

Productivity Commission Inquiry into Tasmanian Shipping and Freight

Initial Tasmanian Government Submission

December 2013

I. Introduction

The Tasmanian Government's initial submission to the Productivity Commission's *Inquiry into Tasmanian Shipping and Freight* responds broadly to the Commission's terms of reference, released on 29 November 2013. The submission draws attention to key considerations relating to Tasmania's shipping and freight sector and lays out the Government's position on the Australian Government's current freight and passenger equalisation arrangements.

The submission draws heavily on the analysis, findings and recommendations of the recently released final report of the Freight Logistics Coordination Team (FLCT). The FLCT is an industry-led body established in 2012 to advise the Tasmanian and Australian Governments on freight, logistics and supply chain issues in the State. A copy of the Tasmanian Government's interim response to the FLCT's Final Report – and the FLCT Report itself – is provided at Attachments A and B, respectively.

The FLCT's Final Report, and associated publicly available consultancy reports which supported its development, describe Tasmania's current freight arrangements in some detail. This level of detail has not been generally repeated in this covering submission. However, the Tasmanian Government can provide further specific information and data to the Commission upon request.

Tasmania's State-owned transport businesses – TasRail, TasPorts and TT-Line – will also provide separate submissions to the Commission's Inquiry, which will include further information about their commercial operations.

The Tasmanian Government anticipates that it will make a further submission in response to the issues, findings and recommendations contained in the Commission's 'Discussion Draft Report', due to be released on 24 January 2014. It will also work cooperatively with the Commission throughout the process to assist the Inquiry team in understanding specific shipping and freight challenges facing Tasmania.

The Tasmanian Government re-iterates its serious concerns regarding the three-month Inquiry timeframe, noting that it does not reflect the scope, complexity and significance of the Commission's task. By way of comparison, the Tasmanian Government notes that the Commission's 2006 *Review of Tasmanian Freight Subsidy Arrangements* - which had a significantly narrower scope than the current inquiry - was conducted over a period of approximately nine months. The Inquiry timeframe is also unreasonable in light of the potential impact on the Tasmanian economy of any proposed changes to existing Commonwealth freight and passenger assistance programs or other broader policy settings or funding arrangements.

The Tasmanian Government has been concerned to note that the Commission is significantly truncating its usually rigorous information gathering and stakeholder consultation processes to accommodate the Australian Government's deadline. This approach will necessarily impact on the ability of the Commission to deliver robust findings and recommendations, particularly given the breadth and complexity of the matters under consideration. The Tasmanian

Government understands that industry stakeholders are similarly concerned about the consultation process.

It appears unlikely that the Commission will be in a position to deliver definitive findings against all of its terms of reference by 7 March 2014. Accordingly, the Tasmanian Government strongly urges the Commission to make implementation of its recommendations conditional on a detailed assessment of their impact on the Tasmanian economy and community and the development, in consultation with the Tasmanian Government and industry, of a detailed transition plan.

2. Tasmanian Shipping and Freight: Strategic Context

Tasmanian businesses face unique transport disadvantages compared to their regional mainland counterparts. The underlying driver of this disadvantage is Tasmania's position as an island-based, export-focused economy. Tasmania has a relatively small internal market, making access to mainland domestic and international markets critical. For example, approximately 75 per cent of Tasmania's total food production is currently sold in interstate (50 per cent) or international markets (25 per cent).

Over 99 per cent of goods leaving and arriving in Tasmania are moved by sea. The Bass Strait crossing is proportionally the single largest transport cost in the supply chain of a typical Tasmanian business. Freight costs and services across Bass Strait are a key determinant of business efficiency, profitability and competitiveness. Freight cost competitiveness is an important enabler for the entire Tasmanian economy.

Sea freight is inherently expensive over short distances, due to its high fixed and low marginal costs. The Bass Strait crossing also brings with it increased supply chain complexity, with significantly more costly intermodal changeovers than a typical interstate road or rail freight journey in mainland Australia.

