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**SUBMISSION 68**

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## **Submission to Standing Committee on Infrastructure, Transport, Regional development and Local Government Coastal Shipping Policy and Regulation Inquiry**

### **1. Fortescue Metals group, Australia.**

Since the Company was formed in 2003, its extraordinary growth has been unparalleled. With a market capitalisation of around \$20 billion and an ever-growing reputation for success, Fortescue is well-positioned to become the next Australian mineral export heavy-weight.

#### **From Construction to Production**

Construction of Fortescue's port, rail and mine project commenced in February 2006 with the turning of the first sod at the Company's port site at Anderson Point in Port Hedland. Just two years later, the open-access rail infrastructure is complete, the Fortescue Herb Elliott Port is operational and the mining operations at the Company's first minesite, known as Cloudbreak, are well underway.

Shipping started on 15 May of 2008 and Project Completion was achieved within months. On the 19th of July, Fortescue's fifth anniversary, the Company successfully mined, railed and shipped at a rate of 24mtpa for a one month period. This accomplishment occurred in line with the detailed business plan for its Pilbara Project.

Project Completion opens the door for the expansion activities to begin.

#### **Finance**

Fortescue's project was founded on the raising of A\$3.7 billion capital, including A\$1 billion equity, during two finance roadshows in August 2006 and July 2007. The August 2006 raising was the largest single high-yield Asia-Pacific transaction, the largest high-yield bond project financing ever, one of the largest corporate bonds out of Australia and one of the largest global bond issues in the sector. Since then Fortescue has grown to become a S&P/ASX 50 company.

Over 27,000 Australians have become shareholders in the proudly Australian founded and managed company.

Initial production will be 55 million tonnes of iron ore per annum and market driven expansion will occur as required. This initial tonnage has sold out and agreements exist for up to 50 million tonnes per annum of expansion tonnage.

#### **Reserves and Resources**

With about 4.5 billion tonnes of Resources, including 1.1 billion tonnes of Reserves already delineated from less than 10% of its 57,500 square kilometres of tenements, Fortescue is well-positioned to take advantage of the current 'golden age' for iron ore.

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The New Force in Iron Ore

Fortescue Metals Group would like to ask for this inquiry to be expanded to include international shipping.

This is where we believe the potential to increase the diminishing personnel in Australian shipping, that would have a natural flow on effect to costal fleets , increase training of cadets, whilst enhancing business overall for shipping from Australia.

Over the last five years I have witnessed first hand at least 30 companies based in Australia (BHP Billiton and Rio Tinto as examples) move their shipping office and business to overseas locations due to better reception on tax and availability of qualified manpower within these regions.

As an international Exporter of Australian goods we believe it is imperative that the Committee looks further than the coast when considering any change to shipping regulations or legislation in Australia.

It is in this area that we strongly believe the most gains to Shipping as an industry can be enhanced by utilising International accepted practice in regards to reforms for Shipping and manning issues.

Currently there is no commercial imperative for Shipowners or ship operators to be based in Australia. As explained in this submission we believe you will find there is no loss to the Government on tax issues or training by implementing the proposals contained herein and can only benefit Australia and Australian shipping

We believe the submission would empower us as a Nation that relies on Blue water transport for our survival in an International world of freight.

### **Australia is a Resources Power – Why are we not a Maritime power ?**

Historically, Australians have lived with the sea since the earliest period of indigenous habitation and following with European settlement. Nonetheless, the connections of the Australian people with maritime industries and issues have been minimal. For example, until recently the major maritime industries in Australia have been controlled by foreign investors. While Australia has been recognised as a 'sea dependent nation' through qualitative and quantitative analysis<sup>20</sup> the Australian people are not aware of their 'ownership' of maritime issues.

<sup>20</sup> See Hill, J. *Maritime Strategy for Medium Powers*, (Annapolis: Naval Institute Press), 1986.

