in farm productivity. Under current arrangements we rely heavily on fertiliser, trade cattle and farm inputs that travel south bound from Victoria. (sub. DR79, p. 2)

More broadly, participants such as Wine Tasmania were concerned that a lack of local substitutes for inputs would deter investment (sub. DR78).

### *Complexity, compliance and administration issues with the scheme*

The scheme's complexity arises from its use of several parameters in an attempt to measure a precise freight cost disadvantage per TEU shipped coupled with a sliding scale of assistance. However, the scheme is inevitably unable to achieve a true measure of cost disadvantage while still imposing onerous reporting obligations on businesses and administration costs on government. The diversity of circumstances and experience of shippers also means that they may not be able to reconcile their own individual experience with BITRE's parameter-based estimate of the cost disadvantage.

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Complexity of the scheme was one of the issues raised by participants (box 3.5). Claimants who are not able to self-assess must provide numerous pieces of information for each claim line item to enable DHS to calculate eligibility for the subsidy and the amount of assistance (box 3.6). DHS processes around 200 000 claim line items each year.

DIRD (sub. 42) raised a number of concerns about the scheme's complexity including:

- that it reduces transparency and complicates administration, which adds to the regulatory burden and leads to a dilution of the scheme's objectives
- the large number of requests to review claims which generates administrative work for DHS assessors and DIRD
- ambiguity in the Ministerial Directions which leads to multiple and conflicting interpretations. This has led to situations where a significant proportion of claims appear to have been made on an 'inferred' basis, with the potential to provide an arbitrary advantage or disadvantage to businesses depending on the interpretation
- eligibility for some niche categories such as sportspersons, entertainers and brood mares, that are not commodities intended for sale.

In 2011-12, there were around 400 claim line items for entertainers, sportspersons and horses receiving around \$224 000 in assistance.

Moving to a flat rate of assistance would remove the main source of scheme complexity — the parameters used to calculate claimants' notional wharf-to-wharf freight cost disadvantage.

The limited uptake of online claiming increases compliance and administration costs. In 2011, the Auditor-General found a number of shortcomings in several areas of program administration, including compliance, quality assurance and claim management (ANAO 2011). DIRD advised that while actions have been taken to improve compliance in response to the Auditor-General's report, funding to pursue compliance activities is limited (sub. 42).

In 2007, in response to the Commission's inquiry, the Australian Government increased funding to develop a new approach to verifying wharf-to-wharf costs, supported by upgraded technology and risk management. However, DIRD advised that while online claiming is available, the complexity of the process and the need for detailed supporting evidence mean that most claims are lodged through the TFES bulk upload system by mail to DHS or in person (sub. 42).

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### Box 3.5 Participants' views on the TFES

Participants' views on the purpose of the scheme exposed the absence of a common understanding of the purpose of the scheme. Its objectives in respect of freight costs were described variously as being to 'normalise' (SeaRoad Holdings, sub. 35, p. 6), 'offset' (Net Sea Freight, sub. 26, p. 11) or 'compensate' (Regional Development Australia - Tasmania, sub. 17, p. 26 and Mondelez, sub. 24, p. 10).

Participants stressed the importance of the TFES to businesses located in Tasmania. Mondelez said:

The TFES is critical to Mondelez International's operations in Tasmania. (sub. 24, p. 3)

Norske Skog highlighted the scheme's importance to their ongoing operations:

... any reduction in assistance would jeopardise Norske Skog's ability to operate a sustainable business in Tasmania. (sub. 39, p. 17)

Harvest Moon pointed to the scheme's contribution to addressing the disadvantage faced by Tasmanian shippers:

The TFES does not provide Tasmanian based shippers with an unfair disadvantage versus mainland companies. It simply means we are only disadvantaged by \$15 to \$20 / tonne rather than \$85 to \$90 / tonne. (sub. 21, p. 2)

Submissions also provided evidence of problems stemming from the design of the scheme. Participants outlined the perverse incentives the exclusion for exports created to move manufacturing processes to the mainland, with Cuthbertson Bros saying that the scheme:

... discourages capital investment and employment in Tasmania to the benefit of Victoria, in particular. (sub. 3, p. 1)

Participants also said the scheme's complexity and compliance requirements created onerous compliance. According to GA Cossar & Co:

The [TFES Guidelines] is a document of 82 pages. At the risk of understatement, it would be reasonable to conclude that the interpretation of this complex document may be beyond some of those it is intended to assist. (sub. 7, p. 2)

According to the Department of Infrastructure and Regional Development, the scheme's complexity increases errors and the incentives to maximise claims:

A number of administrative issues have arisen from the complexity of the scheme including a very large overpayment (notified to DHS by the firm involved) and incorrect and inconsistent payments. (sub. 42, p. 20).

Adopting a flat rate is likely to lead to a substantial lowering of the compliance and administration burden under the TFES. However, this may only provide some marginal reduction in the compliance burden on claimants and the administration burden on government arising from the material required to accompany claims. DIRD states that some actions which could be taken to improve compliance, in particular improved information technology systems, have not been pursued due to

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a lack of funds (sub. 42). Improved information technology systems may provide some scope to lower the compliance burden on businesses and administrative costs to government without compromising quality assurance and the integrity of the scheme.

**Box 3.6 Shipment details required to make a claim**

According to the TFES guidelines, each shipment requires the following details for the processing of claims:

- transport company used
- consignment note number
- date of shipment
- invoice number
- evidence of payment of freight costs
- type of goods shipped (used to assess TFES eligibility).

In addition, the following information is required to determine the amount of assistance payable:

- the number of tonnes or cubic metres shipped (not required for livestock)
- the type of goods shipped
- the density of the goods shipped
- whether the goods were shipped as dry freight or reefer freight
- if livestock, the number of head and type of livestock
- origin and destination of the shipment (also to assess shipment eligibility)
- transport task (e.g. wharf to wharf or door to door)
- total freight paid excluding GST
- the container or trailer size and the number of containers or trailers, if the shipment is a full container load
- the number of pallets, if the shipment is a less than full container load.

*Source:* DITRDLG (2013).

The scheme's administration and auditing would be further improved by greater transparency in the publication of scheme data, particularly the assistance paid to scheme recipients. In its 2006 inquiry the Commission recommended more comprehensive reporting of scheme data, including payments to recipients. This would build on BITRE's publication of scheme data in its parameter reviews.

Some participants raised concerns that the publication of detailed scheme data could breach commercial confidentiality. During the public hearings participants indicated that publication of claimant names and the amount of assistance received would not compromise businesses. The Commission notes that this would also be consistent

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with reporting obligations under the Department of Finance and Deregulation's Commonwealth Grant Guidelines.

RECOMMENDATION 8

***The Australian Government Department of Human Services should examine the benefits and costs, including compliance costs for claimants, of upgrading its technology to provide greater access to online claims under the Tasmanian Freight Equalisation Scheme and improve internal claims processing.***

RECOMMENDATION 7

***The Department of Infrastructure and Regional Development should provide more comprehensive public reporting of information under the Tasmanian Freight Equalisation Scheme, including annual payments to recipients.***

The scheme's complexity also increases the need for many claimants to use agents.

Changes to the scheme in 2002 attempted to address this issue by allowing companies who supply goods to claimants in the agricultural, forestry or fishing industries under the southbound or intrastate components of the scheme to act as agents on behalf of their customers (DITRDLG 2013). The TFES guidelines require that agents pass the full amount of TFES assistance to eligible claimants (DITRDLG 2013).

However, other claimants use third parties to claim on their behalf. Net Sea Freight dominates this market with a claim value of around \$7.1 million in 2011-12 (table 3.4). The Commission acknowledges, based on public hearing evidence, that Net Sea Freight provides a service valued by scheme recipients and represents a reasonable commercial outsourcing of a bespoke financial function, especially for smaller businesses. DIRD noted that simplifying the scheme would reduce the need for agents (sub. 42).

A small number of claimants have been invited by DHS and DIRD to enter an agreement to 'self-assess' their claims (ANAO 2011). Self-assessed claimants are selected based on their history of compliance and the accuracy of their claims (ANAO 2011).

In 2010-11 there were nine self-assessed claimants who received 30 per cent of all TFES assistance in that year (ANAO 2011).

Self-assessed claimants have the following obligations (ANAO 2011):

- they submit the same claim form as other claimants, but are not required to submit supporting documents

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- they must keep records of all documents for five years
  - they provide an independent annual audit of their claim forms and supporting documentation.

Further, their claim forms are not verified against supporting documents before being accepted and paid (ANAO 2011).

As self-assessment reduces the compliance burden for these claimants, and the administration burden for government, the Commission considers that there would be merit in extending the self-assessment facility to a broader pool of claimants. This recommendation has received broad support from inquiry participants. Further scope to extend self-assessment would be enhanced under a flat rate of assistance.

#### RECOMMENDATION 10

***The Department of Infrastructure and Regional Development should encourage and facilitate the take-up of the self-assessment facility under the Tasmanian Freight Equalisation Scheme where appropriate.***

In 2011-12, the average amount paid for a claim line item was \$463.50. However, the median amount paid for a claim line item in 2011-12 was less than \$44. This means that around 100 000 claim line items, each of which generally would have been a separate shipment, required the information outlined in box 3.6 in order to receive a very small TFES benefit. Around 123 300 claim line items had amounts paid of less than \$100 and around 61 400 claims had amounts paid of less than \$10.

The Commission considers that in addition to a flat rate payment per TEU, given the large number of small claim line items, each of which is generally for a separate shipment, it would be appropriate to introduce a minimum threshold for payment. This should be set so as to distinguish business transactions from those that are minor or likely to be personal in nature.

In its draft report, the Commission sought views on an appropriate minimum claim line item value that would meet the objectives of the scheme, while reducing administration and compliance costs.

Participants including Veolia Environmental Services, Cuthbertson Bros, Harvest Moon and Net Sea Freight were concerned by the impact of a minimum threshold, including the possible disadvantage for small businesses that made a number of small claims. GA Cossar and Co suggested a minimum threshold over a specified period would address this concern.

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To ensure that a minimum threshold achieves a reasonable balance between genuine and material business transactions and administrative efficiency, the Commission recommends that DIRD should examine the benefits and costs to claimants and the Australian Government of options to introduce a minimum threshold for TFES assistance including through greater use of invoice consolidation by smaller claimants.

#### RECOMMENDATION 9

*The Department of Infrastructure and Regional Development should examine the benefits and costs to claimants and the Australian Government of introducing a minimum value for:*

- *individual sea freight invoices*
- *a consolidated set of sea freight invoices over a 12-month period*

*that are eligible for assistance under the northbound component of the Tasmanian Freight Equalisation Scheme.*

### **The Tasmanian Wheat Freight Scheme**

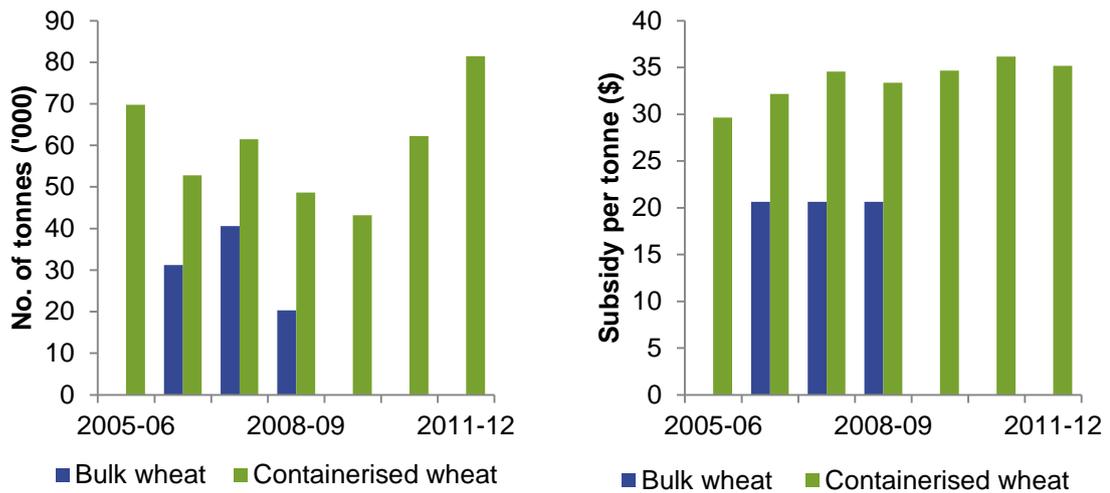
The TWFS had its origins in the 1948 Commonwealth Wheat Marketing Plan which assumed the States would enact legislation fixing the price at which wheat would be sold by the Australian Wheat Board in Australia (ISC 1985a). Each State enacted provisions fixing the price of wheat and the same price was prescribed by each State (ISC 1985a). However, the legislation did not oblige the Australian Wheat Board to supply wheat to Tasmania and this led to controversy as to who would pay the cost of shipping wheat to Tasmania, complicated by the determination of the basic wage, influenced by the price of bread. The Commonwealth introduced a levy on all domestic wheat sales to finance the shipping costs in 1953.

In 2004, the TWFS was refocused to address Tasmanian wheat users' extra transport and handling costs and to provide transitional support to these users while they adjusted to the removal of administered pricing.

In the sixty years since support for shipping wheat across Bass Strait was introduced, there has been significant deregulation and reform in wheat and labour markets. The price of wheat is estimated to contribute only around 5 to 10 per cent to the retail price of bread (ACCC 2008b), which in turn is not the uniform commodity it was in the 1950s. This suggests that the objectives of the scheme have been met and are no longer relevant.

In addition, as well as wheat for human consumption (which was the rationale for the TWFS), animal feed companies appear to make a significant proportion of claims for wheat shipped in containers under the TFES.

**Figure 3.4 Trends in bulk and containerised wheat shipments**  
2005-06 to 2011-12



Source: BITRE (2013).

As no claims have been made under the scheme for five out of the last eight years, and none since August 2009, the Commission considers that the scheme has become redundant given the subsidisation of wheat shipped under the TFES.

However, it is clear that at least some of these shipments would be more efficient in bulk form and the current practices induced by the schemes involve the loss of this efficiency. In 2006, the Commission recommended that wheat should no longer be eligible for assistance under the TFES as it distorted the efficient pattern of wheat transport (PC 2006b).

Abolishing the TWFS would acknowledge its redundancy and that its objectives have been met. However, the calculation of assistance for wheat (and other grains) shipped in containers under the TFES should be based on the lowest feasible cost option for transporting grain to Tasmania.

Participants did not oppose removing the scheme but were concerned that a lower rate would increase bread prices for independent bakers. However, to the extent that shipping wheat in bulk is feasible and more efficient than shipping it in containers, the Commission's recommendation should reduce the costs for businesses as well as their reliance on the TFES subsidy.

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## RECOMMENDATION 12

*The Australian Government should terminate the Tasmanian Wheat Freight Scheme as its original policy rationale, and therefore the scheme itself, is redundant.*

*The calculation of assistance for wheat and other grains shipped in containers under the Tasmanian Freight Equalisation Scheme should be based on the lowest feasible cost option for transporting grains to Tasmania.*

### **The Bass Strait Passenger Vehicle Equalisation Scheme**

The Australian Government's stated current intention is to retain the BSPVES (Coalition 2013). Participants raised a number of issues with the scheme.

The main issues identified with the BSPVES are:

- there is confusion around the purpose of the scheme
- the extent to which the subsidy benefits consumers and provides financial support to TT-Line
- there is some dissatisfaction with post-subsidy fares and service provision
- there are anomalies in the scheme.

#### *Purpose of the scheme*

Participants' views on the scheme's objectives, and therefore their assessment of its effectiveness, reflected both access and tourism aspects. This is likely to reflect that over time the scheme has changed from a partial 'equalisation' model to a flat rate that extends to recreational vehicles associated with tourism.

The scheme provides support to those perceived by many inquiry participants to be its intended primary beneficiaries — Australian residents travelling between the mainland and Tasmania with their vehicle. The stated aim of the BSPVES when it was introduced in 1996 was to reduce the net fare of a driver sharing a standard cabin to a cost similar to driving an equivalent distance on a highway (Sharp 1996).

Many participants including the National Sea Highway Coalition, TICT and the Caravan, RV and Accommodation Industry of Australia (CRVA) expressed the view that the primary purpose of the BSPVES should be to equalise the cost of inbound and outbound travel across Bass Strait.

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Assessed on this basis, some participants suggested that assistance should increase as the value of the scheme had been eroded over time, particularly as indexation had been in place only since 2008. Other participants argued that it meant the BSPVES should be broadened.

However, other inquiry participants viewed the scheme primarily through a tourism lens. This was consistent with expectations at the time the scheme was introduced, that it was expected to assist Tasmania's tourism industry and Tasmania more broadly (Sharp 1996):

This Coalition initiative will encourage demand for travel across Bass Strait, with direct benefits to the tourist industry and potential growth in jobs, investment and population for Tasmania. (Sharp 1996, p. 1)

Participants including Austrade, TICT and CRVA acknowledged that the scheme provides a benefit to tourism, although TICT did not consider that it was the Australian Government's role to provide an ongoing subsidy to the tourism industry (trans., p. 98). While there was a range of estimates as to the scheme's impact on tourism, its primary tourism benefit was acknowledged to be through self-drive tourists, who were more likely to stay longer in the state and visit regional areas. The CRVA said that Tasmania relies on tourism outside capital and metropolitan areas as National Survey Visitor data show that around half of all domestic visitor expenditure is in regional areas (sub. DR76).

The Tasmanian Government noted that the *Spirit of Tasmania* carried 10 per cent of all visitors to Tasmania who accounted for 20 per cent of all visitor expenditure in Tasmania (sub. DR85). While the Tasmanian Government said that 'grey nomads' were an important albeit relatively small sector of the touring market (sub. DR85), a KPMG report prepared for the CRVA expects slower rates of growth in the 55 to 69 year old age cohort over the next decade (KPMG 2013).

TICT, Tourism and Transport Forum and Cradle Coast Tourism Executive said that the total value of direct visitor spending by leisure visitors arriving in Tasmania by sea in 2012-13 was around \$255 million (sub. 48).

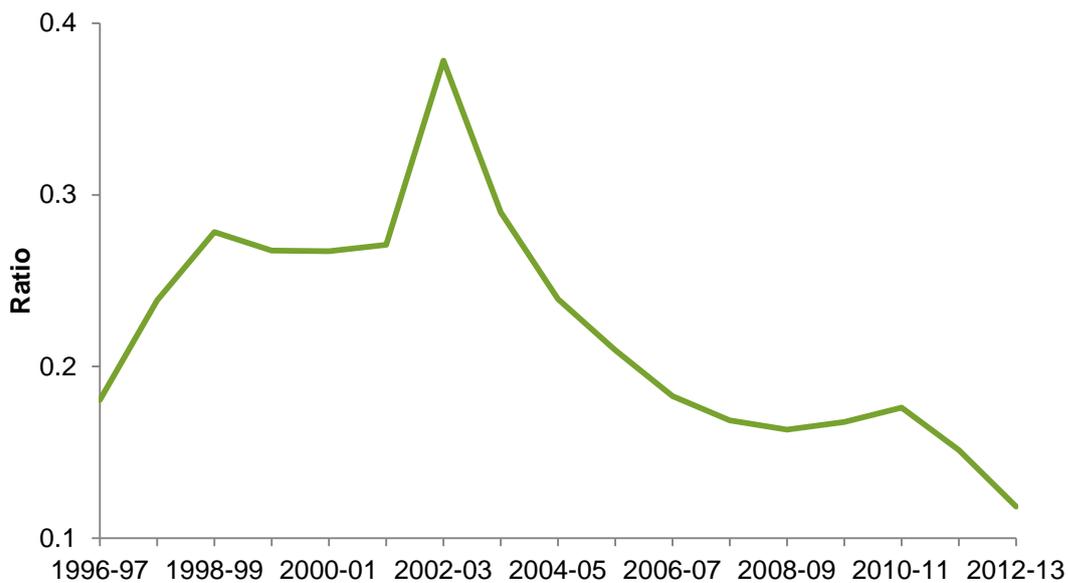
From a tourism perspective, sea travel remains a small part of the overall passenger task and has declined in recent years.

Against the backdrop of materially lower discount air fares to Tasmania — which the Commission views as the single most important development to advance Tasmanian tourism — an overall picture of trends in passenger travel across Bass Strait is shown by the ratio of sea to air visitors (figure 3.5). For adult visitors travelling to Tasmania, the ratio of those travelling by sea to those travelling by air rose after the introduction of the BSPVES, peaking in 2002-03. As a proportion of

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overall adult visitors travelling to Tasmania, travel by sea is now lower than it was when the scheme was introduced. However, if looking at the BSPVES through the ‘access’ lens, that is being able to travel to and from Tasmania with their own vehicle, air travel is not a perfect substitute.

**Figure 3.5 Ratio of sea travel to air travel**  
Adult visitors to Tasmania



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Source: BITRE (2014).

BITRE estimates indicate that fewer Tasmanian residents have chosen to travel by sea over the past few years consistent with falling passenger numbers overall for sea travel. In 2012-13, only 5 per cent of adult Tasmanian residents making return journeys to the mainland travelled by sea, while the comparable figure for inbound tourists was 11 per cent (BITRE 2014). While the availability of the subsidy provides Tasmanian and mainland residents with travel choice, the data indicate that, consistent with overall passenger travel trends, they have a relatively low reliance on sea travel, and by inference, the BSPVES.

The confusion as to the scheme’s purpose, and therefore the assessment of its benefits, suggest that there would be merit in the Australian Government articulating the scheme’s objective as a basis for any future evaluation.

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RECOMMENDATION 13

***The Australian Government should clearly articulate the objective of the Bass Strait Passenger Vehicle Equalisation Scheme, and any future evaluation of the scheme should be assessed against that objective.***

*Subsidy benefit and Bass Strait services*

Participants expressed concern about the extent to which the subsidy benefits consumers, with some calling for the subsidy to be increased to offset fare increases.

Irrespective of who the beneficiaries of the BSPVES are intended to be, the scheme provides only diluted support as some of the subsidy is inevitably captured by TT-Line as the main (virtually sole) carrier of passenger vehicles across Bass Strait. In this context, any increase in the BSPVES may not flow through fully to the intended beneficiaries.

TT-Line suggested that the characteristics of supply and demand in the Bass Strait passenger services market were such that the supply of ferry services was more responsive to price changes than demand for those services and that this was evidence that TT-Line was not capturing any part of the subsidy (sub. DR84). This implies that for a given price change, the additional supply of shipping services would exceed increased demand for those services.

However, this appears inconsistent with anecdotal evidence provided to the inquiry that there was unmet demand for some users of TT-Line services due to difficulties in accessing these services (including at a reasonable cost) and perceptions that the supply of passenger services was adversely affected by the TT-Line's freight service (box 3.7).

Austrade said that while they did not disagree that a portion of the subsidy had leaked to TT-Line, they also observed that consumers were paying for a different package than was the case when the scheme was introduced (trans., p. 115).

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### Box 3.7 Participants' views on the BSPVES

#### On the scheme's purpose:

... Bass Strait is part of the national highway and the infrastructure that makes it work to improve productivity and efficiency is no different than a road or rail on the mainland. This is why a 'one in, all in' approach to passenger and freight movements is considered justified in spite of potential added cost. (National Sea Highway Coalition Tasmania, trans., p. 209)

#### On the scheme's effectiveness:

... a declining share of the modal for traffic accounted for by maritime versus aviation should not be seen [as] a sign that the scheme is failing. Rather, it is simply a recognition that in a sense, it's perhaps not as attractive to consumers as it was when it was introduced in 1996. Nevertheless, it is still important in inducing a significant number of business and expenditure to Tasmania that would not have otherwise occurred. (Austrade, trans., p. 113).

#### On pricing and services:

We need consistency in pricing for RV travellers. The variance in pricing, cost is becoming prohibitive for the RV market as they have to spend up to \$1800 just getting to the island and this fluctuates depending on the season and availability. Travel for RV's is considered seasonal. (Campervan and Motorhome Club of Australia, sub. DR91, p. 1)

From what I can ascertain there is very little variation in fare costs for vehicles that fit the minimum size criteria (under 6 meters) but large variations and inconsistencies occur with larger vehicles ... (Napier, sub. DR66, p. 2)

To travel across Bass Strait, it is necessary to pay for the vehicle, trailer and passengers, plus, because of the speed of the boat, it is nearly impossible to not pay for some form of accommodation or seating to make the trip bearable ... [the cost] is up to four times the cost of a similar journey between mainland States (Caravan Industry Australia – Tasmania, sub. 63, pp1-2)

... an A-class ocean liner is not required, just a well managed ferry. No shop is necessary. An A-class restaurant is not required. A buffet would be more than necessary. A bar is not essential. Poker machines and dancing is not essential but we accept younger passengers would probably like this facility. (Tarlinton, trans., p. 511)

... last time I travelled back to Tasmania they told me that they're only allowed to sell 60 pensioner discounts on each sailing and they had sold 59 and I was coming back with my partner so we had to pay one full fare and one pensioner fare. That to my mind is ridiculous for a public transport operation; you know, there's no limit on the number of pensioner fares on the train going between Melbourne and Sydney for instance and any other public transport. (Napier, trans., p. 222)

Participants appeared to view the subsidy's effectiveness through the prism of the pricing and quality of TT-Line's service. Anecdotal evidence suggests that TT-Line pricing and services may not meet the needs of many passengers who are seeking a lower-cost service to travel with their vehicle, compatible with the concept of the Bass Strait as a sea highway. Some TT-Line users were concerned about the transparency of TT-Line's pricing and the impact that its freight services had on the provision of passenger services (box 3.7).

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TT-Line pricing for vehicles is set out in their fares schedule on the *Spirit of Tasmania* website and is based on the vehicle's dimensions. However, there was anecdotal evidence of some fare anomalies, including in relation to fare differences for comparable sized recreational vehicles (box 3.7).

Some participants with recreational vehicles stated that TT-Line restricted access to TT-Line services for their vehicles in order to carry freight. TICT suggested that this could reflect experiences of people booking for travel during peak periods (trans., p. 107). Participants also suggested TT-Line may be over-servicing the Bass Strait route (box 3.7).

In light of these issues, and that the subsidy is provided by the Australian Government but the service provider is a Tasmanian Government-owned enterprise, the Commission considers that the Australian and Tasmanian Governments should take a joint approach to ensuring greater transparency around TT-Line's pricing. The Australian Government and Tasmanian Government should also assess the extent to which the subsidy is passed on to the intended beneficiaries.

#### RECOMMENDATION 14

***The Australian Government should undertake discussions with the Tasmanian Government on a joint approach to ensuring greater transparency around TT-Line's pricing, and an assessment of the extent to which the subsidy offered by the Bass Strait Passenger Vehicle Equalisation Scheme is passed on to the intended recipients.***

However, the potential for any subsidy increase not to flow through fully to passengers remains where there is subsidy capture by TT-Line.

While TT-Line's pricing and services are commercial decisions, the Commission notes that there is an absence of competition for passenger ferry services, and therefore market discipline. As with other federal and state-owned enterprises, TT-Line is subject to competitive neutrality principles. Tasmania's competitive neutrality policy requires that TT-Line maximise the sustainable return to Tasmania (including through obtaining commercial returns), having regard to the economic and social objectives of the Tasmanian Government (Government of Tasmania 1996).

To the extent that any leakage of the subsidy to TT-Line impacts on its commerciality, this should be consistent with the Tasmanian Government's objectives. To that end, the Commission considers that the Tasmanian Government should state its objectives for having a government-owned Bass Strait ferry service and whether TT-Line is the most cost-effective means of meeting these. Further,

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given the operation of the schemes, and TT-Line competing with commercial operators in the freight market, and contestability of the passenger and vehicle market, there is an imperative to ensure that TT-Line fully satisfies the principles of competitive neutrality across these services. The Commission's recommendation, discussed in the context of freight services, is in chapter 4.

#### *Anomalies with the Bass Strait Passenger Vehicle Equalisation Scheme*

Participants raised anomalies with the BSPVES. Several pointed to the perceived inequity of permitting vehicles with caravans to access the subsidy, whereas vehicles with trailers or boats are not permitted (National Sea Highway, sub. 54; Brohier, sub. 59). The Boating Industry Association of Victoria (sub. 13) and TT-Line (sub. 9) suggested that the subsidy be extended to trailers towed by eligible passenger vehicles.

The King Island Shipping Group raised the cost of travel for King Island residents (sub. 19). This included that the subsidy was not available for travel between King Island and Tasmania, despite the high cost of passenger transport which was limited to air travel. The Commission notes that passengers who travel by air between Melbourne and King Island or the Furneaux Group of islands are eligible for the subsidy where they ship their passenger vehicle between King Island and the mainland or the Furneaux Group and the mainland.

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## 4 Sea freight

### Key points

- Tasmania relies heavily on shipping for its interstate and international freight task.
  - The relatively small size of its economy and freight volume (and the lack of growth in this volume since 2007) limits the scope for competition, economies of scale and hence more efficient shipping and port costs.
  - The viability of direct international shipping is constrained by low volumes (compounded by being spread among multiple ports) and port infrastructure that restricts access for larger vessels.
- The extent of competition in the Bass Strait shipping market is unclear. Thus the extent to which anticipated changes in the industry in the near future (new vessels, coastal shipping changes, and possible resumption of an international service) will result in lower costs being passed on to users is similarly unclear.
- Changes to coastal shipping regulation since 2009 have added to the cost and reduced competition for Australian coastal shipping and direct international shipping (where coastal shipping formed an important revenue component). Coastal shipping regulations should be reviewed immediately.
- Government ownership of TT-Line has the potential to distort the market by providing a barrier to entry and to private investment in more efficient Bass Strait shipping operations.
  - The rationale behind Tasmanian Government involvement in the shipping market is not clear.
  - Commission estimates suggest TT-Line has not earned a commercial rate of return over the past five years.
- The low volumes of the Tasmanian freight task place added emphasis on the need for efficient infrastructure provision and use. However the Tasmanian Ports Corporation (TasPorts) has adopted uniform pricing across the State which masks price signals, potentially supports less efficient ports (and community facilities) at the expense of others, and reduces opportunities for scale economies.
- The Melbourne Port Corporation Port Licence Fee falls heavily upon Bass Strait trade, materially diluting the benefit of the Tasmanian Freight Equalisation Scheme.
- Participants' concerns throughout the inquiry have primarily related to containerised freight across Bass Strait. There appear to be fewer concerns regarding bulk trade except in relation to coastal shipping regulations.

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## 4.1 Key features of Tasmania's domestic and international shipping

Shipping accounts for over 99 per cent of all freight to and from Tasmania by volume, and about two thirds of Tasmania's total inter- and intrastate freight task.

The total volume of Tasmanian freight (bulk and non-bulk) shipped in 2011-12 was just under 13 million tonnes.

About 8 million tonnes of that total (some 62 per cent) was bulk freight (BITRE 2013c). Around half of this bulk freight (48 per cent) was for Australian domestic use, with the remainder shipped internationally (40 per cent shipped on a direct service). Bulk freight is largely the domain of single companies that charter vessels to transport their commodities, and commonly use private wharf facilities (Aurecon 2013a).

The remaining 4.9 million tonnes — around 38 per cent of the total freight task — was non-bulk (container and break bulk) freight (BITRE 2013c). Of this total, about 1 million tonnes represented international imports and exports. Non-bulk traffic is the primary focus of this report.

The main characteristics of the domestic container shipping task are shown in figure 4.1.

### Domestic shipping across Bass Strait

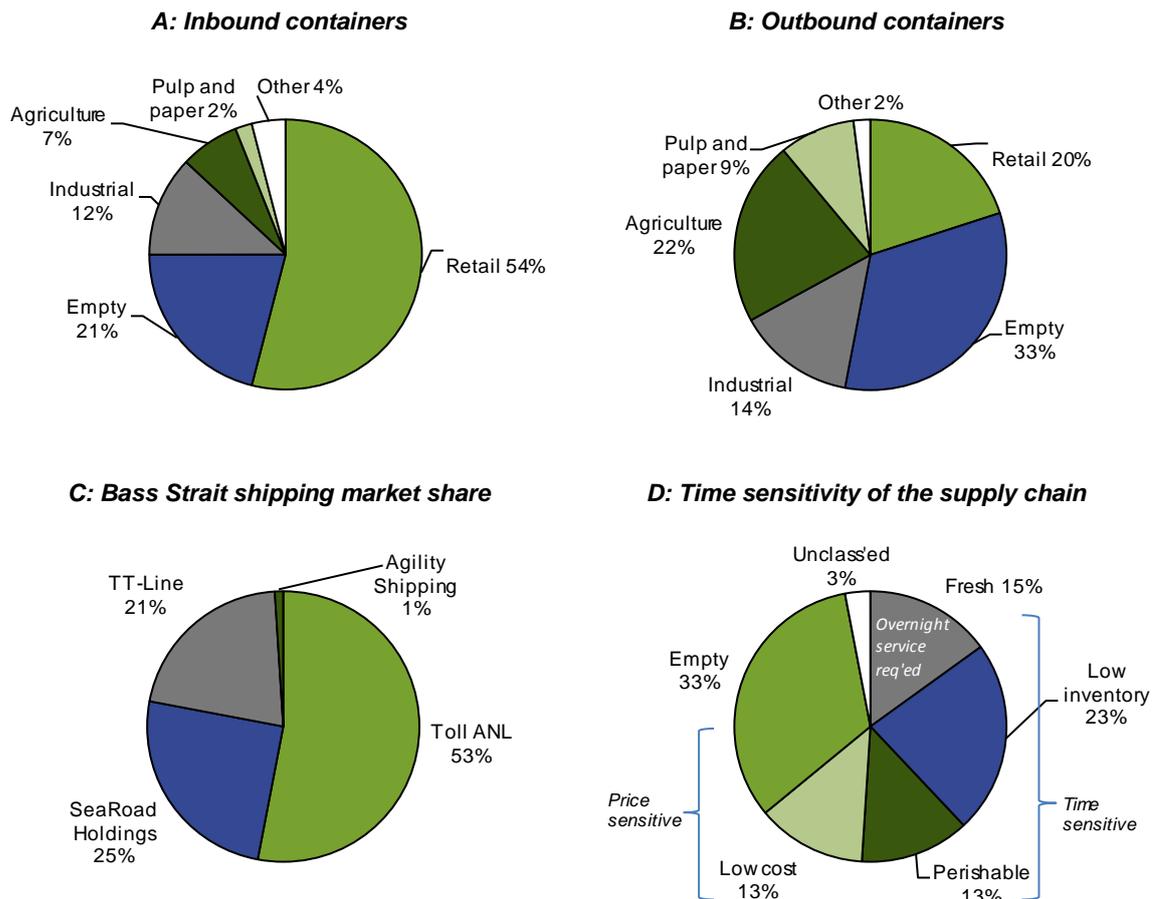
The diverse nature of Bass Strait non-bulk freight is catered for by roll-on roll-off (RORO) vessels. Three shipping operators provide freight services with six vessels across the Bass Strait: Toll ANL (Toll), SeaRoad Holdings (SeaRoad), and TT-Line (table 4.1).