Tasmania's fundamental transport disadvantage stems from its regional location and its distance from markets, combined with its lack of alternative modal options for freight compared to mainland Australia. The latter is the key reason why Tasmania is considered a 'special case' in terms of receiving Commonwealth assistance to reduce freight cost disadvantage.

While the Tasmanian Government is committed to the ongoing pursuit of land-side supply chain efficiencies, these efforts will have a very limited impact on the significant 'blue water' cost of Bass Strait shipping, which comprises the largest component of the overall freight cost. Assistance to off-set sea transport cost disadvantage therefore plays a substantial and ongoing role in helping Tasmanian industries remain competitive.

This is the case particularly in the current economic climate. While the size and structure of the Tasmanian economy has grown and diversified significantly over the past 20 years, more recently, Tasmania's key economic indicators such as employment, investment and economic growth have deteriorated, relative to the national economy. Tasmania's unemployment rate, for example, is currently 7.9 per cent, compared to the national rate of 5.8 per cent.

These indicators reveal a Tasmanian economy that is currently undergoing a period of significant structural change, at the same time as experiencing significant cyclical pressures including, most notably, a persistently high exchange rate which is, in turn, driven by high growth in other parts of the nation. The minerals boom has not benefited the Tasmanian economy to the same extent as in other jurisdictions, and in terms of labour out-migration has had a number of negative repercussions.¹

Any significant reduction of, or changes to, freight and passenger equalisation assistance in this context would deliver an additional short-term economic shock. This would have serious consequences for Tasmania's ability to ride out the current cyclical pressures it is facing, as well as its transition to longer-term structural changes. Hence, any changes to current arrangements need to be carefully considered and introduced progressively, even if it is believed that they will improve Tasmania's long-term transport efficiency.

The Tasmanian Government welcomed the Commonwealth Government's re-affirmation, with the release of the terms of reference for this Inquiry of its previous commitment to retain the Tasmanian freight and passenger vehicle equalisation schemes. 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.

The value and importance of the Tasmanian tourism sector is likely to continue to grow in the context of the long-term structural economic changes discussed above. The Bass Strait Passenger Vehicle Equalisation Scheme (BSPVES) plays a critical role in supporting a key aspect of Tasmania's tourism industry, by increasing access for visitors who wish to bring their own vehicles from mainland Tasmania. In the absence of the BSPVES, it is likely that a significant portion of this market would be lost to Tasmania, with self-drive recreational vehicle (RV) and caravan visitors in particular likely to substitute other mainland destinations for Tasmania when faced with the actual cost of transporting their vehicle across Bass Strait. These visitors are of critical importance to Tasmania's self-drive tourism industry, which supports many of the State's regional communities. Many of these communities are dealing with a decline in historically significant activity, most notably relating to forestry.

Unfortunately, many of the cost drivers for Bass Strait shipping cannot be easily influenced by Tasmanian businesses or by the Tasmanian Government. Input costs such as labour and fuel costs – in addition to other costs such as port licence fee pass-throughs from Victoria - are all outside of Tasmania's control. Nonetheless, the Tasmanian Government is committed to a strategic approach – in partnership with industry – to driving improvements in the efficiency of Tasmania's freight supply chains, as a key part of its broader infrastructure reform agenda.

The Tasmanian Government's commitment to a range of change initiatives demonstrates both its willingness to tackle the challenges it can influence and its understanding that well planned and efficiently delivered infrastructure services provision is an important pre-condition to

¹ For a more detailed discussion of these issues, see the Tasmanian Department of Treasury and Finance (2013) 'Structural Change in the Tasmanian Economy: Information Paper' - [http://www.treasury.tas.gov.au/domino/DTF/DTF.nsf/LookupFiles/Structural-Change-in-the-Tasmanian-Economy-Info-Paper.pdf/\\$file/Structural-Change-in-the-Tasmanian-Economy-Info-Paper.pdf](http://www.treasury.tas.gov.au/domino/DTF/DTF.nsf/LookupFiles/Structural-Change-in-the-Tasmanian-Economy-Info-Paper.pdf/$file/Structural-Change-in-the-Tasmanian-Economy-Info-Paper.pdf)

enhanced economic performance. For example, the Government has consistently pursued a significant suite of micro-economic reform and infrastructure projects over recent years, including:

- Rationalisation of four ports corporations into one entity;
- Significant upgrade of the National Highway;
- The creation of TasRail and associated investment in transport intermodal hubs and hard stands;
- Structural and pricing reform of water and sewerage infrastructure and service delivery;
- Significant structural changes to the electricity supply industry, including the planned introduction of competition for residential and small business customers from 1 July 2014;
- The largest expansion of irrigation infrastructure in Tasmania's history; and
- Support for the National Broadband Network roll-out, and ongoing expansion of the natural gas network.

As significant as this agenda is, its potential to deliver transformative and lasting change to the Tasmanian economy will only be fully realised if Tasmania has a transport and freight logistics network that is capable of efficiently and effectively supporting the needs of our industry and our community.

Improving freight transport efficiency is one of the key strategic challenges facing the Tasmanian community and a significant body of work is currently underway to tackle this challenge. A central component of this effort was the establishment in 2012 – with support from the Australian Government - of the Tasmanian Freight Logistics Coordination Team (FLCT), to provide evidence-based, expert advice on freight and supply chain issues in Tasmania, and to inform the development of a long-term freight strategy.

The FLCT's Final Report – released on 17 December 2013 – highlights the myriad issues that are impacting on Tasmania's freight system. It confirms that Tasmania's freight issues are complex, particularly for Bass Strait, and that integrated, system-wide improvements are required to improve long-term outcomes. The FLCT's work makes clear that there are no 'silver bullets' for improving the efficiency and competitiveness of Tasmania's freight sector. Rather, it points to a series of interrelated activities that will require organised and dedicated effort to implement.

Principal themes to emerge from the FLCT's work include:

- The complexity and importance of the Bass Strait shipping market;

- The critical role of ports as central points in both supply chains and freight infrastructure networks;
- The need for prioritisation of investment across a freight infrastructure hierarchy;
- Small to medium freight users and international exporters face challenges in the current freight system;
- In the context of budgetary constraints, alternative infrastructure funding models and sources need to be investigated; and
- Decisions on Tasmania's freight system must be based on evidence, and informed by industry expertise.

The FLCT has made 26 recommendations in relation to Tasmania's freight system in five key areas. The recommendations are comprehensive, covering -

- Ports, road and rail;
- Shipping capacity, services and cost;
- The Tasmanian Freight Equalisation Scheme;
- Infrastructure funding and investment priorities; and
- Freight and supply chain information and collaboration.

The Government has released its interim response to the Final Report, in which it has committed to immediate implementation of a number of recommendations. An important part of this is the Tasmanian Government's commitment of \$1.25 million per year, over two years, to establish a Freight Expert Advisory Panel. The Panel will provide freight, supply chain and logistics advice direct to business. The Panel will look at the potential for aggregation and coordination models between small freight users in sectors like agriculture, where shippers have a diversity of products with an export focus.

One major issue the FLCT Report emphasises is the cost pressures that Bass Strait shipping continues to place on Tasmania's exporters. With the withdrawal of Tasmania's only direct international container service in 2011, exporters have been forced to trans-ship their goods via the Port of Melbourne, at significant additional cost, relative to direct international shipment. This is particularly the case for smaller exporters who do not have sufficient market volumes to negotiate with shippers on price. These cost pressures have been compounded by the introduction in 2012 of the Port of Melbourne port licence fee, which impacts disproportionately on Tasmanian shippers.

Goods originating from Tasmania and bound for international destinations are not currently eligible for any level of assistance for the Bass Strait journey under the Tasmanian Freight Equalisation Scheme (TFES), despite the absence of direct shipping options for exporters.

The Tasmanian Government strongly supports the FLCT's call for a multi-pronged approach to exporter assistance, which includes extending TFES to international export goods and – recognising this is likely to take some time to implement - the delivery of \$40 million in previously-committed immediate structural assistance funding from the Australian and Tasmanian Governments.

