Tasmanian Government Submission

Senate Select Committee on the Tasmanian Freight Equalisation Scheme

September 2024

Department of State Growth

Tasmanian Government

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Introduction

The Tasmanian disadvantage, as it relates to the movement of goods and free trade with other Australian states, has been the subject of investigations and reviews since Federation. Implemented in 1976, the Tasmanian Freight Equalisation Scheme (Scheme) provides Tasmanian businesses with a more equal footing to compete in mainland markets. It recognises that, sea transport across Bass Strait poses costs to businesses in excess of the costs of transporting goods the equivalent distance by road or rail.

Approximately 99 per cent of Tasmanian goods sold outside Tasmania, or outside goods brought into Tasmania, are freighted across Bass Strait by sea. Moving goods across Bass Strait is relatively expensive when compared to road and rail transport, due to the high-fixed costs of shipping over relatively short distances. Several studies have demonstrated that these additional costs are both unavoidable and materially impact the competitiveness and profitability of Tasmanian businesses.[1]

Tasmania has a relatively small internal market and relies on goods sold to the Australian mainland and internationally for a substantial share of its income. Exports of physical goods to the Australian mainland and overseas are estimated to comprise, typically, between a third and 40 per cent of Tasmania's gross state product. The volume of Interstate exports generally exceeds the volume of international exports of goods.

In the absence of the Scheme, many Tasmanian businesses would experience multiple levels of disadvantage, including:

- higher costs for inputs shipped into Tasmania used to make other final goods in major industries (manufacturing, mining, agriculture, forestry and fishing)
- higher costs for shipping final goods to markets in Australia and internationally for sale; and
- generally, higher transport and shipping costs will have a negative impact on delivery of key infrastructure and impact the Tasmanian economy as a whole.

Freight costs and services across Bass Strait are a key determinant of business profitability and competitiveness. Freight cost competitiveness is an important enabler for the entire Tasmanian economy.

The Tasmanian Government appreciates that some level of ongoing oversight is required for a Scheme of this scale, to maintain confidence in its effectiveness and integrity. Oversight should always 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. Tasmanian shippers and shipping service providers deserve a high level of certainty when making medium-to-long term investment decisions.

[1] For example, the *Final Report* of the Freight Logistics Coordination Team (2013) concluded that "Bass Strait is proportionally the single largest transport cost in the supply chain of a typical Tasmanian business."

The merits and weaknesses of the Scheme and if it is currently fit for purpose

In its 2020 Monitoring Report, the Bureau of Infrastructure and Transport Research Economics (BITRE) reported that assistance under the Scheme was provided for the movement of 210,480 twenty-foot equivalent units (TEUs) in 2018-19. Interstate movements accounted for 76 per cent of these payments. For the same period, TasPorts reported that a total of 536,283 TEUs transited through Tasmanian ports[2]. This means that almost 40 per cent of TEU movements across Bass Strait received assistance.

This supports the widely held understanding that assistance through the Scheme is deeply embedded in Tasmania's freight arrangements and assists many Tasmanian businesses. A 2022 Tasmanian Government survey of 100 Tasmanian freight generating businesses found that two-thirds had benefited from assistance.

It is acknowledged that a large proportion of the total assistance is paid to larger exporters. For example, nearly 55 per cent of total payments were received by the top 20 Scheme customers in 2023-24. These exporters include several important Tasmanian manufacturers that employ a significant number of Tasmanians. These businesses have high levels of productive output and high total freight costs.

Past modelling exercises have demonstrated the broader benefits for Tasmania's economy deriving from the Scheme. The Scheme materially boosts Tasmania's gross state product and employment, particularly in many industries located regionally, including in agriculture, forestry, wood and paper products, aquaculture, and some mining activities.

