Australian Government
Infrastructure Australia

24 May 2012

The Hon. Anthony Albanese MP
Minister for Infrastructure and Transport
Room MG 43
Parliament House
Canberra ACT 2600

Dear Minister

I refer to your letter of 13 March 2012 seeking an initial set of findings and recommendations in relation to Tasmanian ports and shipping.

I am disturbed that despite nearly 36 years of subsidy for Tasmanian freight a series of inequities and inefficiencies remain. The so-called Tasmanian freight equalisation scheme is now built into industry's expectations with costs to the Commonwealth now in excess of $100 million.

The approach to freight in Tasmania is reactive, disjointed, fragmented and costly. The opportunity cost of past and future Tasmanian Freight Equalisation Scheme payments needs consideration against alternatives e.g. road, rail, port and supply chain improvements.

There is though a positive, proactive way ahead for Tasmania as a vital part of Australia's freight network.

My initial views are that you might consider:

1. The establishment of a review of shipping costs and competition policy issues for both sea freight and passenger services to be undertaken by the Australian Competition and Consumer Commission.
2. A reference to the Australian Federal Police given the number of allegations made to me of possible fraud associated with the Tasmanian Freight Equalisation Scheme. This will be a sensitive issue as little direct evidence has been provided. The outcome of such an inquiry may provide greater confidence in the scheme particularly in light of the ANAO's recent report.
3. Subject to points 1 and 2 an updated examination by the Bureau of Infrastructure, Transport and Regional Economics of the freight disadvantage to Tasmania as compared to other parts of Australia.
4. The inclusion of all non-bulk goods between Tasmania and the mainland for consideration in any equalisation scheme.

5. The Commonwealth withdraw its direct funding of the Tasmanian Freight Equalisation Scheme and request the Commonwealth Grants Commission to consider the freight disadvantage in its work on the distribution of GST revenues. Alternatively, a transition process say over 10 years with 10% of TFES being withdrawn each year and converted to capital improvements in Tasmania's infrastructure.
6. Part allocation of the $20 million recently provided to Tasmania to:
    a. The Australian Competition and Consumer Commission to review shipping costs and competition policy issues;
    b. The creation of a freight logistics coordination team with an industry leadership group similar to the Hunter Valley Coal Chain logistics team and the model proposed for the Mt Isa to Townsville supply chain:
        i. To focus on individual industry issues e.g. agriculture, metal, paper, food etc. including initial work on the top ten issues and Tasmanian Freight Equalisation Scheme claimants;
        ii. Coordination between customers, road, rail, ports and in particular the Port of Melbourne;
        iii. Progress strategic work associated with long term planning including Tasmania road and rail systems to lift to the standards proposed in the national land freight strategy – super B doubles, and carrying capacity for 25 tonne axle loads on the national rail system;
        iv. Provide for any immediate capital works that would provide a net productivity improvement;
        v. The development of Tasmania's ports as heralded in the national ports strategy i.e. development of 50 year plans in concert with the Port of Melbourne and its mainland supply chain; the expeditious development and transparent reporting against a set of key performance indicators as proposed in the national ports strategy;
        vi. To maximise the benefit of the Brighton intermodal hub;
        vii. Work with Tasmania's exporters, and
        viii. To drive costs down across the supply chain.
    c. Any payments to industry as 'compensation' for withdrawal of international shipping should only be considered if there is a strong case, on the basis that this is a 'one-off' structural adjustment payment and should not become a separate 'entitlement' similar to the Tasmanian Freight Equalisation Scheme.

7. Close liaison with your Department under the Nation Building program to ensure capital funds are expended to satisfy the outcomes proposed by the national ports and freight strategies; and close liaison with your Department and the Tasmanian government concerning the opportunities proposed in the Coastal shipping legislation before the Federal Parliament currently.

I have further consultations to undertake particularly with Infrastructure Tasmania and will report further.

Yours sincerely

Michael Deegan
National Infrastructure Coordinator

TERMS OF REFERENCE

- Identification of any immediate whole-of-government measures that may be warranted to address the current issues; and
- The development of a long-term Tasmanian ports and freight strategy that will identify optimum investments in freight transport and port capacity.

to report on:

- International shipping trends and developments, particularly with reference to implications for Tasmania;
- Trends and developments with freight flows and logistics chains in Tasmania;
- Current and prospective government and private sector investments in port facilities and logistics infrastructure;
- The operation of the Tasmanian Freight Equalisation Scheme and other mechanisms providing assistance to Tasmanian companies;
- Efficient port and logistics structures for Tasmania;
- Implications of developments with Tasmanian and Victorian ports; and
- Recent relevant analysis and research in the area.

CONTEXT

On 23 March 2012, the Minister for Infrastructure and Transport, the Hon. Anthony Albanese MP announced that the Australian Government was providing "a $20 million package to enable local exporters to access international markets" (AA042/2012). As part of the same announcement, Minister Albanese also directed "Infrastructure Australia to work with Infrastructure Tasmania in developing a long term strategic transport plan" (AA 042/2012).

Minister Albanese also counseled that "[s]imply changing the Tasmanian Freight Equalisation Scheme is no silver bullet or a substitute to a long term solution". (AA042/2012).

The Tasmanian Freight Equalisation Scheme was the central result of the Nimmo Commission into Transport to and From Tasmania, established by the Whitlam Government on 10 April 1974 – the day Parliament was dissolved for the 1974 General Election. The Government had a key stake in this inquiry, as its Deputy Prime Minister, Mr. Lance Barnard, was himself a Tasmanian.

The Nimmo Report identified some key problems with Tasmania's infrastructure, many of which continue to influence the local and national supply chain to the present day. One key issue identified by Nimmo was bureaucratic. In 1974, Tasmania's ports were operated by local Port Authorities and there was no central coordination. It was only in 2006 that this lack of a coordinated approach was addressed with the amalgamation of each of the four port companies into Tasports.

Also identified were issues of worn out and out of date infrastructure, particularly in rail. In Infrastructure Australia's most recent call for submissions, the Tasmanian Government has submitted a proposed Rail Revitalisation Scheme. Given that this was one of the preconditions set by Nimmo in 1976, it is worth considering why it has taken almost forty years for the Tasmanian Government to act on the issue of out of date rolling stock and infrastructure.