The daily Bass Strait shipping capacity in one direction is around 860 twenty foot equivalent units (TEUs) or 275 000 TEUs in one direction annually (Aurecon 2013a). Demand over peak periods is higher and the shipping companies increase their sailings to meet this demand. TT-Line estimates its average capacity utilisation is currently around 90 per cent, and considers that Bass Strait shipping has reached its capacity limit (sub. 9). Toll, however, considers that:

... there is currently more than enough freight capacity on Bass Strait. The only exceptions to this are the weeks leading up to Christmas and Easter each year. (sub. 55, p. 1)

The service is a fast, reliable overnight service between Tasmania and the mainland, enabling products to access markets quickly. The faster travel time and later sailing times of TT-Line's *Spirit of Tasmania* vessels make them more suited to highly time-sensitive products.

Figure 4.1 Characteristics of Bass Strait container shipping in 2011-12



Data source: Aurecon (2013c).

However, only around 15 per cent of freight requires an overnight service. According to a study prepared for the Freight Logistics Coordination Team (FLCT) around 46 per cent of freight in 2011-12 was more sensitive to price than time (or speed with which freight could be transported) (Aurecon 2013a). Amongst this group are products such as zinc, aluminium, pulp and waste paper, furniture and timber, as well as empty containers. Even amongst the time sensitive group, an overnight service may exceed some shippers' needs. For example, some perishable items (confectionery and frozen vegetables) and low inventory items (paper, beer, crude fertiliser and animal foods) may be better suited to a regular but low cost service, rather than daily or overnight.

While producers in Tasmania have diverse needs and many would prefer a lower cost and less frequent service, they have mostly adapted their business operations to the current level of service.

**Table 4.1 Features of Bass Strait shipping services**

| <i>Feature</i>         | <i>Toll</i>   | <i>SeaRoad</i>  | <i>TT-Line</i>  |
|------------------------|---|---|---|
| Vessels                | Two RORO vessels: <i>MV Tasmanian Achiever</i> (500 TEU) and <i>MV Victorian Reliance</i> (500 TEU) | Two RORO vessels: <i>MV Searoad Tamar</i> (260 TEU) and <i>MV Searoad Mersey</i> (182 TEU)                | Two ROPAX <sup>10</sup> vessels: <i>Spirit of Tasmania I</i> (160 TEU) and <i>Spirit of Tasmania II</i> (160 TEU) |
| Frequency              | Overnight, six days per week plus extra sailings during peak demand                                 | Overnight, six days per week plus extra sailings during peak demand, plus a weekly service to King Island | Overnight, daily plus extra day sailings in peak demand   |
| Ports                  | Operates between Port of Burnie and Port of Melbourne   | Operates between Port of Devonport and Port of Melbourne, and weekly to King Island                       | Operates between Port of Devonport and Port of Melbourne  |
| Freight carried        | General purpose containers, refrigerated containers, cars and trailers, equipment, and livestock    | General purpose containers, refrigerated containers, cars and trailers, equipment and livestock           | Road freight trailers, cars and trailers, caravans and other wheeled units  |
| Other services offered | Logistics and freight forwarding services   | Logistics and freight forwarding services   | Vessels primarily designed to carry passengers  |

Sources: Aurecon (2013a, 2013c).

The Commission notes that some other limited services operate from Tasmania to the mainland. For example, Shipping Australia Limited commented that:

There is a regular service from NSW — (Eden) a vessel operates carrying explosives to Bell Bay and returns carrying cattle from King Island. (sub. 53, p. 2)

However, the overwhelming focus of participants' concerns throughout the inquiry has been on non-bulk shipping services between Tasmania and the Port of Melbourne.

<sup>10</sup> Combining roll-on roll-off and passenger carrying capabilities.

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## *Bass Strait Islands*

King Island is serviced by SeaRoad with a weekly service provided by the *MV Searoad Mersey* (sub. 35). The service, catering for livestock, plant and machinery and containerised general freight, sails from Melbourne to Grassy, and on to Devonport. LD Shipping also provides a livestock freight service, transporting livestock on open decks between Grassy and Stanley (King Island Beef Producers Group, sub. 15). Availability of a suitable vessel is considered a critical factor for King Island freight. As King Island Shipping Group commented:

The restrictions to the capabilities of our existing wharf infrastructure limit the ability for the island to drive competition and freight costs. Currently a vessel restriction ... is imposed on the wharf access. This prohibits any access to competition from alternative freight providers as these vessels do not exist in the open market and are not economically viable for a service provider to operate. (sub. 19, p. 1)

As such, King Island Shipping Group recently tendered for a service provider but was unable to reach an adequate outcome:

Over the last four years ... we put our freight task, the consolidated freight task to the market and our market response was less than adequate in terms of what our demand was and we could not provide, could not generate any solutions out of that market tender and as such the current situation with the King Island freight task still remains a challenging position in terms of trying to find alternative solutions to competition. (trans., p. 413)

The Furneaux Group of islands are serviced by Furneaux Freight, which sails from Bridport (in north-eastern Tasmania) to ports on the Furneaux Group of islands, including Lady Barron and Cape Barren. The Furneaux Group of islands freight task mostly services the livestock industry, particularly demand generated by the export of live animals to markets in Tasmania and Victoria, and imports of goods such as fertiliser and machinery (Flinders Council, sub. 23).

## **International shipping**

In May 2011, direct international container shipping<sup>11</sup> to and from Tasmania ended with the withdrawal of the Asia Australia Alliance (AAA) consortium's Bell Bay-Singapore service.<sup>12</sup>

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<sup>11</sup> A direct international container service involves a voyage that includes one or more stops at international ports.

<sup>12</sup> At the time of AAA's withdrawal the service was operating on a fortnightly basis (SeaRoad, sub. 81).

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The consortium comprised four international shipping lines — Mitsui OSC Lines, Orient Overseas Container Line, Malaysian International Shipping Corporation and Pacific International Lines. The Commission understands the AAA service catered for between one third to two thirds of Tasmania’s international containerised trade over the life of the service.

While there is a paucity of data regarding AAA’s freight volumes, annual container volumes in and out of Bell Bay show a significant decline in volumes, as shown in panels A, C and E of figure 4.4.<sup>13</sup> However, the demise of the AAA service was not underpinned by any one factor but rather the culmination of several factors including low volumes — in part due to a reduction in Tasmanian exports, and several key shippers deciding to tranship through the Port of Melbourne — as well as issues associated with scheduling and vessel size (MMC Link 2012; Net Sea Freight, sub. 26; SeaRoad, sub. DR81).

AAA’s exit occurred against a background of strong commercial pressures in global shipping and a trend to larger vessels on international routes, which led to commercially marginal services withdrawing and larger vessels providing international container services from the Port of Melbourne. These changes may further isolate Tasmania (and other ports in Australia) from regular direct international services.

As a result of the withdrawal of the AAA service, most international container freight that was shipped through Bell Bay is now transhipped through the Port of Melbourne. Transhipment has added materially to transport costs and transit times (GPS 2013). Participants commented:

... it is worth noting that following the withdrawal of international shipping in 2011, the cost impacts have been substantial. (Northern Tasmania Development, sub. 27, p. 3)

We have been exporting logs in containers to Asia to undertake tests to make advanced wood products which we hope to produce here in Tasmania. The impact on timing and cost as a result of containerized wood products being sent via Melbourne or elsewhere and the lengthy turnaround time has made our plans for innovation more costly and less efficient. (Forestry Tasmania, sub. 37, p. 1)

With smaller exporters the invoices that I have ... they’re all in February 2011. Bell Bay to Hong Kong for a 20-foot container it was \$852. As at ... 12 September last year, the same costs were \$1728 for the same container, so from February 2011 to September 2013 the cost has gone from \$852 to \$1728. (Tasmanian Exporters Group, trans., p. 135)

These higher costs and transit times were exacerbated when Agility Shipping terminated its Melbourne–Bell Bay service in August 2011. For some businesses,

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<sup>13</sup> ANL and Agility Logistics also previously shipped container freight through Bell Bay.

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that decision added distance to their land leg as it required containers to be shipped through Burnie or Devonport on their journey to or from the Port of Melbourne.

In response to the cessation of direct international container shipping services, in 2012 the Australian and Tasmanian Governments agreed to a \$20 million temporary assistance package for Tasmanian exporters (box 4.1).

**Box 4.1 Temporary assistance for Tasmanian exporters**

The 2012 assistance agreement provided funding for:

- (a) Direct shipping transition assistance for exporters with funding to be provided via a two-tranche allocation process.
  - (i) \$11 million for previous users of direct international services who can demonstrate they have suffered increased costs as a result of cessation of those services, and who can provide evidence of positive measures implemented or planned in response to the new shipping environment.
  - (ii) \$3.5 million for other exporters who are able to provide evidence of positive measures implemented or planned to maintain ongoing competitiveness.
- (b) Burnie Port improvements — \$4 million to fund stage 1.1 of the planned redevelopment of Burnie Port, which includes the redevelopment of the southern railyard and the closure of a public street and creation of a high productivity transport link within the port precinct from the southern railyard to the existing shipping terminal.
- (c) An industry-led freight logistics coordination team — \$1.5 million to establish an industry-led freight logistics coordination team to consider strategic issues associated with the development of Tasmania's freight and logistics sector.

*Source:* COAG (2012).

Incidental and limited international container shipping resumed in 2013, when Bell Bay Aluminium (BBA) negotiated with Swire Shipping to collect largely break-bulk freight from Bell Bay for delivery to Asia (BBA and Swire 2013). Swire now provides a monthly service for break-bulk and some containerised freight.

The new service caters for almost half of BBA's container shipping needs (around 150 containers per month), with the remainder shipped via the Port of Melbourne, and provides some modest capacity for other Tasmanian exporters and importers (BBA and Swire 2013; BBA, trans., pp. 323-324).

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In February 2014, the Tasmanian Government announced that it had chosen Swire Shipping as the preferred carrier for an international container shipping service from Bell Bay (Tasmanian Government, trans., p. 437). This selection followed a competitive tender process run by the Tasmanian Government. The process was facilitated by commercial shipping consultants Thompson Clarke. It is envisaged that the new service could provide an export/import service on a regular (14-21 day) basis with connections to North Asian hubs (Hong Kong and Shanghai) and calls to ports on the Australian east coast. However, it is premised on some level of ‘transitional’ assistance funded by the Tasmanian Government (reported to reside in a range of \$4 million to \$33 million).

A direct shipping service has advantages and disadvantages compared to transshipment through the Port of Melbourne. Direct international shipment can mean savings in freight charges and improved transit times. It enables shippers to minimise the length of their supply chain and transshipment movements, and reduce the risks associated with greater handling of freight. On the other hand, a direct international service may only offer limited services to some international markets and potentially limited capacity, while transshipment through Melbourne opens access to multiple shipping lines with more frequent services to ports around the world (GPS 2013). The relative merit is ultimately a commercial matter for shippers and informed by the ultimate route, costs and transshipment services through other hubs.

The Commission received mixed views on the value of a direct service.

... if we are going to be enticing an international ship here, it is going to help some people but it is not going to be able to help everybody with their international shipping. (Agility Logistics, trans., p. 372)

As discussed in chapter 3, some participants, such as the Tasmanian Exporters Group (trans., p. 135), Northern Tasmania Development (sub. DR93), Veolia Environmental Services (trans., p. 251, sub. DR103) and Cuthbertson Bros (trans., p. 286, sub. DR104) emphasised the necessity of such a service for international exporters, particularly for those in the Bell Bay area. Other participants noted that a direct service is unlikely to suit everyone’s needs:

I would like to categorically state that Nyrstar does not have any requirement for a direct international shipping service from Tasmania, with the Port of Melbourne offering far greater optionality ... (Nyrstar, sub. DR105, p. 1)

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... it is realistic to expect that a direct international service ... could only call on a fortnightly basis. This implies an approximate two-week delay between sailings, and would immediately exclude a number of exporters where this timeframe is not appropriate, especially if goods are of a time-sensitive nature, such as fish and vegetable products ... there is also the challenge in determining to which port the ship would call, recognising that at least 50% of the freight would need to be transhipped to other global destinations. (Net Sea Freight, sub. 26, p. 8)

... international shipping service[s], they're not all the same ... you've got different destinations. Just because you export it doesn't mean it goes on an export ship and it gets to where you want it to go, whereas out of Melbourne we can get to anywhere in the world weekly. That's a much better service. (Harvest Moon, trans., p. 341)

Finally, as the Department of Infrastructure and Regional Development (DIRD) notes, a range of other bulk and general cargo vessels call at Tasmania destined for overseas ports, carrying a range of products including chemicals, crude oil, liquid petroleum, cement and wood chips (sub. 42). Concerns from inquiry participants, however, have focused on a direct containerised freight service between Tasmania and international markets.

## **Cost of shipping**

The cost of operating a ship across Bass Strait is a function of various fixed and operating costs (table 4.2) and the size and configuration of the vessel. Aurecon (2013c) and SeaRoad (sub. DR81) have noted that the cost of shipping services on RORO vessels is generally higher than for dedicated container ships.

The relatively short distance across Bass Strait (about 420 kilometres) is also an important influence on the costs of these shipping services. The short voyage means freight is loaded and discharged twice in every 24 hour period, subjecting vessels to greater wear and tear (Aurecon 2013c). The short voyage means vessels also spend more time in port, incurring proportionately higher port and stevedoring charges compared to vessels on longer routes (Net Sea Freight, sub. 26).

The costs (prices) faced by users of Bass Strait shipping are not uniform. They differ based on factors such as size and frequency of shipment, variability of user demand and type of container required. Thus, freight users with low volumes or who have highly seasonal requirements will generally pay more than users with large and consistent volumes (FLCT 2013b). The unit costs they face will also reflect the capacity utilisation of that service (and, thus, the ability of the shipping line to spread its costs over the volume of freight carried).

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**Table 4.2 Bass Strait voyage costs**

| <i>Costs</i>  | <i>Proportion (%)</i> |
|---|-----------------------|
| Capital and financing costs (such as interest payments) | 35–45                 |
| Fuel costs for voyage                                   | 30                    |
| Crewing, wages, administration and on-costs             | 15                    |
| Repairs, surveys, dry-docks and maintenance             | 15                    |
| Port costs, such as berthing and pilotage               | 5                     |

*Source:* Aurecon (2013c).

For the typical freight user, the cost of shipping across Bass Strait is the largest single transport cost in their supply chain (FLCT 2013b). Data from the Bureau of Infrastructure, Transport and Regional Economics (BITRE), for example, indicate that in 2011-12, the median wharf-to-wharf cost for Tasmanian Freight Equalisation Scheme (TFES) claims was \$1129, which represents around 62 per cent of the median total door-to-door cost of \$1800 per TEU (BITRE 2013b). Bass Strait shipping rates fell significantly in real terms from the early 1980s to the end of that decade, and appear to have since settled into a pattern of fluctuation around a slowly declining trend (figure 2.5). Commenting on recent shipping costs, Net Sea Freight noted:

There has been a reduction in costs and improved service through shortening lead times, removing logistics steps, improving asset utilisation and introducing automation where appropriate. (sub. 26, p. 9)

Despite these gains, many participants expressed concerns about excessive Bass Strait shipping costs. Mondelez, for example, claimed that the costs were inefficiently high:

The freight services between Tasmania and the mainland are reasonably adequate in terms of time and capacity. However, the inefficient costs of the freight on Bass Strait results in substantially higher costs for the operations of Mondelez International in Tasmania. (sub. 24, p. 3)

The Commission also heard some anecdotal evidence that the departure of the AAA service had competition implications for shipping across Bass Strait, including that it led to an increase in freight rates:

The lack of a direct service was soon followed [by] freight rate increases imposed by the Bass Strait shipping providers. Incidentally both Toll/ANL and Sea Road have increased freight rates in close proximity to each other on a semi regular basis since. (John Barker and Associates, sub. 44, p. 1)

[when AAA exited the market] ... we were paying \$800 to Melbourne and overnight it went up 25 per cent to a thousand. (Cuthbertson Bros, trans., p. 295)

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However, SeaRoad disputed these claims:

There has been some comment in the submissions to the Inquiry that Bass Strait shipping rates increased after the withdrawal of the AAA service from Bell Bay. SeaRoad's existing shipping rates (non-overseas feeder rates) did not increase outside the normal annual review. (sub. DR100, p. 2)

The Commission also received evidence on the high transport costs faced by producers on King Island and the Furneaux Group of islands:

Freight for King Island beef producers is 26% of farm operating costs – compared to freight of comparable mainland beef producers at 3% of operating costs. Prior to the abattoir closing, freight costs were less than 3% of farm operating costs. (TFGA - King Island Branch, sub. DR79, p. 3)

The cost of shipping across Bass Strait is also an issue for international shippers. Compared to direct international shipping through Bell Bay, transshipping through the Port of Melbourne adds an average of about \$800–\$1500 per container in transport costs. It can also add up to 3–5 days to the transit times of northbound shipments and 7–10 days to southbound shipments (GPS 2013). Participants provided examples of how this was affecting their business:

Harvest Moon export approximately 220 TEUs per year. The extra handling cost of containers due to transshipping through the Port of Melbourne is equivalent to \$1025/TEU or a \$225 500 per annum bottom line impact on Harvest Moon. (Harvest Moon, sub. 21, p. 3)

The loss of the Bell Bay service was a cost blow for Simplot. Transition to a 'via Melbourne' supply chain added \$400 000 to the route per annum. (Simplot, sub. 50, p. 4)

Two and a half years ago, when a direct international shipping service was available Cuthbertsons was shipping 40 foot containers from Bell Bay to China for \$1090. Today that price is road Launceston to Burnie \$500, shipping Burnie to Melbourne \$1000 and shipping Melbourne to China \$500, a total of \$2000. (Cuthbertson Bros, sub. 3, p. 2)

More broadly, the Tasmanian Liberal Party commented that the loss of the international shipping service was directly costing Tasmania's exporting industries an estimated \$20–\$40 million per year, and the cost to the Tasmanian economy was even greater (sub. DR68).

The added costs of transshipment have exacerbated the difficulties that many exporters face to remain competitive and are claimed by some to be responsible for a fall in exports:

The loss of an international shipping service has caused sea freight exporters ... to bear significant additional costs as a consequence of shipping through the Port of Melbourne. Many companies cannot absorb this cost as they are price takers in international markets. (TCCI 2012, p. 5)

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There is no doubt that Bass Strait shipping costs are high relative to road transport costs over an equivalent distance. But the extent to which Bass Strait shipping costs are excessive or inefficient (as some participants claim and benchmarking suggests) for such a short haul sea journey remains unclear.

Benchmarking Bass Strait shipping costs against comparable routes is intrinsically difficult and subject to many caveats and qualifications. Aurecon was commissioned by the FLCT to undertake this task and compared Bass Strait shipping with two similar RORO services in Europe. It found that Bass Strait costs were about 24 per cent higher, although this should be viewed in the context of higher costs in Australia for some inputs, particularly for labour and bunker fuel (Aurecon 2013c).

Toll disputed Aurecon's findings, arguing that a more accurate assessment shows Bass Strait costs to be similar or less than the European examples:

Comparisons of other sea freight costs, while interesting, are not equivalent given cost of bunker fuel, crew and economies of scale on ship maintenance and wharf infrastructure. ... [The Immingham to Rotterdam] rate does not include any terminal charges, power or equipment because typically the shipper supplies the trailer or container in Europe. By comparison, Toll's 20ft GP rate of \$700–\$950 (depending on weight and service) includes the cost of terminals which is in the order of \$250 a TEU plus the supply of equipment of approximately \$60. On that comparison, the European rate would be in the range of \$922 plus fuel and wages. (sub. 55, p. 2)

## **4.2 Efficiency drivers of Tasmania's shipping**

### **Scale and composition of freight flows**

The size and composition of Tasmania's interstate and international freight flows have a major influence on the cost of shipping services provided to Tasmania.

The relatively small volume of trade across Bass Strait limits the scope to realise economies of scale, and the number of competitors that the market can sustain. On this issue, the Australian Competition and Consumer Commission (ACCC) observed:

The relatively small size of Tasmania's economy and limited trade volumes is likely to explain some of the freight cost differential between it and mainland markets ... Because economies of scale generally prevail in shipping, lower volumes are likely to affect the cost of supplying freight and shipping services to Tasmanian businesses. (sub. 28, pp. 1, 3)

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Similarly, Net Sea Freight and SeaRoad stated:

... the low volume of trade is likely to dictate that the present number of operators is about appropriate, given the relatively high fixed costs operators incur; fragmentation of the market may well require higher prices for services to ensure sustainability of operators. (Net Sea Freight, sub. 26, p. 5)

... it is true for Bass Strait RORO operators that the relatively small volume of trade across Bass Strait would not sustain another RORO operator. (SeaRoad, sub. DR81, p. 15)

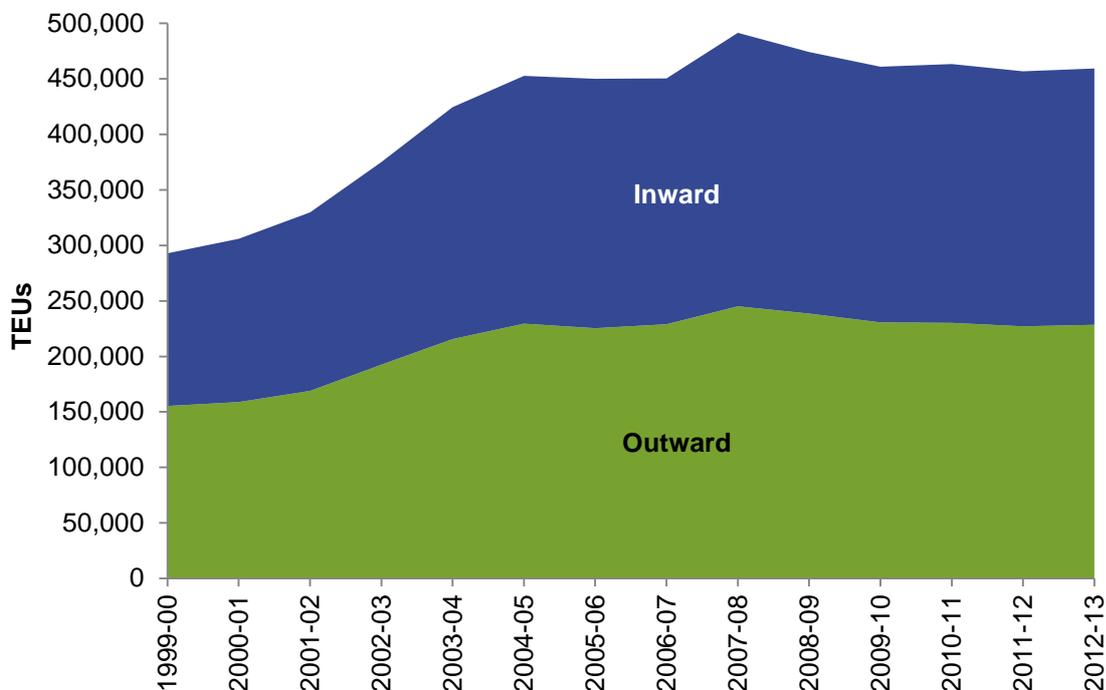
The Burnie Chamber of Commerce and Industry noted the inherent disadvantages of Tasmania including that ‘the volume of cargo is small’ and ‘With low cargo volume it is essential to accumulate freight at one port for regular and frequent collection’ (sub. 57, p. 2).

The TFGA — King Island Branch also highlighted that low volumes have a major influence on the cost of shipping services to their island:

The reality is that the volume of freight will never be enough to create true competition. Our sea freight system is expected to operate under a free market system yet in reality we have a duopoly on livestock and a monopoly on all container, vehicle and trailer freight. (sub. DR79, p. 1)

In recent years, container movements (both domestic and international) have remained relatively stable, despite a decline in bulk volumes (figure 4.2). However, there are differing views of the outlook for Tasmania’s future freight flows. In 2009, the Port of Melbourne Corporation estimated that Tasmanian container trade would grow at an annual average rate of 4 per cent to 2025 and 3.8 per cent to 2035 (Port of Melbourne Corporation 2009). The FLCT considers these estimates may be optimistic, and has adopted an annual average growth forecast of 3 per cent in its report (FLCT 2013a). Among participants, the Tasmanian Exporters Group presents a range of container trade growth forecasts, and suggests a range of 3.4–5.3 per cent growth is possible (sub. 14).

**Figure 4.2 Tasmanian container movements<sup>a</sup>**  
TEUs loaded and unloaded at Tasmanian ports



<sup>a</sup> Data includes international and domestic movements, and empty containers.

Data source: TasPorts (2013).

Freight volumes are fundamental to the viability of international services, with firm commitments for minimum volumes a necessary (but not sufficient) condition for attracting direct liner calls. However, as mentioned in chapter 3, it is difficult to estimate the volume of TEUs exported from Tasmania to international markets and the proportion of these that would utilise a direct service, rather than tranship through the Port of Melbourne. For example, the Tasmanian Government and the FLCT estimate that currently, Tasmania’s total international container volumes are around 37 000 TEUs, while BITRE estimates that exports could be around 76 000 TEUs (BITRE 2013b; FLCT 2013a; Tasmanian Government, sub. 43).

A number of participants to the inquiry have noted Tasmania’s low container freight volumes limit the potential for an international service:

... international shipping services are inhibited, in that current volumes are not sufficient to have a port-to-port service. (Net Sea Freight, sub. 26, p. 2)

The underlying factor inhibiting the provision of international shipping services to Tasmania is volume(s), or lack thereof. This has a direct impact on costs and has been the catalyst for the ... decline in shipping lines being able to service and meet our needs. (Veolia, sub. 38, p. 2)

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Low volumes to/from Tasmania (especially containers) make it difficult to provide a regular service of sufficient frequency ... (Shipping Australia Limited, sub. 53, p. 1)

GPS Logistics estimated the minimum volume required to attract a weekly service similar to the previous AAA service, using a 2500–3500 TEU vessel, would require an exchange of 700–1000 TEUs per call to be viable (about 36 000–52 000 TEUs per year). A similar weekly service by a smaller 1500–2500 TEU vessel would require an exchange of 450–700 TEUs per call (about 23 000–36 000 TEUs per year) (GPS 2013).

On the basis of volume alone, GPS Logistics (2013) estimated current levels would be marginally sufficient to support a weekly, direct international container service.

Compounding the issue of low volumes is the problem that Tasmania's international container freight is spread across the three main northern ports, reducing the critical mass of freight volume available at any single port. The sustainability of any direct international service would therefore likely be contingent on a coordinated approach by a small number of large exporters to consolidate the international freight task at a single port.

Another factor that would likely affect the availability of freight volumes for an international service, and therefore the viability of such a service, is the potential extension of the TFES to all eligible freight shipped through mainland ports (regardless of their intended destination) (chapter 3). That scheme extension would reduce the cost of some exports transhipped through the Port of Melbourne and other mainland ports, making a direct international service a relatively less attractive option at the margin for some exporters.

The Commission notes the FLCT's view that the viability of a commercially sustainable international shipping service must be determined by the market (FLCT 2013a). The Commission supports this view — that the market and underlying economics should determine the viability and therefore sustainability of any direct international service.

The composition of Tasmania's domestic and international freight flows is also responsible for the high proportion of empty containers shipped to and from Tasmania (figure 4.1) (Aurecon 2013b; FLCT 2013b). These empty container shipments add significantly to costs for shippers. For overseas, shipper controlled empty containers, repositioning can cost around \$400–600 per container, depending on their final destination (Aurecon 2013a). Containers owned and provided by the domestic Bass Strait operators are repositioned empty (initially) at the operators expense, and the cost (around \$60) ultimately included in the shipping rate (SeaRoad, sub. DR81).

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The FLCT identified opportunities to reduce empty container movements and shipping costs (such as carrying domestic freight in international containers and dry freight in refrigerated containers).

While shipping companies and shippers have a powerful incentive to pursue options that reduce the cost of empty containers, their efforts are only likely to have an effect at the margin (GPS 2013). The Tasmanian Government noted:

There are no obvious or simple solutions to addressing the empty container issue, given this issue is driven largely by an imbalance in Tasmania's northbound and southbound container types ... (sub. 43, p. 14)

### **The competitiveness of Bass Strait shipping**

A significant concern for many participants to this inquiry has been the extent of competition in the Bass Strait shipping market. As the ACCC observed, competition has a role in encouraging businesses to operate at lowest sustainable cost and to ensure that prices facing shippers will be lower and quality higher than would be the case if there were little or no competition (sub. 28, p. 3).

Shipping services carrying freight across Bass Strait face no competition from road or rail alternatives. Air transport offers some competition, but is generally only feasible for time sensitive, high value freight, such as shellfish and abalone, and passengers. However, within the freight shipping market, three companies — Toll, SeaRoad, and TT-Line — compete for business.

Competition for freight falls into segments, with a relatively minor share of freight (which Aurecon estimates to be 15 per cent) requiring time sensitive overnight shipping, largely met by TT-Line and the balance serviced chiefly by Toll and SeaRoad.

Participants had differing views on how effective this competition was in practice. For example, Nyrstar commented:

TT Line does not provide any competitive pressure for Nyrstar ... the container capacity of Toll ANL is far greater than that of Sea Road, while TT-Line predominantly receives trailers as opposed to containers. (sub. DR105, p. 2).

Some argued that the number of providers is not sufficient for a competitive market. Regional Development Australia (RDA) — Tasmania, for example, stated:

A key theme that emerged from the comparing of 15 recent reports into Tasmanian Shipping is an inherent lack of competition in the marketplace. There are only two commercial shippers who compete on the Bass Strait route with limited influence from the Tasmanian Government operated TT Line. (sub. 17, p. 1)

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Ship owners and their representatives see the market as genuinely competitive:

Strong competition exists between the three Bass Strait shipping companies. It also exists between the freight transport providers who use Bass Strait shipping services ... SeaRoad and its competitors all actively compete for volume on both price and service offerings. (SeaRoad, sub. 35, pp. 2, 5)

There is substantial competition between the domestic Bass Strait operators as evidenced by the number of customers who go to tender. Tenders result in either contracts and/or volumes changing from one shipping line to another on a regular basis or an improvement in rates and/or services for the customer. Generally speaking tenders occur once to twice a month with an estimated total annual value of \$10-\$20 million. (SeaRoad, sub. DR100, p. 1)

Shippers' views on the competitiveness of Bass Strait shipping were mixed, with larger shippers reporting some price competition. Simplot commented:

Simplot's significant freight task is sought after by both major shippers, and therefore Simplot is able to perform a competitive tender process. ... Simplot is comfortable with the competitiveness of the Bass Strait Shipping. (sub. 50, p. 3)

However, some users of freight services, for example, smaller shippers or shippers that have specific freight requirements, raised concerns around competitiveness.

Information from the ACCC, which examined this market in 2006, 2009 and 2013 as part of its merger assessments involving Bass Strait shipping and freight forwarding services, also suggests the presence of some effective competition in the Bass Strait shipping market:

- In 2006, it considered the proposed acquisition by Toll of Patrick Corporation, and found that divestiture by Toll of Patrick's Bass Strait shipping operations (subsequently purchased by SeaRoad) would ensure a vigorous and effective competitor to Toll would remain in the market (sub. 28).
- In 2009, it concluded that a proposed joint venture between Toll and ANL would not substantially lessen competition for Bass Strait shipping services. The ACCC considered the joint venture parties were likely to be competitively constrained by the two existing competitors — SeaRoad and TT-Line (sub. 28).
- In 2013, it concluded that a proposed acquisition of Linfox's Trans-Bass Freight Forwarding business by Toll would not substantially lessen competition. In the market for Bass Strait shipping services, it considered the proposed acquisition would not materially affect competition between Toll, SeaRoad and TT-Line or the extent to which SeaRoad and TT-Line would provide an ongoing competitive constraint on Toll (sub. 28).

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The ACCC, however, cautions that its test relates to the lessening of competition, and its merger analysis ‘... is not an analysis of the competitiveness of a market per se’ (sub. 28, p. 4).

On the basis of available information, it is not possible to reach a definitive conclusion on the level of competition across the whole Bass Strait shipping market.

That said, the market is undeniably thin yet dynamic, with imminent and material changes within the industry likely to significantly influence the level of competition.

For example, each of the current Bass Strait shipping operators has expressed intentions to invest in new vessels to service the route. These vessels will be larger than their current ships (in SeaRoad’s case, increasing capacity by up to 50 per cent) and will deliver improved operational efficiency. For example:

SeaRoad’s planned investment in new vessels will expand freight capacity in the Bass Strait market ... The new vessels will be more efficient and economical than existing ships dedicated to the Bass Strait trade. (sub. 35, p. 5)

This SeaRoad investment, if approved by the company and debt financiers, alone would result in a 12.5 per cent increase in capacity on the route.