**THIS HAS NOT CHANGED OR BEEN DEVELOPED SINCE 1986!!!!**

### **The Australian Maritime Skill Shortage**

- **The number of trainees serving on Australian vessel declined from 83 in 1993 to Zero in 2000~2001**
  - This is due partly to a decline in the fleet, from lack of investment or expansion
  - Note this is also the same period that saw an explosion in the UK and German fleets due to the tonnage tax regimes in these countries
- **AGE Profile**
  - 36% > 50 years
  - 29% between 36 & 50 years
  - 35% below 36 years
  - Total pool 1500
- **Australian resident officer pool**
  - is declining by 15% per annum
  - Requires 60-70 new trainees per annum to maintain the pool of 1500

The New Force in Iron Ore

- This does not allow for expansion of the pool for vessel growth

### **Australian Qualifications Demand**

- AMSA – Officer pool
  - In 2002 58% of Staff qualified as seafarers were over 50 years of age
  - In 2002 88% of Coastal pilots (Great Barrier Reef) were over 50 years of age
  - These two organisations alone require 10 superior qualified seafarers per annum to fill the vacancies left due retirements
- Other maritime Skills leakage
  - Government and Private pilotage services, booming because of increased vessel movements
  - Shipping and resource companies
  - State transport departments
  - Port Authorities

### **Australians position in Seaborne trade**

Australia's international seaborne trade grew substantially in 2004/05 to 680.6 million tonnes reflecting an annual growth rate of 9.3 per cent (the largest annual growth rate since 1997/98).

FIGURE 2: AUSTRALIAN CONTRIBUTION TO THE WORLD SEABORNE TRADE (PER CENT)

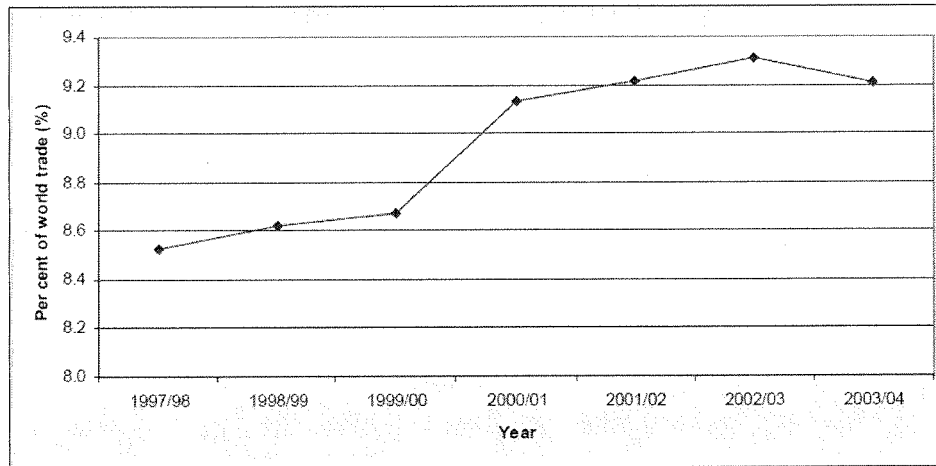


FIGURE 5: OUTLOOK FOR TONNES CARRIED BY INTERNATIONAL SHIPPING (MILLION TONNES)