Importantly, the Scheme boosts output across nearly all of the Tasmanian economy and not just among those industries that are direct recipients of payments. This is compared to the marginal impact on the national economy in meeting the cost of the Scheme. Furthermore, the Scheme allows for a diversity of goods and services that Tasmania contributes to the national market and allows mainland businesses to serve the Tasmanian market more easily.

Despite the longstanding existence of the Scheme, it has not acted as a disincentive to reduce freight costs in all other aspects. Successive Tasmanian Governments and transport businesses have worked to improve freight transport and efficiencies within the State. For example, shortly after the Australian Government reaffirmed its support for the Scheme and announced an expansion in 2015, the Tasmanian Government released its Integrated Freight Strategy, which, among other things, targeted improved efficiency, cost-effectiveness, capacity, customer choice, responsiveness, competitiveness, safety and reliability in the freight sector.

Similarly, under the Scheme, Tasmanian businesses have strong incentives to innovate, to improve their efficiency and to compete with their mainland counterparts. While the Scheme seeks to reduce shipping disadvantages incurred by Tasmanian businesses, it does not create any competitive advantage over other Australian businesses. The Scheme cannot compensate for the travel-time disadvantage of shipping compared to road and rail freight or the logistical constraints imposed by Bass Strait.

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[2] Tasmanian Ports Corporation Pty Ltd, 2023, *Annual Report 2022-23*.

Has the Scheme kept up with increasing costs over the past decade?

Since its inception in 1976, the Scheme has operated on the basis that assistance rates are calculated as the difference between the costs of moving a consignment across Bass Strait and the costs of moving a similar consignment by road. Over time, there have been changes to methodology, assistance rates and an expansion of eligible routes and goods. However, the broad concept of addressing the disadvantage 'problem' has remained the same.

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 on mainland Australia. Industry representatives have voiced their concerns that the intermodal allowance is likely to undervalue the cost of intermodal changeovers for a Bass Strait freight trip, in comparison to a mainland road freight trip. It is noted that the intermodal allowance is a flat fee and has remained $100 since 1998.

Inquiries conducted between 1998 and 2014 indicated that the sea freight cost disadvantage was likely to have decreased over that period[3].

However, the 2020 BITRE monitoring report noted that after receiving assistance, the nominal Bass Freight rate increased by 22 per cent from 2010-11 to 2018-19, in comparison to a 16 per cent increase for inter-capital road freight over the same period. This indicates that there was a slight increase in the freight disadvantage for Tasmanian businesses.

Some Tasmanian businesses have expressed a view that the Scheme should be rebased, to account for current freight costs and then indexed to keep pace with inflation. However, an inflation-based index is a strong deviation from the intent and design of the Scheme. Changes in shipping costs, and transport costs generally, are distinct to the consideration of the comparative change in shipping costs over land transport costs. It is the latter with which the Scheme is concerned.

If there is a desire to include indexation in the calculation of the parameters, further consideration will be required to determine the appropriate indexation to apply for the road freight equivalent cost and the Bass Strait shipping cost. Decisions must also be made regarding how often indexation is applied, or how often parameters are revalued more generally.

The degree of freight disadvantage experienced by Tasmanian shippers has reportedly fluctuated between the various parameter reviews and shipping inquiries over time. Parameter revaluations would be calculated on historical information and would presumably not extend to forward-looking forecasts. Regular revaluations would therefore better reflect the historical variations but would sometimes reduce the assistance payable to shippers. This practice would create volatility in the assistance payable under the Scheme and potentially increase uncertainty for Tasmanian businesses. These matters would require careful consideration.

It is important that the Scheme continues to operate effectively to offset the freight cost disadvantage for Tasmanian businesses, while maintaining appropriate incentives to maximise efficient freight movement across Bass Strait. The Scheme should not introduce uncertainty for Tasmanian businesses.