Simplot considers these new vessels have the potential to introduce a new era of competition across Bass Strait:

... in an environment of limited service providers it is the spare capacity in the market that will support industry price competitiveness. Ship upgrades flagged by both major providers will increase market capacity and promote a competitive environment. (sub. 50, p. 3)

These next generation vessels should lower the cost of shipping across Bass Strait.

Further, if a more frequent direct international container service returns to service Tasmania this would also affect competition in the Bass Strait market. As Agility Logistics noted:

... if we have one [international] shipping line taking a big chunk of that [Bass Strait] freight out and then we have other shipping lines that are currently based here with some of that market share already, the viability of those shipping lines staying here may not be something that they would consider and they may pull out of the Tasmanian market. (trans., p. 373)

Changes to coastal shipping legislation arising from the Government’s foreshadowed review may also affect competition in the industry, for example, by increasing the incentives for foreign ships to include a Tasmanian port call in their voyages.

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The extent to which any lower costs resulting from these anticipated changes are passed on to users via lower freight rates will depend on the level of competition in the market.

Regardless of the competitiveness of the current shipping industry structure, barriers to entry and government ownership of TT-Line may operate to constrain competitive pressures in the Bass Strait shipping market.

### *Barriers to entry*

Barriers to entry may inhibit competition in the Bass Strait shipping market. As Net Sea Freight observed:

It is not a simple matter to enter the Bass Strait shipping trade due to high barriers to entry arising from the need to gain access to ports, the high cost of assets, relatively low and irregular volumes, the high cost of infrastructure, and the need to have the benefit of complete supply chains enjoyed by existing operators, such as the existence of vertically integrated services. (sub. 26, pp. 6–7)

A new shipping entrant would require a significant initial investment in ships and terminal infrastructure. For regular Bass Strait shipping, purpose built vessels are required to meet Bass Strait conditions, on-land infrastructure and the particular nature of the freight task. This introduces the associated risk of this investment not being readily transferable to another shipping route. Combined with low container volumes across Bass Strait, these characteristics represent a market barrier — a significant deterrent for potential entrants.

Other factors are also likely to act as barriers to new Bass Strait shipping operators. Port access has been suggested as a fundamental constraint to new entrants. The inability to secure a permanent berth at the Port of Melbourne was one factor contributing to the 2011 withdrawal of Agility Shipping from the Bass Strait trade (MMC Link 2012). Toll and SeaRoad have both informed the inquiry of the importance of securing berths at the Port of Melbourne when their current leases expire. For example, Toll noted that ‘the renewal of commercially sustainable long-term leases at Webb Dock is a core concern for Toll Group in 2014’ (sub. 55, p. 3).

The Port of Melbourne Corporation is redeveloping Webb Dock (used by Toll and SeaRoad) as an international container handling terminal. It has stated that throughout the project the port will continue to provide ‘the vital freight connections between Tasmania and the mainland’ (Port of Melbourne Corporation 2012a, p. 7).

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While the existing RORO services have dedicated terminal facilities at Tasmanian ports, it is not clear whether new entrants would have difficulty in accessing Tasmanian berths. RDA–Tasmania considers that ‘new entrants may find the process of sharing facilities and infrastructure with established operators challenging’ (sub. 17 Att., p. 24). However, information from TasPorts on berth occupancy suggests that current capacity is underutilised (sub. 30, Att.).

Participants (such as Net Sea Freight) also commented on vertical integration (between freight forwarders and shipping companies) in the Bass Strait freight market as a barrier to shipping entrants.

The ACCC examined the issue of vertical integration in the context of Toll’s acquisition of Linfox’s Trans-Bass Freight Forwarding business and found it imposed no substantial lessening of competition among existing Bass Strait shipping operators (sub. 28). Toll can provide a consolidated service encompassing the Bass Strait route and international services through ANL.

#### *Government ownership of TT-Line*

One of the three main shipping companies carrying freight across Bass Strait is the Tasmanian Government-owned TT-Line. TT-Line accounts for around 21 per cent of the annual volume of non-bulk freight carried across Bass Strait.

Commission estimates based on TT-Line’s annual reports (table 4.3 and box 4.2) indicate that it is generally covering its operating costs but, over the past five years, has not been earning a commercial rate of return. An assessment by the Tasmanian Auditor-General found TT-Line’s return on equity to be below the risk free rate in three of the last four years (table 4.3).

An ongoing failure to achieve a commercial rate of return may suggest that non-commercial activities are contributing to the poor financial performance of TT-Line.

Whether TT-Line is earning a commercial rate of return raises the issue of whether the principles of competitive neutrality are being satisfied. A failure to satisfy these principles can result in a distorted market and perversely act to reduce competition. This is an issue relevant for both the passenger vehicle and freight segments of TT-Line’s business (see also chapter 3).

**Table 4.3 Financial performance of TT-Line**

| <i>Indicators</i>   | <i>Units</i> | <i>2006-07</i> | <i>2007-08</i> | <i>2008-09</i> | <i>2009-10</i> | <i>2010-11</i> | <i>2011-12</i> | <i>2012-13</i> |
|---|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Profit before tax   | \$'000       | 5 103          | 13 422         | 6 379          | -11 696        | 273            | 1 554          | 16 782         |
| Operating profit margin                                     | %            | 4.0            | 7.9            | 4.5            | -5.6           | 0.3            | 0.1            | 8.0            |
| Cost recovery   | %            | 104.2          | 108.6          | 104.7          | 94.7           | 100.3          | 100.1          | 108.7          |
| Return on assets  | %            | 3.2            | 5.2            | 2.9            | -3.0           | 0.7            | 0.6            | 6.4            |
| Return on total equity                                      | %            | 5.7            | 6.3            | -0.2           | -5.8           | -1.2           | 0.1            | 3.6            |
| Auditor General assessment of return on equity <sup>a</sup> | %            | na             | na             | na             | 8.2            | 0.4            | 0.4            | 4.8            |
| 10-year Australian government bond yield <sup>b</sup>       | %            | 5.73           | 5.74           | 5.70           | 5.60           | 5.55           | 5.36           | 5.15           |

<sup>a</sup> Analysis undertaken by the Tasmanian Auditor-General. <sup>b</sup> An historical ten year average of the 10-year Australian Government bond yield.

na Not available

Sources: Commission estimates derived from TT-Line annual reports; PC (2008); RBA (2014); Auditor General (2013).

However, TT-Line was adamant that it operates on a commercial basis and complies with competitive neutrality:

TT-Line rejects the notion that it operates on a non-commercial basis and hence ‘distorts the true market price of shipping’. On the contrary, TT-Line operates on a fully commercial basis. TT-Line fully complies with the policy of Competitive Neutrality, as prescribed by the Office of the Tasmanian Economic Regulator and the Department of Treasury and Finance. (sub. DR84, p. 9)

The Commission notes that TT-Line’s reported profitability, like any business, can be subject to fluctuation due to the treatment of line items such as vessel revaluation or impairment which can have a material impact on reported results.

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#### Box 4.2 Financial performance of Government Trading Enterprises

Profitability indicators provide governments and the community with a means of evaluating how well Government Trading Enterprises (GTEs) are using the assets vested in them.

- Profit before tax — the performance of an entity before income tax is paid.
- Operating profit margin — the surplus (before interest expense and income tax) earned on operating revenue.
- Cost recovery — the ability for an entity to generate adequate revenue to meet operating expenses. A GTE that persistently achieves cost recovery below 100 per cent is unable to fully recover its depreciation and maintenance costs in the long term.
- Return on operating assets — the rate of return earned from operating assets. In order for a GTE to be commercially sustainable, it would need to achieve a rate of return that includes a premium for non-diversifiable risk.
- Return on equity — the rate of return that an entity is providing to shareholders.

The 10-year Australian Government bond rate (on a rolling ten year average basis) is widely used as the risk-free rate of return benchmark. Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that GTEs should be generating returns on assets above the risk-free rate.

*Source:* PC (2008).

A lack of transparency around the financial relationship between the Tasmanian Government and TT-Line makes it difficult to understand TT-Line's commercial performance.

The Tasmanian Government's ownership of TT-Line has been represented as a significant barrier to further private investment and to new entrants in the Bass Strait shipping market (Juturna 2013). According to RDA-Tasmania, the provision of a government-owned service:

... is seen by many industry stakeholders as interventionist and an unwelcome intrusion into the market. The existing shipping providers currently determine their price based on the traditional supply and demand determinants and the inclusion of a government owned service competing with them could potentially distort the true market price of shipping. (sub. 17 Att., p. 29)

Recent reports of TT-Line's plan to introduce a dedicated freight service may deter potential Bass Strait shipping entrants who could expect that TT-Line would compete on an uncommercial basis. However, it is likely to have a more immediate impact on investment planning by the other carriers on this route. The Burnie Chamber of Commerce and Industry commented:

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There can be no justification for the T.T. Line to consider purchasing a freight only vessel to compete with the commercially owned shipping services, nor to leave passengers' vehicles on the wharf so as to take freight. (sub. 57, p. 3)

TT-Line's enabling legislation, *TT-Line Arrangements Act 1993* (Tas), states that:

The principal objective of the Company is to manage and facilitate the operation of a shipping service to and from Tasmania in a manner that is consistent with sound commercial practice. (Sch 1, cl 1)

However, it is not apparent (and not specified in the Act) what the underlying objectives are for government ownership and operation of a shipping service across Bass Strait. In the absence of any explicit objectives, it is difficult to assess whether the operation of TT-Line is achieving those objectives in an effective or efficient manner (see also chapter 3).

Given the effect that TT-Line has on the Bass Strait shipping market, the Tasmanian Government should clearly articulate the case for TT-Line's presence in this market and the implications for future TT-Line investment in increased capacity. Further, and given investment decisions are in prospect by TT-Line and the private sector shipping operators, it is imperative that an independent and public review be undertaken of the extent to which TT-Line satisfies the principles of competitive neutrality.

Government ownership of TT-Line also prompts inquiry about whether this might result in higher economic costs for the services TT-Line provides across Bass Strait.

Empirical evidence generally indicates that private ownership delivers services more efficiently (at lower cost) than does government ownership, although there are many mitigating factors (King 2002; Villalonga 2000). Among these factors, the level of market competition is significant (unless it receives subsidies from its owner, a government-owned business in a competitive market will usually be forced to operate efficiently or perish).

In this regard, TT-Line competes with air travel for passengers, but is effectively a monopoly provider in the passenger/accompanied vehicle market<sup>14</sup> and, by its own admission before the Tasmanian Parliament's business scrutiny commission, primarily operates in a niche freight market, not provided for by Toll and SeaRoad:

TT-Line is very much focused on time-sensitive freight. (O'Byrne 2013, p. 5)

This view was repeated in the Commission's public hearings:

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<sup>14</sup> Toll and SeaRoad have minimal capacity to service this market.

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... they have a particular market segment which they meet which is peculiar ... TT-Line play a significant role in supporting particularly our time-sensitive fresh freight. That is something that Toll and SeaRoad are not able to fully respond to. (Tasmanian Government, trans., p. 453).

This suggests that, at present, TT-Line is somewhat insulated from market pressures (in two of its markets: time-sensitive freight and passenger/accompanied vehicles) that would otherwise sharpen incentives to deliver efficient shipping services.

#### RECOMMENDATION 15

##### *The Tasmanian Government should:*

- *articulate its underlying objectives in owning and operating a freight and passenger/vehicle services business, and assess whether ownership of TT-Line is the most cost-effective way in which to achieve those objectives*
- *initiate an independent and public review of the extent to which TT-Line's freight and passenger/vehicle services business satisfies the principles of competitive neutrality.*

##### *An alternative approach?*

Throughout the inquiry, the Commission raised the question of whether there was merit in considering a potential alternative to the TFES/Bass Strait Passenger Vehicle Equalisation Scheme model — for the Australian and Tasmanian Governments to collectively use their current financial commitments to secure more directly the Bass Strait freight and passenger services they are seeking. A similar approach has been suggested by the National Sea Highway (sub. 54).

The proposal received very limited support in submissions (National Sea Highway, sub. DR102), and some submissions were critical of the idea. SeaRoad, for example, considered such an approach was inappropriate to serve the Bass Strait shipping market:

... the market between the main island of Tasmania and mainland Australia is complex with many types of freight and customers. While there is very limited competition in terms of types of transport on offer (sea versus air), there is strong competition within the incumbent shipping operators. A subsidised service in Bass Strait would discourage non-subsidised competition in the trade with no incentive to improve service. (sub. DR81, p. 2)

Net Sea Freight was also sceptical of the merit of such an approach:

The proposal to replace multiple private and public operators with a single, government-subsidised, monopoly operator appears counter-intuitive to the

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Commission's implicit aim of promoting innovation, increased private sector involvement and enhancing a competitive environment. (sub. DR75, p. 9)

In view of the feedback from participants and practical barriers to implementing it (notably high barriers to entry and the information advantage enjoyed by incumbent shipping lines) the Commission has not considered this issue further.

## **Regulatory environment**

### *Coastal shipping regulation*

As an island state, Tasmania is particularly vulnerable to regulatory changes that increase the cost of engaging in coastal trade (box 4.3). As DIRD noted:

Tasmania's heavy reliance on shipping services means that it is likely to be more sensitive to changes in domestic coastal shipping arrangements ... (sub. 42, p. 12)

From the early 1990s, Australia relaxed its coastal shipping requirements, resulting in a downward trend in coastal shipping costs (Bertho 2011). However, in recent years, changes to the regulations under the Fair Work Act (in 2009) and a package of coastal shipping policy changes introduced in 2012 appear to have reversed that trend. These regulations involve: extending Australian wage rates to workers on foreign flagged vessels inside Australia's Exclusive Economic Zone; new hiring, licensing and registration regimes; and tax concessions to certain Australian vessel owners/operators (appendix C).

The new regulations reduce the commercial attraction for international vessels to engage in the Australian coastal trade. They also increase costs of providing domestic coastal services and reduce the level of competition in Australia's coastal trading network. Further, to the extent this service incorporates the carriage of some domestic cargo, the regulations may also adversely affect the likelihood of a resumption of a direct international container service to Tasmania.

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### Box 4.3 The effects of cabotage on Tasmania

Cabotage can be broadly defined as trade or navigation within coastal waters. Various studies have concluded that cabotage restrictions are more likely to adversely affect Tasmania than other Australian jurisdictions:

Cabotage has meant that the cost of coastal shipping services in Australia has been well above international levels and has worked against the use of sea transport for interstate trade in those areas where Tasmania may be expected to have a competitive advantage. Given Tasmania's reliance on shipping for moving most of its imports and exports, cabotage has had the effect of limiting its capacity to export to both mainland Australia and the rest of the world. (Rae 2002, p. 44)

... 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. These include ... Perpetuating high operating cost structures in Australian coastal shipping ... (PC 2006, sub 34, pp. 2-3)

Of all Australian state and territories, any inefficiencies in national coastal shipping laws impact most strongly on Tasmania — Tasmania's island setting means that any inefficiencies in or a failure to take advantage of all the benefits of Australia's Coastal Trading shipping legislation, which limits coastal trade to Australian-flagged vessels — would impact on the efficiency of Tasmania's freight task far more than in other states, because unlike other states, Tasmanian shippers do not have access to 'substitute' freight service providers on rail or road to overcome any coastal shipping deficiencies. (Juturna 2013, pp. 4–5)

Sources: Juturna (2013), PC (2006b), Rae (2002).

For Tasmania, the regulatory changes of 2009 and 2012 affect two main areas:

- vessels transporting dry and liquid bulk freight under temporary licences must now pay Australian wages for the third and subsequent voyage (and, in some circumstances, hire Australian workers), increasing shipping costs and freight rates in the process
- Australian vessels carrying containerised cargo across Bass Strait (all three shipping lines) are entitled to either an income tax exemption or accelerated depreciation for each vessel they own. The extent to which these benefits pass through to freight rates is unclear.

Further, according to the ACCC:

Additional costs imposed on international lines may affect whether such lines compete in the market for Australian coastal shipping. Where domestic trade represents an international shipping line's marginal business, any additional costs or regulatory requirements ... [on carrying] domestic cargo could act as a general disincentive to entering the domestic shipping market. (sub. 28, p. 6)

This is particularly pertinent for Tasmania, where freight volumes are smaller and the viability of port calls by international lines is more likely to be marginal. In fact,

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evidence suggests there has been a reduction in the number of foreign-flagged dry and liquid bulk vessels calling at Tasmania. The number of voyages fell from a total 239 voyages conducted under single (and urgent single) and continuing voyage permits in 2011-12 to around 198 voyages conducted in 2012-13 (appendix C).<sup>15</sup>

The Commission understands that a significant proportion of Tasmania's liquid bulk cargo is carried under temporary permit. Given the increase in costs associated with the Fair Work Act changes and the additional compliance costs associated with the new licencing regime, it can be expected that freight rates for liquid bulk will increase in Tasmania.

DIRD was circumspect about the effects of the 2012 Coastal Trading Act in particular:

The Department is not aware of evidence that demonstrates a direct link between any increases in freight costs and the introduction of the new coastal trading legislation ... (sub. 42, p. 12)

However, DIRD (and others) acknowledged the high costs faced by Australian flagged vessels:

... Australian flagged ships are faced with a more expensive cost structure than their foreign flagged counterparts, primarily due to higher wage rates through enterprise agreements, higher Australian insurance costs and bunkers (fuel) at Australian prices. (sub. 42, p. 12)

While the exact nature of their impact is uncertain, some participants argued that the coastal shipping regulation changes were an important factor in increasing shipping costs for Tasmanian businesses. For example, participants noted:

Following introduction of the Coastal Trading Act 2012, BBA faced increased costs from \$18.20 a tonne in 2011 to \$29.70 in 2012, or 63 per cent. This compared with \$17.50 a tonne charged by international operators in 2012. (BBA, sub. 12, p. 3)

The new licensing arrangements have led to greatly reduced shipping options and competition in the market and an associated increase in the cost of shipping. (Australian Aluminium Council, sub. 10, p. 2)

Since the 2012 legislation was introduced, there is evidence that the costs associated with using coastal shipping services across Australia (including routes to and from Tasmania) have risen. One company has experienced a 63 per cent increase in shipping costs to Tasmania. Another company estimates an additional 1000 hours of labour annually are required to administer the new scheme. (BCA, sub. 47, p. 1)

The changes to the Fair Work Act ... directly added \$150 000 to Simplot's Tasmania to Fremantle route. In addition the omission of coastal bookings on certain vessels creates

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<sup>15</sup> Some of this difference may be explained by ships operating under transitional general licences.

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a lumpy supply chain, excess wharf power charges and additional charges to use alternative methods to re-supply WA (i.e. train or road). (Simplot, sub. 50, p. 5)

However, the Maritime Union of Australia (MUA), was critical of these claims, and questioned whether they were due to the 2012 changes (sub. DR89, p. 14).

There is also some indication that the regulatory changes have adversely affected cruise ship operators who wish to call at Tasmanian ports. A Ministerial Exemption allows cruise vessels over 5000 gross tonnes capable of at least 15 knots, and carrying more than 100 passengers to be exempt from the Coastal Trading Act, with the exception of those travelling between Tasmania and Victoria. Some participants drew attention to the costs this exemption imposed on expedition vessels under the 5000 gross tonne threshold that wish to operate along the Australian coast and the significant cost associated with incorporating a stop in Tasmania:

... we have no plans to return to Tasmania in the foreseeable future which is driven by two main issues.

1. Australian Cabotage laws (Coastal Trading)
2. The cost of Ports in Tasmania (APT, sub. 11, p. 1)

The Coastal Trading Act (the Act) is currently having a negative impact on expedition cruise shipping costs, acting as a barrier to foreign flagged operators wishing to include Tasmania on domestic itineraries that commence from another Australian port. (Austrade, sub. 41, p. 7)

Further, by excluding journeys between Tasmania and Victoria from the Ministerial Exemption, this effectively only benefits TT-Line as an Australian-flagged vessel by restricting the potential for competition from other cruise vessels.

The impact of the 2012 shipping reforms on the Australian economy more broadly are thought to be significant. For example, the Cement Industry Foundation noted:

The CIF is concerned that these reforms have numerous unintended consequences. For example, heavily protected coastal shipping routes will become even less competitive against international shipping leading to an outcome that negatively impacts on the competitiveness of Australian dry bulk shipping users, including cement and clinker, which will in turn lead to a reduced demand for coastal shipping services. (sub. DR83, p. 2)

The then Australian Department of Infrastructure and Transport has previously estimated that the changes associated with the Coastal Trading Act could cost the Australian economy as much as \$202 million in net present value terms over 20 years (DIT 2011). In addition, the tax incentives are likely to cost the Australian Government around \$70 million a year in forgone revenue (Swan 2012), and the more the objectives of the policy changes are realised, the more they would cost Australia overall (DIT 2011).

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In addition, the Regulatory Impact Statement (RIS) that found a net benefit to Australia from the 2012 changes (and so informed the parliamentary consideration and decision to introduce them) appears flawed. That RIS assumed substantial benefits would flow from a productivity compact with the maritime unions and would be sufficient to offset costs otherwise associated with the licensing and taxation reforms. These assumed benefits included a reduction in crewing numbers, fewer days per year in dry dock due to maintenance work being undertaken by riding gangs and lower accommodation standards on new ships (DIT 2011).

Importantly, the Commission heard evidence that the RIS was prepared and submitted to the Government and Parliament prior to the preparation of the compact:

... the compact being completed after the RIS was completed. There were a number of assumptions made [in the RIS] that subsequently the compact actually reviewed ... I think people know things now that weren't known at the time the RIS was actually undertaken. (DIRD, trans., p. 479)

... the regulatory impacts statement made some assumptions based on the analysis of what was intended in the compact which ultimately transpired. They didn't have the benefit of the compact at that stage. (MUA, trans., p. 49)

The compact does not provide for any definitive productivity improvements rather it provides a process to consider and negotiate potential improvements:

... [the compact] is premised on the need for continuous improvement in, if you like, labour utilisation. (MUA, trans., p. 48)

Further, the compact has yet to deliver on its RIS assumed benefits. For example, crewing levels were expected to fall significantly from an average of about 18, but this has not yet eventuated, and comments from the MUA suggest such reductions are unlikely:

... the average crewing level on Australian coastal trading vessels is already 17 ... and on some vessels down to 16. This is world's best practice crewing for the vessel classes. (sub. DR89, p. 16)

Nonetheless, the MUA stated that crewing requirements are under review:

... the MUA is deep in negotiations with Rio Tinto and its crewing agents for a restructure of the crewing complement on the Rio Tinto bauxite vessels servicing the aluminium industry. Once concluded, the new standard is expected to be trialled and introduced on a range of other like vessels. (sub. DR89, p. 16)

The MUA also noted that a current set of negotiations with an employer was expected to deliver significant operational savings. For these negotiations (which include the restructure of the crew complement and better labour utilisation of crewing) the employer has a cost reduction target per ship per year of \$675 000.

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The MUA observed that if this target is achieved and if replicated across the Australian coastal fleet, this would deliver an annual reduction in costs of about \$13.5 million (sub. DR89, p. 17).

While these productivity benefits will be welcomed if and when they occur, they are unlikely to be of sufficient magnitude to offset the costs associated with the licensing and taxation reforms. Further, a commitment to undertake public reporting to industry in relation to the outcomes of the compact has not been met (DIRD, trans., p. 478). Accordingly, the RIS based justification for the 2012 changes is questionable.

Deputy Prime Minister Warren Truss has recently foreshadowed a review of the coastal shipping arrangements:

... I am determined to put the current system under the microscope to streamline processes and foster a vibrant and sustainable shipping industry in Australia. This will include looking at the eligibility requirements around the Temporary licence application process and applications for a variation to a permit. (Truss 2013)

DIRD also drew attention to that proposed review:

The coastal trading regulatory framework is currently being reviewed as part of the Government's broader commitment to reducing the burden of excessive red tape on the Australian economy. (sub. 42, p. 12)

In view of the higher shipping costs evident in Tasmania, the likely broader impacts on Australian businesses generally, and concern about the integrity of the RIS, the Commission recommended in its draft report that the foreshadowed review of coastal shipping be expedited with the objective of increasing the competitiveness of Australia's coastal shipping.

This recommendation received widespread and strong support from inquiry participants. For example:

Mondelez International fully supports a review of coastal shipping regulation. ... It is particularly critical that such a review understands and considers the unique geographical impact on commercial enterprises in Tasmania. (Mondelez, sub. DR98, p. 5)

Simplot strongly agree with the draft report recommendation to immediately review all Coastal Shipping legislation and impact of the Fair Work act on coastal shipping. (Simplot, sub. DR96, p. 5)

We would also like to commend the Productivity Commission's support for the Federal Government's review of Coastal Shipping Regulation as soon as possible ... (Norske Skog, sub. DR67, p. 5)

Removal of coastal shipping restrictions (cabotage) would be strongly supported by Veolia. Veolia believe that the removal of such coastal shipping regulations would

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provide an incentive for international shipping lines to return. (Veolia, sub. DR103, p. 3)

A number of participants have also suggested areas where changes to the regulations are required.

The MUA, for example, raised concerns with the operation of the changes to the Coastal Trading Act (sub. 32, pp. 4–5). At the public hearings, the MUA stated:

... we have no difficulties with a further review, subject to the terms of reference of course, but the review could be a very useful exercise to address some of the unintended consequences of the legislative framework that was introduced in 2012 and also to clarify some ambiguities and flaws in the legislation. (trans., p. 41)

In particular, the MUA noted that the provision allowing the Minister (or Minister's delegate) to consider commercial matters such as freight rates is unwarranted. It argued that this provision '... must be amended to restrict consideration of freight rates by the Minister (Minister's delegate)' (sub. 32, p. 5).

The Business Council of Australia (BCA) suggested immediate changes to the regulations including:

- abolish the requirement of five voyages for a temporary licence and extend the 12-month temporary licence period
- license the entire consignment to cover all ports used by the vessel while unloading the consignment, instead of requiring each port visited to be specified
- reduce information requirement in forms and reporting to the minimum specified in legislation. (sub. 47, pp. 1–2)

The Australian Shipowners' Association also nominated areas for change, including:

- temporary Licence voyages should not be subject to Australian pay rates
- reduce red tape by removing the 5 voyage minimum for Temporary Licence applicants
- introduce an 'express' Temporary Licence in certain circumstances. (sub. 29, p. 3)

Austrade proposed that the threshold for Ministerial Exemption for cruise ships be lowered to 500 gross tonnes (a proposal supported by Cruise Down Under, sub. DR72):

Granting expedition cruise ships weighing between 500 and 5000 gross tonnes the same freedom to operate as larger cruise vessels will increase tourism expenditure, deliver economic benefits across Tasmania, and help the Australian Government achieve its broader policy objectives. (sub. 41, p. 8)

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Some participants called for more wholesale changes, including addressing the impact of cabotage generally. The Institute of Public Affairs, for example, commented:

... tinkering around of the edges ... will still not deliver cheap, efficient transport for Tasmania. We say that the best results ... would be simply to remove any cabotage laws in Australia with respect to coastal shipping. (trans., p. 19)

Some participants called for immediate regulatory changes that would provide specific targeted relief from coastal trading regulation for Tasmania. For example, BBA suggested:

... there is an option which has not been considered in the current recommendations. That is, should there be a 'Tasmanian exclusion zone' from legislation such as the Coastal Trading Act, which would have the potential to benefit every Tasmanian business/person who relies on sea transport? This could be in addition to broader reforms of the Coastal Trading Act at a Federal level. (sub. DR77, p. 1)

The Commission considers that the greatest ongoing benefit for Tasmania would be through realising the efficiencies associated with a more liberalised coastal trading regime Australia-wide. For example, it would enable an international service to Tasmania to supplement its services with other coastal stops around Australia, potentially increasing its commercial viability and sustainability.

The Commission therefore considers that the review should have a broad scope to examine all regulations that impact upon coastal shipping, including an assessment of the current approach to cabotage in Australia. The assessment should also include consideration of the arrangements for cruise vessels as identified in this inquiry. At a minimum, it should identify and remove any anticompetitive provisions from legislation, unless a robust and transparent case can be demonstrated that they deliver a net benefit.

#### RECOMMENDATION 1

***The Australian Government should proceed with the foreshadowed review of coastal shipping regulation (including cabotage) as a matter of priority. The objective of the review should be to achieve the most efficient coastal shipping services feasible for Australia.***

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### 4.3 Key features of Tasmanian ports

Port costs generally constitute a relatively small share of the cost of shipping across Bass Strait, although they can be significant for some users (Nyrstar, sub. DR105). On this issue, TasPorts noted:

The fixed port costs in a round-trip voyage (e.g. the fixed port costs would be a combination of costs in Burnie and Melbourne for a Bass Strait container vessel voyage) are estimated to encompass only 5% of that total amount. (TasPorts, sub. 30, p. 1)

Although freight shipped to and from Tasmania also incurs other, variable port costs — such as wharfage and the Port of Melbourne port license fee (SeaRoad, sub. DR89) — these would also generally represent a relatively small share of the total supply chain costs.<sup>16</sup>

Accordingly, the potential for port efficiency improvements to directly reduce shippers' costs is commensurately modest. However, as ports are an integral link between shipping and land freight, inefficiencies in the port system can significantly hinder the optimal functioning of the logistics chain and, thus, have cost implications beyond those otherwise suggested by the direct share of supply chain costs (see earlier discussion of access to berths).

While Tasmania is served by a large number of ports (figure 4.3), the main ports are Bell Bay, Burnie, Devonport and Hobart. The majority of freight and virtually all regular sea passenger travel to and from Tasmania flows through the northern ports of Bell Bay, Burnie and Devonport, while Hobart is largely focused on cruise ships and Antarctic operations.

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<sup>16</sup> As an indication of this, BITRE has estimated the median total door to door cost for TFES claims is around \$1800 per TEU.

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Figure 4.3 The 12 ports managed by TasPorts

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Source: TasPorts (2012a).

The characteristics of the three main northern ports are described in table 4.4. For these ports the Tasmanian Government has a strategy of ‘one port, three locations’.

**Table 4.4 Characteristics of Tasmania's northern ports**

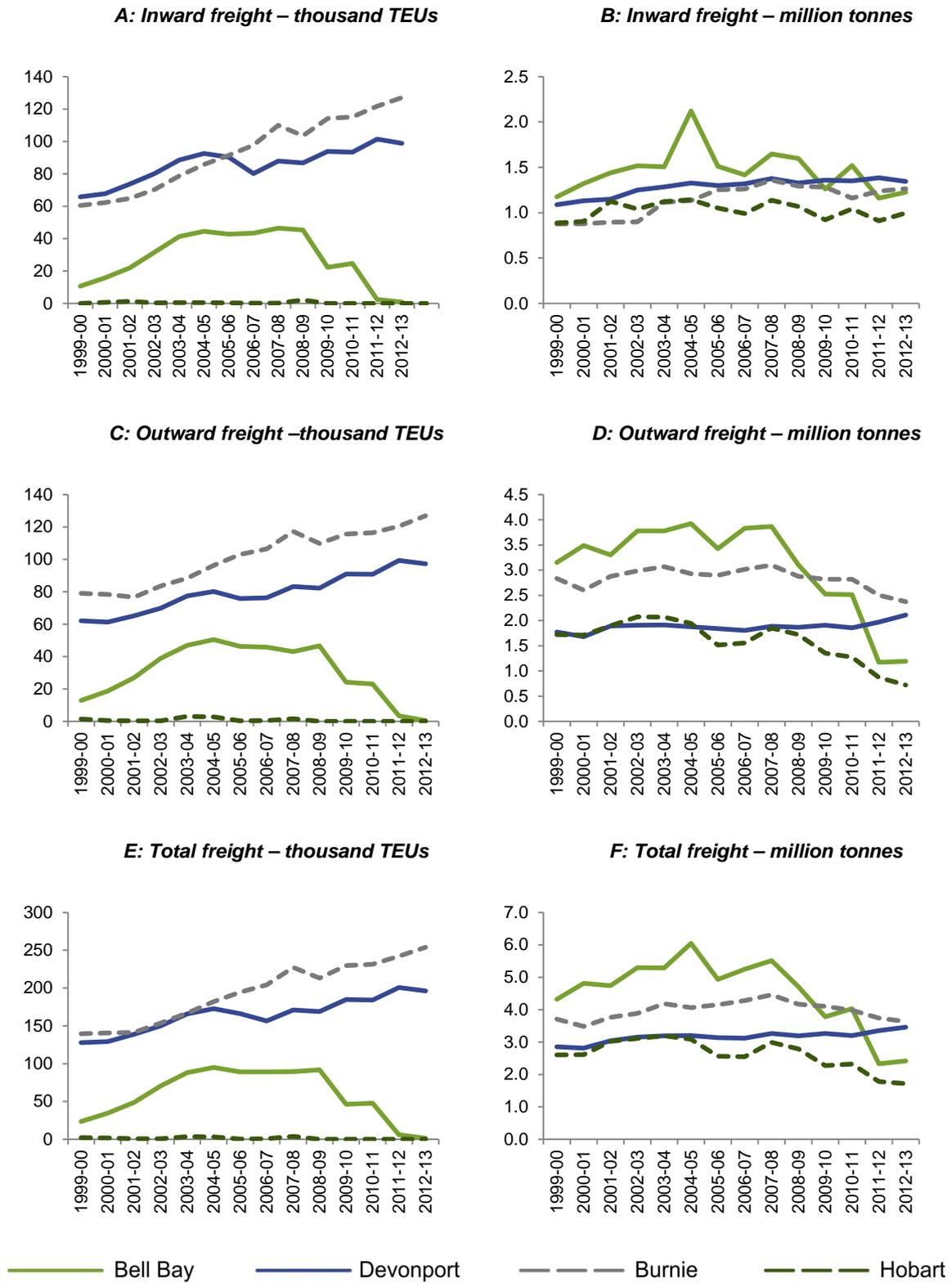
|                          | <i>Devonport</i>  | <i>Burnie</i>       | <i>Bell Bay</i>  |
|--------------------------|---|---------------------|--|
| Operators                | TT-Line and SeaRoad, as well as Cement Australia and Origin Energy  | Toll and bulk ships | Not used at present for domestic Bass Strait freight<br>Used by international service and bulk ships   |
| Position of port         | Port straddles the Mersey river with the west bank for bulk goods and east bank for containers and passengers | On the north coast  | Along the Tamar river  |
| Distance from sea        | Approximately 1.5 nm from river entrance  | On the sea          | Approximately 9.0 nm from river entrance   |
| Navigational issues      | Turning basin of 300m in river; vessel length limited to 205m due to width of river                           | No issues           | Turning basin in river and sharp turns in the river make navigation difficult; length limited to 250m. |
| Depth of channel         | 9.2m  | 10m                 | Greater than 12m   |
| Dredged depth at berth   | 6.7m TT-Line (berth 1E)<br>8.6m SeaRoad (berth 2E)  | 10.5m (berth 4)     | 12m (berth 5)  |
| Available terminal space | TT-Line: 2 ha<br>SeaRoad: 7 ha  | 6 Ha                | 7 Ha   |

Source: Aurecon (2013b).