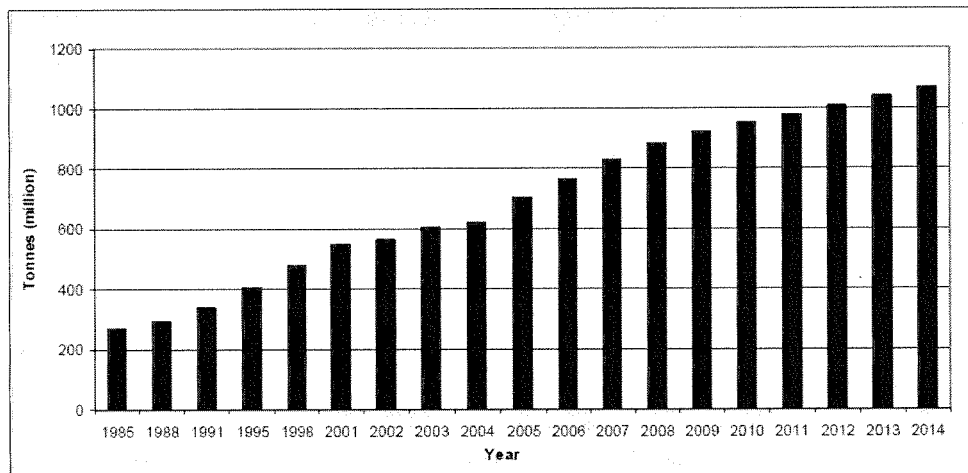
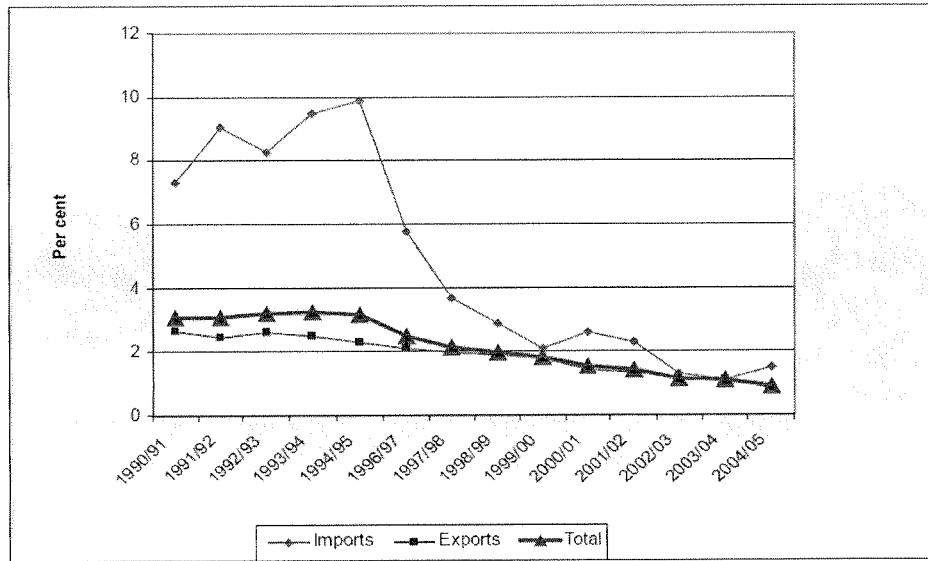
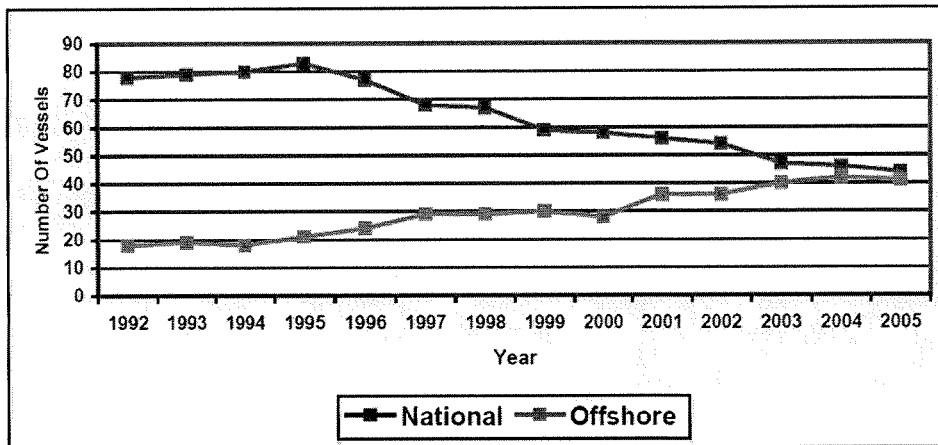