Since the Nimmo Inquiry, there have been three further inquiries of note into Tasmanian Freight Schemes, conducted by the Interstate Commission in 1985, the Tasmanian Freight Equalisation Scheme Authority in 1998 and the Productivity Commission in 2006.

Tasmania has recently lost direct international sea trade, this was conducted through an intermodal terminal from Bell Bay, resumption is considered unlikely, yet expansion to the Bell Bay Intermodal Terminal remains proposed. In view of the loss of international trade, Government and the private sector must consider whether it is wise to fund expansion of the terminal.

The Tasmanian Freight Equalisation Scheme acts as a barrier to Tasmania understanding the virtues of economic self-sufficiency. If Tasmania is to be a productive member of the Australian Commonwealth then it must take risks, and provide the opportunities that will give it a productivity boom.

International trends in shipping and the impact on Tasmania

As an island state, Tasmania relies on sea trade. Until April 2011, the Port of Bell Bay boasted a regular weekly containership service from the Port of Bell Bay to Singapore. With the increase in size of containerships, and Bell Bay's channel depth, the loss of this service was all but certain.

In terms of coastal and international trade, Tasmania's key ports lie in the north of the state. They are Bell Bay, Hobart, Devonport and Burnie.

PORT	CHANNEL DEPTH
Bell Bay	10.8m
Burnie	9.4 to 10m
Devonport	9.4 to 10m
Hobart	12.5 to 13.7m

Source: TasPorts

An analysis of channel depths goes some way to explaining why the international consortium AAA ceased its Tasmanian operations in 2011.

On the mainland, ports have taken to dredging to ensure that they are able to maintain access to the international containerised shipping market. One such example is the Port of Melbourne, which underwent extensive channel dredging to ensure it maintained its status as Australia's premier international ports gateway. The cost to dredge Tasmanian channels to 14m depth would be prohibitive.

For Tasmania, the loss of the AAA service which enabled Tasmanian products to reach Asia without transshipment through Melbourne, the increased size of container vessels has all but ensured Tasmania is shut out from the international market.

The Tasmanian Freight Equalisation Scheme appears to have been created to avoid Tasmanian businesses becoming unviable by virtue of their reliance on shipping. Due to the growing size of vessels servicing the Australian mainland, it is unlikely that Tasmania will have a direct international shipping service.

In response to the cessation of international shipping from Tasmania, on 23 March 2012 Minister for Infrastructure and Transport, the Hon. Anthony Albanese MP, announced that

"...the Federal Labor Government will provide a $20 million package to assist local exporters access international markets". (AA042/2012)

Trends and developments with freight flows and logistics chains in Tasmania

In the year ending December 2011, the agricultural sector was responsible for over half of Tasmania's exports, accounting for a total of 51.6% of all exports during that period according to data collected by the Port of Melbourne Authority.

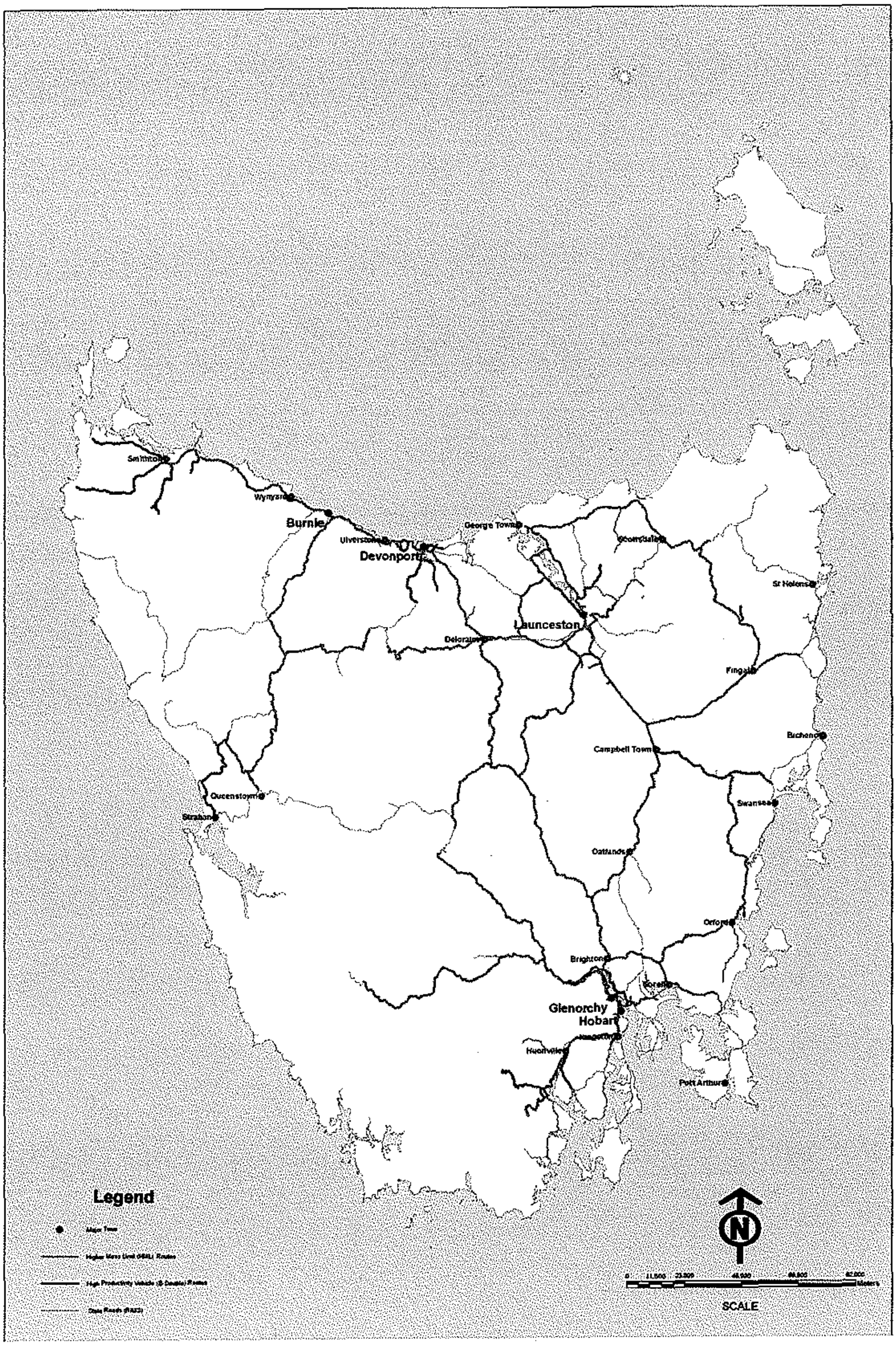
There is evidence of a disconnect between customers of the various Tasmanian ports and TasRail. This was evidenced when, not long after TasRail opened its service to Bell Bay, Norske Skog and Nyrstar transferred their operations to the port of Burnie. This is significant because both are claimants of the Tasmanian Freight Equalisation Scheme.