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[3] Productivity Commission, 2006, *Tasmanian Freight Subsidy Arrangements,* Report No. 39, Inquiry Report, Canberra; Bureau of Infrastructure, Transport and Regional Economics, 2008, *Tasmanian Freight Schemes Parameter Review*, Canberra; Bureau of Infrastructure, Transport and Regional Economics, 2011, *Tasmanian Freight Schemes Parameter Review*, Canberra; Productivity Commission, 2014, *Tasmanian Shipping and Freight*, Report No. 69, Inquiry Report, Canberra.

The cost and budget of the Scheme

The Scheme is an Australian Government grant of financial assistance to persons other than a State or Territory. It is included in Part 3 of *the Financial Framework (Supplementary Powers) Regulations 1997* and empowered through section 32B of *The Financial Framework (Supplementary Powers) Act 1997*. Operation of the Scheme is enshrined in the Tasmanian Freight Equalisation Scheme Ministerial Directions, which can be amended at any time by the Australian Government.

It is the position of the Tasmanian Government that the Australian Government's funding for the Scheme should remain uncapped and demand driven.

The Tasmanian Government strongly supports the current equalisation arrangements, as they uphold the Scheme's fundamental objective of addressing Tasmania's freight cost disadvantage. This includes the permanent changes included since 1998 that address additional elements of the inherent freight cost disadvantage. Permanent changes include:

- 2008: extension to cover eligible shipments moved between the main island of Tasmania and the Bass Strait Islands.
- 2016: extended to include a flat rate of assistance for eligible non-bulk goods being shipped across Bass Strait for the purposes of transhipment through an Australian mainland port.
- 2021: the international transhipment assistance extended to eligible imported goods shipped to Tasmania via a mainland port where there is no Australian equivalent good.

In the past, critics of the Scheme have pointed to other possible mechanisms for delivering a similar economic benefit to the State. A major limitation of any alternative mechanisms is that they do not address the equity issues that face many Tasmanian businesses that freight goods across Bass Strait. This was a stated reason for the Australian Government's decision to retain and even expand the Scheme.[4] The Scheme allows the State's businesses to participate and compete in national and other markets in a more equitable manner than would otherwise be the case.

The Productivity Commission has previously recommended replacing the domestic variable rate with a flat rate per TEU, in line with the assistance available for transhipped freight. The rationale is that a flat rate would promote freight efficiencies and incentivise cost minimisation for freight transport on Bass Strait. It would also provide certainty to Tasmanian businesses regarding the value of assistance available and would make it easier to price tenders for long term contracts. However, if the flat rate were to be lower than the current maximum amount of assistance, it will result in a situation with winners and losers among participants in the Scheme. This would likely disadvantage small to medium businesses, which do not have the volumes and purchasing power to negotiate more competitive freight rates.

If the Scheme were to be discontinued or reduced, there would be negative economic repercussions for Tasmania, including employment. Direct impacts would also be concentrated in a number of industries important to regional economies. Any reduction in support through the Scheme could be expected to

[4] "The TFES and BSPVES [Bass Strait Passenger Vehicle Equalisation Scheme] were introduced to address the higher transport costs faced by Tasmanian producers and passengers in accessing mainland Australia, as result of the need to ship goods across Bass Strait. They were not intended to address broader economic and social challenges." Australian Government, 2015, *Australian Government Response To The Productivity Commission Inquiry Report: Tasmanian Shipping And Freight*, Canberra.

increase Tasmania's relative disadvantage compared to other states. This would then be a material consideration under the Commonwealth Grants Commission's equalisation scheme.

It is the Tasmanian Government's position that Tasmanian businesses should be no worse off under any changes to the scheme.

Shipping costs, competition and shipping industry competitive structures across Bass Strait, including alternative freight options

The Tasmanian Government is committed to the ongoing pursuit of land-side supply chain efficiencies. However, these efforts will have a very limited impact on the relative cost of Bass Strait shipping, compared to land transport. It is reasonable to expect that Bass Strait shipping costs will remain the largest component of the overall freight transport costs for businesses. Assistance to offset sea transport cost disadvantage therefore plays a substantial and ongoing role in helping Tasmanian industries remain competitive.

