

Net Sea Freight – Tasmania Pty Ltd

Comments on Productivity Commission Draft Report Tasmanian Shipping and Freight, January, 2014



NET SEA FREIGHT
TASMANIA P/L

'The Logistics Administrative Specialist'

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1. Introductory Comments

- 1.1. Net Sea Freight – Tasmania (NSF-T) is grateful for the opportunity to comment upon **the Productivity Commission’s Draft Report into Tasmanian Shipping and Freight (‘the Report’)**. In view of the brief period over which we are able to consider the document and produce a written response, and **our firm’s scope of activities, we have chosen to** restrict our discussion to matters closely related to the Tasmanian Freight Equalisation Scheme (TFES) and its operation.
- 1.2. Before making reference to chosen Draft Recommendations and Requests for Information that we feel are within NSF-T’s remit, it is appropriate to comment on some general assumptions and presumptions touched on within the report.

- 1.2.1. The aim of the TFES is stated and understood as being to alleviate the sea freight cost disadvantage incurred by Tasmanian shippers. The Report comments that, **“Participants’ views on the purpose of the Scheme exposed the absence of a common understanding of the purpose of the Scheme. Its objectives in respect of freight costs were described variously as being to ‘normalise’ (SeaRoad Holdings Pty Ltd, sub. 35, p6), ‘offset’ (Net Sea Freight, sub. 26, p11) or ‘compensate’ (Regional Development Australia - Tasmania, sub. 17, p26 and Mondelez Australia Pty Ltd, sub. 24, p10).”** (Box 3.4 p89)

We do not understand why there should be such a focus on how companies interpret the aim of the Scheme. These are words that effectively mean the same thing.

- 1.2.2. There appears to be an assumption that the Scheme should not cost more than around \$100m per year. The preamble to Information Request 1 (p33) refers to maintaining the expenditure within current funding levels. We note that funding for the TFES is uncapped.
- 1.2.3. The Report asserts (several times) that the Scheme removes the incentive to find the lowest freight cost. No evidence has been provided for this claim. As many submissions (including ours) have stated, the Scheme does not completely address the freight cost disadvantage, and shippers will always have an incentive to minimise their net freight costs.
- 1.2.4. A number of the initial submissions to the Productivity Commission indicate that the TFES does not fully address the freight cost disadvantage imposed by shipping across Bass Strait. We agree with these submissions. However it is asserted in the report that Tasmanian shippers are over compensated for their freight cost disadvantage. This proposition appears to be drawn from data collected by Bureau of Infrastructure, Transport and Regional Economics (BITRE). It concerns NSF-T that such reliance is placed on a report that holds a view that is counter to the reality faced by Tasmanian shippers.
- 1.2.5. A number of submissions claim, correctly, that the Scheme does not eliminate the cost disadvantage faced by shippers. The proposed BITRE parameter revisions (p35, Statistical Report) are suggested to reduce TFES payments by \$90m over a two-year period. This is prima facie **a contradictory action if the Scheme’s aim is to** alleviate freight cost disadvantages. The BITRE qualification was that the estimates **“assume no change in shipper behaviour”,** when a more realistic implication to

assume **would be that if the Scheme’s cost reduction was** achieved (i.e. taking around \$45m p.a. out of the Scheme), expenditure would have been reduced by even more due to the demise of some claimants.

- 1.2.6. **In discussing existing subsidy schemes, the Report asserts, “However, the widening gap between Tasmania and mainland jurisdictions in terms of income growth and employment indicates that these measures do not address the fundamental issues affecting the underlying competitiveness of Tasmania” (p3). It is inappropriate to conclude that Tasmania’s poor performance on many economic indicators is evidence that the TFES has failed. Some modelling would be required to provide evidence that the TFES does not address the widening gap.**
- 1.2.7. There appears to be a belief that because assistance under TFES makes such a small percentage reduction to the total cost of production, it has little impact on a **firm’s** decision to remain in Tasmania or its profitability. A number of submissions suggest a contrary view. (Box 3.4, p89).

2. Comments on Recommendations and Information Requests

NSF-T has chosen to offer extended comments upon only three of the Commission’s Draft Recommendations, and on three of the invited Information Requests.

2.1. Draft Recommendation 2

If the Australian Government chooses to retain the Tasmanian Freight Equalisation Scheme in essentially its current form, it should ensure that the payment rates are based on the findings of Bureau of Infrastructure, Transport and Regional Economics parameter reviews. These reviews should be conducted every two years. Payment rates should be revised to reflect the latest available parameter estimates.