In 2008-09, six axle vehicles transported the largest proportion of freight with rail coming in at only 10 per cent, about a quarter of the total freight task transported by six-axle vehicles. This disproportionate modal share may have something to do with the state of Tasmania's railways which are dilapidated in parts and speed restrictions are in place making rail an inefficient modal choice for freight at the present time.

The Tasmanian Department of Infrastructure, Energy and Resources Review of Gazetted High Productivity Vehicle Network also demonstrated a problem being faced by Tasmania's road network in that a number of sections of road are classed as either "Does not meet the Tasmanian Guidelines" or "Marginally Below the Tasmanian Guidelines".

This is unacceptable in light of the nature of Tasmania's rail network and goes some way to explaining Tasmania's economic malaise in that the two networks required to transport freight throughout the State are structurally incapable of doing so.

Tasmanian's High Productivity Vehicle Route Network (Source: DIER)



Current and prospective government and private sector investments in port facilities and logistics infrastructure

The Tasmanian Government has presented four proposals in the current submissions round to Infrastructure Australia in the area of port facilities and logistics infrastructure. However, only one of these has actually been taken onboard.

First identified as a major problem for Tasmania's freight and logistics sector by Commissioner Nimmo in the 1970s, the Tasmanian Government has approached Infrastructure Australia with a view to revitalising Tasmania's Rail Network. The work Tasmania has identified includes upgrades to the Melba, Fingal and Bell Bay Lines and to re-sleeper much of the existing network with concrete sleepers. Much of the network is at present subject to speed restrictions, and derailments are frequent, meaning that the road network is probably carrying more of the freight and logistics task. The project has been assessed by Infrastructure Australia as being at Early Stage.

The Tasmanian Government has also submitted proposals for the Midland Highway (as part of the Rural National Network) and the Brooker Highway (as part of the Urban National Network) – these projects have not been recommended. It is instead proposed that Tasmania develop a Hobart to Launceston transport strategy.

The road network, more broadly, suffers from a lack of private sector investment. This has largely eventuated because of convoluted processes currently in place which present a barrier to private sector investment. In addition, 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.

TasPorts' submission to Infrastructure Australia on the Bell Bay intermodal expansion is also worthy of discussion at this point. Whilst it remains on the Priority List, on the basis of potential future capacity constraints, given the loss of international traffic and rail from the Port of Bell Bay, consideration must be given as to whether the project remains viable for the future.

The operation of the Tasmanian Freight Equalisation Scheme and other mechanisms providing assistance to Tasmanian companies

ORIGIN

It has been said that:

"the existence of the scheme probably reflects political realities at the Commonwealth level".

And that:

"care should be taken that it does not offset market forces in such a way as to cause inefficiency in the Bass Strait transport industry or in the wider Tasmanian Economy".

The Tasmanian Freight Equalisation Scheme was the central result of the Nimmo Commission: *Transport to and From Tasmania.*

Nimmo's 1976 report identified some major problems with Tasmania's port, road and rail infrastructure, many of which continue today. A further issue identified was bureaucratic: a lack of a coherent framework for freight.

At that time the Bass Strait container trades were dominated by two firms that exercised market power because they were shielded from competition. A result was held to be that the shipping services did not meet best practice: containers, ships and cargo handling equipment used for Tasmanian trades were obsolescent.

The report recommended a freight equalisation scheme with stated aims being to:

- offset Tasmania's freight disadvantage;
- promote economic development in Tasmania; and
- promote the development of an efficient transport system.

It was argued that Tasmania deserved assistance not accorded to other areas of Australia because it was a State and that at Federation, the States had agreed to pool resources to attain a consistent standard of living across the country.

The proposed scheme was to offset freight cost disadvantage but take into account the benefits of businesses locating to Tasmania.

The scheme introduced by the Fraser Coalition Government in 1976 only considered freight cost disadvantage. The recommendation to include locational advantages in Tasmania was ignored.

Export cargoes were excluded from the Scheme, possibly for reasons such as the potential for:

- breaches of Australia's obligations under the General Agreement on Tariffs and Trade;
- benefits to be captured by shipping lines rather than Tasmanian businesses;
- export payments to work against direct international ship services to Tasmania.

PURPOSES

There are various statements as to the purposes, objectives and aims of the Tasmanian Freight Equalisation Scheme.

Most recently the Bureau of Infrastructure Transport and Regional Economics stated that the objective is:

" to alleviate the freight cost disadvantage incurred by shippers of eligible non-bulk goods moved between the mainland and Tasmania by sea".

Other formulations refer to matters such as sea freight disadvantage.

The scheme appears to have been created to reduce the potential for Tasmanian businesses becoming unviable by virtue of their reliance on shipping. These formulations might be compared with that proposed by Nimmo who referred to Tasmanian economic development and transport efficiency.