Consistent with the FLCT's recommendations, the Tasmanian Government is also actively testing the market with international shipping lines to establish whether re-establishment of a direct service is commercially viable. This work is expected to be substantially advanced by the end of February 2014.

Many of the FLCT's other recommendations will require further, detailed consideration, together with consultation and advice from key stakeholders. An enduring benefit of the FLCT's work will be as a key input to the new Tasmanian Freight Strategy, which will outline a long-term, system-wide approach to ports and land-side infrastructure investment and planning. The Government has committed to completing the Freight Strategy by June 2014.

Key issues for consideration in the Freight Strategy include:

- 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.

In developing the Strategy, the Government will further consider the need for a coordinated, whole-of-system transport network that unlocks greater efficiency and productivity in the freight sector and drives economic growth.

As part of this work, a new transport model will be developed that will better define the relationship of freight demand to Tasmania's economic growth. This will assist with the identification of significant 'step change' points that will drive future infrastructure investment.

3. Tasmanian Freight and Passenger Equalisation Schemes

3.1 Tasmanian Freight Equalisation Scheme

The Tasmanian Government welcomes the Australian Government's re-affirmation of its pre-election commitment to retain the Tasmanian freight and passenger vehicle equalisation schemes.

This commitment recognises the critical role that TFES, in particular, plays in reducing the impact of the fundamental transport cost disadvantage faced by many Tasmanian businesses. As noted above, this disadvantage stems from the geographic reality that most Tasmanian businesses have no viable choice other than to transport their goods by sea across Bass Strait, in order to access their domestic and international markets.

TFES provides significant levels of assistance to a number of important Tasmanian manufacturers, reflecting the productive output of these larger businesses and their higher total transport costs. However, it is important to note that the scheme provides transport cost disadvantage assistance to over 1500 Tasmanian businesses in total and that it is therefore deeply embedded in Tasmania's freight arrangements.²

Economic modelling commissioned by the Tasmanian Government in 2005³ clearly showed the significant economic benefit to Tasmania of the TFES, with real gross state product (GSP), real consumption and employment being between 1 and 2 per cent higher as a result of the scheme. In dollar terms, GSP impact was estimated at up to \$300 million, with around 4300 jobs linked to the existence of the scheme. Moreover, this significant economic benefit to Tasmania was found to come at a negligible negative impact on the Australian economy overall.

The modelling also showed that beneficiaries were not only those industries that were in direct receipt of assistance but rather that all Tasmanian industries had higher output with TFES than without.

Conversely, the modelling of a hypothetical withdrawal of the scheme showed a significant negative economic impact, including the loss of over 4000 jobs in the 10-year period following any withdrawal of the scheme.

While there have been significant changes in markets and the Tasmanian economy since 2005, there is no doubt that the TFES remains critical to ensuring that Tasmanian businesses are not rendered uncompetitive as a result of their inherent transport cost disadvantage.

The Tasmanian Government would be extremely concerned if the Commission recommended substantive changes to the TFES in the absence of information/evidence as to their economic impact. The Tasmanian Government intends to commission updated

² See Australian National Audit Office (2011) *Tasmanian Freight Equalisation Scheme 2010-11 Performance Audit Report*

³ Monash University Centre of Policy Studies (2005) *The Economic Effects of the Tasmanian Freight Equalisation Scheme*

modelling for the 2012-13 financial year to quantify the economic impact of TFES to the State. This work is scheduled to be completed by mid-February 2014 so that it may be considered prior to the release of the Commission's Final Report.

While the Commonwealth has committed to the retention of equalisation schemes, the Tasmanian Government notes that the Commission's terms of reference nonetheless allow significant scope to identify and recommend changes to the design and delivery of TFES.

As a matter of principle, the Tasmanian Government is strongly opposed to any changes to the current equalisation arrangements that would undermine the scheme's fundamental objective of addressing Tasmania's freight cost disadvantage.

The Tasmanian Government's position is that total funding for the scheme should remain uncapped and demand-driven.