- 2.1.1. NSF-T agrees with the principles proposed in this recommendation. We believe a set of well-defined parameters, regularly updated, will serve to ensure the Scheme will meet its objective. However, the derivation of the values chosen for these parameters, as well as the values actually proposed, deserves inspection. We comment upon two particular values, those for the road freight equivalent (RFE) and the inter-modal allowance.
- 2.1.2. The proposal of BITRE that the RFE be revised upwards to \$650 per TEU has recognised that road transport has experienced increased costs since the Nixon parameter value of \$281 was adopted in 1998. As we noted in our December Submission, improvements in productivity have occurred over the period to dampen the cost increase in spite of significantly increased labour, amortisation and fuel costs. The Report also notes (p53) that rail is a cheaper option than road and that a significant proportion of freight travels by rail. Given that the distance over which the RFE is calculated (the 420km Bass Strait trip) might be classed as suitable for rail use – **certainly ‘long’ in Tasmanian terms** – we recommend that BITRE should consider some sort of weighted average of the per TEU costs of rail and road to determine a land freight equivalent (LFE). For example, Victorian producers have an extensive rail service available to Port Melbourne docks. It is logical that a relevant RFE (or LFE) should include a rail usage component.

2.1.3. In the same way, we have long felt the intermodal allowance at \$100 per trip is too low. If consideration is given to those costs necessarily incurred as a result of a shipping exercise, in comparison to a purely land-based task, shippers will be liable for expenses outside of what are encompassed in a wharf-to-wharf figure. The BITRE document notes several of these in acknowledging that the allowance might be lower than actual costs. Costs incurred include charges that would not arise in a solely land-based operation, where cargo handling occurs only at the start and end of the task. The comment (p26, BITRE) that two large shippers pointed to **significantly higher intermodal charges “attributable to the need for a sea journey”**, should have prompted an updating similar to that proposed to the RFE value in order for the intermodal allowance to be reflective of actuality. It may be that the task is too complex, in that there is likely to be a series of almost unique intermodal costs associated with each freighting exercise. Nevertheless, that fact that a one-size-fits-all value has been extant since 1998, and has been implicitly accepted as a necessary component in the freight-cost-alleviation procedure, suggests that the allowance be considered for revision.

2.2. Draft Recommendation 5

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

The Bureau of Infrastructure, Transport and Regional Economics should recommend a dollar amount for assistance, taking into account:

the parameter or parameters that the flat rate should be based on; and

that the flat rate should provide assistance that is compatible with the incentive to seek the lowest shipping cost.

If the Government does not adopt a flat rate, assistance under the Tasmanian Freight Equalisation Scheme should only be payable on the basis of evidence of actual wharf-to-wharf cost.

- 2.2.1. NSF-T does not agree with this proposal. We believe that a flat rate has negatives for less frequent shippers. The Report admits (p88) such is the case.
- 2.2.2. A property of the current Scheme is that it has a built-in incentive for shippers to minimise freight charges. This property is, rightly, suggested as an attribute of the proposal. As pointed out in the Report, larger (or more frequent) shippers currently have a greater capacity to negotiate (and with success) more favourable rates than their smaller counterparts. This capacity will be unaffected by a change to a flat rate assistance per TEU.
- 2.2.3. For example, suppose a shipper pays a door-to-door rate of \$1,500 for eligible goods, based on a non-refrigerated, full, standard density TEU travelling from Northern Tas to Laverton Vic. The shipper would receive \$731 in TFES assistance. Should the door-to-door rate increase to \$1,600 then the assistance would be \$781. The original net rate was \$769, after the increase it has become \$819. **The incentive to seek a lower freight rate has ‘increased’ by \$50. This debunks the assertion that the current Scheme diminishes incentives to seek lower rates.**

2.2.4. A number of submissions to the present inquiry indicate that the current Scheme does not fully compensate for the freight cost disadvantage, which only strengthens the argument above. If a flat rate is proposed as a means of reducing the complexity of the TFES, whose purpose is to provide assistance to alleviate freight cost disadvantage, the disadvantage for some shippers would be exacerbated.