The proffered purposes, including those by Nimmo, were assessed by the Productivity Commission in 2006 (see below). It noted:

'there has been longstanding concern about the ambiguity of its underlying objectives'

and concluded:

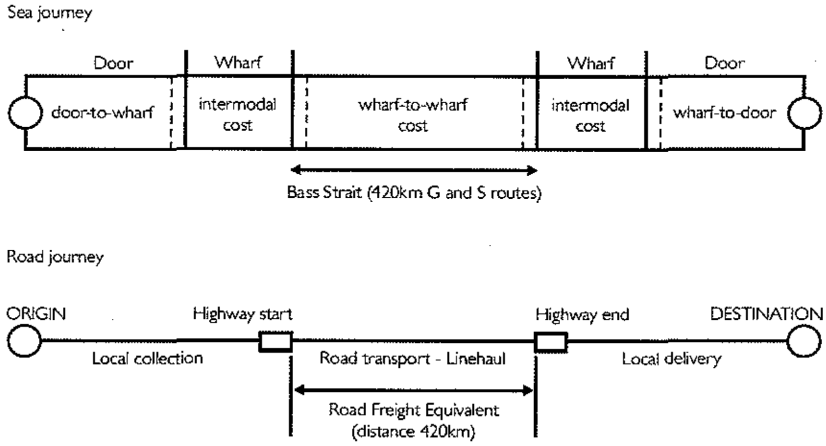
'there is no clear underlying rationale for providing freight assistance to particular Tasmanian shippers'.

OPERATION

Payments are made by the Australian Government to shippers on the basis of an estimate of wharf to wharf sea costs across Bass Strait compared with a mainland road haul of the same distance. The sea journey and road journey are shown in Figure 1.

Figure 1: Structure of the Scheme

FI Conceptual model and structure of the TFES



Note: G and S routes are Victoria–northern Tasmania.
Source: BITRE based on TFES Review Authority (1998) and Ministerial Directions (DITRDLG 2008).

'Parameters' are estimated for the segments in Figure 1, following recommendations of a review of the structure of the Scheme by the Tasmanian Freight Equalisation Scheme Review Authority in 1998.

A formula is used to calculate a rate of subsidy for movement of a twenty foot equivalent unit (teu) container. The rate is paid for all relevant containers, meaning that the potential total subsidy cost is uncapped. The formula is complicated, attempting to address 'incentives', different weights etc. Payments are made by Centrelink.

Overall the formula appears to be intended to reduce a differential between actual sea shipping costs and hypothetical costs were the containers to be carried on land transport systems similar to those on the mainland – the differential reflecting a number of 'factors'. The latest calibration of factors was in 2011 further to a report by the Bureau of Infrastructure Transport and Regional Economics.

REVIEWS

Inquiries into Tasmanian Freight Schemes include by the Interstate Commission, the Tasmanian Freight Equalisation Scheme Authority, the Productivity Commission and the Australian National Audit Office.

Interstate Commission (1985)

The Interstate Commission was asked to calculate rates of assistance and examine the extent to which payments made under the Scheme provide appropriate compensation for any interstate freight cost disadvantages.

The Commission found that:

"those who consign non-bulk goods by sea between Tasmania and Australia are at a demonstrable disadvantage compared with those who consign comparable goods between mainland points of origin and destination".

But:

"those who ship [bulk] commodities between Tasmania and the mainland suffer no comparative cost disadvantage".

It found no economic reason for subsidies to 'equalise' Bass Strait freight costs with mainland freight costs. But it did see a case for subsidies to be paid to Tasmanian shippers to offset the adverse effects on them of government transport policy decisions that kept the costs of coastal shipping higher than they otherwise would be. It recommended that the Scheme be configured as a compensation, rather than an equalisation scheme.

In the Commission's view, Tasmania's transport disadvantage arose solely from the *Navigation Act*. The Government accepted the Commission's recommendations regarding rates of subsidy, but it did not accept its view on causes of transport disadvantage.

Tasmanian Freight Equalisation Scheme Authority (1998)

This review found that the then scheme failed to adequately define 'freight cost disadvantage'. It recommended a change in the method of calculating subsidy including the introduction of 'parameters' such as the 'road freight equivalent', 'wharf to wharf' basis etc:

'[t]he TFES should be placed on a basis where the concept of sea freight disadvantage is defined, widely understood, and the related entitlement to assistance is quantifiable and capable of annual update'.

In later years the subsidy calculation methodology proposed by the Authority and adopted has been described as 'very Heath Robinson'.

Productivity Commission (2006)

The Commission was asked to report on the merits of arrangements for subsidising shipping between the mainland and Tasmania.

It found:

'there is no sound underlying economic rationale for the scheme.

– If a broader objective of regional development is intended, a sea freight subsidy is unlikely to be the most economically efficient way of meeting this.'
The subsidies are not equitable within Tasmania. The TFES discriminates against industries that are ineligible for payments under the Ministerial Directions, and favours transport-intensive industries and methods of production.

While the review was in progress, the Government announced that the Scheme would continue. The Commission observed that the Scheme lacked an economic rationale, and was not consistent with Australia's regional development programs:

'As a result, it is difficult to draw meaningful conclusions about the appropriate scope of the scheme. However, as the Government has announced that the scheme will remain, the Commission has taken its current scope as a 'given' and focused on ways to make the arrangements operate more efficiently and effectively.'

The absence of a rationale was seen as causing a range of concerns about the operation of the Scheme, with the root cause being its design. A key problem was the difference between the perception that the scheme is robust and the reality that the core element of the scheme - the measurement and compensation for freight disadvantage - is problematic. The parameters used to 'measure' disadvantage were:

'far from robust and.... essentially arbitrary'.

The Commission was also concerned about the potential for market power to affect costs, and capture the benefits of the scheme. The presence of several shipping companies did not allay this:

'The ACCC (2006) considered that barriers to entry into Bass Strait shipping were high, one reason being there is very little opportunity for a new entrant to gain access to berths, or develop additional berths within the Port of Melbourne. It also identified the effect of vertical integration between carriers and freight forwarders, high capital costs (without guaranteed volume) and the deterrence posed by current excess capacity'.

The Commission heard from businesses in Tasmania who claimed that the scheme had substantial impacts. It questioned the extent of these impacts at a State level:

Potentially significant impacts of the TFES at the firm level do not imply similar impacts for the Tasmanian economy overall. TFES payments are equivalent to about 0.9 per cent of total costs and about 2.3 per cent of the value added for the agriculture, mining and manufacturing sectors of the Tasmanian economy .... It would be reasonable to expect the overall output and employment effects from withdrawing the TFES to be commensurate.

Information provided to the Commission included modelling conducted for the Tasmanian Government which argued that if the Scheme was abolished:

"the Tasmanian economy would experience substantial negative effects on employment and activity that would intensify over time.... with total employment down by up to around 4,250 jobs'

In response, the Commission noted the modeling shows that continuation of the Scheme leads to:

'very little improvement in Tasmanian welfare in per capita terms because of the population growth induced by the extra economic activity generated by the sea freight subsidy.'