FIGURE 6: MARKET SHARE OF AUSTRALIAN-FLAG SHIPPING (PER CENT)



Above fall corresponds with BHPB selling 100% of their fleet during the 1990's after closing Newcastle and divesting Port Kembla Steelworks

FIGURE 14: NATIONAL VS OFFSHORE REGISTRATION FOR AUSTRALIAN CONTROLLED VESSELS (NUMBER)



## Offshore registration increase, whilst Australian flag registration decreases? Why ?

TABLE A-6: AUSTRALIA'S SEABORNE TASK BY FLAG

	IMPORTS			EXPORTS			TOTAL		
	2002/03	2003/04	2004/05	2002/03	2003/04	2004/05	2002/03	2003/04	2004/05
<b>AUSTRALIAN</b>									
GWT('000)	820.82	702.21	1,046.90	8,111.80	8,131.48	5,153.46	8,932.63	8,833.69	8,209.35
% MARKET SHARE	1.31	1.09	1.50	1.13	1.10	0.84	1.15	1.10	0.91
<b>FOREIGN</b>									
GWT('000)	61,727.96	63,479.79	68,885.75	534,579.83	552,164.33	605,466.54	598,307.79	615,644.12	674,372.29
% MARKET SHARE	98.69	98.91	98.50	98.87	98.90	99.16	98.85	98.90	99.09
<b>TOTAL</b>									
GWT('000)	62,548.78	64,182.00	69,932.64	540,691.63	558,295.81	610,640.00	603,240.42	622,477.80	680,572.64
% MARKET SHARE	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

### Salient Themes:

- Australia accounts for 9.8 % of world seaborne trade (over 1 billion mt per annum)
- Australian Shipping represents 0.84% whilst 99.14% is carried by foreign flagged vessels
- Norway (Population 4.5 million) has 768 National flagged vessels, Australia (Population 21 Million) has 44

### Australian Flagged vessels / Investment – The Economics

Basis an investment in Capesize at June 2008:

170,000mt dwt, 5 years old, IRR 10%, Financing Libor 4.5% average, 15 years

In June 2008 this vessel would cost US\$88 Million to purchase

#### Crewing Costs

100% Australian = US\$4.36 Mill per annum (US\$11,900 p/d)

100% Ukrainian = US\$1.367 Mill per annum (US\$3,735 p/d)