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.

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 enhanced economic performance. For example, the Tasmanian 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.
- port infrastructure upgrades to increase freight capacity and vessel movements.

The inherent need for Tasmania to move its goods by sea also makes it vulnerable to any Australian Government policy changes in relation to coastal shipping. Any increase in costs or red tape for coastal shipping will disproportionately impact on Tasmania and its economy. The Tasmanian Government will participate in the upcoming independent reviews of the *Shipping Registration Act 1981* and *Coastal Trading (Revitalising Australian Shipping) Act 2012* and is optimistic that practical reform will deliver downward pressure on shipping costs.

Tasmanian businesses trading interstate must do so through mainland ports. Other jurisdictions trading interstate have modal and freight terminal choices. Increases in port and stevedoring fees, additional freight movements within ports and industrial action disproportionately impact Tasmanian shippers.

Tasmania is currently supported by international shipping services through the Port of Bell Bay. MSC commenced its international service in 2015 and COSCO/OOCL introduced a fortnightly international container service in 2023.

Tasmania's ability to attract investment from international shipping lines is limited by relatively low container freight volumes, and a need for shipping lines to invest in vessels that meet Bass Strait conditions and available on-land infrastructure. Additional services can be expected to lead to more competitive pricing across shipping lines servicing Tasmania. However, it is also Tasmania's experience that international shipping lines do not have the same level of vested interest in maintaining dedicated Tasmanian services, and the cost benefits of increasing competition must be sustainable and take into consideration the long-term cost effectiveness of providing reliable and secure services for shippers.

While Tasmania has had access to an international service for almost ten years, the service has not been consistent, which reflects the needs of the shipping businesses to adjust services in response to Tasmanian demand. MSC most recently changed its route in August 2024 with the international service now cycling through Sydney. This change removed the direct route from Auckland (NZ) to Bell Bay and the route from Bell Bay to Melbourne. The impacts of this change on Tasmanian businesses are not yet known.

Transhipment costs are a significant cost pressure for exporters and importers accessing international markets.

Eligibility criteria under the Scheme

Some of the limitations of the Scheme that have been identified in the past have related to the challenges of managing a scheme that is simple in principle, but more complex to administer in practice. In particular, the barriers to entry into the Scheme, and the cost of complying with its requirements, are likely to be larger for smaller businesses and those not regularly moving goods in large quantities.

Freight rates are not the same across all shippers. Businesses that ship large consignments frequently have more bargaining power to negotiate lower rates than smaller, infrequent shippers. It is the smaller infrequent customers that tend to have higher freight costs per unit and consequently have a lower proportion of their freight invoices covered by assistance under the Scheme.

Businesses report difficulties in understanding eligibility for the Scheme, administrative frustrations, and barriers to access. This is especially the case for smaller businesses that may ship less than full container loads of freight. The Tasmanian Government has consistently advocated for changes that improve the operation, simplicity, timeliness, and fairness of the Scheme.

The operation and administration of the Scheme

The Tasmanian Government supports changes to the Scheme 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 and for less than full container loads.

The Select Committee 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.

How the scheme impacts businesses on King Island and Flinders Island

Like the main island of Tasmania, the Bass Strait islands are reliant on sea freight for almost all basic needs. Reliable and affordable services are essential to meeting the freight task, which is a combination of general freight, refrigerated freight, hazardous goods, and livestock.

Bass Strait islands have limited access to shipping options that provide a direct service between the islands and mainland Australia. The majority of freight movements between the islands and mainland Australia must transit through a port on the main island of Tasmania resulting in two freight legs. This is more expensive and has implications for assistance available under the Scheme. It also highlights the difference in assistance that is available for shippers on King Island, compared to those in the Furneaux Group.