2.2.5. **On p88, the Report argues that “Moving to a flat rate of assistance would remove the main source of scheme complexity - the parameters used to calculate claimants’ notional wharf-to-wharf freight cost disadvantage.” Our response is that the complexity of the Scheme (in terms of how disadvantage is calculated) does not translate into complexity for claimants or the administration of the Scheme. Shipment details required for a claim (Box 3.5, p90) already exist on a standard shipping invoice and consignment documentation. Once the required details relating to the claim, however complex, are input to an existing assessment software program, the calculation is straightforward, and removes any complexity for both the claimant and the assessor.**

Should a flat rate scheme be adopted, the claimant will still be required to provide the same detail of information to receive (especially in the case of small to medium shippers) a lesser rebate, and hence fall even shorter of the Scheme’s **intention** to address the freight cost disadvantage. Requiring claimants to provide a breakdown of the individual costs attributed to a door to door movement is in fact creating a more onerous task as this detail does not appear on standard shipper documentation.

2.2.6. Setting a flat assistance rate may have the perverse effect of inducing shipping service operators to increase freight rates to match the flat rate, so that the flat rate becomes interpreted as a floor price, which could possibly lead to a larger portion of the assistance being captured by the shipping operators, referred to in the **Report as ‘subsidy leakage’ (p81)**. In such a case, small shippers with little or no bargaining power would be worse off.

2.2.7. While assistance is paid on the basis of a notional wharf-to-wharf cost, determination of its value is often problematic. Shippers pay for an integrated service from door-to-door, not three services: door-to-wharf, wharf-to-wharf and wharf-to-door. In most cases, freight forwarders provide an invoice for a door-to-door movement. To provide an actual wharf-to-wharf cost would require additional information. In many cases this would be difficult to provide, particularly for LCL movements. It is difficult to determine the costs of stevedoring, container hire and wharfage for such shipping exercises.

2.3. Draft Recommendation 8

The Department of Infrastructure and Regional Development should impose a threshold on the minimum value of a claim line item under the northbound component of the Tasmanian Freight Equalisation Scheme to distinguish between business and minor transactions.

2.3.1. Whilst we acknowledge that the value of a claim line should ideally exceed the marginal cost to both the claimant and the department administering the claim, if a potential claimant decides that he is entitled to a claim, however small, it ought to be the decision of the claimant whether to pursue the claim. It is the practice of

NSF-T in servicing clients' claims that a built-in mechanism is employed such that non-economic claims, less than \$2 in assistance, are not submitted. Clients are advised in all cases.

- 2.3.2. It should be the responsibility of the department administering the claim to determine the most efficient way to process the claim. We suggest efficiency improvements could be achieved by aggregating small claims, using a sampling process to 'test' a sample of like claims, or paying the claim on good faith. To reject a claim based on its value being too small, when the claimant has already incurred a cost in submitting it, could involve appeals and a substantial increase in both administrative time and cost.

2.4. Information Request 1

What would be the potential impacts (both positive and negative) on Tasmanian firms and industries, and the Tasmanian and Australian economy more broadly, of the following optional changes to the coverage of the Tasmanian Freight Equalisation Scheme within current funding levels:

extending the northbound component of the Scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne

extending the northbound component of the Scheme to include all eligible goods shipped from Tasmania to the Port of Melbourne and removing the southbound component of the Scheme for all goods shipped from the Australian mainland to Tasmania?

- 2.4.1. The TFES is designed to at least partly alleviate the freight cost disadvantage incurred by shippers moving freight across Bass Strait. The cessation of operations by an international carrier from Tasmania has meant that export goods must be freighted across Bass Strait to be transhipped from Port Melbourne. Accordingly, a cost disadvantage is now incurred by firms that must ship export goods via Port Melbourne, compared with those exporters able to land deliver their goods to the Port. By extending the coverage of TFES to include freight destined for export, this disadvantage would be at least partly alleviated as the Scheme intends. It would **also have the benefit of eliminating the practice of changing an exporter's business model** to facilitate minimal, and probably confected, processing in Melbourne (for example) undertaken to gain access to the current assistance available. There would be a positive effect on economic activity in Tasmania.
- 2.4.2. Under the current Scheme, customers who split-ship full containers with both export and domestic product cannot claim TFES assistance unless they can explicitly identify that which is for domestic consumption and that which is to be exported. Therefore some existing northbound eligible freight is not receiving assistance. Extending the Scheme to include exports will alleviate this.
- 2.4.3. There is merit to maintaining the restrictions imposed by the current southbound Scheme. For a disadvantage to exist, a Tasmanian firm must be intending to sell the end product using cost-assisted imported inputs somewhere other than Tasmania. This is because their mainland-sourced inputs are subject to a higher freight cost (due to crossing Bass Strait) than their mainland competitors. This may be a reason as to why the southbound component of the Scheme is currently being