This comment is particularly significant in the light of Nimmo's argument about Tasmania deserving assistance because it joined the Federation. Nimmo referred to 'standard of living', which equates with welfare per capita as distinct from (say) business profits. The Commission effectively found that this type of scheme is ineffective in addressing Nimmo's argument.

The Commission also found that

- The output and employment benefits to the Tasmanian economy are largely at the expense of economic activity elsewhere in Australia and at a small net cost to the Australian economy as a whole; and
- Some subsidy recipients expressed concern about 'manipulation' of claims.

Australian National Audit Office (2011)

The Australian National Audit Office noted that:

"[t]he Scheme is demand driven, and while an annual budget is set for the total assistance available for claimants, in practice there is no upper limit to the total annual payments that could be made to claimants".

FISCAL COST

Payments by the Australian Government under the scheme, and the 'real $' value of the scheme are shown in Table 1.

Table 1: Australian Government outlays on Tasmanian Freight Equalisation

Year	Nominal outlays	Real value (2010)*
1976-77	$16.4m	$82.7m
1977-78	$20.9m	$96.5m
1978-79	$24.7m	$105.9m
1979-80	$27.6m	$107.4m
1980-81	$29.5m	$105.2m
1981-82	$29.4m	$94.2m
1982-83	$27.2m	$78.5m
1983-84	$29.3m	$77.8m
1984-85	$30.1m	$77.9m
1985-86	$27.5m	$65.8m
1986-87	$27.5m	$60.0m
1987-88	$28.0m	$57.0m
1988-89	$34.4m	$65.1m
1989-90	$36.5m	$64.0m
1990-91	$32.8m	$53.8m
1991-92	$32.7m	$52.9m
1992-93	$32.9m	$53.1m
1993-94	$37.6m	$59.5m
1994-95	$39.5m	$60.9m
1995-96	$42.7m	$62.7m
1996-97	$41.2m	$59.6m
1997-98	$41.4m	$60.0m
1998-99	$41.8m	$59.7m
1999-00	$59.4m	$83.3m
2000-01	$67.0m	$88.8m
2001-02	$72.0m	$92.5m

2002-03	$77.2m	$96.3m
2003-04	$83.0m	$101.1m
2004-05	$89.1m	$105.8m
2005-06	$91.9m	$109.4m
2006-07	$94.2m	$106.2m
2007-08	$100.7m	$105.4m
2008-09	$109.4m	$114.7m
2009-10	$98.3m	$100.9m
2010-11	$98.5m	$98.5m

* using December quarter all groups consumer price index as deflator

Table 1 shows the real value of the scheme increasing in early years to around $10m to $110m then stabilising in the $50m to $60m range from the late 1980s to the late 1990s. There have been substantial increases since, and it has consistently been around the $100m to $110m range in recent years. In total around $2.9b has been expended in 2010 dollar terms.

Efficient port and logistics structures for Tasmania

The multiple port strategy

Tasmania currently has a strategy of facilitating trading through a number of ports with a single entity, Tasports, responsible for all ports. A Tasmanian Government briefing note examining the issue advances the argument that:

"[a] one 'multi-port' three terminal makes the best economic use of existing infrastructure and transport networks, without significant capital cost".

Notwithstanding this, Tasports revenue and profits have reduced significantly in recent years. Its return on assets is now negligible.

Each of Tasmania's ports supports and is supported by local businesses, for example in the Bell Bay industrial precinct. Containers for the main ports are shown in Table 2.

Table 2: TEU per port

Year	Burnie	Devonport	Bell Bay
2006-07	204,028	156,464	89,300
2007-08	206,348	104,930	89,458
2008-09	192,127	72,408	91,987
2009-10	211,997	79,739	40,534
2010-11	231,615	103,939	48,707

The overall Tasmanian container task is significant, and of a national scale compared with other jurisdictions - for example total port throughput of 384,000 teu exceeds the 297,000 teu for Adelaide in South Australia.
However, the split between three ports results in Tasmanian industry not enjoying some scale economies available to their mainland counterparts.

A further issue not experienced by other States is the relatively long land-transport segment between these ports and some principal markets. For example, while a large majority of Botany container cargo stays within of that port (Sydney), the distances between northern Tasmanian ports and Hobart are much larger – in the order of 250 km to 300km.

Channel depths and ships

The channel depths at each container port are not adequate to meet trends in international container shipping. Depths are: Bell Bay - 10.8m; Devonport - 10m; Burnie - 10m.

The issue of channel depths is not unique to Tasmania - mainland ports such as Fremantle and Melbourne have undertaken extensive dredging programs to cater for the larger container ships now entering international trades. Fremantle and Melbourne are now dredged to at least 14m depth.

In the cases of Fremantle and Melbourne, channel deepening was made economic by the volume of container trade - reflecting both the size of the cities and consolidation of the container tasks into a single port.

The lower volumes of Tasmanian cargo, and its split among three ports, would reduce the economic viability of a channel deepening program in any of Tasmania's ports.

Loss of international shipping service

Until April 2011, Tasmania had a regular weekly international containership service ('AAA' - between Bell Bay and Singapore). However, given trends in container ship size and restricted channel depths, the loss of this service was arguably inevitable. Infrastructure Australia has been advised the reinstatement of direct international services is unlikely in the short term.

An effect of the loss of the AAA service is that international trade ex Tasmania needs to be trans-shipped through Melbourne. It is claimed that this increases the costs of ex-Tasmania shipments of exports and imports, and therefore weakens the competitive position of Tasmanian industry on domestic and international markets.

In response to the loss of direct international shipping, on 23 March 2012 along with the direction to Infrastructure Australia to work on a plan for Tasmanian freight, the Minister announced that:

"...the Federal Labor Government will provide a $20 million package to assist local exporters access international markets"

Infrastructure in Victoria

Infrastructure in Victoria is relevant to shipping to Tasmania.

Potentially significant matters are:

- the effect of availability of berths etc. on market power (see above);
- Victorian ports and freight plans;
- new charges at the Port of Melbourne.

Previous published Victorian ports and freight plans argued for the relocation of 'interstate' rail activities from the Dynon precinct – proximate to the port – to terminals in western or northern Melbourne.
The vacated site would be used for international shipping. While this could have implications for freight ex Tasmania, the issues have not been raised with Infrastructure Australia.