However, the Tasmanian Government supports changes to TFES that can be shown to improve efficiency and simplicity for claimants, reduce overall administrative costs and improve confidence in the integrity and transparency of the scheme, on the basis that any such changes will underpin the ongoing sustainability of the scheme. For example, consideration should be given to reducing the administrative cost of the scheme – to both claimants and the Australian Government – by simplifying arrangements for any claim below a threshold level.

At the same time, the Commission should also consider inconsistencies, anomalies and potential inequities in the current scheme, particularly with regard to shippers and goods that are currently ineligible for assistance.

The FLCT report found that, without any TFES assistance, international exporters currently pay approximately double the Bass Strait shipping costs of a TFES-assisted domestic exporter. International exporters also pay additional costs associated with repositioning empty containers. In recognition of this inequity – and its subsequent impact on Tasmania's export trade - the FLCT has recommended that the TFES should be extended to exports. This is consistent with the stated position of the Tasmanian Government since 2011. The Government supports the extension of TFES to exports that are trans-shipped.

The Tasmanian Government would be willing to explore linking an extension to transhipped exports to its commitment to addressing the major strategic challenges identified by the FLCT and the Tasmanian Freight Strategy. It is also noted that this extension would remove the perverse incentive under existing TFES arrangements to move Tasmanian manufacturing to mainland Australia.

There are other instances where the different treatment of goods under TFES is potentially leading to inequitable, perverse and/or inefficient outcomes, particularly for south-bound inputs to manufacturing. For example, industry stakeholders have noted that reusable plastic crates are currently ineligible for assistance, whereas single-use cartons and plastic do receive assistance. A similar situation exists for reusable beer kegs and wine bottles – where the latter is eligible for equalisation and the former is not.

The Tasmanian Government also understands that under the current TFES southbound assistance model, integrated businesses that undertake both agricultural production and manufacturing activities have to nominate the category that best describes their business – i.e. either agricultural producer **or** manufacturer – and are then only eligible for assistance on inputs to the relevant nominated activity.

The Tasmanian Government would support consideration by the Commission of these anomalies with a view to improving consistency and equity in how assistance is applied.

Tasmanian shippers and shipping service providers deserve a high level of certainty when making medium to long-term investment decisions. However, Tasmania's freight assistance arrangements have been subject to almost constant review - or the threat of review – since their inception in 1976. The Tasmanian Government's strong view is that any changes to the current equalisation arrangements coming out of the current Inquiry should be recommended on the basis that, if implemented, they will prevent the need for another wholesale TFES review in the medium term (e.g. at least 10 years).

The Tasmanian Government appreciates that some level of ongoing oversight is required for a scheme of this size in order to maintain confidence in its effectiveness and integrity. However, oversight processes should involve key Tasmanian industry stakeholders and focus on the efficient and effective operation of the scheme in the context of its objectives and agreed parameters. They should not perpetually leave open the possibility of either significant changes to, or the abolition of, the scheme.

Whatever changes the Commission might recommend with regard to the current scheme as part of this Inquiry, it is absolutely critical that Tasmanian businesses have sufficient opportunity for adjustment. A carefully staged approach to implementing any changes, including the provision of structural adjustment assistance to affected parties, is essential to avoid unnecessary or unanticipated shocks to key sectors of the Tasmanian economy.

3.2 Bass Strait Passenger Vehicle Equalisation Scheme

The intention of the BSPVES when it was introduced in September 1996 was to increase the demand for travel across Bass Strait through the reduction of the cost of sea travel for passengers' accompanying an eligible vehicle. The objective of the resulting fare reductions was to help to increase the demand for travel across Bass Strait, with direct benefits to the tourist industry and potential growth in jobs, investment and population for Tasmania.

The Tasmanian Government notes the 2012 Bureau of Infrastructure, Transport and Regional Economics' (BITRE) latest BSPVES monitoring report suggests that in 2011-12, motor vehicle passengers on the Spirit of Tasmania may have been 30 per cent higher than without the Scheme, and found that only 25 per cent of these additional passengers would have travelled as berth-only passengers on the Spirit of Tasmania in the absence of the BSPVES. While the BITRE report includes estimates of the overall spend by these passengers, it does not consider the wider economic benefit to Tasmania.