#### Total OPEX Capesize vessel (Inc Ship management, H&M, P&I, Stores)

100% Australian = US\$16,436 p/d

100% Ukrainian = US\$9,050 p/d

#### Differential in OPEX (Australian V.S Foreign)

US\$2.69 Million p/a or US\$7,386 p/d

#### CAPEX (Purchase conditions as above)

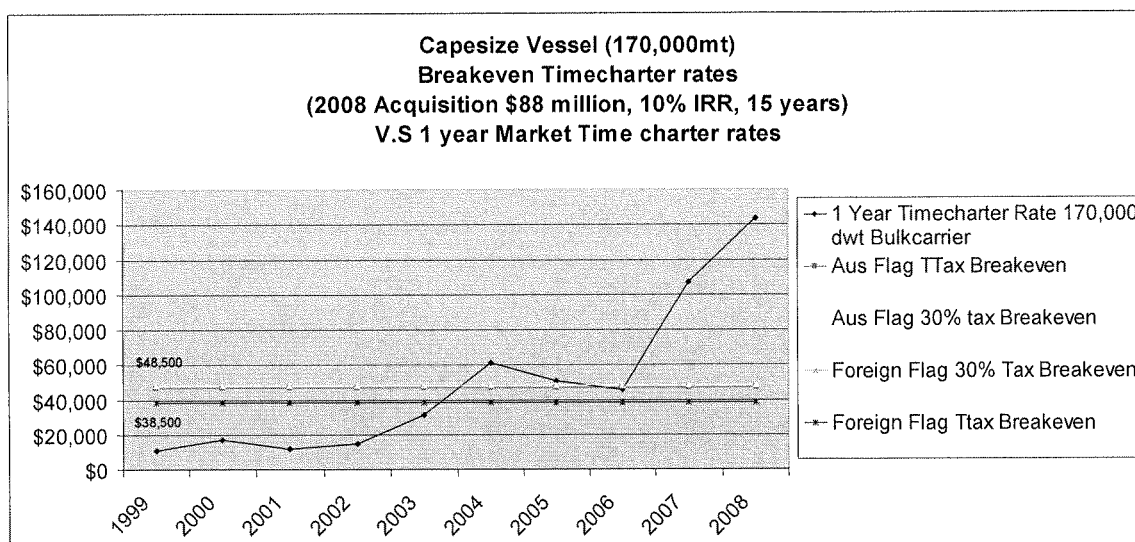
US\$23,030 p/d

#### Total Running Costs for Investment as above

100% Australian Crew = US\$39,466 p/d

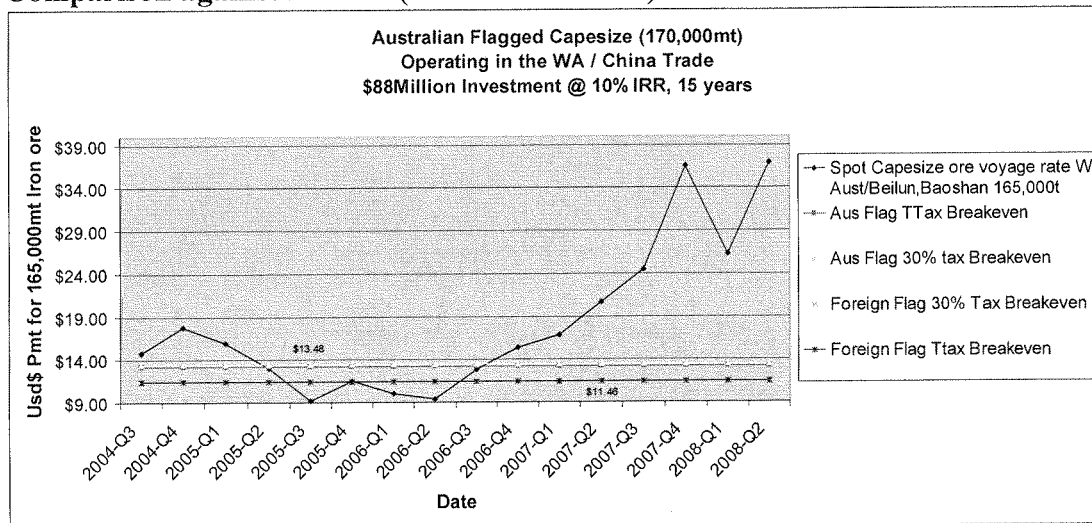
100% Ukrainian Crew = US\$32,080 p/d

### Comparison against Market (Time Charter)





### Comparison against Market (WA/China Trade)



Does Australian need Maritime skills?

Is Australia cost competitive against international competition?

### Global Shipping Approach to Taxation – For Australia ?

#### Tonnage Tax regime versus Corporate Taxation

1. Corporate taxation in Australian is currently 30%
2. There is no other taxation rules applicable for shipping

The principle ~ “The more you earn the more you pay”

#### Tonnage Tax

1. Is a flat tax based upon the Net registered tonnage of the vessel only, irrespective of revenue earned
  - a. This Australian vessel operating at its B/E rate of \$48,000 p/d would pay around \$400,000 per annum in tax
  - b. This vessel operating under a (UK) type Tonnage tax would pay \$27,000 per annum in tax
  - c. This vessel operating under the Singapore AISE system would pay \$0 annual tax (this is an exemption from tax rather than a tonnage tax)
  - d. This vessel operating under a German TT regime enjoys a low effective tax rate (2%) and encourages non-shipping domestic investment through the KG system, through which investors only pay 7% tax on returns rather than personal tax (60% high end). This system is equivalent to Australia’s consideration of the forestry industry
2. The benefits of this special shipping taxation regime, requires the owner to be domiciled in the territory, operate under its flag and train NATIONALS of its territory