The Scheme provides (at 3.13.1 of the TFES Ministerial Directions) additional assistance for eligible northbound freight shipped from the Furneaux Group to the mainland via the main island of Tasmania. This recognises the additional disadvantage of needing to employ two shipping legs and increases the maximum assistance payable to $1 710 per TEU (compared to a maximum of $855 for King Island shippers). The Scheme also provides additional flat rate assistance to the Furneaux Group in relation to goods imported or exported to international markets, which is not available to King Island shippers.

An extension to the Scheme to provide additional assistance to King Island is an opportunity to alleviate cost pressures for the King Island community. The additional assistance could mirror that available to Furneaux Group shippers to promote consistency in the application of the Scheme on the Bass Strait Islands.

Additionally, the extra assistance that is available to Furneaux Group shippers for northbound domestic freight could be extended to apply to southbound freight with two shipping legs; and expanded to apply to King Island shippers.

These extensions are expected to be minor in terms of overall cost of the Scheme. The total King Island freight task for 2022-23 was 9 057 TEUs, around one per cent of the total Tasmanian freight task. The corresponding freight task for the Furneaux Group was 564 TEU, around 0.09 per cent of the total Tasmanian freight task. These volumes include a range of products not eligible for assistance, such as bulk freight and empty containers.

Any other related matters

Through conversations with industry representatives and analysis of the information available on the Australian Government websites, it is clear that much of the confusion about the Scheme stems from the limited amount of publicly available administrative data. It is noted that the Productivity Commission's Inquiry Report *Tasmanian Shipping and Freight*[5] recommended that the Australian Government should provide more comprehensive public reporting of administrative data, including assistance paid to individual recipients, to improve transparency about the Scheme. The Australian Government, in its response to the report[6], accepted this recommendation. However, it is unclear how the data was improved to aid understanding and transparency.

In an effort to improve the available information and transparency of the Scheme, the Tasmanian Department of State Growth recently wrote to the Department of Infrastructure, Transport, Regional Development, Communications and the Arts to request that BITRE consider and include the following information in its 2024 monitoring report:

- where graphs or figures compare road and sea freight rates, that these are presented with value points at relevant intervals, or with accompanying data tables. This will help Tasmanian shippers identify the value of the changes in freight costs and understand how Bass Strait freight costs are increasing in comparison to the equivalent road freight cost
- the percentage of claimants in Class 1, Class 2, Class 3 and Class 4 in accordance with Schedule 3 of the Ministerial Directions for the operation of the Tasmanian Freight Equalisation Scheme
- median and maximum notional entitlements of Class 4 shippers, along with a figure showing the distribution of claimants against relevant value categories from $1 006.51 up to the maximum notional entitlement recorded in the review period. If there have been significant changes across the years of the review period, additional commentary on how this has changed would be useful
- an update to the figure that shows the time taken from the shipment of eligible goods and payment of the claim. Given that shippers have six months to make a claim, this information will be enhanced by showing how the total time is split between the time taken by shippers to lodge the claim, and the time taken by Services Australia to assess the claim
- any information that can be shared from the claims data to show how the increase or decrease of non wharf-to-wharf costs has impacted the total value of claimants' freight invoices. As this portion is not eligible for Scheme assistance, this information will help shippers understand why they may receive less assistance than they expect.

The Tasmanian Government is of the view that these enhancements to the BITRE monitoring report should not require any change to the analysis undertaken by BITRE but will enhance the utility of the report for readers.

[5] Productivity Commission, 2014, *Tasmanian Shipping and Freight*, Report No. 69, Inquiry Report, Canberra.
[6] Australian Government, 2015, *Australian Government Response To The Productivity Commission Inquiry Report: Tasmanian Shipping And Freight*, Canberra.

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Department of State Growth

4 Salamanca Place Hobart
Hobart TAS 7001 Australia

Phone: 1800 030 688

Email: info@stategrowth.tas.gov.au

Web: www.stategrowth.tas.gov.au