Tasmania is a touring destination, with 78 per cent of all visitors using a vehicle to self-drive around Tasmania. This includes hire car/motorhome and own or family car/motorhome. The BSPVES plays a critical role in supporting the touring model, by increasing access for visitors who wish to bring their own vehicles from mainland Tasmania. In the absence of BSPVES, it is likely that a significant portion of this market would be lost to Tasmania, with self-drive RV and caravan visitors in particular likely to substitute other mainland destinations for Tasmania when faced with the actual cost of transporting their vehicle across Bass Strait.

Tasmanian tourism directly supports 16,000 jobs and indirectly supports 38 000 Tasmanian jobs. The value and importance of the Tasmanian tourism sector is likely to continue to grow in the context of the long-term structural economic changes discussed above. The Tasmanian Government will be examining the economic impact of the BSPVES as part of the economic modelling work it is commissioning as an input to this Inquiry.

101 800 visitors came to Tasmania via the Spirit of Tasmania in the year ending June 2013, representing 11 per cent of all travellers. The Tasmanian Visitor Survey indicates that 81.5 per cent (83,000) of these visitors brought their own vehicles. These visitors are of critical importance to Tasmania's self-drive tourism industry, which supports many of the State's regional communities. Visitors arriving by sea stayed a total of 1.85 million nights and spent \$259 million during the year. Over 85 per cent of these visitors are in the State for a holiday or leisure activities.

Critically, visitors arriving on the Spirit of Tasmania stay longer in the state, dispersing into more regional areas and spending more money on their holiday. The average length of stay is 18 nights compared to 8 nights for visitors who travel by air. The average spend is \$2550 compared with \$1450 for visitors who travel by air. While, in the time available, it has not been possible to investigate this issue thoroughly, it is assumed that Victoria's regional tourism centres would also experience similar outcomes with regard to outgoing Tasmanian tourists travelling with vehicles.

Air visitors spend more nights in and around Hobart, where sea visitors disperse their nights in regional areas, highlighting the value and impact of the passenger equalisation scheme to Tasmania's regional communities.

The North West/West region of Tasmania in particular relies heavily on tourism and the Spirit of Tasmania. It was noted as the fifth most tourism-reliant region in the country in Tourism Research Australia's 2011 report into the Economic Importance of Tourism to Australia's Regions. Visitors from the Spirit of Tasmania accounted for 485 000 visitor nights in the North West region.

When established in 1996 the BSPVES rebate was calculated on the basis of charging a net fare for an eligible passenger vehicle plus driver, travelling in standard share cabin accommodation, that is comparable to the notional cost of driving an equivalent distance on a highway.

This 'equivalent highway cost' was based upon the sea distance of 427 kilometres between the ports of Devonport and Melbourne multiplied by an estimated running cost for an average family saloon according to the NRMA, which in 1996, was 39.87cents per kilometre. This provided an 'equivalent highway cost' of \$170 for a one-way trip.

In 1996 this represented a 50 per cent rebate on the standard cost of passage on the Spirit of Tasmania including vehicle and cabin space, or essentially making the cost of car transport to \$0 - which was the intent of the government of the day.

The current value of the rebate is \$204 one-way. TT Line charges an additional \$79 per vehicle each-way to cover the gap between the rebate and the actual cost of passage, which is passed onto the passenger through the fares. The BSPVES was not increased at all for over 12 years, until 2008 when the Rudd Government introduced indexation for the schemes rebate.

The Tourism Industry Council Tasmania has suggested that if indexation based on CPI had been incorporated into the system since its introduction, not just since 2008, the rebate today would be around \$280 one-way.