The results of a TT regime:

- UK – between 1999-2006, the number of vessel operating under the UK system grew 160%, the DWT grew 450%
- As the UK TT allows registrations under foreign registries, UK flagged vessels only grew 2%
- The UK TT System did not increase the number of UK nationals trained because the system did not LINK national training to TT uptake

Conclusions from the UK TT regime:

- ⊗ *Provide a link between fiscal incentives (e.g. tonnage tax) and the employment of UK officers*
- ⊗ *Increase the scope and value of support for British seafarer training*

NUMAST

**The Cost of Australian Crews**

A much talked about cost, but what is this value compared to that of Australia's National Interest

- A 100% Australian crewed vessel costs between \$2.6-3.0 Million per annum greater than that of a foreign crew
- There is 44 vessels in the fleet or approximately \$114 million additional cost on average
- A fleet comprising 10 Australian Flagged vessels & 10 Foreign Flag (Tonnage tax KPI linked) vessels would provide berths for 45% of the existing Australian fleet serviced by 539 new personnel or 36% of the existing pool of Australian seafarers

**A Global Maritime Concept for Australia**

(10 Australian Flagged + 10 Foreign Flagged vessels under a TT regime)  
At Breakeven cost analysis (Today) - Capesize

20 Australian Flagged vessels

The New Force in Iron Ore

- Existing tax payable - \$10 million per annum
- Additional costs to employer (Australian crew) \$54 Million
- \$64 Million in TAX + Additional cost to Australian Shipowner

20 vessel fleet (10 Australian + 10 Foreign) under tonnage tax (UK Style)

- Tax Payable - \$5.2 Million per annum
- Additional cost to employer (Australian crew) \$26 Million
- \$31.2 Million in Tax + Additional cost to Australian Shipowner

Lower the Tax Burden to ZERO by linking Australian Maritime Skill development

- 20 vessel fleet (10 Australian + 10 Foreign) under tonnage tax (Zero)
- Tax payable - \$0
- Additional Cost to employer (Australian Crew) \$26 Million
- \$26 Million in Additional cost alone

**Consider the consequences:**

- What would a shipowner do? – A) the lowest cost option = No Australian Vessels and no Maritime Skill development
- Does the ATO through its shipping revenue invest in Australian Maritime Skills? – No
- Should an Australian leveraged resource company invest in vessels to underwrite freight, if they could promote it as an investment in Australian Maritime Skills? – they should, and so should governments
- International freight hedging tools are now available which eliminate / mitigate many of the arguments against cost competitiveness of Australian vessels – Provided such companies operate in today's global environment

**What can be done to re-invest in Australian Shipping?**

- Investment in shipping can be achieved in Australia provided the Federal, and State Governments, the ATO and Unions implement attractive policies to promote investment
  - Zero or Tonnage tax regime on Shipping revenues, abolish corporate taxation for vessels
  - Continue accelerated depreciation for vessels
  - TAX reductions for commercial investors in Australian Shipping funds (a KG system of shipping investment similar to Germany)
  - Link the number of Australian flagged vessels to the number of Foreign flagged vessels per ratio
    - EG 1 Aus + 1 FF, or 1 Aus + 1 10% Aus + 1 FF
    - This allows
      - The investment in a fleet
      - Provides revenues to companies