Tasmanian industry has raised concern about the impacts, and constitutional validity of Victoria's *Port Management Amendment (Port of Melbourne Corporation Licence Fee) Bill 2011* which seeks to impose a charge on containers passing through port Melbourne. The Tasmanian Government and Tasmanian Chamber of Commerce and Industry are seeking to ensure Tasmanian industry is not unduly disadvantaged by the charges.

In December 2011, the Port of Melbourne Corporation issued a fact sheet on how the charge would be applied to the different freight tasks, as an example, an outline of the revised container freight charges is shown in Table 3.

Table 3: Port of Melbourne current and new charges

	Current charge $teu	Estimate new charge $teu
Full	40.10	60.15
Full Bass Strait	41.80	62.70
Empty	10.00	15.00
Transhipment	50% of published rate	50% of published rate

Tasmanian roads

With the strategy of operating three ports, and the distances of these ports to Hobart, the efficiency of land transport is a key issue for Tasmania. This involves trucking and (possibly) rail hauls among the three northern ports and between these ports and Hobart.

A State freight strategy is under development, but at this time neither roads nor rail lines meet the standards for the mainland national network in terms of designs for efficient vehicle use or infrastructure condition.

On the mainland national network, road designs and operations are generally designed for a minimum of B-double operation, including with 'higher mass limits'. In comparison there are restrictions on the main roads used for freight in Tasmania such that Tasmanian industry is unable to enjoy the scale and scope economies from trucks that are currently available to mainland firms (see map).

The Department of Infrastructure, Energy and Resources review of the high productivity vehicle network shows that road sections among the northern ports, and to Hobart do not meet Tasmanian guidelines for efficient freight vehicle use.

Infrastructure Australia has argued for even better designs for main freight routes to ensure access by high productivity vehicles – such as B-triples for long hauls, and super B doubles capable of taking two 40ft containers (or four 20ft containers) in a single move. The concept of super B doubles is seen as especially important for inter-port or port-inland terminal road transport.

The unavailability of modern truck technology to Tasmanian industry – and the potential impact on Tasmanian businesses - is highlighted in the Bureau of Infrastructure Transport and Regional Economic's advice on settings for the Freight Equalisation Scheme.
In this advice, the Bureau's notional costs of mainland hauls assume the low rates achievable with B-doubles, but the costs of hauls in Tasmania assume the higher rates that would be charged with semi-trailers.

To date Infrastructure Australia has not received a proposal for road improvements specifically targeted at modern truck technology for Tasmania.

Tasmanian railways

Tasmanian industry suffers from similar problems regarding railways, with an additional issue of Tasmanian narrow gauge incompatibility with either the standard gauge national network or the local broad gauge network in Victoria.

Tasmania's railway issues arise from an historical context – the takeover by the Commonwealth Australian National Railway in 1975, privatisation in 1997, takeover by Pacific National in 2004, renegotiation of track leasing in 2007, and renationalisation by the State via Tasrail in 2009.

In 2011, Tasmania submitted an outline of a rail revitalization program to Infrastructure Australia. Essentially this is a renewals program, aimed at restoring infrastructure and eliminating track induced delays, operating restrictions etc.

A characteristic of Tasmania's rail system for many years has been its low density– tonnages per km of track are relatively low by mainland mainline standards (2.5mt on 632km of operational track) and it is constructed for relatively light axle loads.

In 2010-11 Tasrail received an operating subsidy of $19.5m. These engineering, operational and commercial characteristics are more similar to mainland branchlines than to mainlines.

As is the case with mainland branchlines, the primary consideration in restoring any rail infrastructure in Tasmania should be the likelihood of its use at an adequate density – a higher density than at present. This likelihood depends on alignment between the strategies of industry, freight providers, and railways.

However, in Tasmania there is evidence that industry-freight-railway strategies are disconnected rather than aligned - not long after TasRail opened its service to Bell Bay, customers Norske Skog and Nyrstar transferred their operations from Bell Bay to Burnie. It might be noted that both are claimants under the Tasmanian Freight Equalisation Scheme.

Tasmania's proposed infrastructure investments

In its current submission to Infrastructure Australia, the Tasmanian Government presented three groups of proposals which could be related to freight.

The first group comprises road proposals: the Midland Highway (as part of the Rural National Network) and the Brooker Highway (as part of the Urban National Network). These proposals do not specifically target the introduction of more productive trucks onto the road network or their potential cost savings to Tasmanian businesses.

Infrastructure Australia has pointed to more general issues regarding road 'investments' and freight, notably the absence of a mechanism for the freight industry to identify and gain benefits from road improvements. These general issues also occur on the mainland. In essence, there appears to be no robust mechanism for industry and freight customers to influence road 'investments'. The second group of proposals involves the rail revitalisation plan, discussed above.

The third group relates to a proposed Bell Bay Intermodal terminal. This is on the national infrastructure priority list and has been listed as an 'early stage' project for several years. Given the recent changes in shipping, and the three ports strategy, the prospects for further advancement in the short term may not be strong.

Infrastructure Australia is also considering the more general question of investment in port infrastructure and has undertaken some preliminary work on balance sheet capabilities of a sample of Australia's ports. A number of port authorities, including Tasports, face a financial situation which is not conducive to substantial economic or commercial investment in their ports. Infrastructure Australia's work to date suggests that across the sample of ports there may be legacy issues, such as sub-commercial arrangements for leases etc – that inhibit ports from making commercial investments.

Implications of developments with Tasmanian and Victorian Ports

Victoria is Tasmania's gateway into the mainland Australian market. Developments in the Victorian port sector have the potential to affect the economy across the Bass Strait.

Recently, Tasmania has faced the loss of its direct sea connection to Asia, provided by the AAA Consortium. As a result of the decision of the AAA Consortium to discontinue its Bell Bay-Singapore Service, some additional Tasmanian freight must now pass through the Port of Melbourne to reach the Australian and international markets.