The throughput of the four major ports is shown in figure 4.4. In 2012-13, the total throughput (including empty containers) of Tasmania's three northern ports was around 451 000 TEUs, of which Burnie accounted for around 56 per cent. This may be compared with the current volume (full and empty) going through Flinders Ports' Adelaide Container Terminal of just under 350 000 TEUs (ACCC 2013).<sup>17</sup> Over the past five years, the total volume of container freight through Burnie and Devonport has increased while volumes through Bell Bay and Hobart have declined.

<sup>17</sup> Flinders Ports was privatised by the South Australian Government in 2001 and operates seven ports, including Port of Adelaide.

**Figure 4.4 Freight movements through Tasmania's main ports**



Data source: TasPorts (2013).

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TasPorts, a government-owned enterprise, is responsible for the management of 12 Tasmanian ports, including the four major ports. The port system had historically been operated by independent port corporations — four were remaining in 2005. Several studies over the past two decades identified benefits from moving to one statewide port entity, culminating in the passage of the *Tasmanian Ports Corporation Act 2005* (Tas), creating TasPorts. On 1 January 2006, all assets, liabilities and employees of the former port corporations passed to the new entity (Auditor-General 2012).

The Bass Strait RORO and ROPAX services operate their own dedicated terminals at the northern ports, while other terminals are operated on a ‘community user’ basis. SeaRoad and Toll have provided and funded their own infrastructure on terminals leased from TasPorts (SeaRoad, sub. DR81).

#### **4.4 Efficiency drivers of ports**

Participants expressed concerns about port costs in Tasmania. BBA was particularly critical, claiming:

Port of Bell Bay costs are higher than other ports when comparing the same size and type of ship and reason for the port call. ... For example, for coastal alumina shipments between Gladstone and Tasmania, BBA pay the following port costs in their freight rate:

- Gladstone Port costs ~A\$38 000 versus
- Port of Bell Bay costs ~A\$107 000. (sub. 12, pp. 5, 6)

At Tasmania’s main freight ports, three factors appear to be of particular importance in determining the scope for those ports to operate more efficiently: scale of operations, adequacy of infrastructure and government ownership.

Participants also expressed concern about increased costs at the Port of Melbourne, arising from the recently introduced Port Licence Fee.

#### **Scale of port operations**

As with shipping, volume (or the scale of throughput in the case of ports) is a major factor affecting port efficiency.<sup>18</sup>

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<sup>18</sup> Efficiency and productivity of ports is often captured in measures such as average container turnaround time, the number of containers a dockside crane lifts on or off a container ship in an hour, and the rate at which the ship is unloaded (BITRE 2013d).

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It is generally accepted that there are economies of scale in the operation of ports. The efficiencies available to a larger operator, typically in terms of management and coordination of workforce and equipment, may not be available to ports operated on a smaller scale. In fact, economies of scale have been found to be a more significant factor in market entry and exit than the associated costs (ACCC 2013).

Related to economies of scale is the concept of a minimum efficient scale (MES) of operations at ports (box 4.4). This is the point at which the average costs fall to the efficient level, and implies that port operations must be of a sufficient size to operate most efficiently. For container terminals, recent analysis suggests it could be in the region of 0.5–1 million TEUs (ESC 2007). In 2008, the ACCC investigated the minimum total volume of container traffic that would be required to justify investment in a second terminal on a greenfield site. Market inquiries suggested a minimum total volume of approximately 550 000 TEUs per annum, though a number of submissions suggested that 600 000 TEUs per year was a more realistic threshold for new entry at Port Adelaide (ACCC 2008a).

However, there is no consensus on a uniform MES across all ports, and no consensus on the MES for Tasmanian ports.

**Box 4.4 Minimum efficient scale at Australian container ports**

An analysis of the Port of Melbourne in 2007 suggested that the market would be sufficient to support a third terminal once throughput reached 2.8 million TEUs (ESC 2007). While in Sydney, a third terminal was deemed appropriate when throughput reached 1.784 million TEUs. In Brisbane, a third terminal was approved in 2008, when the Port of Brisbane's throughput was 943 000 TEUs (Kaselimi et al. 2011).

*Sources:* ESC (2007), Kaselimi et al. (2011).

Given Tasmania's relatively low freight flows, and those flows being spread across three terminals, Tasmanian ports have been limited in their ability to achieve economies of scale (Infrastructure Australia 2012b; Juturna 2013).

According to Infrastructure Australia (2012b), subscale operations and fragmentation of the freight task across ports has likely had a negative impact on the competitiveness of Tasmanian business and the Tasmanian economy generally.

Similarly, lower levels of throughput reduce the potential for competitive stevedore services to develop at terminals. While three terminal competitors can theoretically be a significant enabler of port competition (as is occurring at several mainland ports), without adequate scale, multiple port operators are unlikely to be viable. For

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example, Kaselimi et al. (2011) have suggested that viable competition between terminals is only thought to be possible where the market size is at least twice as large as the MES for providing terminal services. If not, scale economies are only realised with one supplier of port services.

Given the advantages that come from greater scale at ports, there may be scope to increase efficiency through rationalisation and increasing the volume of port throughput.

The Commission understands that a strategy of terminal specialisation will be part of the 30 Year Plan currently under development by TasPorts. TasPorts has noted:

The specialisation approach aims to limit duplicating infrastructure at multiple ports, while still maintaining viable and economic supply chains from point-of-origin to destination market. Where a commodity group can achieve an economy of scale, as in the container segment, the port specialisation will be directed towards a single port set of infrastructure for that commodity. In the short term, this approach must also be cognisant of the commercial arrangements that some industry operators have in place. (sub. DR97, pp. 2–3)

This approach is likely to bring some consolidation of freight services, although the extent to which it will achieve economies of scale is currently unknown.

## **Adequacy of port infrastructure**

Recent reports have identified ageing and inadequate infrastructure as a problem for Tasmanian ports; acting as a bottleneck to capacity and limiting their ability to deliver cost-effective port services. The Tasmanian Freight Logistics Council, for example, suggests that Tasmanian ports already have capacity constraints on their land side operations and that physical capacity limits will be reached in the near term (TFLC 2013, p. 10). Similarly, RDA–Tasmania drew attention to ‘Ageing Infrastructure at multiple port facilities that are small and specialist’ (sub. 17, p. 3).

Not all infrastructure at Tasmania’s major ports is old or inadequate though. As Toll noted:

Our dedicated terminals at ... McGaw Wharf in Burnie utilise cutting edge RORO cargo handling technology to efficiently handle all cargo types. (sub. 55, p. 1)

For international shipping services, infrastructure deficiencies (particularly in channel depths) can mean vessels are physically unable to call into a port. A global trend to larger container ships (box 4.5), even for regional international shipping lines, means Tasmanian ports will increasingly face the need to upgrade their infrastructure if they are to attract and retain an international container service:

By Australian and worldwide standards, Tasmania’s potential international container ports ... all face challenges with regard to access and infrastructure. Bell Bay has potentially the best opportunity to support an international service; however there are many issues such as tidal constraints, suitable crannage and berth length which would impact on an international shipping line or consortium considering a call into Tasmania. (GPS 2013, p. 2)

**Box 4.5 Global trend to larger container vessels**

Annual reviews of maritime transport reveal that container vessels are getting larger (UNCTAD 2012). In part, this trend to larger vessels is a consequence of the widening and deepening of the Panama Canal, to allow the passage of bigger vessels:

... the ... plan to widen and deepen the Panama Canal will have a significant impact on the global trading patterns of the current containership fleet and will most likely create a spurt in new building activity in the 5000–12 000 TEU size range with the existing class of 4000-4500 TEU Panamax containerships and 60 000–70 000 dwt bulk carriers cascading down to minor and newly developing trades. (Meyrick and Associates 2007, p. 37)

In Australia, that trend is supported by local factors:

... analyses we have performed for various port authorities suggests that the average and maximum containership sizes deployed on Australian trades will rise within 20 years from a current average of 2700 TEU and maximum of 4100 TEU to a future average of around 4500 TEU and maximum of around 6000 TEU. (Meyrick and Associates 2007, p. 40)

... the maximum size of containerships is expected to increase from the current 4100 TEU to around 6000 TEU after completion of the planned Melbourne channel deepening in 2010. (Meyrick and Associates 2007, p. 48)

Sources: UNCTAD (2012), Meyrick and Associates (2007).

An Infrastructure Australia report highlighted channel depths at Tasmania’s northern ports (table 4.5) as a major obstacle to attracting direct international shipping services given that, in the future, navigation channels will need to cater to vessels with a draught of 12–13 metres (GPS 2013). That report also noted that the cost to address this deficiency would be prohibitive (Infrastructure Australia 2012b). The ports at King Island and the Furneaux Group of islands face more acute physical constraint issues (box 4.6).

**Table 4.5 Channel depths at Tasmania’s main ports**

| <i>Port</i> | <i>Channel depth</i> |
|-------------|----------------------|
| Bell Bay    | 10.8 m               |
| Burnie      | 9.4 to 10.0 m        |
| Devonport   | 9.4 to 10.0 m        |
| Hobart      | 12.5 to 13.7 m       |

Source: Infrastructure Australia (2012b), citing TasPorts.

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The physical constraints inherent in Tasmania's northern ports (where channel depths and other restrictions impose a draught limit of around 12 metres and a vessel length of 265 metres) are likely to be too costly to address, or face intractable environmental hurdles. If this proves so, then port access will be limited to 3000-4000 TEU vessels, which will only be adequate for the domestic Bass Strait trade.

**Box 4.6 Port infrastructure at King Island and the Furneaux Group of islands**

Ports are central to industry and the communities on King and Furneaux Group of islands. In 2012-13, there were 92 ship calls at King Island, with a freight task of around 8110 TEUs (TasPorts, sub. 30, p. 2).

As the Flinders Council states:

Having a modern port facility to ensure the proper handling of goods and livestock, while maximising efficiencies in stevedoring are essential to the economic future of Flinders Island. (sub. 23, p. 3)

Both the King and Flinders Island ports have size restrictions. Currently, the existing volume is easily serviced by the current vessels operating from these ports (TasPorts, sub. 30, p. 4).

However, there is concern that future increases in vessel size may put a sea freight service to the islands at risk. The TFGA — King Island Branch commented:

There are limitations with the Grassy Port around ship length and depth of harbour with regard to a potential replacement ship. (TFGA — King Island Branch, sub. 8, p. 3)

This is an issue facing many smaller ports in Australia (such as Adelaide) and around the world, as international shipping moves towards a hub and spoke model, with fewer, larger hubs and larger ships serving them. As ANL commented in regard to Tasmanian ports:

These container ports are very small by world standards and the dilemma facing small ports the world over is the increasing size of container ships ... The issue for the smaller ports is having enough throughput for a big and more expensive (in overall daily cost) vessel calling direct and having the necessary infrastructure to service them in terms of draft, berths and number of quay cranes. (sub. 33, p. 4)

According to TasPorts, however, some northern ports are still capable of handling international vessels, and it does seem likely that Tasmanian port infrastructure is not the main impediment to international shipping operations:

TasPorts has assessed the capability of Burnie and Bell Bay ports to accommodate calls by international container ships currently serving the Australian market. With berth parameters of 280 ML (at Burnie) and 265 ML (at Bell Bay), Tasports' infrastructure

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could handle in excess of 50 % of container vessels calling at Melbourne within the current channel, berth depth and quay length parameters. (sub. 30, p. 4)

Addressing infrastructure deficiencies is essential if Tasmanian ports are to cope with the freight task required of them and deliver more efficient port services. However, being able to do this is closely linked to the issue of scale — greater throughput can provide justification for investments needed to overcome capacity bottlenecks and improve infrastructure efficiency — and issues around ownership of the port system. As such, infrastructure investment implications would need to be considered in any strategy for port rationalisation.

As noted, TasPorts is developing a 30 Year Plan which scopes future need for the ports in Tasmania:

The strategy is based on an incremental infrastructure plan, the benefits of which include building capacity as required, avoiding duplications and maintaining the ability to flexibly manage ongoing pressures and potential innovations. (sub. 30, p. 5)

The FLCT (2013a) has suggested that incremental investment in port infrastructure at Burnie would provide sufficient capacity to handle growth in volume. The main port related recommendations of the FLCT are outlined in box 4.7.

**Box 4.7 FLCT port recommendations**

The final report of the FLCT made a series of recommendations regarding Tasmanian ports and the Port of Melbourne:

- Port development is critical for Tasmania and should be progressed on the following basis:
  - Formalise a long-term port strategy that recognises Burnie Port as Tasmania's principal domestic container port in the medium to long term, based on potential for deep water expansion, closest sea travel time to Melbourne, the ability to develop at comparatively lower cost and alignment with land transport networks.
  - Ensure investment in other ports is targeted to meet specific freight needs, with no investment in duplicated functions.
  - Formalise an involvement by the Tasmanian Government with the Victorian Government in Port Planning that recognises Tasmania is a significant customer of the Port of Melbourne.

*Source:* FLCT (2013a).

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## Port ownership

Most Tasmanian ports are owned and managed by TasPorts, a government business enterprise. This contrasts with most mainland capital city ports which have been privatised — the Port of Melbourne is the only remaining mainland capital city port still government-owned (van Duyn 2013).

Ports have also generally adopted a landlord model, separating ownership of the port from the operation of services such as stevedoring and towage. Under this model, investment decisions at terminals should be driven by core commercial imperatives. In Tasmania, TasPorts provides towage and pilotage as well as ownership of the ports (SeaRoad, DR81).

In Tasmania, the three Bass Strait shipping companies use dedicated terminals under long term leases. The Commission understands that this has facilitated significant private investment in infrastructure at these terminals. It has also prompted some private investment in land transport infrastructure, including a tripartite project between TasPorts, TasRail and Toll to redevelop the Burnie rail yard and improve access to the Toll terminal (DIER 2013b).

That said, government involvement in the port system introduces the risk of weaker incentives for effective management of assets compared to private sector businesses (PC 2008). Studies indicate that private sector involvement in infrastructure provision more generally can deliver savings, for example of around 22 per cent in the design and build phase under a public private partnership model (Mercer 2011).

The TasPorts Members Statement of Expectations sets out the principal commercial objective of TasPorts as:

- be a successful company by operating in accordance with sound commercial practice and as efficiently as possible
- achieve a sustainable commercial rate of return in accordance with its corporate plan, having regard to the social and economic objectives of the State, as agreed in writing with the Members (TasPorts 2012b, p. 2).

An assessment of the financial performance of TasPorts indicates that it is not making a commercial return and in the past two years did not recover operating costs (table 4.6). The rate of return on equity, for example, is significantly below the risk-free rate of return.

**Table 4.6 Financial Performance of TasPorts**

| <i>Indicators</i>                                     | <i>Units</i> | <i>2008-09</i> | <i>2009-10</i> | <i>2010-11</i> | <i>2011-12</i> | <i>2012-13</i> |
|---|--------------|----------------|----------------|----------------|----------------|----------------|
| Profit before tax                                     | \$'000       | 7 604.0        | 1 483.7        | 34.2           | -7 713.0       | -1 334.8       |
| Operating profit margin                               | %            | 8.2            | 3.0            | 0.0            | -9.0           | -0.9           |
| Cost recovery   | %            | 108.9          | 103.0          | 100.0          | 91.7           | 99.1           |
| Return on assets                                      | %            | 5.4            | 1.7            | 0.8            | -2.7           | 0.1            |
| Return on total equity                                | %            | 4.1            | 1.7            | 0.2            | -2.4           | -0.4           |
| 10-year Australian government bond yield <sup>a</sup> | %            | 5.70           | 5.60           | 5.55           | 5.36           | 5.15           |

<sup>a</sup> An historical ten year average of the 10-year Australian Government bond yield.

Sources: Commission estimates, based on TasPorts annual reports; PC (2008); RBA (2014).

The Tasmanian Auditor-General reached a similar conclusion:

- While financial performance improved, Tasports' average operating margin over the past four years was still under our benchmark.
- Return on assets and return on equity ratios were well below what would be regarded as commercial returns (Auditor-General 2013, p. 122).

Although the Auditor-General also observed:

'... Tasports' performance has been reasonable in the context of the economic decline and other structural changes to the Tasmanian economy and [the combined ports' financial performance] would probably have been worse if no amalgamation had occurred.' (TasPorts, sub. DR97, p. 1)

Factors outside TasPorts' control appear to explain much of its poor performance. The structural changes cited by the Auditor-General, for example, have resulted in major reductions in woodchip exports (and associated port revenues) (TasPorts 2012a).

In addition, long term lease arrangements inherited by TasPorts on its formation limit its ability to increase lessee charges. As the Launceston Chamber of Commerce noted:

... prior to the formation of Tasports, the Burnie Port authority provided a major volume discount to the private container operators using the port at that time. This arrangement has at least another 10+ years to run ... (sub. DR70, p. 2)

Further, inadequate or ageing port infrastructure and a lack of investment in new infrastructure have also contributed to poor performance, although these were also problems evident prior to port amalgamation and were inherited by TasPorts (Juturna 2013). TasPorts indicated it is taking steps to address the legacy infrastructure problem:

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Our recent financial performance is a direct result of a shareholder endorsed strategy to increase investment in the remediation and renewal of wharf assets and infrastructure. Since 2010 Tasports has increased its expenditure in maintenance of priority assets by 166% and this will continue in the short to medium term. (sub. DR97, p. 1)

Major port users have also shown a willingness to invest in the infrastructure needed to support their operations or alternative use developments (facilitated by the security of tenor from long term leases):

It should also be noted that both SeaRoad and Toll have provided and funded their own infrastructure on terminals leased from TasPorts. (SeaRoad, sub. DR81, p. 18)

... the recently announced alternate-use development plan at Macquarie No.1 in Hobart will be supported by a long-term lease to the VOS Group. (TasPorts, sub. DR97, p. 1)

In addition, TasPorts has been rationalising some assets through partial privatisation and divestment:

... local privatisation within port areas is a feature with examples including the Bell Bay Aluminium terminal in Bell Bay and the Nyrstar terminal in Hobart. ... Targeted divestment of port assets has also occurred since amalgamation ... (TasPorts, sub. DR97, p. 1)

There are, however, factors within TasPorts' control that are likely to be contributing to its poor performance: a deliberate policy to pursue some non-commercial activities and a policy of statewide uniform pricing.

TasPorts has been undertaking some activities that are clearly non-commercial. For example, the TasPorts chairman has stated:

When we did the business case on [Macquarie Wharf 2] it did not meet the commercial benchmark. We set a rate of return for investment, so just looking at it from a purely commercial basis you would say it would be fairly marginal but the board considered, in the broader context of the contribution that that facility would make beyond the revenue that we get in the tourism industry. We spoke to our owners and said, 'This is what we propose to do. It's not strictly a commercial investment but we are disposed to do it. Tell us if you have a problem with that'. They were comfortable with what we did. (Norton 2013, pp. 10–11)

Further, TasPorts has identified other non-commercial activities it undertakes:

Tasports does have carriage of a number of community based assets which are non-commercial in nature and therefore do not generate sustainable revenue to cover essential operating costs. However it is imperative that they are maintained for the safety of the public as well as to assist industries such as tourism within the state. (sub. DR97, p. 3)

While this makes clear that TasPorts considers it has an obligation to pursue such non-commercial activities for the greater benefit of the community, the Tasmanian

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Government has not explicitly directed TasPorts to do so nor provided it with an explicit community service obligation<sup>19</sup> payment to reimburse it for meeting non-commercial objectives. (TasPorts 2012b).

TasPorts' statewide pricing strategy may also be contributing to its poor financial performance. Under the Members' Statement of Expectation, TasPorts is expected to set prices, fees and charges that:

- meet the objectives of efficiency, and financial sustainability
- represent fair value to its customers
- to the extent possible, move towards a commercial return on assets employed as set out in the annual Statement of Corporate Intent (TasPorts 2012b, p. 5).

A uniform pricing policy across disparate ports is unlikely to be efficient. Further the observed under-recovery of TasPorts' costs (table 4.6) indicates it may not be charging users the full cost of services it provides. Below-cost pricing would reduce future profitability of TasPorts and exacerbate a cycle of poor profitability and poor capital management. Some participants were critical of this approach:

Uniform pricing by TasPorts implies that it is behaving as a monopoly with little or no negotiation. There is no competition between ports. (SeaRoad, sub. DR81, p. 4)

Nyrstar does not believe the current pricing strategy of TasPorts reflects efficient costs of providing the port infrastructure and services. ... Nyrstar fully supports the draft report's view that the current pricing strategy of TasPorts results in cross-subsidisation across ports and port activities. Nyrstar would like to see a full review of TasPorts' pricing strategy ... (Nyrstar, sub. DR105, p. 3)

The system of statewide uniform pricing adopted by TasPorts introduces a lack of flexibility in pricing, and likely results in some cross-subsidisation across ports and port activities. Pricing that is inefficient and not cost reflective may mask price signals, limit potential for competition between ports, and potentially support less efficient ports at the expense of others.

The Commission received evidence from TasPorts that it has the potential to determine pricing on a customer basis and in fact does so for some customers:

While a state wide pricing tariff has been adopted this does not restrict Tasports in negotiating confidential contractual arrangements with key customers and such arrangements do exist. (sub. DR97, p. 3)

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<sup>19</sup> Community service obligations are non-commercial activities performed by GTEs in the pursuit of community benefits, at the behest of government. Typically the activities would not be undertaken by a business operating under commercial imperatives (PC 2008).

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SeaRoad, however, argued that the scope for customers to negotiate with TasPorts was limited because of its monopoly position:

During the 1990s SeaRoad's predecessor consolidated its Tasmanian operations to one hub in mainland Tasmania. Robust negotiations were held ... Competitive offers were received from both ports and Devonport was chosen as the successful bidder. This ability to negotiate independently was lost when all the Tasmanian ports were consolidated under the one entity of TasPorts. It is our opinion that there are no longer the same competitive tensions between the Tasmanian ports because TasPorts is effectively a monopoly. Current and future negotiations will take place in this environment and it is unlikely that favourable commercial arrangements can be achieved resulting in increased costs to the shipping lines and ultimately an increase in shipping rates. (sub. DR100, p. 3)

Some participants claimed that TasPorts' charges are high relative to other Australian ports. For example:

... the Gladstone towage charges are about \$8000. To bring that same ship into Bell Bay is \$33 000. To park it on the wharf is about \$8300 in Gladstone and it is \$18 800 here in Bell Bay — the same ship, same load, same journey. (BBA, trans., p. 322)<sup>20</sup>

It is Nyrstar's commercial experience that port charges for its Risdon wharf are excessive and have been increasing well beyond any other Australian port year on year. Alarming over the past four years Nyrstar has seen port costs increase by 71% with no visible improvement in port infrastructure or service resulting in Nyrstar believing that we are subsidising other ports within Tasmania. (Nyrstar, sub. DR105, p. 2)

APT, a cruise shipping operator, cited the cost of ports in Tasmania as one reason why it is unlikely to return to Tasmania in the foreseeable future (sub. 11).

Given TasPorts is a monopoly service provider, these concerns may be legitimate. However, the Commission does not have sufficient evidence to conclude that market power is currently being exploited by TasPorts. Further, it is not clear whether the cost differences experienced by users are due to scale factors, or result from cross-subsidies to support unprofitable ports.

Concerns around the pricing of TasPorts suggest there would be benefits from the Office of the Tasmanian Economic Regulator undertaking an inquiry into TasPorts' pricing arrangements. This would increase transparency around pricing processes and assist in ensuring that users of port services pay prices that reflect the efficient costs of providing a particular service and are cost reflective where appropriate. In carrying out this inquiry, the Tasmanian Economic Regulator should particularly consider and make recommendations on whether pricing at the three northern ports — through which TFES-eligible freight is moved — is efficient and cost reflective.

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<sup>20</sup> Although the comparison provided (with the Port of Gladstone) is complicated by differences in the scale of operations and available infrastructure at each port.

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RECOMMENDATION 16

***The Tasmanian Government should direct the Office of the Tasmanian Economic Regulator to conduct an inquiry into the pricing policies of TasPorts. In carrying out the inquiry, the Tasmanian Economic Regulator should consider and make recommendations on the extent to which pricing at the three major northern ports is efficient and, where appropriate, cost reflective of individual ports.***

Improving the performance of TasPorts should be a key concern for the Tasmanian Government. Ultimately, the Tasmanian Government's tolerance of low rates of return on assets or equity for TasPorts, if sustained for extended periods, must represent an implicit subsidy to TasPorts and to the users of port services.

As the FLCT noted:

At a minimum, Government should create greater options for private sector involvement through supporting efficiency led improvements in government business returns, and increased information transparency (FLCT 2013a, p. 22).

MMC Link has also suggested that TasPorts 'must seek opportunities for efficiency, including specialisation, to reduce operating costs' (MMC Link 2012, p. 18).

However, TasPorts operates within the planning and development framework established by the Tasmanian Government. As such, the Tasmanian Government's commitment to a 'one port three locations' strategy in the north is a likely impediment to TasPorts accessing economies of scale and focusing investment in infrastructure.

With this in mind, the Commission considers that the Tasmanian Government should assess the commercial viability of TasPorts and potential changes that could enhance its operation. Part of this assessment should include consideration of alternative funding models for infrastructure, including privatisation and long term leases. These models are a growing component of structural reform programs in most mainland jurisdictions. The assessment would provide an opportunity to reprioritise and redirect capital and also to ensure capital investment decisions are underpinned by commercial imperatives. Further, it may be an opportune time for the Tasmanian Government to seek commercial third party advice on the merit of testing the market for interest in TasPorts.

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RECOMMENDATION 17

*The Tasmanian Government should assess the commercial viability of TasPorts and potential changes to enhance its operation. The assessment should include a consideration of alternative models for the provision of port infrastructure, including the feasibility of privatisation or long term leases to private operators and be informed by the findings of recommendation 16.*

### **Facilitating a more efficient future for Tasmanian ports**

Previous sections have identified barriers to improving the efficiency of Tasmanian ports. Addressing those barriers will require substantial investments in port and landside infrastructure.

However, that investment will occur within the policy framework of the Tasmanian Government and reflect its vision for the future of the ports it owns and operates (box 4.8). In this regard, TasPorts is developing a 30 year ports strategy, due to be released by 30 June 2014. This long term plan is intended to be consistent with the National Ports Strategy, which aims to identify: effective regulatory and governance frameworks; ways to improve land planning and corridor preservation; and the future infrastructure requirements of Australia's ports, including road and rail links (Infrastructure Australia 2011).

#### **Box 4.8 Tasmania's port development plan**

Tasmania's current port strategy is aimed at developing a single port system of specialised terminals (one northern port with three terminals at Bell Bay, Devonport and Burnie). The strategy involves:

1. The short term development of container terminal and intermodal capacity at Burnie (0–5 years)
2. Medium to long term — Tasmanian Port development (three terminals)
  - (a) Bulk minerals terminal at Burnie and dry bulk terminal at Bell Bay
  - (b) Specialised terminal (i.e. TT-Line, Cement Australia) at Devonport
  - (c) Priority Container terminal (Location still being developed)

The Port of Hobart is to specialise in Antarctic operations and cruise vessels.

It is estimated that Burnie, through proposed expansions, can handle up to 350 000 TEUs per year. Based on this figure and a projected 3 per cent average annual growth, Burnie is forecast to reach capacity by 2020. Based on this, it is not anticipated that the Bell Bay Intermodal Expansion would be required before 2020.

Source: DIER (2012).

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Ports are key to effective long term freight planning for Tasmania, with appropriate planning processes for ports also critical to decisions around key road and freight corridors (FLCT 2013b). For example, planning for landside infrastructure such as rail access and the length of rail marshalling yards are closely linked to issues of scale, rationalisation and specialisation.

The Commission notes that the FLCT has made a number of recommendations on Tasmanian ports, including that Burnie become Tasmania's principal domestic container port (box 4.7). The Commission considers that any decision on port strategy should be made within the context of Tasmania's broader freight transport planning framework (chapter 5) and following the Tasmanian Government considering the fundamental issues raised in recommendations 19 and 20 of this report, discussed in chapter 6.

### **Port of Melbourne licence fee**

The efficiency and associated costs of the Port of Melbourne have an important role in the cost of transporting freight, especially non-bulk freight, to and from Tasmania given that most of this freight moves through that port. Tasmania's inbound and outbound non-bulk freight constitutes around 25 per cent of the freight flow through the Port of Melbourne (Tasmanian Government, sub. 43). It is also possible that transshipment through the Port of Melbourne will remain the dominant means of shipment for Tasmanian exports in the future (Juturna 2013).

In 2011, the Victorian Government introduced the Port Management Amendment (Port of Melbourne Corporation Licence Fee) Bill 2011, which required the Port of Melbourne Corporation (PoMC) to remit an annual fee (PLF) to the Government. The PLF was \$75 million in 2012-13 and is indexed to a CPI based adjustment factor (in 2013-14, the PLF will recover \$76.4 million). The PLF is recovered through an increase in the general fees and charges included in the PoMC's Reference Tariff Schedule, with the intent of spreading the cost across all of the port's trade sectors (Port of Melbourne Corporation 2013a). Approximately 34 per cent of the PoMC's 2013-14 standard charges (excluding the wharfage infrastructure fee) relate to the recovery of the PLF (Port of Melbourne Corporation 2013b). The impact of the PLF is described in table 4.7.

While the cost increase associated with the PLF represents only a small proportion of shippers' total costs (around 1.4 per cent of the median total door-to-door cost for TFES claims), some inquiry participants drew attention to the significant added costs this licence fee imposed on their businesses. Harvest Moon, for example, estimated that the introduction of the PLF has an impact equivalent to

\$96 000 per year (sub. 21), while Simplot noted that it adds \$350 000 to its Bass Strait shipping task (sub. 50).

**Table 4.7 Port of Melbourne wharfage fees for containerised freight**  
Before and after the introduction of the Port Licence Fee

| <i>Containerised</i> | <i>Tariff 1 July 2011,<br/>excluding GST</i> | <i>Tariff 1 July 2012,<br/>excluding GST<br/>(with PLF)</i> | <i>Tariff 1 July 2013,<br/>excluding GST<br/>(with PLF)</i> |
|----------------------|--|---|---|
|                      | (\$/TEU)                                     | (\$/TEU)  | (\$/TEU)  |
| Full                 | 40.10  | 61.20   | 64.40   |
| Full Bass Strait     | 41.80  | 63.60   | 66.90   |
| Empty                | 10   | 15.20   | 16.00   |
| Transshipment        | 50 per cent of<br>published rate             | 35 per cent of published<br>rate                            | 35 per cent of published<br>rate                            |

*Sources:* Infrastructure Australia (2012b), Port of Melbourne Corporation (2012b, 2013b).

The Victorian Government advised the Commission that the PLF is a revenue raising measure, unrelated to port services or costs. While the licence fee is levied across all users, the nature of freight movement through the Port of Melbourne means that Tasmanian shippers bear a large proportion of the cost of the licence fee, around \$20 million in 2013-14.

The Commission does not have definitive advice on whether legal recourse is available to address this matter, but notes the comment of the Tasmanian Government:

We took advice on the constitutionality of it and of course because the licence fee ... was levied on all business, not necessarily just interstate business but that was clearly not a matter for constitutional lawyers to argue ... Our understanding is that unless the Victorian government makes a determination that they will change their position then ultimately they have acted lawfully. (trans., p. 444)

However, the PLF, by taxing business inputs, is an inefficient way to raise revenue. It also negatively impacts upon businesses in non-Victorian jurisdictions.

Further, the PLF effectively embodies a revenue transfer from the Australian Government to the Victorian Government at the expense of Tasmanian business through its effective and material dilution of the benefit of the TFES.



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## 5 Land freight

### Key points

- The road network accounts for most of the land freight task in Tasmania — 82 per cent on a tonne kilometre basis in 2011-12.
  - While Tasmania has an extensive road network, there are limitations on the use of high productivity vehicles, such as B-Doubles, as there are on most mainland networks.
- Road freight rates in Tasmania do not appear to be substantially out of step with rates on the mainland.
- Rail accounts for a relatively small share of the Tasmanian land freight task — 18 per cent on a tonne kilometre basis in 2011-12. In comparison, rail accounts for over half of the land freight task nationally. Bulk commodities including cement, coal and minerals account for the majority of rail freight in Tasmania.
  - Rail has had a chequered history in Tasmania, with various operating arrangements including Australian Government ownership and part-private operation. The rail network returned to full Tasmanian Government ownership in 2009 and has continued to operate at a loss.
  - While substantial upgrades to tracks and rolling stock have recently been funded by the Australian and Tasmanian Governments, it is unclear whether these are justified on the basis of the potential growth in freight volumes and the forgone benefits from alternative investments in other Tasmanian infrastructure.
- There is a relatively high degree of substitutability between road and rail in Tasmania because of duplicated networks and relatively short distances.
- The Australian Government's share of road expenditure in Tasmania has averaged 43 per cent (1998-99 to 2011-12), significantly above the Australia-wide average of 27 per cent.
- Many inquiry participants have identified the lack of an integrated freight strategy for Tasmania. The absence of such a strategy raises the risk of inefficient decision making in relation to road and rail corridors and their connectivity to ports, and whether developments in freight infrastructure support Tasmania's long term economic growth prospects most efficiently and effectively.