It is also acknowledged that the majority of passengers receiving BSPVES payments for accompanied vehicles use the TT-Line. However, TT-Line plays an important structural role in the Bass Strait by adding a critical third choice for customers in a market that would be otherwise be likely to be serviced by a duopoly. TT-Line's current business model involves a combined passenger, passenger vehicle and freight service offering. Again, TT-Line's financials present prima facie evidence that it is disciplining Bass Strait freight rates.

This highlights the general risk of examining either the TFES or the BSPVES in isolation. Any changes to either scheme must carefully consider flow-on implications to wider economic and structural outcomes.

3.3 Tasmanian Wheat Freight Scheme

The last bulk wheat shipment to Tasmania was in June 2009.

With the closure of the Hobart silos and the silting of the Tamar River, Devonport is currently the only accessible port for bulk wheat. Given the silo size at Devonport and issues with Mersey River navigation, 5,000 tonnes is the maximum parcel size for delivery. Vessels of this size are difficult to secure, with the unit cost for shipping by bulk uneconomically high. The silos and ship receival facilities at the Devonport port are currently for sale.

Given containerised wheat and other feed grains are eligible for assistance under TFES, it is unlikely that there will be interest in future bulk grain importation.

The Tasmanian Government is therefore open to potential options the Commission may identify for re-allocating the approximately \$1 million of funding currently set aside for bulk wheat shipments under TWFS to assisting another aspect of the Tasmanian freight task, particularly one of benefit to agricultural freight customers.

4. Bass Strait Shipping: Costs and Competition

The key shipping services for most of the State’s freight demanders are interstate container services, operating from Burnie and Devonport. The majority of these services go to the Port of Melbourne, and Tasmanian freight is estimated to comprise around 25 per cent of the annual throughput of the Port of Melbourne.

Approximately 450 000 TEUs per annum - split almost equally between northbound and southbound - are currently shipped across Bass Strait. The container freight task is shared by Tasmania’s three northern ports, with Burnie and Devonport accounting for the vast majority of the container task – see **Table I**.

Three shipping lines provide near-daily services between Tasmania and the Port of Melbourne. Toll-ANL Bass Strait Shipping and Searoad Shipping both provide six day per week sailings, while TT-Line provides a daily roll-on, roll-off service as part of its passenger service, with some twice-daily sailings added during peak periods.

Bulk shipping services are chartered by specific industries, such as mining, to move product out of Tasmania direct to interstate and international destinations.

Table I: 2012-13 Tasmanian Container Volumes

Number of Containers for 2012-13 (TEU)			
Port	Inward	Outward	Total
Burnie	126,986	126,847	253,833
Devonport	98,883	97,244	196,127
Bell Bay	849	434	1283

The FLCT focused heavily on Bass Strait container shipping, and commissioned major consultancies to understand current service levels, cost structure and supply chain relationships. The FLCT found that that Tasmanian supply chains were broadly efficient, supported by a high-quality, reliable and frequent service provided by Tasmanian shipping lines.

Shipping cost benchmarking undertaken for the FLCT found that Bass Strait shipping is 24 per cent more expensive than a comparable European service. However, it also found that around 23 per cent of this could be explained by the higher fixed input costs for the Bass Strait voyage compared to Europe.

The benchmark Hobart to Melbourne shipping cost derived by Aurecon is \$1403 per TEU. With TFES applied, this cost can reduce to \$853. However, this is still more expensive than a comparable mainland freight journey, which Aurecon estimated at between \$564 and \$799.

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, particularly as high productivity vehicles and/or more cost competitive rail options using infrastructure that is publicly funded become increasingly widespread on mainland Australia. This is an issue the Tasmanian Government wishes to further explore with the Commission.