- Can underwrite freight cover for resource companies
  - Provides a training platform for cadets officers and crew
  - Provides a long term maritime skill base for Australia
- Provisions directly linking training as Key KPI's on achieving zero tax provisions
    - This can be an accumulation of Seagoing, Shore based and government based positions (AMSA, DPI etc..)
    - Include provisions for 100% tax free income & superannuation & frozen leave for employees conducting NVR (naval voluntary reserve) training ( as per the MUA issue of PAYE tax at 0)
    - Consider a compulsory service element for skilled seafarers in NCS (naval control of shipping), subsidized by the defence budget
    - Mandatory ISO 14001 accreditation for vessels the highest environmental standard
  - Seafarers taxation
    - Include provisions for a 0 tax income & superannuation for employees serving more than 6-9 months offshore (outside territorial waters) but resident in Australia (merchant navy)
      - This will promote service on foreign trades
    - Change the provisions for seafarers away from the PAYE system to account for the international service of the seafarer
      - Reduce the personal income tax on Seafarers, which encourages trainee take-up and rapidly develops Australia's maritime skills base
      - Also reduces the payroll tax burden on companies employing Australian seafarers
  - Company employment
    - Officer Cadet (engineer & deck) training (Skills investment) by companies requires a cadet to repay the training commitment (4 years) with a minimum 4 years sea service once qualified
    - Integrated ratings must serve on company vessels for a minimum of 4 years if after qualification if taken up in any trainee programme (union agreement required)
    - Both options may include serving with foreign crews, an attractive role for unions in bolstering ILO and ITF acceptance amongst crews / crewing agencies
    - Include qualified foreign crews and cadets as immigrants, not 457 permit, but full immigrants to Australia for neighbouring nations Pacific islands, Philippines, and Indonesia etc)
    - Include an Aboriginal incentive program to allow the best chance of this group entering a skilled workforce.

### **The Cost to the Shipowner / Resource Company**

- A 20 vessel fleet over 15 years would cost \$400 Million in additional cost over a foreign crewed fleet
- An investment in Australia's Maritime Skills base far in excess of the \$72 Million potentially generated through ATO revenues
  - **ATO revenues would not reach this level as there is currently NO incentive to invest in Australian Shipping**
- Zero Tax on Shipping
- The Freight Market will not always be profitable but reducing the Cost / Breakeven is essential in management of the fleet cost

### **The Benefits to the Shipowner / Resource Company**

A highly qualified pool of seafarers to engage in

- Manning & operating of vessels
- Managing the Environmental impact of ship operations in Australia
- Vessels competitively engaged in exporting Australian products
- Zero Tax on Shipping revenues
- Shoreside port operations, company towage operations
- Shorebased technical evaluation in shipping or mine expansion planning
- Commercial and operational chartering and transferable skills and education
- Freight management – long term managed vessel provide and operation efficiency not achieved through commercial chartering
- Freight hedging tools through FFA's - can minimise exposure to freight market volatility for Australian vessels. This tool is available today and allows greater risk mitigation than past Australian shipowner endeavours

**The benefit to the National Interest (Australia)**

- An increase in the % of Australian cargos carried by Australian companies and seafarers
- Increased Seafarer employment opportunities
- Increased Australian's Maritime Skills base
- Improving the national capability to manage maritime activities in Australia and its Oceans
- Facilitate the participation of Indigenous people
- Greater Australian content in AMSA, DPI, State marine bodies
- Greater Australian content in Pilotage, Towage and marine services on the Australian coast
- Greater transferable skills with the ADF and the development of increased ADF reserve resources
- An increased voice at the IMO (greater tonnage under flag)
- An increased Australian Fleet presence
- Lead a governmental approach to environmental management and sustainable development at sea

**Conclusion**

- The current Australian taxation system neither supports the development of the Australian fleet nor the declining Maritime Skills base
- By considering a ZERO tax environment for shipping, linking this to KPI's and encouraging investment in Shipping through tax deductions, resource, shipping, private companies State and Federal governments in Australia can fund this growing deficiency in Maritime Skills, and remain competitive in an international shipping market.

Kind regards,

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