Intrastate land transport represents a significant component of Tasmania's economic infrastructure and the overall freight task for many Tasmanian businesses. The efficiency of road and rail infrastructure and service provision is therefore an important element in the overall costs of moving freight between Tasmania and the

mainland, particularly in the context of the more limited scope for public investment over, at least, the medium term.

This chapter looks at the land freight sector in Tasmania with a focus on the adequacy and efficiency of road and rail infrastructure and their interface with port infrastructure.

## 5.1 Land freight movements

In 2011-12, the freight task moved on Tasmanian roads and railways was estimated at around 23 million tonnes, down from 28 million tonnes in 2008-09 (DIER 2009, 2013a). This was roughly double the volume of freight shipped to and from Tasmania. On a tonne kilometre basis (that is, the movement of one tonne of freight over one kilometre) the land freight task totalled almost 1.9 billion tonne kilometres (table 5.1).

Table 5.1 **Tasmanian freight movements, 2011-12<sup>a</sup>**  
By road type and rail<sup>b</sup>

|                        | <i>Total length (km)</i> | <i>Tonne kilometres travelled (million)</i> | <i>Per cent of tonne kilometres travelled</i> |
|------------------------|--------------------------|---|---|
| National Network roads | 404                      | 872   | 47  |
| State roads            | 3 592                    | 512   | 28  |
| Local government roads | 16 826                   | 105   | 6   |
| Other roads            | 28 200                   | 39  | 2   |
| <b>Total roads</b>     | <b>49 021</b>            | <b>1 528</b>                                | <b>82</b>                                     |
| <b>Total rail</b>      | <b>632</b>               | <b>329</b>                                  | <b>18</b>                                     |

<sup>a</sup> The Tasmanian freight survey is based on interviews with major freight users and understates the total freight task. For instance, it does not include freight moved by light commercial vehicles. Other sources suggest the total road freight task in Tasmania is substantially higher. The ABS estimates total Tasmanian road freight movements for 2011-12 at 2874 million tonne kilometres (ABS Cat. No. 9208.0). <sup>b</sup> National Network roads are those roads identified as part of the National Land Transport Network and are the key roads linking the urban centres and ports. State and Local road figures exclude those parts of State or Local roads included in the National Network. Other roads includes roads operated by Forestry Tasmania, Hydro Tasmania, TasPorts and privately owned roads, of which 26 000 km are authorised access or privately owned. The rail network of 632 km includes 432 km which is included in the National Network.

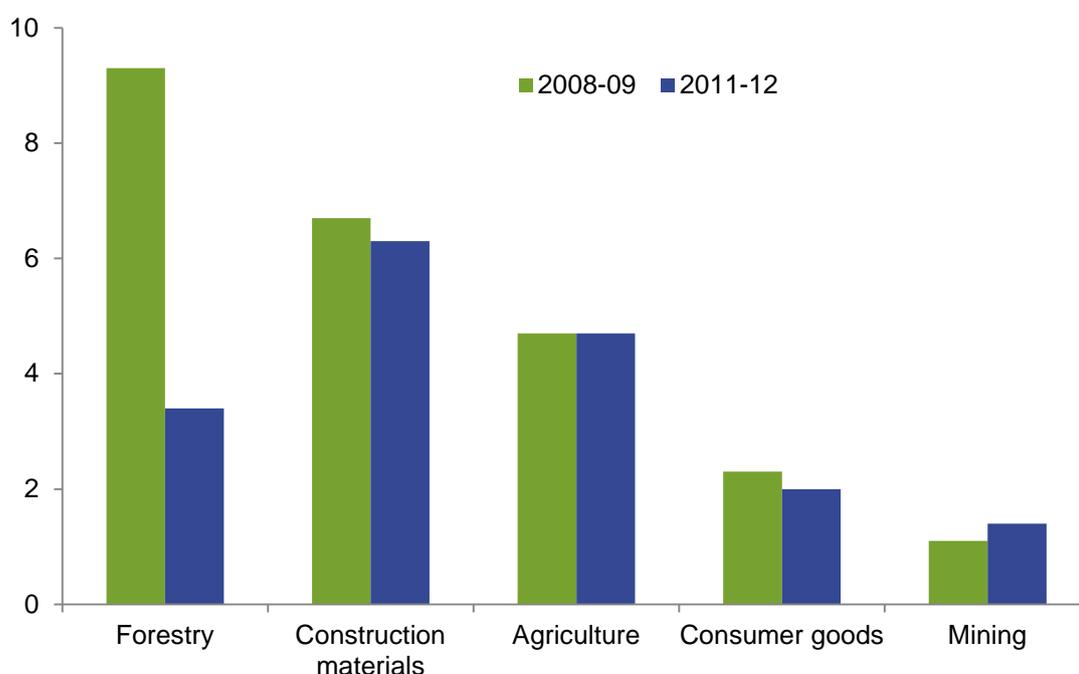
Source: DIER (2013a).

The Tasmanian road network comprises around 49 000 kilometres, although most freight movements occur on a relatively small proportion of the road network. The National Network roads (which comprise the main freight corridors between the major population centres and ports) accounted for almost half of total land freight movements. Given their small share of the total road network, these roads operate at much higher levels of utilisation relative to regional and local roads.

In moving road freight, larger capacity vehicles are typically used for longer journeys. Accordingly, their share of the freight task is larger in terms of tonne kilometres travelled than in absolute tonnage. In 2008-09, B-Doubles accounted for 28 per cent of the Tasmanian land freight task, but 34 per cent in terms of tonne kilometres travelled (DIER 2009).<sup>21</sup>

Five sectors account for most of the freight moved by road or rail — agriculture, construction materials, consumer goods, forestry and mining. The biggest change in the land freight task recently has been a result of the significant decline in the production volumes and therefore transport (by road) of forestry products (figure 5.1).

**Figure 5.1 Total freight moved by road or rail, key industries**  
Million tonnes



Data sources: DIER (2009, 2013a).

## 5.2 Road freight

Road transport accounts for the bulk of intrastate freight movements. For some businesses, the intrastate transport leg represents a significant share of the cost of

<sup>21</sup> B-Doubles were reported separately in the 2008-09 Tasmanian Freight Survey, but combined with rigid trucks and trailers in the 2011-12 survey.

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moving goods between Tasmania and the mainland. Inquiry participants located in the south of the State have noted that the efficiency of the road freight sector in Tasmania is an important factor in their overall freight costs.

The efficiency of road freight transport is influenced by: the adequacy of road infrastructure and its accessibility for high productivity vehicles; the efficiency of investment in road infrastructure and pricing structures; and competition in the provision of road freight services.

### **Adequacy of road infrastructure**

While the Tasmanian road network is extensive, the bulk of freight movements are concentrated on key roads (see chapter 2, figure 2.4). The primary freight corridor — part of the National Land Transport Network — runs from Burnie (through Devonport) to Hobart, comprising the Bass Highway, Illawarra Road (which bypasses Launceston), the Midland Highway and the Brooker Highway (south of the Derwent River). The East Tamar Highway connects Bell Bay to the Midland Highway. Beyond these major trunk roads that connect Hobart and the major northern centres and ports, road freight is dependent on numerous regional roads, as well as the network of local roads for the initial collection and final distribution of freight.

Recent proposals for upgrading road infrastructure have focused on the primary freight corridor. For instance, the Tasmanian Government, in its 2012 *Nation Building 2* submission to the Australian Government, outlined a number of proposed road projects, including:

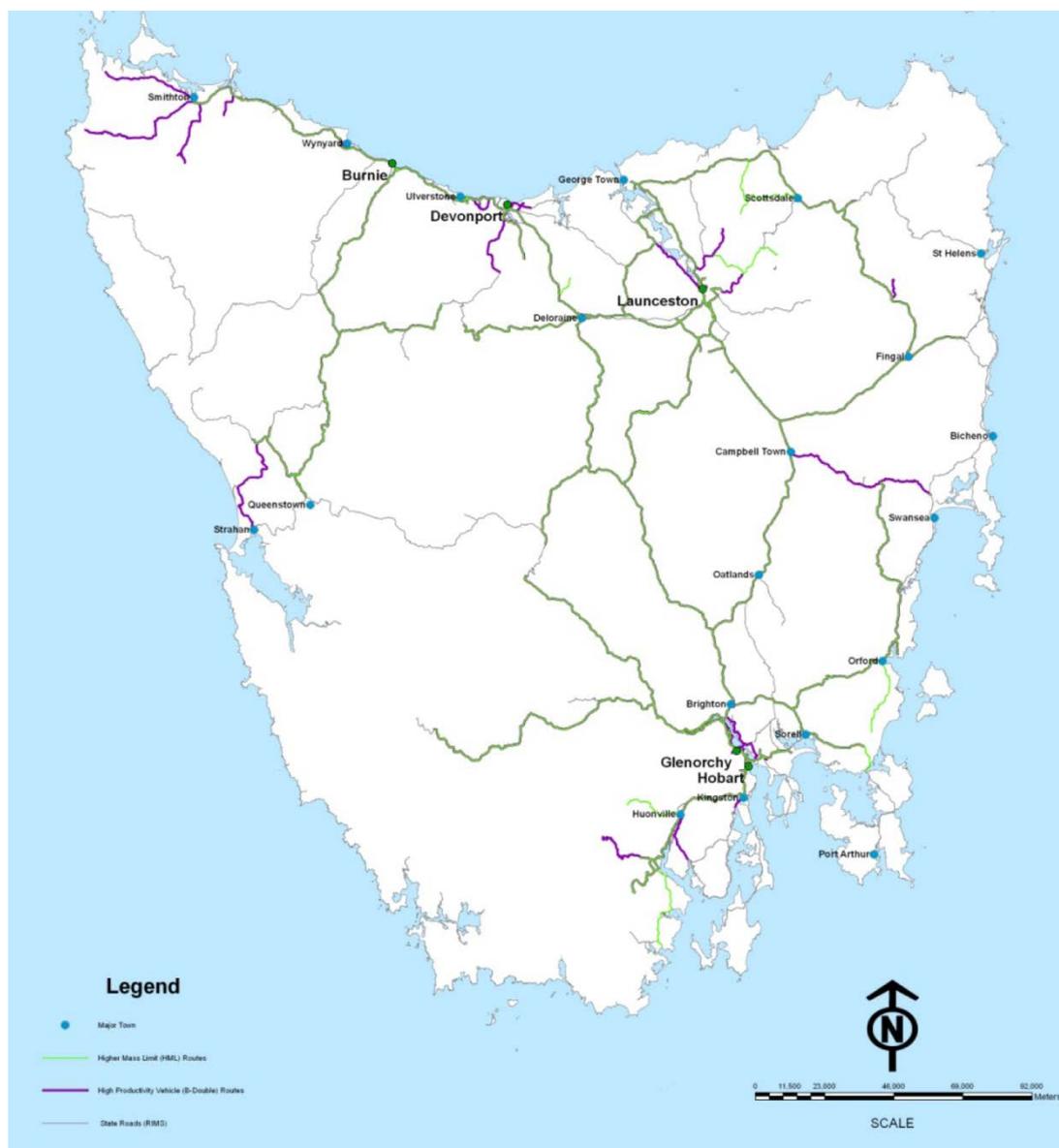
- Brooker Highway upgrades
- Illawarra Main Road South Perth bypass and upgrades on the western section of road
- Midland Highway projects
- Murchison Highway upgrades
- Birralee Main Road upgrades (Tasmanian Government 2012).

#### *Access for high productivity vehicles*

High productivity vehicles (HPVs), such as B-Doubles, are restricted to a gazetted road network (figure 5.2). While in 2008-09 B-Doubles accounted for around a third of freight movements in Tasmania, concerns have been raised, particularly by Infrastructure Australia (2012b), that the use of HPVs in Tasmania is being

constrained by the condition of the road network. While the gazetted routes cover the main Tasmanian roads, there appear to be gaps in the routes that might prevent greater utilisation of higher mass vehicles. Many gazetted roads are not considered to be of a sufficient standard for use by HPVs. A 2011 review, against some newly developed Tasmanian guidelines, determined that 32 per cent of the gazetted network met the guidelines, 35 per cent was marginally below the guidelines and 33 per cent did not meet the guidelines (DIER 2011a). This may be an optimal investment strategy by the Tasmanian Government.

Figure 5.2 **Gazetted routes for high productivity vehicles<sup>a</sup>**



<sup>a</sup> Shows both higher mass limit (HML) routes (in green) and high productivity vehicle (HPV) routes (in purple). HML routes allow slightly higher gross weights, 67 tonnes, versus 62 tonnes on HPV only routes.

Data source: DIER (2011a).

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Nationally, reform options to increase the efficiency of road transport have been proposed, including by Infrastructure Australia (2012b). These include the introduction of even higher productivity vehicles, such as B-Triples or super B-Doubles.

Infrastructure Australia previously raised the issue of expanding HPV access in its discussion paper on development of a National Land Freight Strategy in February 2011. But in response, the Tasmanian Department of Infrastructure, Energy and Resources (DIER) stated that:

... in Tasmania's case, it is unlikely that further major road productivity improvements would be justified in the short to medium term. Tasmania's current road network would require significant upgrades to meet the geometric standards required for the highest productivity vehicles available (i.e. B-triples). It is the Department's position that the focus for Tasmania's freight network needs to be on maximising the productivity and capacity of the three key northern ports and the relative efficiency of their connection to major road and rail freight corridors, both in Tasmania and interstate. (DIER 2011b, p. 2)

Infrastructure Australia's June 2012 update on developing the National Land Freight Strategy maintained that Tasmania should:

... more widely introduce the higher productivity vehicles necessary to reduce costs to the local businesses that trade with the mainland and internationally. (Infrastructure Australia 2012a, p. 5)

While the use of HPVs offers advantages, such as lower unit freight costs and reduced vehicle movements, it also imposes a cost on road infrastructure, including through the need for better road geometry and higher capacity bridges. A benefit-cost approach should be used to assess expanding access for HPVs (B-Doubles) and higher mass vehicles. The Commission views this as an appropriate approach to inform related deliberations in the foreshadowed development of an integrated Tasmanian freight strategy, detailed further below.

### *Prioritising road investment*

While there appear to be some access constraints for high productivity vehicles, road accessibility overall does not appear to currently be a significant constraint on the Tasmanian freight task and was not raised as a significant issue in this inquiry. Similarly, the Freight Logistics Coordination Team (FLCT) recently concluded that:

Generally, capacity across the road and rail network is sufficient, and this is a benefit to users. (FLCT 2013a, p. 13)

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Nonetheless, the FLCT noted the need to prioritise road investment on the main freight corridor in its final report recommendation:

Road investment in Tasmania should target one high standard freight corridor, supported by key regional connections and –

- a. Prioritise road expenditure to the Burnie-Devonport to Hobart primary freight corridor, which is part of the National Freight Network, developing this corridor as Tasmania's highest standard freight route.
- b. Ensure that investment outside this corridor prioritises key regional freight roads that connect to the primary freight corridor. This include the Bass Highway west of Burnie, East Tamar Highway and Frankford-Birrallee-Batman corridor.
- c. Inform the development of a high-productivity vehicle access policy by the Tasmanian Government. (FLCT 2013a, p. 5)

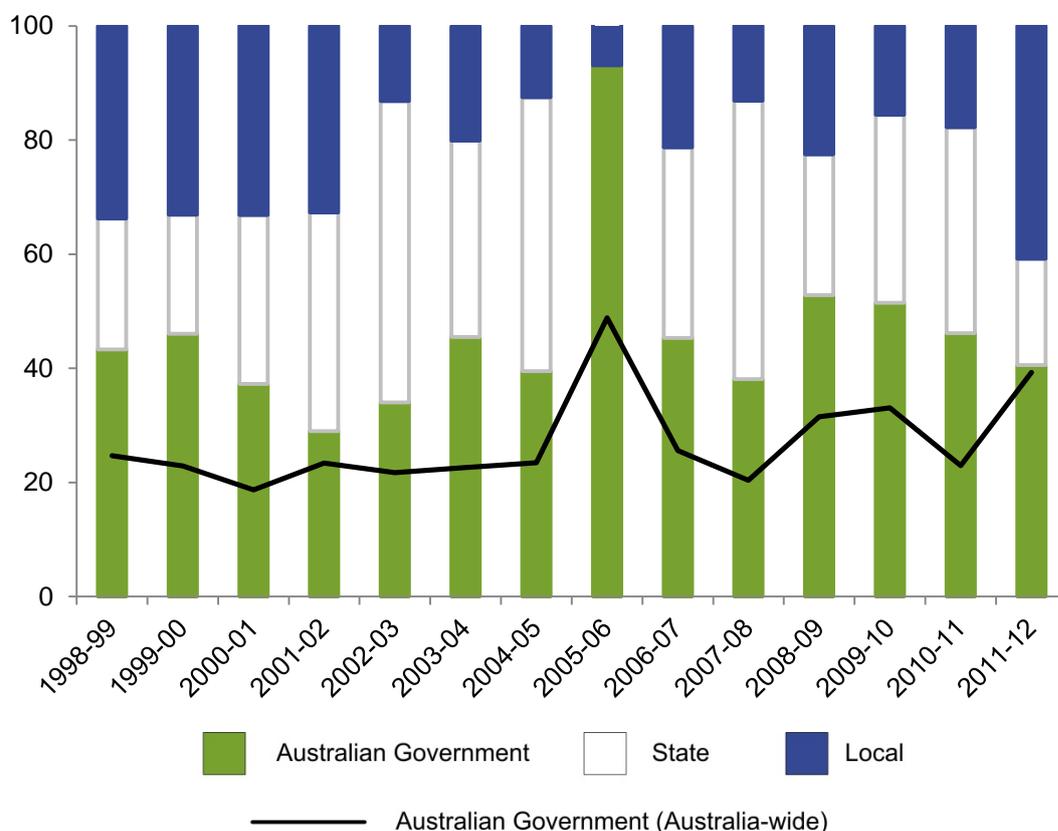
The Tasmanian Government has indicated its support for this FLCT recommendation and indicated that development of a HPV access policy will be completed by December 2014.

## **Road funding and user pricing**

Roads are largely funded by governments because they display a range of features — such as large lumpy capital expenditure, economies of scale, network planning and management requirements, and benefits from interconnectivity — that generally make provision of a single integrated network the most efficient outcome. They also typically exhibit a degree of non-excludability, in that it is difficult to directly charge users and beneficiaries of a particular road, with the exception of those road corridors designed and constructed to allow efficient tolling.

Road expenditure is undertaken by all three levels of government. Over time, there have been substantial changes in the share of road expenditure by level of government, with significant year to year volatility (figure 5.3). Over the period 1998-99 to 2011-12, the Australian Government's share of road expenditure in Tasmania has averaged 43 per cent, significantly above the Australia-wide average of 27 per cent.

**Figure 5.3 Share of Tasmanian road expenditure by level of government**  
Per cent



Data source: BITRE (2013e).

Road funding is allocated through a range of programs. For instance, Australian Government funding has been allocated through funding programs such as: the National Network; Black Spots; Roads to Recovery; and Local Government Financial Assistance Grants Identified for Roads (BITRE 2011a). In addition, funding may also be allocated to particular projects on an individual basis, separately from broader funding programs. For example, in its election commitments, the Coalition committed to providing \$400 million (comprising \$40 million a year for ten years commencing in 2014-15) for upgrading the Midland Highway (Coalition 2013).

The current funding model for roads can lead to a less than efficient allocation of investment, with funding not always directed to projects, especially maintenance, that deliver the greatest net benefits. As Infrastructure Australia noted:

... roads are more prone to highly politicised spending decisions, especially in the absence of data on baseline road cost and condition. The lack of information on road cost and condition means that governments are perceived to allocate funding on the basis of particular needs within the political cycle, rather than for the longer term. (Infrastructure Australia 2012b, p. 9)

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Of course, the weaknesses in Australia's road funding arrangements are not unique to Tasmania, although the greater dependence on Australian Government funding in Tasmania may exacerbate the issue.

One underlying road funding issue — which contributes to less than optimal investment decisions — is the current manner in which road users are charged. Notwithstanding the use of toll roads in most major capital cities, road user charges, for both light and heavy vehicles, are levied in the form of fixed annual vehicle registration charges and fuel excise. The latter crudely approximates use-based charging, as fuel use (and hence excise paid) will generally be higher for heavier vehicles or those that travel longer distances. However, these charges are not location determined, that is, they do not reflect the difference in costs that heavy vehicles impose on different types of road.

As the Commission found in a previous inquiry into *Road and Rail Freight Infrastructure Pricing*:

The main efficiency losses with current road charging arrangements derive from the averaging of costs and charges ... and the disconnect between road revenue and spending decisions.

– These provide poor price signals and distort the incentives needed for efficient road use and provision. (PC 2006a, p. XXVI)

Likewise, the Australian Competition and Consumer Commission (ACCC) submitted that:

Existing national road pricing structures do not encourage efficient investment in essential freight infrastructure. ... In particular, the ACCC considers that reform of heavy vehicle road provision and charging is necessary to better reflect the cost of road use and ensure the right investments in roads are undertaken. (sub. 28, p. 7)

This issue was also noted by the Tasmanian Government in its recent *Nation Building 2* submission:

Unlike the rail sector, the road sector does not operate within a market framework. Although heavy vehicle registration charges are set to cover past expenditure on roads used by these vehicles, there is currently little direct relationship between use of the road network and road funding allocations. Within current frameworks, the opportunity for private sector funding of freight roads is limited. (Tasmanian Government 2012, p. 20)

However, in its 2006 inquiry, the Commission noted that developments in road pricing technology could create opportunities for more cost reflective pricing which, in combination with institutional changes to link road supply and demand, could offer substantial efficiency gains. It subsequently recommended a phased approach

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to reform which could see the roll out of location-based charging, subject to an assessment of the costs and benefits (PC 2006a).

National reform options are being developed through the Heavy Vehicle Charging and Investment (HVCI) project. This is a reform best undertaken at a national rather than State level. The Council of Australian Governments identified heavy vehicle charging as a major transport reform at its December 2013 meeting and is seeking further advice on the HVCI proposals for its next meeting (HVCI 2014).

## **Road freight charges**

The Tasmanian road freight sector appears to be competitive, with charges comparable to those for mainland services, notwithstanding slightly higher fuel costs. This was illustrated by G. Riley, Fresh Freight Tasmania, who testified that:

I think Tasmania is very competitive on road transport. There's plenty of options out there ... (trans., p. 129)

Similarly, Veolia submitted that:

In Veolia's experience Tasmania pricing is competitive ... (sub. DR103, p. 13)

Aurecon (2013a), in its report to the FLCT, compared Tasmanian road freight rates (for a 19 metre semi-trailer, assuming a load of two twenty foot equivalent units) with those in Victoria. It concluded that rates were marginally more expensive than in Victoria, which it attributed to higher fuel costs in Tasmania relative to the mainland.

Mondelez submitted a similar claim about road transport costs in Tasmania:

Road freight costs in Tasmania are marginally higher than on the mainland. The main contributor to this higher cost appears to be the higher cost of fuel on the island. (sub. DR98, p. 17)

Relative to other transport modes such as rail or shipping, the scope for anticompetitive behaviour in the road freight industry is limited. Barriers to entry in the industry are relatively low, and while there are economies of scale in the industry, road freight can be efficiently conducted on a relatively small scale, including by businesses themselves.

A feature of the road freight market is the presence of integrated freight logistics businesses, whereby the Bass Strait shipping operators, Toll ANL and SeaRoad Holdings, also provide road transport services. However, no evidence was presented to this inquiry to indicate that this was having significant ramifications on competition in the Tasmanian road freight market. Similarly, the ACCC noted that:

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In 2013, the ACCC concluded that a proposed acquisition of Linfox Australia's Trans-Bass Freight Forwarding business by Toll would not substantially lessen competition. In the market for freight forwarding services between Tasmania and mainland Australia, the ACCC considered that remaining competitors would provide an ongoing competitive constraint. (sub. 28, p. 5)

### 5.3 Rail freight

Railways in Tasmania comprise the freight-only Tasmanian Rail Network and the historic rail lines. There are no passenger services.

In 2011-12, rail accounted for 10 per cent of the total Tasmanian freight task by tonnage, and 18 per cent of the total freight task based on tonne kilometres travelled (DIER 2013a). Bulk freight (coal, ores and cement) accounted for most freight moved by train, but there has recently been an increase in non-bulk (or 'intermodal') freight volumes, including containers and a recommencement of log transportation (TasRail 2013).

While rail accounts for a small share of the total land freight task in Tasmania (nationally, rail accounts for over half of the land freight task<sup>22</sup>), for many of those businesses that use rail, it is their primary form of intrastate freight transport. For instance, Norske Skog submitted:

Given 96% of all production is shipped across Bass Strait, the Boyer Mill has a clear reliance on moving its freight as efficiently as possible between the Mill, near Hobart to the Port of Burnie on Tasmania's North West Coast. This is undertaken with the support of TasRail which represents a vital link in Boyer's inbound and outbound freight task. Rail freight between the Mill warehouse hardstand and the Port of Burnie offers the lowest cost option to move large volumes of containerised product in an efficient manner, while also removing the significant freight volumes from the Tasmanian road network.

All sales volumes destined for markets outside Tasmania are transported by TasRail on a dedicated northbound train to Burnie leaving the Boyer Mill 6 days per week. (sub. 39, p. 8)

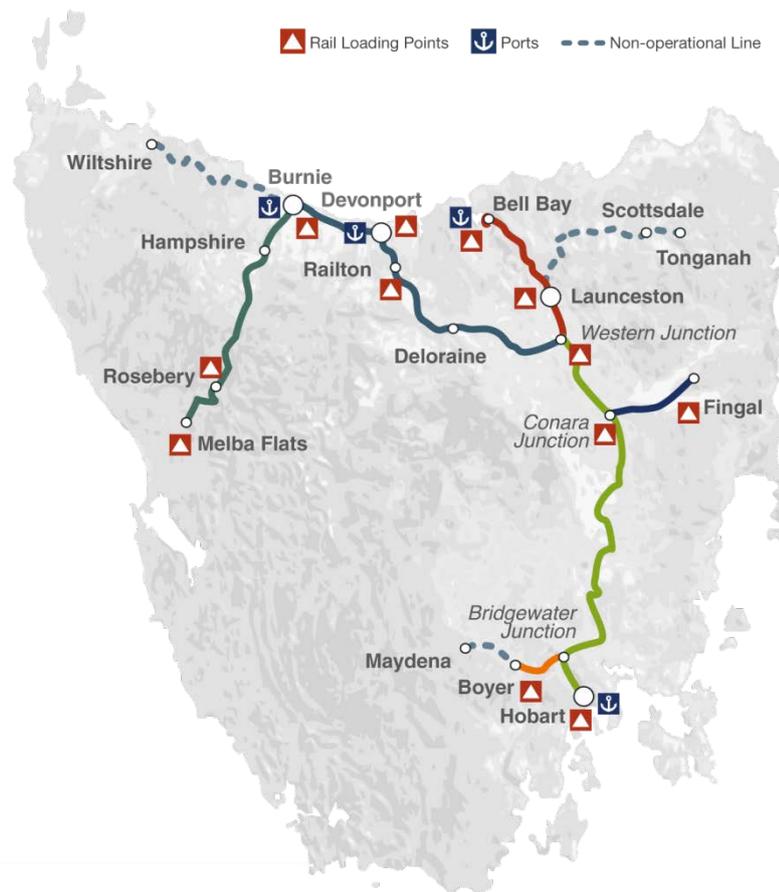
The Tasmanian rail network consists of a single line narrow gauge track. There are 632 kilometres of operational track (there are also a further 211 kilometres of non-operational lines), with the main rail line following a similar route to the main road corridor (figure 5.4).

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<sup>22</sup> In 2009-10, national rail freight movements (bulk and non-bulk) totalled 259 billion tonne kilometres, versus 192 billion tonne kilometres moved by road (BITRE 2013e).

TasRail, a Tasmanian Government-owned corporation, is now responsible for all aspects of the rail system — track, terminals and rolling stock. This follows a period of private ownership and operation of above rail assets from 1997 to 2009.

Figure 5.4 **Tasmanian rail network**



Source: TasRail (2013).

### Issues facing Tasmanian rail

The issues facing Tasmanian railways have been well documented, including by Juturna (2013), Infrastructure Australia (2012b) and Engineers Australia (2010). As a business enterprise, it has been constrained by small volumes and short distances. The network itself has been hampered by low volumes, an absence of commercial success and resulting poor track condition and aged rolling stock, which have further limited the attractiveness of rail for moving freight. As TasRail submitted, it:

... inherited a business characterised by many decades of capital under-investment. This had critically constrained the ability of rail to contribute to the business

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development of the State and led to increased volumes of freight being transferred to the road network. (sub. 22, p. 2)

In its 2010 assessment, Engineers Australia rated the Tasmanian rail network as an ‘F’, finding that the infrastructure was:

... inadequate for current and future purposes, and that the magnitude of the works required to provide any reasonable utility from this infrastructure is enormous. (Engineers Australia 2010, p. 25)

TasRail is in the process of undertaking substantial capital upgrades. The Australian Government, through its *Nation Building* funding program from 2008-09 to 2013-14, has contributed \$210.5 million for track upgrades. In addition, the Tasmanian Government has committed capital funding of \$137.2 million over seven years to 2015-16. The capital upgrades have mainly comprised track renewal, particularly the replacement of sleepers and bridge works. Rolling stock is also being upgraded, with 17 new locomotives and 191 wagons being rolled out in late 2013 and 2014. Other capital works include a new train control system and refurbishing of the bulk minerals shiploader at Burnie (TasRail 2013).

There are also plans for further capital upgrades. Under the *Nation Building 2* program<sup>23</sup>, the Australian Government announced funding of \$119.6 million over five years from 2014-15 to 2018-19, conditional on a matching level of funding being contributed by the Tasmanian Government (TasRail, sub. 22).

There is some evidence that these capital upgrades are attracting additional business for TasRail. The Department of Infrastructure and Regional Development submitted:

There is a clear correlation between the improvements in rail efficiency and demand in the market. As a result of the recent investment in rail upgrades, new contracts have been entered into with Venture Minerals and coal mining company Hardrock. TasRail has secured an extended service agreement with MMG for haulage of mineral concentrates between Rosebury and Burnie; and have also reached agreement with Forestry Tasmania for transportation of log freight between Brighton and Bell Bay. These contracts indicate the growing confidence in rail due to the infrastructure upgrades. (sub. 42, p. 19)

Further, TasRail submitted that its contract with Venture Minerals ‘will increase TasRail’s annual tonnage by approximately 35%’ (sub. 22, p. 3).

A key question remains to be addressed — whether the expected growth in freight volumes was sufficient to warrant this additional investment. While the Tasmanian

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<sup>23</sup> This program has been retitled as the Infrastructure Investment program under the current Australian Government.

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Government considers that keeping the future rail system option open is critical for supporting the development of key industries in Tasmania (such as mining), it is not clear to what extent this option has been assessed against alternatives.

As a general rule, there is limited substitutability between road and rail because the two modes are generally best suited to different types of freight tasks. Rail's strength lies in the movement of large quantities of non-time sensitive freight over relatively long distances between a limited number of fixed points. Conversely, trucks move smaller loads, but can do so more quickly and between almost any locations.

However, in Tasmania there is a higher degree of substitutability between road and rail because of the relatively short distances involved. In its submission, TasRail noted that the rail freight network in Tasmania is duplicated by the road network:

... rail has no unique markets or geographic advantage and faces very strong competition from road transport. (sub. 22, p. 4)

Given the availability of road as a viable alternative option, the long term viability of rail in Tasmania needs to be carefully assessed from a long term, Tasmanian economywide perspective. This is particularly pertinent in the context of TasRail's financial performance coupled with the State's fiscal constraints (reflecting Tasmania's demographic and economic profile).

TasRail is not achieving a sustainable rate of return on its operations. In 2012-13, its total loss for the year was about \$47 million (compared with \$37 million in the previous year). While this includes a \$45 million impairment expense associated with accounting treatment related to Australian Government funding of capital upgrades, total revenue also includes an operating subsidy from the Tasmanian Government of around \$16 million. Actual revenue from freight services (about \$33 million) was less than variable costs (including wages, maintenance, fuel and administration) (TasRail 2013). To improve its commercial sustainability, TasRail needs to increase its revenues and/or reduce costs.

To the extent that capital improvements to the network increase the speed and capacity of rail travel, and there is efficient terminal infrastructure for transferring cargo to and from ships and trucks, there may be greater uptake of rail freight. TasRail has submitted that its freight task and revenue is forecast to grow significantly:

Revenue, total tonnes and NTKs [net tonne kilometres] are about to increase considerably as TasRail grows intermodal volumes and begins haulage for a new major mining development. On this basis, TasRail share of the total freight market increases by around 70% over the 2011/12 figure by 2015/16. (sub. DR74, p. 2)

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Conversely, TasRail (sub. DR74) does not see any immediate scope to lift freight rates. In part, this is because many of their customers are on long-term contracts, but it also reflects the strong competition that rail faces from road. TasRail submitted that if rail charges were lifted to achieve full cost recovery, it:

... would lead to a decline in TasRail's revenue, profitability and commercial viability in the long term. (sub. DR74, p. 7)

Highlighting the fundamental issue facing the Tasmanian rail network — limited customers and strong competition from a largely duplicative road network — TasRail went on to submit that:

TasRail is currently the only user of the rail network and does not generate sufficient access fees to fully fund track maintenance and renewal. (sub. DR74, p. 7)

Alternatively, network rationalisation could provide an opportunity to reduce costs while maintaining the more profitable freight volumes. In its October 2013 interim report, the FLCT made the finding on the Tasmanian rail network that rail investment should be prioritised to:

- a. Implementing Nation Building 2 outcomes which focus on the Burnie-Devonport to Hobart primary freight corridor, a link in the National Freight Network; and
- b. Maintain and enhance other lines based on their relative potential to operate on a full cost recovery basis within a 10-year timeframe. (FLCT 2013b, p. 2)

Similarly, Juturna (2013), in its final report for the FLCT, highlighted that network rationalisation had not yet occurred. It also stated that this was difficult because there had not yet been a rationalisation of ports, making it challenging to prioritise rail investment strategies.