In addition to this, Tasmanian industry has raised concern about the impacts, and constitutional validity of Victoria's *Port Management Amendment (Port of Melbourne Corporation Licence Fee) Bill 2011*. As of March 1 2012, the Tasmanian Government and Tasmanian Chamber of Commerce and Industry (TCCI) have been working together to ensure Tasmanian industry is not unduly disadvantaged by the charges, with TCCI's Chairman Robert Wallace indicating that his organisation "will also work closely with our constituents in seeking alternatives to their shipping needs – particularly international exporters". (Media Release, 1/3/2012).

In December 2011, the Port of Melbourne Corporation issued a fact sheet on how the charge would be applied to the different freight tasks, as an example, an outline of the revised container freight charges are reproduced below.

CONTAINERISED	CURRENT TARIFF 1 JULY 2011 exc. GST ($/TEU)	ESTIMATED TARIFF WITH PLF IMPACT exc. GST ($/TEU)
Full	40.10	60.15
Full Bass Strait	41.80	62.70
Empty	10.00	15.00
Transhipment	50% of published rate	50% of published rate

Source: Port of Melbourne Corporation

Recent relevant analysis and research in the area

A 2005 Monash University study on the economic effects of the Tasmanian Freight Equalisation Scheme for the Tasmanian Department of Infrastructure, Energy and Resources, raised concerns as to what would occur should the Scheme be abolished. In particular, the study found that

"the Tasmanian economy would experience substantial negative effects on employment and activity that would intensify over time. In that initial year Tasmania would feel just under a third of the ultimate reduction in employment. By the tenth year of the simulation Tasmanian employment would have almost fully adjusted to the loss of the Scheme, with total employment down by up to around 4, 250 jobs compared to the baseline forecast with the existing Scheme in place." (2005:1).

In the following year, the Productivity Commission released its own report on Tasmanian freight schemes, and although it did not specially commission any modeling, there are some important observations as to the level of reliance that Tasmanian industry has on the Tasmanian Freight Equalisation Scheme, in particular, that

"[t]he significance of the TFES relates not only to its quantum but also to how long a business has been receiving payments. The longer that subsidies are received the greater the likelihood that they become part of the trading environment and incorporated into business plans. The more likely also that there will be cases where marginal businesses are sustained by subsidy payments". (2006:48).

The warning provided in the Productivity Commission's report will make it harder to remove the Tasmanian Freight Equalisation Scheme because of the apparent lack of an Economic Plan B, by the Tasmanian Government and industry. The industries that are likely to be most affected, based on Productivity Commission data are the Paper and products sector (responsible for 3.2% of Northbound Tasmanian Freight Equalisation Scheme claims in 2004-05) and the Other machinery and equipment sectors (responsible for 4.0% of all Southbound Tasmanian Freight Equalisation Scheme claims in 2004-05).

COMMENTS

Objectives

Transport is an input or intermediate service – it is a means to an end. Transport serves purposes other than itself. The purpose of a transport subsidy is not to encourage transport, but to enable better productivity, social or safety outcomes by use of transport.

Hence the 'objective' – to address 'freight disadvantage' - is inadequate as a statement of the purpose of the Tasmanian Freight Equalisation Scheme. Rather, that 'objective' merely describes how the scheme is intended to operate – that is, it is intended to reduce the 'freight cost disadvantage' caused by Bass Strait.

It would be circular, and irrelevant, to assess the performance of the scheme, or propose action for the future, only with reference to this.

Rather, the purpose of reducing 'freight cost disadvantage' presumably relates to improving the competitiveness of Tasmanian freight customers compared with mainland industry. This is consistent with the underlying purpose suggested for the original scheme by Nimmo.

High freight costs

The concept of 'freight cost disadvantage' merits careful attention because:

- some argue that recent changes regarding transport increase Tasmanian's 'freight cost disadvantage';
- of the potential inability of the scheme to address any such disadvantage that is caused by inefficient use of infrastructure, fragmented supply chains or market power;
- the Productivity Commission considered the very idea to be problematic, and the source of concerns about the scheme.

Tasmanian businesses are not unique in facing freight costs higher than some mainland businesses. The idea that Tasmanian businesses face 'freight cost disadvantage' must relate to comparisons with other Australian businesses.

There are many situations in Australia where some businesses face higher freight costs than elsewhere. Examples include: 'remote' major settlements such as in Darwin, flood and seasonal affected communities such as in Queensland, communities which face high land transport or domestic shipping costs such as in the Pilbara. Indeed, the arguments about the 'last mile' in road networks are in fact arguments about freight disadvantage.

It would be possible to identify localities on the mainland where businesses face a freight cost disadvantage equal to or greater than those of Tasmanian businesses.

The idea of a 'freight cost disadvantage' estimated by freight costs over a specific distance – for example over the distance of Bass Strait - does not have intrinsic meaning. However, even if it did, it would not equate to the level of assistance necessary (or sufficient) to allow competitiveness with 'çomparable' firms, or to shore up employment, regional economy etc.

Nimmo's formulation of cost advantages of location, and the relative importance of freight costs in total costs are among the obvious additional factors that would need to be taken into account.

Inefficient infrastructure

There is prima facie evidence of inefficient use of infrastructure in Tasmania including:

- the ports; subscale operations at each port reflecting fragmentation of task and less than adequate returns to Tasports;
- the road network; access for efficient freight vehicles is limited;
- the rail network; poor infrastructure condition and operating subsidies.

Each of these would have a negative impact on the competitiveness of businesses located in Tasmania, and on the Tasmanian economy generally.

Fragmented supply chains

Transport 'problems' can arise due to disconnects in supply chains, the most visible of which are failures to achieve interoperability between vehicles e.g. breaks of railway gauge. Other examples include failure to achieve full vehicle/container loads, and breaks in the virtual supply chain - information flows.

There are physical break points in ex Tasmanian supply chains. The inability of parties to provide comprehensive evidence of the performance and costs of the entire supply chain is consistent with disconnects in the 'virtual' aspects of the supply chain.

At this time interoperability between Tasmanian and mainland transport systems does not appear to have received attention. Similarly, the impact of the scheme on vehicle/container loads, and the virtual supply chain has not previously been examined.

A subsidy to general transport is not able to resolve supply chain breaks. Indeed it may cement in disconnects as a result of incentives arising from subsidy value being able to be captured at the interchange points.

More appropriate responses include supply chain coordination adequately supervised by competition authorities, and requirements for infrastructure and vehicle interoperability as a condition of any investment into supply chains.