The FLCT noted that there are a number of factors that drive the current operations of the Bass Strait shipping lines and the costs of their services. As noted above, many of these are largely outside the control of either shippers or the Tasmanian Government, and include:

- The high fixed and relatively low marginal costs of sea freight compared to road – freight shipped across Bass Strait is unloaded and discharged every 24 hours, requiring higher crew numbers compared to longer-distance international liner operations;
- Fuel costs - estimated to be 30 per cent of the cost of a voyage to vessel owners - substantially higher than major bunkering ports in Asia;
- Wages and costs for Australian crews between three to six times higher than rates of international vessels;
- In 2012, the Victorian Government imposed a \$75 million Port Licence Fee on the Port of Melbourne. This cost has been passed on to customers. The Tasmanian Government has been successful in securing lower charges than originally proposed for a number of port services to the benefit of Tasmanian shippers, but the impact on freight costs has still been significant; and
- For exporters, sourcing international containers (due to import/export imbalance) also causes logistics problems and brings an additional cost impost. 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 (i.e. 40 vs 20ft).

It should be noted that the FLCT price analysis was based on rack rates and did not examine the level or robustness of competition in the Tasmanian shipping market, nor did it specifically consider the potential existence or impact of market power. These issues require an examination of the available evidence, rather than relying solely on the economic theory of competition among few participants. TT-Line's publicly available annual report, particularly its financial reporting, does not support the proposition that economic rent is being extracted by the current Bass Strait shipping services, notwithstanding the concentrated nature of the Bass Strait freight market.

The Tasmanian Government understands that the Commission's terms of reference provide for a more detailed analysis of the economic efficiency of the Bass Strait shipping market, which will serve as a useful complement to the FLCT's price analysis.

5. Direct International Shipping

Tasmania's international export freight market is diverse, with different service needs related to product, cost structures and end destinations. International container volumes are currently around 37,000 TEU p.a., out of a total container task of 450,000 TEU p.a.

International export volumes currently exceed imports by a ratio of around 2:1. However, import volumes are growing, particularly for consumer goods. Potential export volumes are likely to be higher when products that currently undergo processing in mainland destinations and/or are re-packaged ahead of international export, are included. As discussed above, current ineligibility of direct international exports under TFES incentivises processing and repacking on the mainland rather than on-island.

Direct international container shipping out of Tasmania ceased in 2011, with the withdrawal of the AAA consortium service from Bell Bay. Since then, Tasmanian exporters have been forced to trans-ship their goods via the Port of Melbourne, at significant additional cost, relative to direct international shipment.

Transshipment costs vary with volumes shipped, types of containers used and other factors. However, the TFLC suggests that an indicative figure is \$1,000 per TEU for a medium sized shipper to tranship across Bass Strait. An indicative international freight rate to ship from Melbourne to Shanghai is in the order of \$1,100 per TEU.

As noted above, transshipment costs are a significant cost pressure for exporters and importers, particularly in the absence of any assistance to exporters under the TFES. Large Tasmanian exporters and importers report that the loss of a direct international container shipping service has resulted in additional freight costs in the millions of dollars over the last two years. This situation is compounded by the new Port of Melbourne port licence fees, as noted above.

A number of potential barriers have been identified with regard to attracting a direct international container service to Tasmania, including relatively small volumes and limitations on vessel size due to port channel depths. However, work completed for the FLCT by consultants Thompson Clarke suggested that there was commercial interest from international shipping lines in providing a low frequency international service to Tasmania.

The Tasmanian Government is currently in the process of testing the market with international shipping lines to determine potential viability of a direct service calling to one of Tasmania's northern ports. This process is being led by the Department of Infrastructure, Energy and Resources (DIER), and is well progressed. DIER has contacted major Tasmanian exporters and importers to understand their freight needs. This has informed meetings with international shipping lines to understand supply-side requirements. Short-listed lines have been identified. All are seeking a commercially-based service.

The Government is now the process of evaluating whether to enter into negotiations with a preferred line early in 2014.

6. Concluding Comments

The Tasmanian Government welcomes the opportunity to work with the Commission on the identification of enhancements to the existing equalisation schemes that improve their efficiency, equity and transparency, on the basis that any such improvements will place the schemes on a sustainable footing and provide enhanced certainty for Tasmanian industry.

However, 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.

The Tasmanian Government is willing to seriously engage with the Commission more broadly on how the current Inquiry process could be used to secure Tasmania's commitment to the major longer-term strategic measures identified in the FLCT Report.

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.