One particular issue with rail services is that they are dependent on relatively few customers, and so face concentrated and therefore elevated commercial risk of customer withdrawal leading to underutilised or stranded assets. For example, Infrastructure Australia cites the case where:

... not long after TasRail opened its service to Bell Bay, customers Norske Skog and Nyrstar transferred their operations from Bell Bay to Burnie. (Infrastructure Australia 2012b, p. 20)

This shift was in response to changes caused by the withdrawal of shipping services at Bell Bay, rather than a commercial, standalone customer decision per se, but it nevertheless illustrates the risks associated with geographically fixed assets in a dispersed logistics system.

However, TasRail has submitted (sub DR74) that it considers that there is little scope to rationalise parts of the network, arguing that:

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- rationalising ‘branch lines would not avoid significant ongoing maintenance expense for TasRail’ (p. 4)
  - there are existing contracted customers utilising the three operational branch lines
  - it assigns a high option value to future use of the branch lines
  - a long-term port strategy is yet to be finalised.

In its final report, the FLCT made the following recommendation about the Tasmanian rail network:

The role of rail in the Tasmanian transport system should be clearly articulated by Government and aim to –

- a. Ensure that above rail operations operate on a commercial basis within five years, where revenue from freight is sufficient to cover operating costs and to provide for future investment in above rail assets.
- b. Ensure that public investment in below rail assets is based on defined network standards linked to freight demand.
- c. Be consistent with a long-term port strategy and consider the long-run adequacy of rail access to ports. (FLCT 2013a, p. 4)

The Tasmanian Government generally supported this recommendation, subject to more detailed consideration in its development of a Tasmanian freight strategy.

For rail to be a viable long-term freight option in Tasmania it needs to operate on a full cost recovery basis, except to the extent that there are social benefits from railway activities that genuinely justify public subsidies. In the case of rail in Tasmania, there are no passenger services, so any spill-over benefits from rail are derived from a reduction in road freight movements. Potential benefits could include reduced congestion, less pollution, and safety benefits, in terms of fewer road accidents. TasRail has submitted — through a consultancy report it commissioned in response to the draft report — that these spill-over benefits are estimated to exceed the annual Tasmanian Government contribution from 2014-15 onwards (sub. DR74, appendix 5). The Tasmanian Government has previously indicated, as part of its *Tasmanian Infrastructure Strategy*, that it would consider the options for privatising above rail assets in the future. However, in its post-draft submission it has stated that:

It is the Tasmanian Government’s clear position that none of its freight or freight-related assets are up for sale. (sub. DR85, p. 14)

There is some private contribution to customer-required infrastructure. In addition to Toll’s investing in the Brighton Transport Hub, TasRail notes another example where it has:

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... recently entered into a contract with a mining company to invest capital directly into the rail corridor, which will result in a boost to the network capacity and loading infrastructure for that business. (sub. DR74, p. 9)

There is also an open access regime, so there is some potential for above rail competition. TasRail submitted that:

With new large volume miners (in a Tasmanian context) commencing operations, TasRail considers the likelihood of another operator entering the network increasing ... (sub. DR74, p. 9)

The FLCT, in its final report, has recommended, more generally, that the government consider ways to increase the scope for private investment in Tasmanian transport infrastructure. These avenues should be thoroughly explored, but the 1997 to 2009 experience of private ownership suggests that with the exception of customer specific investment this might only be possible on some risk sharing basis. The Commission notes that in other jurisdictions, private-owned port operators have at times facilitated the involvement of private investment (by business users) in freight critical rail investment.

The utilisation of Tasmanian rail will have to increase to improve its commercial performance. While the recent capital upgrades should make rail more attractive to freight users, it is not clear whether these are justified on the basis of the potential growth in freight volumes and the forgone benefits from alternative investments in other Tasmanian infrastructure. Future investment decisions should be made in the context of an overarching strategy for freight infrastructure and on a relative cost-benefit analysis basis. In the long run, it seems likely that a State with a small tax base will have to confront the costs associated with largely duplicated road and rail networks and determine whether multiple networks provide the most efficient transport system for Tasmania.

## **5.4 An integrated Tasmanian freight strategy**

Discussions with stakeholders and submissions to this inquiry have highlighted the need for a specific long term strategy or ‘vision’ to guide the development of freight infrastructure in Tasmania. For instance, Regional Development Australia – Tasmania (RDAT) suggested examining the need to:

Develop a long term freight strategy for Tasmania that is supported by all key stakeholders which considers the longer term needs for Port infrastructure and Road and Rail networks ... (sub. 17, p. 2)

In a similar vein, the Cradle Coast Authority put forward the case for:

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A long term logistics plan for Tasmania, covering Bass Strait and international shipping and the port, road and rail systems that support them, including road and rail corridors linking Burnie to the West Coast and Smithton, and a long term shipping solution for King Island ... (sub. 20, p. 1)

And Engineers Australia submitted that State governments need to:

- Develop long-term infrastructure visions and plans that accommodate projected economic growth and population increases.
- Establish independent planning infrastructure advisory groups to provide advice on infrastructure priorities and provide infrastructure planning and funding advice. (sub. 36, p. 5)

The terms of reference establishing the FLCT stated that its primary purpose was to provide expert advice and guide the completion of a long term freight strategy. In its December 2013 final report, it recommended that:

1. The Tasmanian Government should complete a Tasmanian Freight Strategy by 30 June 2014.
2. The Tasmanian Government should adopt the FLCT's objective for the Tasmanian freight system as the objective for the Tasmanian Freight Strategy.
3. The Tasmanian Government should establish an ongoing high level, public-private freight advisory group. (FLCT 2013a, p. 4)

In finalising the strategy, the FLCT recommended that the Tasmanian Government should ensure that the strategy:

- Incorporates the objective for the Tasmanian Freight System;
- Is based on the outputs, particularly this final advisory report;
- Is based on long-term freight analysis;
- Directly involves industry participants from the freight market;
- Identifies key freight corridors and intermodal points for priority investment;
- Addresses the issue of duplicated port, road and rail infrastructure;
- Clearly articulates the role of, and target standards for, individual modes within the freight system;
- Those roles and targets should be reflected in the strategies of all government owned infrastructure providers and other key stakeholders;
- Proactively anticipates freight system issues by linking planning to current transport model data; and
- Is regularly updated. (FLCT 2013a, p. 41)

Allied to the development of a long term strategy for freight infrastructure, potential benefits from better coordination in the freight logistics chain have also been raised.

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For example, in Aurecon's August 2013 report to the FLCT, one of the recommendations was that:

Consideration should be given to the state wide planning of freight movements. Better planning offers the opportunity to reduce the carriage of empties on ships, reduce empty backhauls for trucks, intelligently route freight to rail, eliminate the stranding of freight and reduce the number of vehicles on roads. (Aurecon 2013a, p. 8)

Similarly, Infrastructure Australia suggested that:

... consideration be given to the creation of a freight logistics coordination team with an industry leadership group similar to the Hunter Valley Coal Chain logistics team. (Infrastructure Australia 2012b, p. 2)

In this regard, in its final report, the FLCT also recommended that the Tasmanian Government should test the viability of a market-based online trading portal to facilitate trade of freight capacity, investigate opportunities to promote industry collaboration, and that funding should be provided for an expert advisory panel to assist small to medium freight users to optimise their supply chains and reduce costs. The FLCT also recommended the development of a publically accessible freight model that:

- Provides data and information on freight supply and demand, including empty container movements.
- Allows users to alter key assumptions (for example sector growth rates) to test possible service offerings and demand aggregation opportunities.
- Transparently reports proposed major capital expenditure and maintenance costs across road, rail, port and shipping providers. (FLCT 2013a, p. 34)

A strategic and coordinated approach to Tasmania's freight future has the potential to reduce the costs of doing business in Tasmania, and thereby make a contribution to the State's economic development. In particular, this could lead to more efficient infrastructure investments that take into account a whole-of-Tasmania perspective. This could, in turn, lead to more efficient Tasmanian freight operations, including, for example, through faster freight journey times from better coordination between transport modes.

A more integrated and transparent approach to freight movements may also be beneficial in terms of addressing the flow of empty containers in the Tasmanian freight system. Repositioning containers is a substantial part of the freight task and imposes significant costs. Cost saving opportunities could be realised through the coordinated sharing of information that may assist in reducing the flow of empty containers. The Commission understands that this issue has proved intractable on many trade routes, including Tasmania.

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Improving freight *coordination* is primarily a matter for freight businesses, noting that the Tasmanian Government owns and operates commercial freight businesses. The role for government should typically be long term planning of infrastructure provision to facilitate improved efficiency in Tasmanian freight services.

In its response to the FLCT's report, the Tasmanian Government has committed to developing a Tasmanian Freight Strategy, with work having already commenced. The Tasmanian Government has submitted that the strategy will deal with issues including:

- Consideration of a long-term ports strategy that clarifies the future roles and functions of each of Tasmania's northern ports, taking into account their relationship with key road and rail links and specific freight needs;
- The ongoing strategic prioritisation of road infrastructure investment around a high standard, principal freight corridor and the development of a high-productivity vehicle access policy;
- The need for greater clarity on the role of rail in the context of Tasmania's contestable freight task; and
- A clear plan to better focus infrastructure investment on the optimal modal mix across both road and rail to meet Tasmania's future freight needs. (sub. 43, p. 7)

The lack of an integrated freight strategy across all components of the supply chain increases the risk of inefficient decision making in relation to road and rail corridors, their connectivity to ports and duplicated infrastructure. In this context, the Commission supports the development of a long term integrated freight strategy for Tasmania which addresses the fundamental issues of productivity and effective capital allocation. A jurisdiction with a small tax base is unlikely to be able to maintain a full and duplicated array of transport assets. The development of such a strategy will help to ensure that developments in freight infrastructure are supportive of Tasmania's long term economic growth prospects and cognisant of the fiscal position of the Tasmanian Government, now and in the future.

While governments should play a key role in developing a long term integrated plan for the State and the Tasmanian Government is currently undertaking such a process, it should be transparent, evidence based and include wide consultations with industry, all levels of government and the community at large, and provide opportunities for private sector investment and operations.

The Tasmanian Government has submitted that the strategy currently under development is a 'state policy and will not be developed at the specific direction of the Australian Government' (sub. DR85, p. 4). However, and importantly, the Australian Government provides significant funding for Tasmanian infrastructure and ultimately determines the prioritisation and direction of those Australian

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Government funds. Ideally, the strategy should form part of the assessment processes by the Australian Government and Infrastructure Australia for the allocation of funds to Tasmanian transport infrastructure. But if this is to be the case, then it seems appropriate that the Australian Government should be consulted in the formulation of that strategy.

RECOMMENDATION 18

*The Commission endorses the need for a comprehensive, long term integrated freight strategy for Tasmania to be developed by the Tasmanian Government. As the Australian Government will retain a role in funding Tasmanian infrastructure investments, it is appropriate that it (including through Infrastructure Australia) be consulted in developing that strategy.*

*In developing the strategy, there should be broad consultation between industry, all levels of government, and the community more generally. A benefit-cost framework should be applied that identifies the most efficient use of investment capital and that clearly identifies the net benefits or trade-offs arising from community service initiatives or region-specific development objectives. As a matter of urgency, the strategy should:*

- *identify Tasmania's likely future freight infrastructure requirements across all modes — sea, road, rail and air*
- *address port developments, including specialisation or rationalisation of existing infrastructure and, informed by the Tasmanian Government's consideration and resolution of the issues in recommendations 16 and 17*
- *address the long term role of rail in Tasmania given the high degree of substitutability with road transport*
- *ensure that the objectives of government business enterprises for ports, shipping and rail are consistent with commercial sustainability.*



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## 6 An economic development approach

### Key points

- The Tasmanian Freight Equalisation Scheme (TFES) has been in operation since the mid-1970s with ongoing and strong support from both Tasmanian-based businesses that receive assistance and the Tasmanian Government.
- Tasmania continues to underperform relative to mainland states on many important economic and social indicators, and this gap has widened over time despite the equalisation schemes.
- Greater emphasis should be given to policies and programs that directly target the underlying causes of economic and social disadvantage in Tasmania.
- The fundamental goal of the Australian and Tasmanian Governments should be to ensure that policy and regulatory settings lead to a more flexible, competitive and resilient state economy.
- All levels of government should work towards making Tasmania more attractive to private sector investment by:
  - improving employment outcomes through skilling and training
  - creating an environment for more private sector involvement in infrastructure provision and operation
  - improving coherence in the provision of infrastructure
  - creating a regulatory environment that reduces the cost of doing business in Tasmania.
- A stocktake of existing economic development policies, programs, projects and bodies should be undertaken, with the results used to refine and develop a single integrated economic development strategy for Tasmania. The recently formed *Joint Commonwealth and Tasmanian Economic Council* is well placed to initiate this work.

The TFES has been in operation since the mid-1970s and has enjoyed ongoing and strong support from both businesses that receive assistance and the Tasmanian Government. Moreover, there is a strong reluctance within Tasmania to make any changes to the TFES (or the Bass Strait Passenger Vehicle Equalisation Scheme — BSPVES) that might reduce the aggregate level of assistance payable. This is premised on the assertion that the economic consequences to both individual businesses and the state economy as a whole would be dire.

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In their submission to this inquiry, the Tasmanian Government stated that:

There is no doubt that the abolition of, or a significant reduction in assistance under, these schemes would be extremely damaging to the Tasmanian economy, particularly at this time. (sub. 43, p. 4)

And that:

The Tasmanian Government's overriding concern is that this inquiry supports the growth of the Tasmanian economy, with the potential to lessen overall the dependence on Australian Government funding in the long term. This objective needs to be kept in mind in examining the current TFES, BSPVES and TWFS arrangements. A strategic and long-term view is required. (sub. 43, p. 16)

Many businesses also made submissions to this inquiry stressing the importance of TFES payments to their ongoing profitability, albeit with limited and non-definitive evidence, with some indicating that their future operation in Tasmania would be compromised by any reduction in the level of assistance provided under the scheme.

The Department of Infrastructure and Regional Development also expressed a wider view of the role of the equalisation schemes in supporting broader Tasmanian economic activity:

... through their actions, successive governments have accepted the rationale for TFES support has effectively expanded beyond a simple equalisation of transport costs to the provision of assistance that recognises Tasmania's need for economic support ... (sub. 42, p. 26)

However, as noted in chapter 2, Tasmania continues to underperform relative to mainland states on many important economic and social indicators. This is despite the existence of the long standing and popular freight and passenger vehicle equalisation schemes. Greater emphasis should therefore be given to policies and programs that directly target the underlying causes of economic and social disadvantage in the state.

## **6.1 Policies to improve economic and social development**

As articulated in its draft report on geographic labour mobility, the Commission sees merit in policies that encourage people to move in response to changing economic conditions (PC 2013a). However, where governments seek to sustain population in a particular region, approaches that are designed to make the region concerned more attractive to business generally — such as improving selected infrastructure, upgrading labour force skills, removing inefficient taxes and

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improving administrative efficiency — are preferable to sponsoring selected firms or encouraging businesses to locate (or remain) there through subsidies. Importantly, such a policy approach should be aligned with an overarching strategy that is consistent with a realistic assessment of the region’s comparative advantages.

In light of this, the Commission considers that the Australian Government should consider policy and other reforms that have national and Tasmanian benefits (such as coastal shipping reform) and those that directly enhance the competitiveness and productivity of the Tasmanian economy.

Where governments nevertheless pursue direct expenditure-based programs, the costs and benefits of a range of options should be assessed. For example, funding of the existing equalisation schemes could require more than \$2 billion in net present value terms over the next 15 years. Some of this funding could be redirected to policies and programs that target areas of weakness in the Tasmanian economy in more direct and cost-effective ways, and thereby generate greater net benefits to the state as a whole.

### **Core elements of successful economic development strategies**

The Commission considers that successful economic development strategies require the active involvement of all levels of government in a number of key areas, including:

- improving employment outcomes through skilling and training
- creating an environment for more private sector involvement in infrastructure provision and operation
- improving coherence in the provision of infrastructure
- creating a regulatory environment that reduces the cost of doing business.

#### *Improving outcomes through skilling and training*

The Commission notes that employment and labour market issues are a particular concern for Tasmania. A recent Commission draft report into labour mobility found low levels of labour mobility in Tasmania, unemployment levels that are consistently higher than the national average, and lower than average educational attainment (PC 2013a). High wages, combined with low skill levels, were also identified as a possible cause of persistently high unemployment levels in Tasmania (PC 2013a).

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Improved education and training programs can improve the skills base of workers, and help to increase employment opportunities. More generally, policies that reduce barriers to employment and remove impediments to greater labour mobility are particularly important for geographically remote economies.

The Australian Government has foreshadowed an inquiry into the Fair Work Act and Australian labour markets. During this inquiry the Commission has seen indications that there are regional factors that should be examined in the Australian labour market inquiry.

*Creating an environment for more private sector involvement in infrastructure provision*

Like many remote regions of Australia, the need for efficient movement of people and goods into and out of Tasmania is important to the competitiveness of the local economy and its future growth path.

Ensuring that transport markets are effective and efficient is a high priority, and governments should reduce regulatory barriers and increase competition wherever this is feasible.

Launceston Airport (sub. 25) has argued that the TFES itself, by subsidising the cost of sea freight, is acting as a barrier to greater private investment in air freight capacity and improved air services, including in relation to air connections to King Island and the Furneaux Group of islands. A similar argument was made by Hobart Airport:

Hobart Airport is prepared to invest in growing the Airport's freight handling infrastructure to service Southern Tasmania's freight sector, improving access to markets and driving positive economic outcomes for Tasmania. However, the current freight subsidy arrangements inhibit private investment in this area. (sub. 46, p. 2)

Greater private sector involvement in Tasmania's shipping and land freight systems should also be considered. As JBS Australia Pty Limited (a meat processing firm) stated:

We also see scope for greater investment in infrastructure by the private sector in Tasmania as seen in other mainland states. (sub. 49, p. 2)

Greater private sector ownership and/or control of freight infrastructure, particularly port and shipping infrastructure, should be considered as part of the longer term economic development of Tasmania. State government ownership and operation of a commercial shipping business (TT-Line) and Tasmanian ports should be subject to periodic and transparent review.

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As noted in chapter 4, there is evidence that restrictions on coastal shipping have led to higher shipping costs between Tasmania and the mainland than would otherwise be the case, and also ultimately impact on the viability of international direct shipping services to Tasmania. The Australian Government's foreshadowed review of coastal shipping regulation should be expedited and examine the impact of the current regulations on shipping competition and costs, and identify scope for reforms that might increase competition and lower shipping costs, including for Tasmanian businesses.

### *Improving coherence in the provision of infrastructure*

The availability and pricing of infrastructure can exert substantial influence on the location decisions of industries and households. In particular, some types of developments may be hindered by inadequate provision of infrastructure, while other regions may experience problems with excess capacity.

This inquiry has not found strong evidence of a major deficiency in the quantity of physical transport infrastructure in Tasmania, but it has found evidence that there is a need for better longer-term planning and prioritisation of infrastructure funding decisions and more effective use of capital (as discussed in chapter 5). Future fiscal pressures and sustainable policy responses will require greater attention to relative returns in allocating scarce capital, and heightens the need for those decisions to be informed by benefit cost analyses.

An integrated freight transport strategy should be one component of the broader economic development strategy for the state as a whole. The Australian Government should also ensure that funding it provides for Tasmanian transport infrastructure is consistent with the goals and objectives of a freight strategy that meaningfully addresses the concerns outlined in this report (including in relation to requisite analysis and prioritisation), and evident in the commentary on improving Tasmania's economic performance.

### *Creating a regulatory environment that reduces the cost of doing business*

The limited role of the private sector in Tasmania may indicate unusually large barriers to new investment in the state. To the extent this is caused by unnecessary or unnecessarily burdensome regulation, economic growth is compromised.

A recent Commission report into major project development assessment processes found that processes in Tasmania could be improved, but that the state approached leading practice in some aspects (PC 2013b). Good practices in Tasmania include

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the use of an independent regulatory assessment agency — the Tasmanian Planning Commission — to conduct integrated assessments of projects of state significance.

In contrast, a study by the Australian Innovation Research Centre (AIRC) into ways to diversify the Tasmanian economy found that environmental regulations and approval processes for new projects were, ‘uncertain, risky, expensive and lengthy’ (AIRC 2012, p. 10). Moreover, the authors found that approvals processes were, ‘overseen by government agencies whose task is to ensure regulatory enforcement with a mandate not to take into account economic concerns’ (AIRC 2012, p. 10).

A commitment to reduce or remove unnecessary regulatory barriers to greater private sector business investment in Tasmania should be a central objective of the state’s economic development strategy. Of particular concern are barriers associated with changing land use (for example, limits on minimum sub-division sizes in rural areas, and constraints on previously cleared land that hinder conversion back to farming) that may be adversely affecting new investment in potential growth industries for Tasmania, including dairy farming, viticulture and horticulture.

#### *A greater willingness to change*

The Commission received several submissions and heard evidence during public hearings of business concern of an entrenched reticence to undertake meaningful structural reform in Tasmania. A submission to this inquiry from Nekon Pty Ltd questioned the willingness of the state and local governments in Tasmania to tackle the state’s fundamental problems, or to embrace change and take risks (sub. DR69). Concerns were also raised in this submission about the reluctance to amalgamate local councils in Tasmania, despite strong evidence of the net benefits:

A recent example of this is a study commissioned by the Southern Tasmanian Councils Authority (STCA, which represents all twelve councils in the South of the State) in 2011. ... This expert panel received 213 submissions of which 83% supported amalgamation of councils in some form. Only 9.8% did not support amalgamation. It went on to make thirteen recommendations to restructure local government in Southern Tasmania ... However, what has been remarkable is the substantive recommendations for structural reform have been disregarded. (sub. DR69, p. 2)

The Commission also heard concerns during public hearings for this inquiry on the pervasive involvement of the State Government in the Tasmanian economy. For example, Tasmanian businessman, John Barker, questioned the extent of government ownership and involvement in the state’s economy, and the extent of government apparatus in the state more generally:

Why is it that Tasmanian ports, Tasmania rail and even one of the three Tasmanian shipping operators is Tasmanian Government owned? Why do we have in a small

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population such as Tasmania 11 departmental secretaries, multiple deputy secretaries, four levels of senior executive service in the public sector, those four levels ranging, valued conservatively, from 120 to 234 thousand? For example, why is it that water and sewerage infrastructure and services is owned by local government with dividends derived from and profitably returned to local government? Why do we have 29 councils? Why do we have 33 road entities and 33 planning authorities for a population of 510,000 people? Why do we have 11 state government departments and 83 state government agencies in Tasmania? (trans., p. 303)

In relation to the broader economic challenges facing Tasmania, Nekon Pty Ltd director Robert Rockefeller said that Tasmania requires ‘tough love’, and that local, state and federal governments are wasteful and encourage a welfare mentality in the state that is resistant to change. He noted that overcoming these problems will require greater willingness to reform by all levels of government, including the Australian Government:

That’s where the federal government can actually reduce (business) cost structures, and ... the cost structures of ... local government, ... in superannuation, ... in water and sewerage charges, whether it’s in relation to planning schemes, whether it’s in relation to a whole range of red tape. (trans., p. 243)

In general, a stronger focus on the merit, if any, of government involvement in commercial or potentially commercial enterprises, administrative efficiency (delivering efficient public services that make a lesser call on taxes and charges to fund them) and an approach to governance that maximises the scope for private sector investment and expansion through competitive tax regimes (local, state and national), should also be high priorities for the Australian and Tasmanian Governments.

### **King Island and the Furneaux Group of islands**

By virtue of their size, sparse population density and remoteness, the specific economic geography of the Bass Strait islands has been raised in submissions and the subject of evidence through public hearings. Their economic sustainability is critically dependent on access to larger processing and end-product markets. In the area of transport logistics, they are clearly more vulnerable relative to the main island due to smaller volumes, high seasonality and very limited choice in transport services.

For example, King Island Shipping Group gave evidence to this inquiry that residents of King Island recently used a tender process to procure shipping services, but found:

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the market response was less than adequate in terms of what our demand was, and we could not ... generate any solutions out of that market tender, and as such the current situation with the King Island freight task still remains a challenging position in terms of trying to find alternative solutions to competition. (trans., p. 413)

Moreover, this remains a major concern to producers on the island, as getting product to market is:

the single most significant hurdle that we face in terms of cost pressure. (trans., p. 414)

The isolation of King Island and the Furneaux Group of islands also causes problems on the cost and feasibility of inputs, including with respect to securing workers. Geoff Cossar from GA Cossar and Co Pty Ltd gave evidence to this inquiry that:

Just attracting staff to (Flinders) island is onerous. The cost of living on the island is high. The profitability is low, so even to attract someone at a basic wage level, it's very, very difficult. (trans., p. 280)

On the other hand, the islands' remoteness provides niche market appeal as reflected in their brand image — which provides a platform for high-value low-volume products in agriculture, and to a lesser extent, tourism.

The economic viability of the communities on these islands is largely a matter for the Tasmanian Government, within the broader context of market drivers. For example, the partnership agreement between the Tasmanian Government and the King Island Council directly address these concerns.

Nevertheless, the Australian Government supports residents of King Island and the Furneaux Group of islands through a variety of ongoing and one-off initiatives. The former include eligibility for remote zone tax offsets, a remote area allowance payable to recipients of income support, pension and Abstudy, and support for parents under the assistance for isolated children scheme. Current one-off initiatives include support for the development of a world leading power supply system for King Island, and funding for airstrip upgrades on Flinders Island and Cape Barren Island.

To the extent possible, policies and programs designed to support economic development on the islands (such as partnership agreements between the state government and island councils and the Australian Government initiatives mentioned above) should ideally be consistent with, or form part of, the broader economic development strategy for Tasmania as a whole.

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## 6.2 Meshing with existing plans and programs

There is an existing array of economic and regional development plans and strategies for Tasmania. Examples include high-level programs and policies such as the Australian Government's *Economic Growth Plan for Tasmania*, and the Tasmanian Government's *Economic Development Plan*.<sup>24</sup>

Other Australian Government initiatives that are specific to (or largely focused on) Tasmania include *Regional Development Tasmania*, the *Forest Industry Structural Adjustment Package*, and the recently announced *Tasmanian Jobs and Growth Plan*.

More generally, a range of initiatives have been developed and funded by all levels of government over time, covering different geographical areas, industries and activities. However it is not clear from this inquiry that these initiatives are collectively coherent and optimal for Tasmania as a whole. In particular, are they consistent and complementary in their design and outcomes?

In the limited time available to this inquiry, it appears that many of these programs are individually aimed at limiting (or responding to) some aspect of disadvantage. They do not appear to be informed by any meaningful questioning of the retention of Tasmanian economy wide structures and processes that have failed to deliver improved outcomes for Tasmania over long periods.

The Commission considers that an important first step in improving the existing approach to economic development in Tasmania is to conduct a stocktake of existing initiatives (policies, programs, development bodies and agencies, plans and strategies) to clarify their nature, intent, timing, coverage, areas of potential or actual duplication and any fundamental gaps. An initial and good starting point is the collection of policies and programs identified by the Australian Innovation Research Centre (AIRC) in its report to the Department of Infrastructure and Regional Development on ways to diversify the Tasmanian economy.

During public hearings for this inquiry, Tasmanian businessman John Barker said that he considered the need for a stocktake of economic development policies and programs in the state to be critical, and added:

I would urge the Government, the Australian Government, to initiate that review as soon as they can. I note the draft recommendation emphasises initiatives established by all levels of government. It should be extended to take a broader view, I believe. (trans., p. 303)

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<sup>24</sup> Details on the latter are available in a Tasmanian Government submission to this inquiry (sub. DR85, p. 16) and from their website.

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The Australian and Tasmanian Governments should jointly undertake the stocktake of existing initiatives with a view to having a publicly available report by the end of 2015. The results should be used by the Australian and Tasmanian Governments to inform a single, fundamental and comprehensive policy strategy to enhance the economic development of Tasmania, and ensure related policies and programs generate the greatest net benefit to the state as a whole.

The Commission notes that a new body — the Joint Commonwealth and Tasmanian Economic Council — has recently been established under the Australian Government's *Economic Growth Plan for Tasmania*. This body will consider competitive reforms to enhance Tasmania's long term economic growth prospects. The council is well placed to initiate the proposed policy and program stocktake as part of its initial work program.

### **6.3 Review and evaluation**

A policy dilemma for the Australian Government is that if assistance made available under a program or economic development strategy does not improve the underlying competitiveness (and therefore attractiveness to investors) of Tasmania, or facilitate the mobility of its inhabitants, there will inevitably be pressures from recipients for the assistance to become permanent. This would not only be likely to reduce the productiveness of the Tasmanian economy more generally, but also involve substantial transfers from the wider Australian community.

For this reason, the Commission considers that the commitment of Australian Government funds to broader economic development objectives in Tasmania should be subject to periodic review, with the assessments conducted by an appropriate independent body. Such reviews would complement the need for periodic reviews of the transport support schemes.

A key to the success of these reviews will be a commitment by governments (at all levels) to collect data and other evidence. Where the data needed to properly evaluate existing programs are not currently available, processes should be put in place to collect them as soon as practicable. In regard to future policies and programs for Tasmania (including those funded by the Australian Government), processes to collect the required data should be embedded at the program design stage, rather than after programs are implemented.

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DRAFT RECOMMENDATION 19

*The Joint Commonwealth and Tasmanian Economic Council should initiate a stocktake of existing programs specific to Tasmania as part of its initial work program. The stocktake should:*

- *cover initiatives established by all levels of government*
- *clarify their nature, intent, timing, scope, governance arrangements and any areas of duplication*
- *assess whether the suite of initiatives represents a coordinated, consistent, targeted, and efficient approach to Tasmania's economic development*
- *include the release of a public report in 2015.*

*The results of the stocktake should contribute to, and inform the development of, an integrated economic development strategy for Tasmania.*

DRAFT RECOMMENDATION 20

*The Australian Government should review and evaluate its programs for Tasmania after a reasonable length of time. Such reviews should be transparent, be conducted by an appropriate independent body and should comprise an ex-post assessment of the aggregate benefits and costs of the strategy to date and an assessment of the benefits and costs of any continued Australian Government financial contribution to these programs.*



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## A Conduct of the inquiry

The Commission received the terms of reference for this inquiry on 29 November 2013. Notices were placed in the media and on the Commission's website inviting public participation. Information about the inquiry was also circulated to parties identified as likely to have an interest.

The Commission initially hosted two roundtables in Tasmania to discuss key issues and to assist inquiry participants in preparing their submissions. The Commission also separately held informal consultations with relevant regulatory bodies, government agencies and companies.

Details of the organisations that were consulted are included in table A.2.

64 submissions were received prior to publication of the draft report on 24 January 2014. A further 49 submissions were received in response to the draft report and are denoted in table A.1 with a prefix 'DR'.

Public hearings were held to discuss the draft report in Melbourne, Hobart, Launceston and Canberra in early February 2014. A list of participants at the public hearings is provided in table A.3.

The Commission would like to thank all those who have contributed to the inquiry.