Market power

In the case of Tasmania, the source of any 'freight cost disadvantage' could include the need to move goods a short distance by sea – it is an intermodal matter.

Issues regarding 'natural monopoly' arise from such matters, particularly at exchange points such as ports, and potential barriers to entry in capital intensive activities such as shipping. Where market power exists it can be exercised to increase costs to customers.

There are risks of placing subsidies into supply chains as some parties are able to exercise significant market power. 'Rents' can be captured and increase the leverage of the strong parties, and deadweight losses can reduce the effectiveness of subsidy in achieving underlying objectives.

The presence of multiple operators does not preclude market power. Assessment and correction of problems caused by market power is a matter for the Australian Competition and Consumer Commission.
The idea that 'compensation is needed' or that there is a requirement for a 'requirement' is at odds with claims of market power.

Policies to promote apparent 'competition' – support of contemporaneous alternatives and operations - are not a sound way of increasing competitive forces, efficiency or productivity. The experiences of Australia's previous two airline policy and vertical separation in low density railways demonstrate this.

In this context, there is a compelling case for understanding, and monitoring in detail, competition issues in ex Tasmanian supply chains, especially while any subsidy is provided.

Business plans

It is claimed that some Tasmanian firms have developed their businesses in expectation of continuation of the Freight Equalisation Scheme. This review has not examined business plans or this claim.

The proposed argument is that the scheme needs to continue lest Tasmanian businesses be disrupted and investment and innovation stifled. However, the matter is unlikely to be as straightforward as suggested.

Some firms may develop their internal business plans to take advantage of a subsidy, and indeed some firms may exist only to take advantage of subsidy.

However, prudent external investors may take a different view, recognising that there is a risk of changes to subsidies that no government, nor Parliament, can rule out. While it could be argued that such risk might be perceived to be low for a long running program such as the scheme, a contra view is that such a risk might be high if a subsidy was seen to be anomalous, without a strong basis, or subject to continuous parameter change.

Some investors and entrepreneurs may be reluctant to involve themselves in industries or locations that are perceived to rely totally on subsidies.

Effectiveness of the Scheme

In the course of this review, convincing evidence of the effectiveness of the scheme was not presented.

Rather, the claims made to the review suggest that after 36 years of operation of the scheme Tasmanian industry still suffers from the same types of freight disadvantage, and underlying infrastructure and coordination issues identified by Nimmo.

In that period, it is almost certain that opportunities arose to deal with issues such as legacy arrangements for ports, however, there is no evidence that they have been addressed to the necessary extent.

Prima facie, the burden of proof about the effectiveness and efficacy of the scheme should rest on its proponents. However, little clear evidence – in the form of robust data - has been presented to demonstrate effectiveness.

Transport subsidies to assist individuals or industry

The concept of a transport subsidy to achieve other ends is not unique to the Freight Equalisation Scheme. Other examples include the School Student Transport Scheme in NSW and public transport concession fares.
It would be useful to consider lessons from those types of schemes – about their design, effectiveness in achieving underlying objectives and unintended consequences.

National significance

While the scheme may have some underlying regional or State purpose, its national purpose is unclear. It is not self evident that the operation of the scheme adds to national level productivity or provides a net national industrial or fiscal dividend, notwithstanding local effects. Indeed, the Productivity Commission concluded that the national effect of the scheme is negative even after accepting that it provides support for the Tasmanian economy.

To further illustrate this, the claim that the Scheme supports over 4000 jobs implies that over $20,000 per annum in taxation based finance is provided to support each job.

Equalisation

Questions regarding national significance do not necessarily negate the significance of regional issues.

The idea of 'equalisation' to account for State or regional disadvantage is known in Australia and addressed through the Grants Commission, even if the idea of an aim of consistent living standards has not been accepted.

In this process, the responsible State Government is provided an opportunity to develop strategies to address local disadvantage through general purpose payments from the Australian Government. The process of provision of general payments from Commonwealth to State Government is considered vitally important to the Federation in terms of a 'subsidiarity' principle and alignment of ability with democratic accountability at each level of Government.

Commonwealth specific purpose payments can be supportive of this scheme provided they have robust national objectives.

The formulation attributed to Nimmo (that the States had agreed to pool resources to attain a consistent standard of living across the country) appears unusual. There always will be significant variations in living standards across localities which cannot be unaddressed by specific Commonwealth payments to businesses for perceived disadvantages caused by their location.

Importantly, the reasoning that it was the States who made such a compact implies that it should be the State Governments who should receive assistance from any 'pool'. In this respect the scheme's payments to business appear to be anomalous even were it accepted that Tasmanian businesses suffered some form of cost disadvantage.

As the Productivity Commission observed the scheme in which Commonwealth payments are made to regional businesses rather than governments (to offset one element of estimated commercial disadvantage) is outside other Commonwealth grants which are targeted at social disadvantage of individuals, enhancing the ability of governments to address their constituents or at national productivity payoffs.

Strategy development

The above suggests that an integrated strategy is needed to sustainably improve freight services for Tasmanian businesses.

The calls for the scheme to be extended to 'exports' and for rates to be raised for 'new' disadvantages confirms the need for a new strategy.

Such a strategy would need to address port, road and rail infrastructure issues – particularly regarding the use of infrastructure. It should also consider market power issues and supply chain coordination.

Around the time of the Nimmo report, the Commonwealth had a much more significant and direct presence in transport services relevant to Tasmania. It:

- owned Australian National Lines a shipping and stevedoring company;
- was responsible for interstate coastal shipping which included restrictions on entry;
- had just taken over the Tasmanian Railways;
- agreed to take full responsibility for national roads including the Hobart-Burnie link.

If a strategic plan for Tasmanian freight was to be developed at that time, the Commonwealth would have been a key – possibly the key – participant.

All of these matters have changed. Further, the national ports strategy and the draft national land freight strategy stress the importance of long term strategic freight plans being developed by industry and States towards national objectives.

Payments from the Commonwealth to certain industry participants on the basis of freight disadvantage do not create a potential and incentives for Tasmania to develop an effective and sustainable freight strategy. In so doing they do not support the aims of the national transport strategies.

Whatever sense payments from the Commonwealth to industry for freight disadvantage may have made in the 1970s, there is less reason today.

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