**Table A.1 Submissions received**

| <i>Participant</i>                                    | <i>Submission No</i> |
|---|----------------------|
| ANL Container Line Pty Ltd                            | 33                   |
| Australian Aluminium Council                          | 10                   |
| Australian Caravan Club Limited                       | DR92                 |
| Australian Competition and Consumer Commission        | 28                   |
| Australian Industry Group                             | DR94                 |
| Australian Pacific Touring                            | 11                   |
| Australian Shipowners Association                     | 29, DR87             |
| Austrade  | 41, DR108            |
| Bell Bay Aluminium                                    | 12, DR77             |
| Boating Industry Association of Victoria              | 13                   |
| Brohier, Peter  | 59, DR111            |
| Business Council of Australia                         | 47                   |
| Burnie Chamber of Commerce and Industry               | 57                   |
| Campervan and Motorhome Club of Australia             | DR91                 |
| Caravan Industry Australia Tasmania                   | 63                   |
| Caravan, RV and Accommodation Industry of Australia   | DR76                 |
| Cement Industry Federation                            | DR83                 |
| Coles Supermarkets Australia Pty Ltd                  | DR80                 |
| Cooper, Cherie Joy                                    | 58                   |
| Cooper, Patricia                                      | 60                   |
| Corporate Financial Consulting Pty Ltd                | 6                    |
| Cradle Coast Authority                                | 20                   |
| Cripps Nubake Pty Ltd                                 | DR99                 |
| Cruise Down Under                                     | DR72                 |
| Cuthbertson Bros Pty Ltd                              | 3, DR104             |
| Dent, Lindsay   | DR86                 |
| Department of Infrastructure and Regional Development | 42, DR107            |
| Engineers Australia                                   | 36                   |
| Flinders Council                                      | 23, DR90             |
| Forestry Tasmania                                     | 37                   |
| GA Cossar and Co Pty Ltd                              | 7, DR82              |
| Greenham Tasmania Pty Ltd                             | DR73                 |
| Harvest Moon  | 21                   |
| Haywards Steel  | DR95                 |
| Hobart Airport  | 46                   |
| Institute of Public Affairs                           | DR65                 |
| JBS Australia Pty Ltd                                 | 49                   |
| John Barker and Associates                            | 44                   |
| Kelp Industries Pty Ltd                               | 4                    |
| King Island Beef Producers Group                      | 15                   |
| King Island Shipping Group                            | 19                   |
| Launceston Airport                                    | 25                   |
| Launceston Chamber of Commerce                        | DR70                 |
| Lindblad Expeditions                                  | 1                    |

(Continued next page)

Table A.1 (continued)

| <i>Participant</i>  | <i>Submission No</i>    |
|---|-------------------------|
| Maritime Union of Australia   | 32, DR89                |
| McDonald, Greg  | 5                       |
| McNamara, Patrick   | DR106                   |
| Mondelez Australia Pty Ltd  | 24, DR98                |
| na Champassak, Phil   | 51                      |
| Napier, Don   | 61, DR66                |
| National Public Lobby   | 2, 52, DR113            |
| National Sea Highway  | 54, DR102, DR109, DR112 |
| National Sea Highway Coalition – Tasmanian Division   | 34                      |
| Nekon Pty Ltd   | DR69                    |
| Net Sea Freight – Tasmania Pty Ltd  | 26, DR75                |
| Norske Skog Boyer Mill  | 39, DR67, DR110         |
| Northern Tasmania Development   | 27, DR93                |
| Nyrstar   | DR105                   |
| Regional Development Australia – Tasmania   | 17                      |
| SeaRoad Holdings Pty Ltd  | 35, DR81, DR100         |
| Shipping Australia Limited  | 53                      |
| Simplot Australia   | 50, DR96                |
| Tarlinton, Trish and John   | 56                      |
| Tasmanian Exporters Group   | 14                      |
| Tasmanian Farmers and Graziers Association  | 45, DR101               |
| Tasmanian Farmers and Graziers Association, King Island Branch  | 8, DR79                 |
| Tasmanian Flour Mills Pty Ltd   | DR71                    |
| Tasmanian Government  | 43, DR85                |
| Tasmanian Liberals  | DR68                    |
| Tasmanian Ports Corporation   | 30, DR97                |
| Tasmanian Railway Pty Ltd   | 22, DR74                |
| Toll Group  | 55                      |
| Tourism Industry Council Tasmania, Tourism and Transport Forum,<br>and Cradle Coast Tourism Executive | 48                      |
| TT-Line Company Pty Ltd   | 9, DR84                 |
| Veolia Environmental Services   | 38, DR103               |
| Viewbanks Pty Ltd   | 16                      |
| Vos Construction and Joinery Pty Ltd  | 62                      |
| Webster Limited   | 40                      |
| Wine Tasmania   | DR78                    |
| Wise, Grant   | 18                      |
| Wooden Boat Association of South Australia  | DR88                    |
| Confidential submissions  | 24, 31, 64, DR105       |

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**Table A.2 Meetings and roundtables**

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*Participants*

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**Tasmania**

Bartholomew, Quinn and Associates  
Bell Bay Aluminium  
Cuthbertson Bros Pty Ltd  
Department of Economic Development, Tourism and the Arts (Tas)  
Department of Infrastructure, Energy and Resources (Tas)  
Flinders Island Council  
Forestry Tasmania  
Fresh Freight Tasmania  
Harvest Moon  
King Island Council  
Killara Pastoral  
Lion  
Launceston City Council  
Markarna Grazing Company  
Mondelez Australia Pty Ltd  
Net Sea Freight – Tasmania Pty Ltd  
Norske Skog Boyer Mill  
Northern Tasmania Development  
Nyrstar  
Petuna Group  
Regional Development Australia - Tasmania  
Simplot Australia  
TT-Line Company Pty Ltd  
Tasmanian Chamber of Commerce and Industry  
Tasmanian Exporters Group  
Tasmanian Farmers and Graziers Association  
Tasmanian Minerals Council  
TasPorts  
TasRail  
Tourism Tasmania  
Webster Limited

**Victoria**

Australian Shipowners Association  
Department of Transport, Planning and Local Infrastructure (Vic)  
Juturna Infrastructure  
Port of Melbourne Corporation  
SeaRoad Holdings Pty Ltd  
Toll Group

**Other**

Malaysia International Shipping Corporation Berhad  
Orient Overseas Container Line

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(Continued next page)

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Table A.2 (continued)

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*Participants*

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Pacific International Lines  
Swire Shipping  
Thompson Clarke

**Australian Government**

Australian Competition and Consumer Commission  
Department of Human Services  
Department of Infrastructure and Regional Development  
Infrastructure Australia  
Joint Commonwealth and Tasmanian Economic Council

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**Table A.3 Public hearings**

| <i>Individual or organisation</i>                            | <i>Transcript page numbers</i> |
|--|--------------------------------|
| <b>Melbourne – 3 February 2014</b>                           |                                |
| Australian Shipowners Association                            | 4–16                           |
| Institute of Public Affairs                                  | 17–24                          |
| Mondelez Australia Pty Ltd                                   | 25–40                          |
| Maritime Union of Australia                                  | 41–55                          |
| <b>Hobart – 4 February 2014</b>                              |                                |
| Norske Skog Boyer Mill and Bartholomew Quinn and Associates  | 59–84                          |
| Tasmanian Bus and Coach Society                              | 85–89                          |
| Forestry Tasmania  | 90–94                          |
| Tourism Industry Council Tasmania and Cradle Coast Authority | 95–110                         |
| Austrade   | 111–121                        |
| Fresh Freight Tasmania                                       | 122–132                        |
| Tasmanian Exporters Group                                    | 133–150                        |
| <b>Hobart – 5 February 2014</b>                              |                                |
| Peter Brohier and John Jones                                 | 153–164                        |
| John Livermore   | 165–173                        |
| Richard John Burgess   | 174–186                        |
| Winemaking Tasmania  | 187–195                        |
| Houston’s Farm   | 196–207                        |
| National Sea Highway Coalition Tasmania                      | 208–217                        |
| Campervan and Motorhome Club of Australia                    | 218–222                        |
| Andrew Wilkie MP   | 223–233                        |
| Nekon Pty Ltd  | 234–246                        |
| <b>Launceston – 6 February 2014</b>                          |                                |
| Veolia Environmental Services                                | 249–269                        |
| Regional Development Australia Tasmania                      | 270–278                        |
| G A Cossar and Co Pty Ltd                                    | 279–285                        |
| Cuthbertsons Bros Pty Ltd                                    | 286–299                        |
| John Barker and Associates                                   | 300–307                        |
| National Sea Highway Coalition                               | 308–318                        |
| Bell Bay Aluminium   | 319–330                        |
| Harvest Moon   | 331–343                        |
| Net Sea Freight – Tasmania Pty Ltd                           | 344–364                        |
| Launceston Chamber of Commerce                               | 365–371                        |
| Agility Logistics  | 372–375                        |

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(Continued next page)

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Table A.3 (continued)

| <i>Individual or organisation</i>                     | <i>Transcript page numbers</i> |
|---|--------------------------------|
| <b>Launceston – 7 February 2014</b>                   |                                |
| Fruit Growers Tasmania                                | 379–389                        |
| Greg McDonald   | 390–398                        |
| Circular Head Dolomite                                | 390–398                        |
| Susan Macdonald                                       | 399–403                        |
| Caravan, RV and Accommodation Industry of Australia   | 404–410                        |
| King Island Shipping Group                            | 411–424                        |
| King Island Council                                   | 411–424                        |
| Palmer United Party                                   | 425–428                        |
| Government of Tasmania                                | 429–456                        |
| Northern Tasmanian Development                        | 457–463                        |
| <b>Canberra – 10 February 2014</b>                    |                                |
| Department of Infrastructure and Regional Development | 467–510                        |
| Trish and John Tarlinton                              | 511–518                        |
| JBS Australia Pty Ltd                                 | 519–536                        |
| Greenham Tasmania Pty Ltd                             | 537–550                        |

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## B Recommendations of the PC 2006 inquiry into Tasmanian freight subsidy arrangements

### Box B.1 The Commission's 2006 inquiry recommendations

#### Recommendation 1

The basis for claiming TFES payments should be restructured to minimise the adverse incentives that the current scheme generates.

#### Recommendation 2

Assistance under the TFES should only be payable on the basis of evidence of actual wharf-to-wharf costs:

- Centrelink should specify the documentary evidence that it will accept as proof of wharf-to-wharf costs. As far as practicable, this should be based on original carrier wharf-to-wharf invoices.
- Parameter adjustments of \$230 per TEU for door-to-wharf and wharf-to-door costs would no longer apply. Other parameter adjustments would continue to be used.

#### Recommendation 3

The administration and auditing of the TFES should focus more intensively on the verification of wharf to wharf costs:

- The systems required to administer the scheme should be updated in the light of the more detailed evidence and data processing needed to verify wharf-to-wharf costs.
- There should be more comprehensive public reporting of information, including the annual payments to recipients.

#### Recommendation 4

DOTARS and the BTRE should revise the methodology for setting and updating the remaining parameters, and review them every three years. In particular, they should review how wharf-to-wharf costs should be defined. The results of parameter reviews should be published.

(continued next page)

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Box B.1 (continued)

Recommendation 5

DOTARS should monitor the operation of the revised scheme to investigate whether there is evidence of ongoing gaming and overcompensation of wharf-to-wharf costs. It should report to Government on this matter during 2009.

The report should also examine:

- the effectiveness of administration and audit controls
- the role of all actual and potential claimants who are not producers and shippers of goods assisted under the TFES
- any aspects of the Ministerial Directions judged to be causing difficulty at that time.

If the Government concludes that gaming and overcompensation of freight cost disadvantage remain significant issues, it should introduce a flat rate of assistance per TEU as per finding 7.1, to operate from 1 July 2010.

Recommendation 6

The TWFS should pay the same level of assistance per tonne to wheat shipped in containers and in bulk:

- Payments under the TWFS should not be capped.
- Wheat should no longer be eligible for assistance under the TFES.

The level of assistance should be based on the least cost method of shipping wheat across Bass Strait and a rail freight equivalent cost:

- Given the lack of recent data on these measures, the Bass Strait wharf-to-wharf container rate and the TFES road freight equivalent should be used in the interim. As such, for three years, the TWFS should pay assistance of \$23.12 per tonne, or the shipper's actual wharf-to-wharf cost, whichever is the lesser.
- In concert with the first three-year parameter and operational review of the TFES, the BTRE should estimate the cost of bulk shipments of wheat and the rail freight equivalent, to update the rate of subsidy from that time.

Source: (PC 2006b).

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## C Coastal trading regulation

### Key points

- Recent changes to Australian coastal trading regulation have been: in 2009, changes to workplace relations, combined with awards modernisation processes in 2011, resulted in Australian wage rates extended to workers on foreign flagged vessels inside Australia's Exclusive Economic Zone; in 2012, hiring, licensing, and vessel registration requirements changed, and tax concessions applied to investments and operations by certain Australian ship operators.
- The cumulative effects of the changes has been: to increase the costs of providing domestic coastal trading services; deter international vessels from engaging in Australia's coastal trade and direct international services that rely on coastal trade volumes for commercial viability; and reduce the level of competition in Australia's coastal trading network.
  - These changes are likely to have a substantial long term impact on Australia's shipping industry, and those Australian businesses that rely on shipping services to transport their goods to market.
- Tasmania, as an island state, is particularly vulnerable to regulations which reduce engagement in coastal trading. Many participants to this inquiry have stated that shipping costs have risen over the past few years, and that the increased costs are attributable to the 2009 and 2012 regulatory changes.
- Foreign flagged vessels are likely to be deterred from engaging in coastal trading in Australia for two reasons:
  - vessel owners are required to pay Australian wages for their third and subsequent voyages in a 12 month period, increasing the costs of calling at Australian ports
  - owners of foreign flagged vessels that engage in triangular trades encompassing two Australian ports have to apply for a temporary licence, nominating five voyages in advance. The foreign flagged vessel owner must negotiate with interested Australian registered vessels, whereby the application could be refused on the grounds that an Australian ship is available to provide the service. However, the Commission acknowledges that this process largely existed under the previous regulatory framework.
- To the extent that the changes have decreased the viability of foreign flagged vessels calling at Australian ports, the level of competition in coastal trading has reduced.
- Removing the regulations will be of some direct and indirect benefit to Tasmania. However, removing them will not fully ameliorate the relatively high costs of shipping across Bass Strait.

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## C.1 Introduction

Coastal shipping can be broadly defined as the carriage of cargo or passengers from a port in a state/territory to a port in another state/territory via water. Whilst common for a vessel to undertake intrastate and/or international legs along with an interstate leg during any single voyage, international legs are not coastal trading. Intrastate travel is not necessarily coastal trading, Australian operators engaging in intrastate trade may opt in to the legislative framework depending on their individual business needs. This appendix outlines some of the recent legislative changes affecting Australia's coastal trade, and the impact of those changes on Tasmania.

Section C.2 covers the 2009 amendments to the Fair Work Regulations 2009 (Cwlth), and the award modernisation process under the *Fair Work Act 2009* (Cwlth), whereby foreign flagged vessels which engage in Australian coastal trading are obliged to pay Australian seafaring wages to their workers (on the third and any subsequent voyages).

Sections C.3 to C.5 discuss the coastal trading changes introduced in 2012. The three main 'reforms' were to: vessel registration requirements; licensing vessels to engage in coastal trading; and a range of tax concessions for Australian flagged vessels and ship operators.

Section C.6 outlines the likely impacts of the recent reforms on coastal trading in Tasmania.

## C.2 Amendments to workplace relations legislation

Prior to 1 January 2010, unlicensed (permit) vessels were not engaging in 'coastal trading' (see section C.4) and, therefore, these vessels were permitted to pay the International Transport Workers' Federation (ITF) prevailing wage rate.<sup>1</sup>

From 1 January 2010, amendments to the Fair Work Regulations 2009 (Cwlth) extended the application of the *Fair Work Act 2009* (Cwlth) to all workers engaged in coastal trading. From 1 January 2011, vessels that were licensed or under permit (see section C.4), as well as majority Australian-crewed vessels, were required to pay prescribed wage rates.

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<sup>1</sup> Permit vessels could have wage conditions set out by their flag state, and they may differ from ITF rates.

Following a process of award modernisation, the Maritime Industry Seagoing Award 1999 was replaced by the Seagoing Industry Award (SIA). On 1 January 2010, SIA Part A applied to vessels covered by the *Fair Work Act 2009* (Cwlth), except unlicensed (permit) vessels. From 1 January 2011, SIA Part B applied to unlicensed vessels, and required employers of workers on those vessels to provide their workers with certain minimum Australian conditions of employment such as specified wage rates, hours of work, and allowances.

Table C.1 illustrates the changes in the prevailing wage rates for different vessel licences before and after the amendments.

**Table C.1 Workplace relations amendments to prevailing wages in the seagoing industry**

| <i>Vessel ownership</i> | <i>License type</i> | <i>Previous wage rate determined by:</i> | <i>Current wage rate determined by:<sup>a</sup></i> |
|-------------------------|---------------------|--|---|
| Australian-owned vessel | Licensed            | MISA 1999                                | SIA 2010 Part A, plus EBA negotiated additions      |
|                         | Unlicensed (permit) | ITF market rate                          | SIA 2010 Part B                                     |
| Foreign flagged vessel  | Licensed            | MISA 1999                                | SIA 2010 Part A, plus EBA negotiated additions      |
|                         | Unlicensed (permit) | ITF market rate                          | SIA 2010 Part B                                     |

<sup>a</sup> The SIA applied to licensed vessels from 1 January 2010, and to unlicensed vessels from 1 January 2011. EBA = Enterprise Bargaining Agreement. ITF = International Transport Workers' Federation. MISA = Maritime Industry Seagoing Award 1999. SIA = Seagoing Industry Award 2010.

*Sources:* Australian Industrial Relations Commission (1999); Fair Work Commission (2010).

According to Deloitte (2012), the SIA Part B wages were around twice the amount of the ITF market rates that prevailed previously. The Australian Shipowners Association (sub. DR87) stated that there are many ITF rates and that it is difficult to generalise what the 'true' differential between ITF market rates and SIA Part B would be, but acknowledged that wages would be higher, particularly for seafarers at lower ranks. Labour costs account for around 10–15 per cent of total voyage costs (chapter 4), and a significant increase in labour costs will adversely affect the profitability of some foreign flagged vessels engaging in coastal trading in Australia, and those engaging in international services augmented with coastal trading volumes.

The amendments require that any vessels entering Australia's Exclusive Economic Zone — which are majority Australian-crewed — pay their workers SIA Part A wages. This requires foreign flagged vessels (which are majority Australian-crewed) operating on international routes to/from Australia to pay SIA Part A wages. Prior to the changes, these vessels would have paid their workers ITF

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market rates. The Commission estimates that solely based on the leave accrual provisions, the labour costs associated with remunerating workers at the SIA Part A rate is more than 80 per cent above the SIA Part B rate. The Commission has not analysed other provisions that exist in SIA Part A which do not exist in SIA Part B such as allowances for: handling and securing cargo; disturbances of sleep; study; living away from home; and meals and accommodation. The total labour costs of remunerating a worker under SIA Part A could potentially be twice as much as for SIA Part B.

### **C.3 Coastal trading reforms: vessel registration**

Prior to 2012, coastal trading was regulated by Part VI of the *Navigation Act 1912* (Cwlth). The *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth) ('the Coastal Trading Act') and consequential amendments Act<sup>2</sup> established the new regulatory framework on 1 July 2012.

The object of the Act is to provide a regulatory framework for coastal trading in Australia that:

- (a) promotes a viable shipping industry that contributes to the broader Australian economy
- (b) facilitates the long term growth of the Australian shipping industry
- (c) enhances the efficiency and reliability of Australian shipping as part of the national transport system
- (d) maximises the use of vessels registered in the Australian General Shipping Register in coastal trading
- (e) promotes competition in coastal trading
- (f) ensures efficient movement of passengers and cargo between Australian ports. (Coastal Trading Act s. 3)

The new regulatory framework introduced three main changes. The changes affected vessel registration requirements (see below); licensing requirements to engage in coastal trading (section C.4); and certain tax concessions for vessels and ship operators (section C.5).

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<sup>2</sup> *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth). Collectively, these two Acts are referred to as 'the Coastal Trading Acts'.

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## Vessel registration

Vessel registration is fundamental to coastal shipping as the flag flown by a vessel determines the license types the vessel can operate under as established by the Coastal Trading Act. It is a requirement that every Australian-owned commercial vessel (with some exceptions — see below) be registered.

At a high level, there are two sets of registers: national registers, and international or open registers. National registers enable domestically-owned vessels to register so they can engage in coastal trading within their territorial waters. Depending on how registers are established under domestic law, international registers may allow domestically-owned vessels to engage in both coastal and international trade in connection with the flag state. Similarly, open registers allow foreign-owned vessels to engage in both coastal and international trade in connection with the flag state, but generally have less restrictive entry requirements. Access to coastal trade in other states is subject to the domestic legislation of the coastal state. It is important to note that there are no ‘standard’ definitions for national, international, or open registers, and as such, the terms are descriptive only.

### *Existing registration requirements in place prior to the 2012 changes*

Prior to the shipping ‘reform’ package, ships were registered on the Australian register of ships under the *Shipping Registration Act 1981* (Cwlth). It was a requirement that every Australian-owned ship over 24 metres in tonnage length (excluding Government ships, fishing vessels and pleasure craft) be registered.

Foreign owned ships were not permitted to be registered on the Australian register of ships.

Under the *Navigation Act 1912* (Cwlth) (which was the relevant Act prior to the 2012 changes), whether a ship was registered in the Australian register of ships had little bearing on its ability — or licensing conditions — to engage in coastal trading (see section C.4).

### *Additional registration requirements after the 2012 reforms*

The *Shipping Registration Amendment (Australian International Shipping Register) Act 2012* (Cwlth) amended the *Shipping Registration Act 1981* (Cwlth) abolishing the Australian register of ships and creating two new registers:

- the Australian General Shipping Register (‘the general register’)
- the Australian International Shipping Register (‘the international register’).

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The general register effectively replaced the Australian register of ships and has the same registration requirements as applied under the *Shipping Registration Act 1981* (Cwlth) prior to the commencement of the changes. One important point to note is that only ships registered on the general register are permitted to apply for general licences to engage in coastal trading (see section C.4).

The international register is a new register, and as stated in the Explanatory Memorandum:

International registers have been established by a number of traditional maritime countries to offer their ship owners an alternative to registering under open registers. International registers offer some of the advantages of open registers, such as the ability to use crew of different nationalities, while maintaining the link between ownership/management of the vessels and the national flag. Maintaining this link ensures that the maritime safety regulator and other regulators of the ‘flag state’ continue to have control of safety and environmental standards, enforcement and compliance, and other matters which underpin the reputation of the national ‘flag’.  
(Albanese 2012b, p. 2)

Ships that are permitted to be registered in the international register must be at least 24 metres in tonnage length, and be:

- (a) trading ships that are Australian-owned ships;
- (b) trading ships that are wholly owned by Australian residents, or by Australian residents and Australian nationals;<sup>3</sup>
- (c) trading ships that are operated solely by Australian residents, or by Australian nationals, or by both;
- (d) trading ships that are on a demise charter<sup>4</sup> to Australian-based operators. (s. 15B)

A prerequisite for registering on the international register is that a collective agreement must exist between the ship owner and the seafarers’ bargaining unit (that is, the relevant seafarer employee organisation).

The registrar must refuse to register the ship if the registrar is satisfied that ‘the ship will not be predominantly used to engage in international trading’: s. 15F(3)(a). This ensures that those ships registered on the international register predominantly engage in international trade, potentially restricting the level of competition between those ships and those on the general register. Ships registered on the

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<sup>3</sup> Australian nationals include a company (body corporate) established by, or under, a law of the Australian Commonwealth, State or Territory: *Shipping Registration Act 1981* (Cwlth) s. 3.

<sup>4</sup> A demise charter is one where ‘the charterer has whole possession and control of the ship (including the right to appoint the master and crew of the ship)’: *Shipping Registration Act 1981* (Cwlth) s. 3.

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international register are not permitted to apply for a general licence to engage in coastal trading (see section C.4).

It is a condition of registration of a ship on the international register that, where possible, the following positions be filled with Australian nationals or Australian residents (and therefore paid Australian wage rates):

- master or chief mate
- chief engineer or first engineer.

The ship can be cancelled from the international register under a range of circumstances, including that the ship has not been or will not be predominantly engaging in international trading, or that a collective agreement is not in force.

## **C.4 Coastal trading reforms: licensing requirements**

Until the regulation changes commenced in 2012, coastal trading was regulated by Part VI of the *Navigation Act 1912* (Cwlth). Under that Act, coastal trading was governed by a licencing and permit regime covering both Australian and foreign flagged ships. After the reforms commenced, the licencing regime was amended to include additional classes of licences, which had differing regulatory obligations on ship owners depending on whether the vessel was Australian registered, registered on the Australian international register, or a foreign flagged vessel.

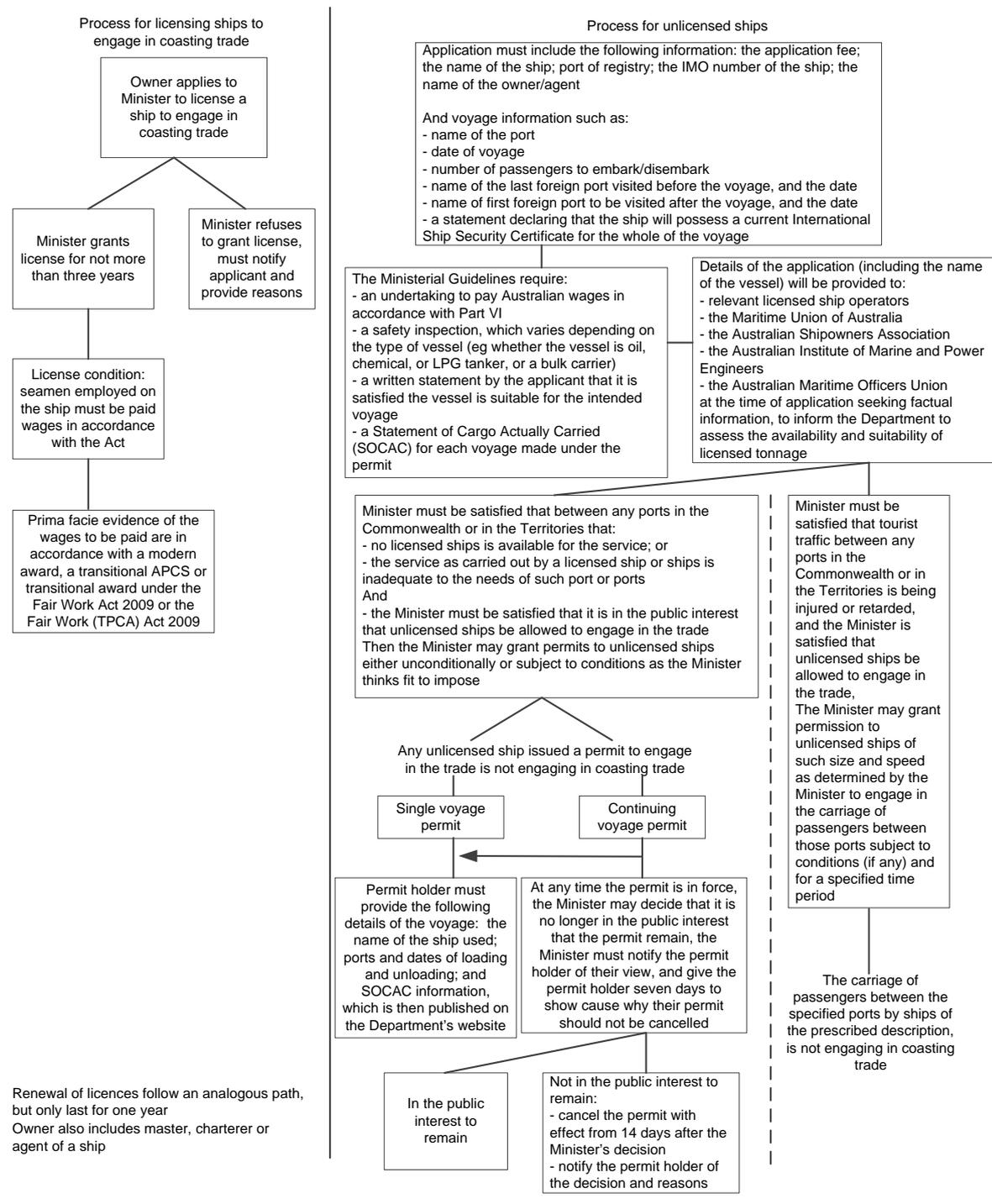
### **Coastal trading under the Navigation Act**

The previous licencing and permit regime under the *Navigation Act 1912* (Cwlth) is depicted in figure C.1. In order for ships to be licensed under the Act, the owner was required to make an application to the Minister to engage in the ‘coasting trade’ (as it is referred to in that Act). There were no ownership restrictions on which ship owners may apply to be licenced to engage in the coasting trade. That is to say, both Australian and foreign flagged ships could apply to become a licenced ship. The major licence condition placed on ships when engaging in the coasting trade was that they must pay the seamen employed the prevailing Australian wage rate. It was not a licence condition that such seaman be Australian citizens.

A ship could alternatively apply for a permit as an unlicensed ship. There were two types of permit: single voyage permit (SVP) and continuing voyage permit (CVP). In order to issue a permit, the Minister must have been satisfied that there was a market gap, either because there was no licensed ship available for the service, or because the current level of service by licensed ships did not meet the needs of the

port(s). The Minister was also required to consider whether it was in the public interest that unlicensed ships be allowed to engage in the trade. If either a SVP or a CVP were issued, the ship was not considered to be engaging in the coasting trade.

**Figure C.1 The previous process for licensed ships to engage in the coasting trade and the process for unlicensed ships**  
Under the repealed Part VI of the *Navigation Act 1912* (Cwlth)



Under the Navigation Act there was no requirement to pay the seamen employed on these voyages Australian wage rates. However, following the commencement of amendments to the Fair Work Regulations on 1 January 2010 and the commencement of SIA Part B on 1 January 2011, there has been an obligation to pay these seafarers Australian wages (see section C.2).

While a CVP was in force, the Minister was permitted to decide that it was no longer in the public interest that such trade be undertaken and could issue the ship owner a show cause notice as to why their permit should not be cancelled. The Minister was then required, after allowing the ship owner to make representations, to decide whether it was in the public interest for that permit to remain.

The obligations on licensed and unlicensed ship owners are described in table C.2.

**Table C.2 Eligibility and conditions imposed on licensed and unlicensed ships under the *Navigation Act 1912 (Cwlth)***  
Australian or foreign flagged ships, pre and post 1 January 2011

| <i>Subject matter</i>                                | <i>Australian ship</i>                                     | <i>Foreign flagged ship</i>                                |
|--|--|--|
| <b>Eligibility to apply for:</b>                     |  |  |
| • licence  | ✓  | ✓  |
| • single voyage permit                               | ✓  | ✓  |
| • continuing voyage permit                           | ✓  | ✓  |
| <b>Is the ship engaging in the coasting trade?</b>   |  |  |
| • licence  | ✓  | ✓  |
| • single voyage permit                               | ✗  | ✗  |
| • continuing voyage permit                           | ✗  | ✗  |
| <b>Conditions imposed on:</b>                        |  |  |
| • licence  | seamen employed on the ship shall be paid Australian wages | seamen employed on the ship shall be paid Australian wages |
| • single voyage permit (prior to 1 January 2011)     | no conditions, unless Minister prescribes conditions       | no conditions, unless Minister prescribes conditions       |
| • continuing voyage permit (prior to 1 January 2011) | no conditions, unless Minister prescribes conditions       | no conditions, unless Minister prescribes conditions       |
| • single voyage permit (after 1 January 2011)        | seamen employed on the ship shall be paid Australian wages | seamen employed on the ship shall be paid Australian wages |
| • continuing voyage permit (after 1 January 2011)    | seamen employed on the ship shall be paid Australian wages | seamen employed on the ship shall be paid Australian wages |

## Recent changes in coastal trading

In 2012, the Australian Government introduced a range of measures that sought to ‘create a stable regulatory environment and provide internationally competitive fiscal incentives to encourage the revitalisation of the Australian shipping industry’ (Albanese 2012a).

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The two Coastal Trading Acts replaced Part VI of the *Navigation Act 1912* (Cwlth), creating a new licensing regime for vessels to engage in coastal trading. The Shipping Registration Amendment Act removed the pre-existing Australian register of ships, creating a general register and an international register (section C.3).

The effect of the Coastal Trading Acts is to replace the previous licensing and permit regime with a system of:

- general licences
- temporary licences
- transitional general licences
- emergency licences.

Emergency licences are only available in the event of natural disasters and are not discussed.

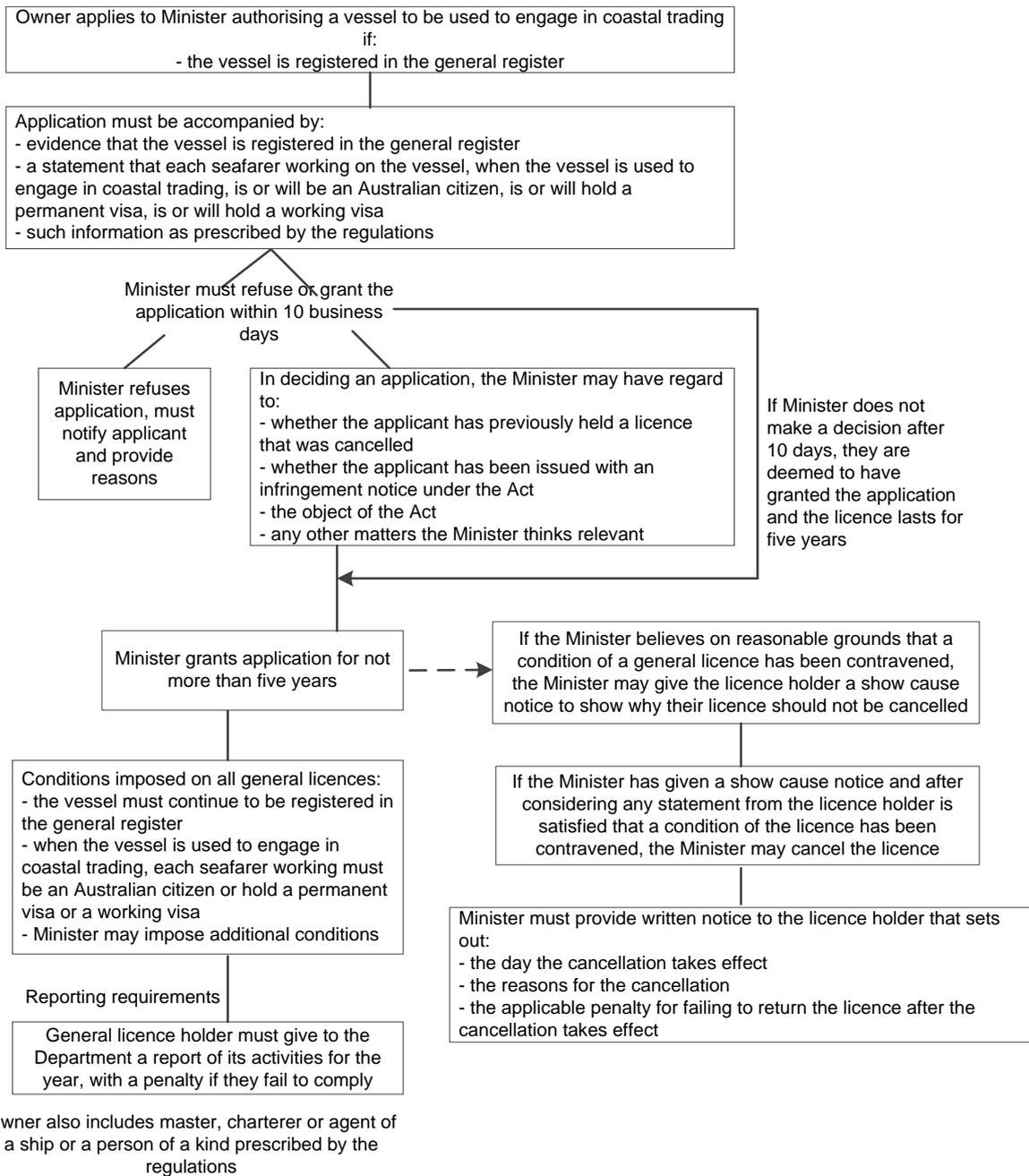
### *General licences*

The process for general licences is depicted in figure C.2. The prerequisites for a general licence are that the vessel is registered in the Australian general register (see section C.3), and that each seafarer working on the vessel (when engaged in coastal trading) is permitted to work in Australia. In effect, this licence is the same as a licence issued under the previous regime of the *Navigation Act 1912* (Cwlth).

General licences are granted to vessel owners for a period not exceeding five years. During the time that the licence is valid, the vessel has unrestricted access to Australian coastal waters, although there is no requirement that the vessel undertake any voyages. In practical terms, because licences can only be issued for a maximum of five years, shipping operators and the users of shipping services can only enter into contracts for the period that the general licence is in force.

Conditions placed on all general licences are that the vessel must remain registered in the general register, and that the seafarers employed during the times when the vessel is engaged in coastal trading must be permitted to work in Australia.

**Figure C.2 The general licensing process for vessels registered in the general register to engage in coastal trading**  
 Under the *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth)



### Temporary licences

The process involved in applying for, and the granting of, a temporary licence is shown in figure C.3.

**Figure C.3 The temporary licensing process for eligible vessels to engage in coastal trading**  
 Under the *Coastal Trading (Revitalising Australian Shipping) Act 2012 (Cwlth)*



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Vessels registered in the general register are not permitted to apply for temporary licences. The only eligible vessels are those that are registered in the international register and foreign flagged vessels.

A temporary licence is valid for 12 months. When applying for a temporary licence, the applicant must nominate at least five voyages to be authorised by the licence and information such as the expected loading dates, the number of passengers or volume of cargo to be carried and the ports at which the passengers or cargo are to be loaded and unloaded.

After receiving an application for a temporary licence the Minister must notify all general and transitional general licence holders of the application, as well as bodies or organisations that the Minister considers would be directly affected, or whose members would be directly affected if the application were granted.

General licence and transitional general licence holders are then given an opportunity to nominate one or more voyages that they could undertake under their general licence, and notify the Minister. If a general licence holder does nominate any voyage(s), the temporary licence applicant must negotiate with the general licence holder ‘whether, and to what extent, the vessel authorised by the holder’s general licence is equipped to carry the passengers or cargo specified in the application’: s. 32(3)(a), and whether they can be carried in a timely manner. The Minister then makes a decision to grant or refuse the temporary licence application, having regard to the matters set out in s. 32(2)(a)-(g).

If the application is granted, conditions imposed on temporary licences are that the vessel be registered in the international register or be foreign flagged and that if any authorised voyage is not to be undertaken to inform the Department of Infrastructure and Regional Development. Temporary licences can be varied (eg where the number of passengers or cargo to be carried changes) or can be changed to include new matters (eg a further voyage). In both instances, general licence holders and bodies or organisations that would be directly affected by such changes are invited to make comments to the Minister, to assist the Minister in forming a decision as to whether the change should be permitted.

Similar to the previous legislative arrangements, a licence may be cancelled for certain reasons. During the temporary licence period, the Minister may issue a show cause notice to the temporary licence holder if the Minister considers that ‘the temporary licence is being used in a way that circumvents the purpose of the general licence provisions or the object of this Act’: s. 63(1).

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### *Transitional general licences*

Under the *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth), transitional general licences were created to transition foreign flagged vessels which were granted a licence under s. 288 of the *Navigation Act 1912* (Cwlth), immediately prior to its repeal. This was to ensure that there was a smooth transition to the new licensing scheme introduced by the shipping changes. In effect, transitional general licences guaranteed that foreign flagged vessels which were licensed would still be able to engage in coastal trading in an unrestricted manner. However, under the new regime, when foreign flagged vessels engage in coastal trading they are required to employ seafarers that are permitted to work in Australia and pay wages determined by the Minister for Infrastructure and Regional Development.

In deciding whether to grant a transitional general licence, the Minister may have regard to ‘whether the owner intends to register [the vessel] under the *Shipping Registration Act 1981*, but is unable to do so immediately because of commercial obligations or requirements under a foreign law’.<sup>5</sup>

Transitional general licences have the same rights and conditions as those imposed on general licences (apart from the requirement to be registered in the general register). Transitional general licences are valid for no more than five years and can only be renewed once. In practice, vessel owners which currently have transitional general licences have a maximum 10 year period where they can engage in coastal trading, whilst being obliged to employ seafarers permitted to work in Australia. At the expiration of the transitional general licence (assuming the foreign flagged vessel owner wishes to continue engaging in Australia’s coastal trading), they will have to either:

- transfer to a general licence — thus become an Australian vessel, hiring Australian workers and continue to pay SIA Part A wages, having unfettered access to the Australian coastal trades; or
- apply for a temporary licence and remain foreign flagged — the owner can maintain its foreign crew, but is required to pay SIA Part B wages for the third and subsequent voyages in a 12 month period; and is required to negotiate with interested general or transitional general licensed vessels to undertake its nominated voyages in circumstances where the general licence holder informs the Department of Infrastructure and Regional Development that it has a suitable

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<sup>5</sup> *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* Sch 2 Pt 3, item 12(2)(a).

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vessel available to conduct a particular voyage or voyages on a licence application; or

- apply for a temporary licence and be registered on the international register — the owner has to, where possible, hire Australians as the master or chief mate, and chief or first engineer, and remunerate all seafarers in accordance with Minister’s determined wages<sup>6</sup>; and spend the majority of its time engaged in international trade.

## C.5 Coastal trading changes: tax concessions

In addition to the measures previously discussed, the coastal trading changes introduced two tax Acts<sup>7</sup> to provide a framework for:

- (a) encouraging investment in the Australian shipping industry; and
- (b) encouraging the development of sustainable employment and skills opportunities for Australian seafarers (Tax Incentives Act s. 3).

Briefly, the effects of the changes are to:

- exempt eligible ship operators from income tax on qualifying shipping activities
- depreciate eligible vessels over a shorter effective life than would ordinarily have prevailed
- defer by 24 months any income tax liability arising from the disposal of an eligible vessel that would otherwise be assessable in the current income year
- permit eligible companies to claim a refundable tax offset for employment of Australian resident seafarers, under certain circumstances
- exempt lease payments made by Australian companies to foreign owners of qualifying vessels from royalty withholding tax.

It was stated in the Explanatory Memorandum that the proposed taxation ‘reforms’ would cost the Australian Government nearly \$50 million in foregone taxation revenue, in its first year of operation and would steadily increase (table C.3).

In order to be eligible to receive any of the tax concessions, certain criteria needed to be met (box C.1).

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<sup>6</sup> In accordance with s. 61AE of the *Shipping Registration Act 1981* (Cwlth). The current Minister determined wages are slightly less than the SIA 2010 Part B wages.

<sup>7</sup> *Shipping Reform (Tax Incentives) Act 2012* (Cwlth) (‘the tax incentives Act’) and *Tax Laws Amendment (Shipping Reform) Act 2012* (Cwlth) (‘the tax amendment Act’).

**Table C.3 Financial impact as a result of the shipping taxation ‘reforms’**  
Over the forward estimates

|                        | 2012-13 | 2013-14 | 2014-15 | 2015-16 | Total impact |
|------------------------|---------|---------|---------|---------|--------------|
| Financial impact (\$m) | 49      | 66.8    | 68.7    | 70      | 254.5        |

Source: Swan (2012).

**Box C.1 Criteria to satisfy in order to seek tax concessions**

The *Shipping Reform (Tax Incentives) Act 2012* (Cwlth) provides a process to obtain a certificate as a first step towards accessing the tax concessions under the *Tax Laws Amendment (Shipping Reform) Act 2012* (Cwlth).

In order to access the accelerated depreciation, income tax exemption (ITE) or refundable tax offset, a company must demonstrate that it is a corporation under Australian law with an eligible vessel (that is, a vessel not excluded, of 500 gross tonnage or more and is registered on either the general or international register). Additional management and training requirements apply in order for the vessel to be eligible to receive the ITE.

Broadly, the process follows four steps:

1. in its first year, the applicant seeks a ‘notice’ establishing that it will likely meet the qualifying conditions
2. the Department of Infrastructure and Regional Development assesses the evidence and issues a notice if conditions are met
3. the applicant seeks and receives a ‘certificate’ at least 30 days prior to lodging their tax return
4. the certificate is required to be annually renewed, which involves reporting to the Department.

Certificates attach to only one vessel, so multiple certificates are required if the owner or operator has a fleet of vessels and wants each to be eligible for the tax concessions.

Once a notice has been issued by the Department, in the following income year the applicant can seek to have a certificate issued. The certificate sets out matters such as the days that the entity is a corporation, and the days that the vessel is an eligible vessel to receive the tax concessions.

If the certificate sets out management and training requirements, the certificate permits the applicant to apply for the ITE. Other certificates can be used to access either the accelerated depreciation or seafarer tax offset provisions.

Once a certificate is issued, if the certificate holder breaches a condition of the certificate (eg fails to provide the requisite number of management and/or training requirements for a prescribed number of seafarers), then the certificate holder can be excluded from reapplying for another certificate for up to 10 years.

Source: *Shipping Reform (Tax Incentives) Act 2012* (Cwlth).

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## Applicability of the tax concessions

Access to the tax concessions under the *Tax Laws Amendment (Shipping Reform) Act 2012* (Cwlth) vary depending on whether it is the vessel owner or vessel operator that applies for them.

### *Income tax exemption*

The income tax exemption (ITE) applies to ‘qualifying shipping activities’, and as attributed to the Explanatory Memorandum:

A generous approach is taken to defining the activities that generate income eligible for the income tax exemption, ensuring that a substantial part of shipping activities are included. (Swan 2012, p. 10)

Shipping operators are eligible to claim the ITE for qualifying shipping activities they undertake. If the operator of the vessel is also the owner, then the operator cannot claim the ITE if the owner claims the accelerated depreciation for the vessel.<sup>8</sup> Given that the three Bass Strait shipping companies (TT-Line, Toll ANL and SeaRoad Holdings) are all Australian owned and operated, they each face a decision whether to apply for the ITE or to have accelerated depreciation for each vessel they own (assuming they wish to receive a tax benefit).

The estimated revenue cost of this tax measure has not been costed on a standalone basis, but the change somewhat amounts to a taxpayer subsidy to partially offset the impost of Australian wage rates for qualifying shipping operators under the regulatory changes.

### *Accelerated depreciation*

Accelerated depreciation is available to owners of vessels for qualifying Australian shipping companies. The accelerated depreciation provision allows for a vessel to be fully depreciated over 10 years, which is a materially shorter life than previously applied (20–30 years).<sup>9</sup> If an eligible owner elects to apply the income tax exemption to their vessel, then the previous depreciation rules apply to that vessel to the extent that that vessel generates any income for a taxable purpose.

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<sup>8</sup> *Income Tax Assessment Act 1997* (Cwlth) s. 40-102(4A).

<sup>9</sup> The relevant operating lives prior to the commencement of the reforms were: passenger vessels (20 years); trading ships including bulk, cargo, containerised, and roll-on roll-off vessels (20 years); oil and chemical tankers (20 years); LNG and LPG tankers (30 years) (Australian Taxation Office 2011).

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### *Roll-over relief*

The roll-over relief enables eligible Australian ship owners to be assessed for a 'balancing adjustment' (box C.2) in a later income year than would ordinarily apply. Previously, a balancing adjustment would need to be reflected in the ship owners' income for the income year in which the adjustment occurred. The tax change allows this adjustment to be deferred until the second income year after which the balancing adjustment occurred.

#### **Box C.2 Calculating a 'balancing adjustment' and roll-over relief**

Simply expressed, a balancing adjustment is the difference between the termination value of an asset and its adjustable value, where:

- the termination value is the sale price of the vessel
- the adjustable value is the cost of the vessel, less its decline in value since the commencement of its use.

In the absence of any applicable balancing adjustment roll-over relief, a balancing adjustment is accounted for in the taxpayer's taxable income in the year of the event. Where the amount is positive it is assessable, and where the amount is negative, it is deductible.

The standard roll-over relief provisions, as described above, are modified to enable an eligible vessel ('the original vessel') for which a balancing adjustment occurs, to apply the balancing adjustment to another vessel ('the other vessel'), providing that 'certificates' (but not a shipping exempt income certificate — see box C.1) are issued to both vessels and cover the relevant day on which the balancing adjustment occurs.

Where circumstances giving rise to roll-over relief apply, the cost of the other vessel is reduced (but not below zero) by the balancing adjustment amount. The roll-over relief on the original vessel does not apply until the second income year after the balancing adjustment occurs.

Effectively this means shipping companies have up to three years within which they can dispose of the original vessel and attain the other vessel, as they must hold the other vessel for a minimum of two years in order to qualify for roll-over relief.

*Source: Income Tax Assessment Act 1997 (Cwlth).*

### *Seafarer tax offset*

The seafarer tax offset entitles a company to a tax offset for salary, wages and allowances paid to Australian resident seafarers who are employed to undertake overseas voyages on certified vessels, if the company employs the seafarer for at least 91 days in the income year.

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The tax offset is available to the employer of the seafarer. The employer may not necessarily be the owner or the operator of the vessel, if a crew management company is engaged to hire workers who then complete the 91 days required. The seafarer must be employed by the one company for the entire 91 days. Although the days do not have to be consecutive, they must all occur within one income year.

A particular day qualifies towards the 91 days required if the seafarer is an Australian resident, employed in a specific capacity,<sup>10</sup> on a vessel which has a valid certificate (see box C.1), and the voyage has at least one international leg, regardless of the number of domestic legs (if any) that the voyage may have.

The seafarer tax offset amounts to 30 per cent of the gross payment amounts that were paid to each employee that satisfied the 91 day employment requirement. The gross payment amounts includes total withholding payments covering matters such as those related to employment, accrual of leave, and training allowances.

#### *Royalty withholding tax exemption*

This tax change provides an exemption from royalty withholding tax to non-resident lessors that lease qualifying vessels to Australian resident companies on a ‘bareboat basis’, where that vessel is then used to undertake qualifying activities during the period of the lease. Vessels leased on a bareboat basis are provided without a captain or crew, giving the lessee the freedom to choose their own captain and crew.

The royalty withholding tax exemption applies only if:

- the lessee is an Australian resident company
- the vessel is not an ‘excluded vessel’ under the *Shipping Reform (Tax Incentives) Act 2012* (Cwlth)
- the vessel is leased on a bareboat basis
- the vessel must be used for mainly business or commercial activities that involve shipping cargo or passengers for money.

Generally, the royalty withholding tax that prevailed prior to the changes was at the rate of 30 per cent, unless a tax treaty was in force between Australia and another country and the treaty specified a different rate.

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<sup>10</sup> As a master, engineer, integrated rating, steward, or deck officer: *Income Tax Assessment Act 1997* (Cwlth) s. 61-705(2)(b).

## C.6 Likely impacts of recent changes

### Summary of changes

The 2009 and 2012 legislative changes have affected Australia's coastal trading through material changes to the licence categories; application processes; and conditions attached to licences to engage in coastal trading (table C.4). Additionally, remuneration and hiring requirements have significantly changed.

Table C.4 Comparison of license categories and license conditions<sup>a</sup>

| Vessel registry   | Navigation Act 1912     |                     |     |                      |                     |           | Coastal Trading Acts 2012 <sup>b</sup> |   |                              |
|---|-------------------------|---------------------|-----|----------------------|---------------------|-----------|--|---|------------------------------|
|   | Prior to 1 January 2011 |                     |     | After 1 January 2011 |                     |           | General license                        | Temporary license                       | Transitional general license |
|   | Licensed                | Unlicensed (permit) |     | Licensed             | Unlicensed (permit) |           |  |   |                              |
|   |                         | SVP                 | CVP |                      | SVP                 | CVP       |  |   |                              |
| <b>Eligibility to apply for a licence:</b>  |                         |                     |     |                      |                     |           |  |   |                              |
| • general register <sup>c</sup>   | ✓                       | ✓                   | ✓   | ✓                    | ✓                   | ✓         | ✓                                      | ✗                                       | ✗                            |
| • international register  | n/a                     | n/a                 | n/a | n/a                  | n/a                 | n/a       | ✗                                      | ✓                                       | ✗                            |
| • foreign flagged vessel  | ✓                       | ✓                   | ✓   | ✓                    | ✓                   | ✓         | ✗                                      | ✓                                       | ✓                            |
| <b>Is the vessel engaging in coastal trade?</b>                                     |                         |                     |     |                      |                     |           |  |   |                              |
| • general register  | ✓                       | ✗                   | ✗   | ✓                    | ✗                   | ✗         | ✓                                      | n/a                                     | n/a                          |
| • international register  | n/a                     | n/a                 | n/a | n/a                  | n/a                 | n/a       | n/a                                    | ✓                                       | n/a                          |
| • foreign flagged vessel  | ✓                       | ✗                   | ✗   | ✓                    | ✗                   | ✗         | n/a                                    | ✓                                       | ✓                            |
| <b>Licence condition to pay Australian wages and/or to hire Australian workers:</b> |                         |                     |     |                      |                     |           |  |   |                              |
| • general register  | pay wages               | ✗                   | ✗   | pay wages            | pay wages           | pay wages | hire workers and pay wages             | n/a                                     | n/a                          |
| • international register  | n/a                     | n/a                 | n/a | n/a                  | n/a                 | n/a       | n/a                                    | hire workers and pay wages <sup>d</sup> | n/a                          |
| • foreign flagged vessel  | pay wages               | ✗                   | ✗   | pay wages            | pay wages           | pay wages | n/a                                    | pay wages                               | hire workers and pay wages   |

<sup>a</sup> Under the *Navigation Act 1912* (Cwlth), *Coastal Trading (Revitalising Australian Shipping) Act 2012* (Cwlth) and *Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Act 2012* (Cwlth). <sup>b</sup> Emergency licenses excluded. <sup>c</sup> For the purposes of the table, it is assumed that the general register is the same as the Australian register of ships as was in force under the *Navigation Act 1912*. <sup>d</sup> Applies to the master or chief mate and to the chief engineer or first engineer of the vessel. SVP = single voyage permit. CVP = continuing voyage permit. n/a = not applicable.

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As shown, regulatory requirements — particularly relating to the payment of wages — have increased as a result of the recent legislative changes. Prior to 1 January 2011, a permit vessel had no requirement to pay Australian wages to its crew. Once the changes to the Fair Work Regulations commenced on 1 January 2011 to permit vessels, vessel owners were required to pay Australian maritime (SIA 2010 Part B) wages. With the commencement of the coastal trading changes on 1 July 2012, vessel owners were additionally required to hire Australian workers when engaging in coastal trading.

Previously, Australian owned vessels could elect to have a general licence or a permit. Since the changes commenced, Australian owned vessels must obtain a general licence to engage in coastal trading, they are not eligible to apply for either a temporary licence or a transitional general licence. Further, it has the potential to allow Australian owned vessels which have a general licence to wait for internationally registered or foreign flagged vessels to make an application for a temporary licence, and then negotiate with the applicant to undertake those voyages (although there is no guarantee that negotiation would be successful or the voyages would be awarded to the Australian operator).

### **Likely effects of the tax changes**

The likely effects of the tax changes on freight rates are explained in table C.5. The net effect of the changes is unclear as it is conditional upon shipping operators passing through any expected benefits of the reforms onto users of shipping services. Additionally, the income tax exemption for operators and the accelerated depreciation for owners are not both available to the same company in respect of the same vessel, which complicates an assessment of overall impacts as they are conditional upon commercial decisions by shipping operators.

The Maritime Union of Australia submitted that the income tax exemption is not as generous as implied by the term ‘exemption’ as it does not extend to the distribution of profits via dividends to shareholders, thus lowering its overall benefit to shipping operators/owners (sub. 32). This view was shared by SeaRoad Holdings which characterised the tax concessions more akin to a tax deferral than an a tax exemption (sub. DR81).

**Table C.5 Expected changes to freight rates from tax reforms**

| <i>Explanation of tax measure</i>  | <i>If tax measure is passed through to users of shipping services:<sup>a</sup></i>   |
|--|--|
| Income tax exemption (ITE) - Exempt ship owners from 30 per cent company tax on income from qualifying shipping activities | <ul style="list-style-type: none"> <li>• As all Australian shipping operators previously paid company tax on all assessable income, this represents a windfall gain. The reduction in tax payable means that shipping operators can reduce their freight rates and still be in the same financial position as they were prior to the tax exemption.</li> <li>• Additional management and training requirements apply if the vessel is granted the ITE and it is unclear to what extent the required level of management and training was undertaken prior to the introduction of the changes, so it is unclear what the overall effect will be on freight rates.</li> </ul>  |
| Accelerated depreciation - Depreciate qualifying vessels after 10 years <sup>b</sup>                                       | <ul style="list-style-type: none"> <li>• The accelerated depreciation provision may provide an incentive to vessel owners to update to newer vessels at the cessation of the 10 year depreciation period. Compared to the previous effective vessel lives, this could result in investment decisions being brought forward, but it is unclear what the overall effect on freight rates will be, given that newer vessels are typically more expensive and have shorter operating lives (increasing freight rates), but this has to be balanced against the potential for newer vessels to be faster, have lower operating costs, and have larger carrying volumes and therefore possibly offer greater capacity on existing and new routes (and potentially decreasing freight rates).</li> </ul>  |
| Rollover relief - Additional 12 months before liability arises in relation to disposal of a vessel <sup>b</sup>            | <ul style="list-style-type: none"> <li>• Roll-over relief complements the accelerated depreciation provisions in that if a balancing adjustment (see box C.2) occurs in relation to the original vessel, then the new vessel's cost is reduced by the amount of the balancing adjustment. This suggests that ship owners will first depreciate their vessels over the 10 year period and then roll-over any balancing adjustment to the new vessel. It is likely that this will incentivise ship owners to invest in new vessels every 10 years so that the roll-over of the balancing adjustment lowers the adjustable value of the new vessel. The overall effect on freight rates is unclear since newer vessels are typically more expensive and have shorter operating lives (increasing freight rates), but this has to be balanced against the potential for newer vessels to be faster, have lower operating costs, and have larger carrying volumes and therefore possibly offer greater capacity on existing and new routes (and potentially decreasing freight rates).</li> </ul> |
| Refundable tax offset – Increases amount of deductions for vessels which hire Australian seafarers                         | <ul style="list-style-type: none"> <li>• Since eligibility to receive the tax offset relates to at least one international leg, the vessel is not engaging in coastal trading. Therefore, it is likely that the tax offset will have little effect on coastal freight rates.</li> </ul>  |
| Foreign withholding tax exemption - Vessels leased to Australian operators are exempt from 30 per cent tax rates           | <ul style="list-style-type: none"> <li>• Should reduce leasing costs for international vessels leased to Australian operators on a bareboat basis, however it is unclear to what extent the previous withholding tax was passed through to Australian operators, particularly in light of the global excess supply of foreign vessels.</li> <li>• It is unclear to what extent foreign flagged vessels were leased to Australian operators prior to the commencement of the reforms, particularly on the Bass Strait route.</li> <li>• It is unclear whether the exemption from withholding tax is sufficient to induce vessels to be leased to Australian operators, given international tax regimes for shipping.</li> </ul>   |

<sup>a</sup> If the tax measures are fully appropriated by the shipping companies then there will be no benefits from the reforms for the users of shipping services. <sup>b</sup> Does not apply if the vessel owner has elected that the ITE applies to that vessel.

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However, it is clear that the tax changes make investment decisions in new vessels relatively more attractive to shipping operators. All three Bass Strait shipping operators are currently considering new vessel investments, and the operators have indicated that the tax changes formed a material consideration in their investment decisions.

The likely effects of the tax changes are twofold:

1. existing eligible vessels registered in either the general or international register (see section C.3) will be able to access the tax incentives
2. foreign flagged vessels may be sufficiently incentivised to:
  - (a) register in either the general or international register as part of becoming eligible for the tax incentives
  - (b) lease their vessels to an Australian shipping operator due to the exemption from the requirement to pay royalty withholding tax.

For vessels registered in either the general or international register, the tax incentives represent a windfall gain to the vessel owners. These owners were previously required to pay company tax at the rate of 30 per cent on income from qualifying shipping activities, and are now no longer required to do so.

The Commission has yet to receive any evidence to suggest that there has been any increase in the number of foreign flagged vessels registering in Australia, and therefore it is unclear whether the tax incentives have been accessed by what were previously foreign flagged ships. However, the Commission understands that there has been an increase in small barges and landing craft registering on the Australian general register, but these vessels have very limited carrying capacity and so the overall tonnage of the Australian general licence fleet has remained relatively stable.

Foreign flagged vessel owners might lease their vessels to Australian operators on a bareboat charter basis because of the cessation of the requirement to pay the royalty withholding tax on bareboat chartered vessels. Prior to the change, the royalty withholding tax exemption only applied to Australian based operators who leased vessels on the basis of time or voyage charter arrangements (whereby a foreign flagged vessel would be leased with an existing and most likely foreign crew). As such, the change can be also viewed as addressing an anomaly. By exempting the bareboat charter vessels from the withholding tax requirement, more Australian operators (and seafarers) may be employed. However, the more foreign flagged vessels that lease their vessels to Australian operators, the greater the foregone taxation revenue from the loss of royalty withholding tax. Further, if by leasing these vessels, new Australian operators enter the shipping industry, they would be

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entitled to the tax concessions introduced as part of the shipping reforms. These new operators would enter the shipping industry and thereby redirect resources from other areas of the economy where the advantageous shipping tax concessions do not apply. That is to say, the further the policy intent is realised, the more the Australian Government can expect to forego taxation revenue from other parts of the economy.

### **Likely effects on dry and liquid bulk**

In 2011-12, vessels operating under permit carried 21.8 per cent and 34.3 per cent of the dry and liquid bulk throughout Australia, respectively (Bureau of Infrastructure and Transport Regional Economics (BITRE 2013a). Therefore, to the extent that the reforms have increased the costs of these vessels in transporting bulk commodities throughout Australia, Tasmania is likely to be adversely affected.

A proportion of the total bulk freight task is still undertaken by foreign flagged vessels in Tasmania. Data provided by the Department of Infrastructure and Regional Development (DIRD) indicate that between 1 July 2012 and 31 December 2013, a total of 222 voyages were conducted from Tasmania to the mainland using 46 different vessels. Over the same period, a total of 75 voyages were conducted from the mainland to Tasmania using 53 different ships.

The 297 voyages undertaken were over an 18 month period, which equates to around 198 voyages per year. Prior to the reforms there were 134 voyages under single and continuing voyage permits in 2011-12 (BITRE 2012). There were a further 105 urgent single voyage permits issued in 2011-12. This suggests that the number of permit voyages to/from Tasmania have reduced from 239 to 198 over the period since the changes, although some of these voyages may now be carried out by ships operating under transitional general licences.

The Commission understands that a significant proportion of Tasmania's liquid bulk cargo is carried under temporary permit. Given the increase in costs associated with the Fair Work Regulation changes and the additional compliance costs associated with the new licencing regime, it can be expected that freight rates for liquid bulk will increase in Tasmania.

### **Likely effects on containerised cargo**

The three domestic operators across Bass Strait (TT-Line, Toll ANL, and SeaRoad Holdings) are all Australian owned. The recent (non-tax) changes will therefore not directly impact their costs. As before the regulation changes, the current Australian seafarer wage rates are in excess of those paid in other countries

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(DIRD sub. 42, p. 38), and to that extent they are adding pressures to the cost of transporting goods across Bass Strait. The regulation changes are likely to have a far more significant impact on international vessels and therefore any competitive pressure they provide to Bass Strait shipping, especially for international freight that is currently transhipped through the Port of Melbourne.

Since 1 January 2011, international vessels are obliged to pay up to twice the amount for labour than they had previously as a result of the awards modernisation according to Deloitte (2012). If the international vessel was then to become majority Australian-crewed, the vessel's labour costs would have increased around a further 80 per cent as a result of the changes. Despite evidence suggesting that labour costs represent only 10–15 per cent of total costs (see chapter 4), an increase in costs of this magnitude could have significant implications for the profitability of engaging in either coastal or international trading. This is further magnified given the global oversupply of international vessels.

Evidence suggests that only 15 per cent of Tasmanian northbound products require an overnight service, yet up to half of all goods transported have logistic chains built around the immediate flow of product after production (Aurecon 2013a). This suggests an opportunity for foreign flagged vessels to collect containerised cargo from Tasmania. However, it is unclear whether the volume is sufficient to attract a service. An international service would provide an opportunity for some Tasmanian businesses to get their product to market, albeit on a less regular basis, at less cost than the current overnight service.

Given the small volume of containers, additional costs imposed on foreign flagged vessels affect whether they compete in the market for Australian coastal shipping. Where domestic trade assists in defraying costs of international shipping, any additional costs — such as the requirement to pay Australian wages on the third and subsequent coastal voyages — or regulatory requirements — such as having to nominate a minimum of five voyages and invite Australian general registered and transitional general licenced vessel owners to compete for those nominated voyages — for carrying cargo between domestic ports, acts as a general disincentive to provide international shipping services to marginal ports such as those in Tasmania.

### **Likely effects on Bass Strait passenger movements**

Participants noted that voyages commencing in Victoria and terminating in Tasmania cannot be offered following the Ministerial exemption associated with the

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coastal trading reforms (Lindblad sub. 1; Australian Pacific Touring sub. 11; Austrade sub. 41).

The Ministerial Exemption for large cruise vessels commenced on 1 January 2013 and states that vessels in excess of 5000 gross tonnes, capable of at least 15 knots, and carrying more than 100 passengers are exempted from the Coastal Trading Act. However, this exemption does not apply to the carriage of passengers between Victoria and Tasmania. The exemption is the same as the previous exemption first introduced in 1998.

The effect of the exemption is that ‘large cruise vessels’ (i.e. those in excess of 5000 gross tonnes that also meet the other requirements) can engage in ‘coastal trading’ between Australian ports — anywhere except between Victoria and Tasmania — and they can avoid the associated costs of complying with the Act.

The Commission has been unable to ascertain the policy rationale underpinning the exemption not applying to the carriage of passengers between Victoria and Tasmania, but notes the effect would be to potentially reduce competition in passenger transit by large cruise vessels across Bass Strait. As such, it seems evident that this policy has the effect of deterring Victorians from visiting Tasmania since the costs of travelling across Bass Strait would be higher (because of the reforms to coastal trading — see section C.4), than they would be from travelling to Tasmania from anywhere else on the Australian mainland. The Commission understands that a significant proportion of visitors to Tasmania are domiciled in Victoria, so the exemption has the potential to curtail tourist traffic.

It is also important to note that Tasmanian tourists travelling to Victoria by sea would be subject to the increased costs associated with the reforms.

What is perhaps more significant is that the exemption has the effect of ensuring that large cruise vessels can compete against each other on a completely open coast, with both domestic and foreign flagged vessels exempted from the application of the Coastal Trading Act. This in turn means that vessels travelling from one Australian mainland port to an interstate port (eg Darwin to Cairns, or from Darwin to Hobart) could do so on international vessels. Australian domestic vessels operating on these routes would need to price competitively with international vessels, or risk losing price sensitive tourists. Tourists would be able to access relatively cheaper interstate cruises than those offered between Victoria and Tasmania where the coastal trading reforms apply.

It is likely that the longstanding impact of the Ministerial exemption since 1998 on Tasmania will be twofold:

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1. Tourist numbers from Victoria to Tasmania would be less than they otherwise would be if the exemption was extended to the carriage of passengers between those States.
  2. Small cruise and expedition vessels would have to offer significantly higher fares as a result of the changes (since carrying passengers would amount to engaging in coastal trading, and thus increase costs), further reducing tourist numbers to Tasmania. Submissions (Lindblad sub. 1; Australian Pacific Touring sub. 11; Austrade sub. 41; Cruise Down Under sub. DR72) indicated services have been withdrawn for this reason.

## Conclusion

It is unclear as to the net effect of the tax and regulatory changes on freight rates for users of Tasmanian shipping services, but the overall impact is likely to be to increase freight rates over time.

The Commission considers that the costs of transporting bulk commodities across Bass Strait will rise as a significant proportion of voyages were, and continue to be (albeit a lesser number), undertaken by foreign flagged vessels, which since 1 January 2011 are obliged to pay Australian wages to their workers for the third and subsequent voyages in a 12 month period. It appears that the containerised market will not be directly affected as a result of the reforms since at all relevant times the vessels servicing the market were Australian owned, operated, and crewed. However, international containerised services may be affected to the extent that coastal trading voyages previously defrayed costs and augmented revenues of providing an international shipping service. The Commission understands that the former Tasmanian international containerised service did undertake coastal trading for this purpose.

Sea travelling tourist numbers from Victoria to Tasmania are likely to be lower than they otherwise would be if the route was exempted from the coastal trading reforms. It is unclear why this route is 'protected' whereas all other mainland Australian trips to Tasmania are not.

It is likely that the overall impact on Tasmania as a result of the 2009 and 2012 regulatory changes is negative. Nevertheless, the removal of the changes would not fully ameliorate the high costs associated with Bass Strait shipping. What is required is a holistic review of cabotage in Australia.