restricted to inputs used by the industries nominated (primary production, mining and manufacture). Enterprises within these Tasmanian industries (with a few exceptions) are predominantly competing on a national and international basis, and as such would otherwise have freight disadvantages for their inputs that their mainland competitors would not in the absence of the southbound assistance. Retailers, who import finished goods for sale in Tasmania, all face the same freight costs and therefore none have a relative disadvantage. This extends to construction, where the finished good remains in Tasmania. There is merit in maintaining this assistance, despite the more rigorous demands in processing the claims for assistance.

- 2.4.4. The trade-off of extending the Scheme to exports but removing the southbound component of the Scheme would severely negatively impact a number of industries in Tasmania. Mining operations such as BCD Resources, Grange Resources and Unity Mining all face higher input costs in comparison to their mainland counterparts due to the freight disadvantage imposed by Bass Strait. As these mines export in bulk, and this form of freight would remain ineligible even under this proposal, these firms lose out entirely. Similarly, large ship builders such as Incat and Richardson Devine Marine, who do not freight the finished product, would also be disadvantaged.
- 2.4.5. Also, firms that have predominantly domestic sales (Tasmania) would not receive the trade-off offered under this proposal. High value agriculture, aquaculture and **viticulture, such as Houston’s Farm, Burlington Berries**, Christmas Hills Raspberry Farm, Tassal, Freycinet Wines and Winemaking Tasmania are specific firms which have indicated to NSF-T that their operations would be seriously affected with the removal of the southbound component of the Scheme, including those involved in the poppy and pyrethrum industries.
- 2.4.6. The Tasmanian economy is undergoing structural change. High value agricultural products, such as pyrethrum, poppies and berries, viticulture, aquaculture, mining and high scale manufacturing are significant industries that underpin that structural change. These industries would suffer a severe negative impact with the removal of the southbound component of the TFES, at a time Tasmania is looking to them to lead an economic transition.
- 2.4.7. Whilst there is some complexity around the eligibility criteria for the southbound component of the Scheme, we note that the parameters that surround this Scheme have not been addressed in the draft report. NSF provided a number of examples in its original submission where there are administrative constraints which do not address the intent of the Scheme. Discarding reference to ANZSIC would be a sound move in the right direction.

2.5. Information Request 2

What minimum claim value (per claim line item) would meet the objective of the Tasmanian Freight Equalisation Scheme while reducing administration costs for government and compliance costs for businesses?

- 2.5.1. Government institutions are able to reduce administration costs using other methods than a minimum claim line, such as consolidating claim lines, requesting

the claims below a threshold must be submitted electronically and adopting a sampling approach to processing claims.

- 2.5.2. NSF-T advises its clients from time to time that particular consignments are of a value such that the compliance costs of obtaining the information would outweigh the value of the claim. These are typically small, individual parcels. For example, a claim with freight value of less than \$20.00 would have a rebate value of \$0.34. An individual claimant who processed a claim with such low value would acknowledge the poor return on time invested and would be unlikely to pursue further similar claims.

2.6. Information Request 4

What would be the potential impacts (both positive and negative) and efficacy of an alternative approach to the current TFES/BSPVES model whereby the Australian and Tasmanian Governments would use their current financial commitments under the schemes to cease paying individuals and businesses and instead secure more directly the Bass Strait freight and passenger services they are seeking through a periodic open tender process?

- 2.6.1. Further clarification of this request is required. If the information request is asking whether it would be better to subsidise one operator (presumably with multiple ships from existing port locations) to manage the freight and passenger tasks between Tasmania and the mainland then a number of issues are raised by this proposition, for which there are usually no definitive answers.
- 2.6.2. If this interpretation is the one intended, an a monopoly firm, or consortium, results from an open tender, there would be an inevitable call for some oversight, or regulation, of freight costs. How to accomplish that would most likely unearth more complexities than the existing TFES structures. Appointing a regulatory body in order to appease a variety of interest groups would be a difficult task. There would likely be a tension between the Federal and State Governments over choosing appointees. Ballooning administrative and resource costs would almost certainly exceed the current annual TFES administrative cost of about one million dollars.
- 2.6.3. If current arrangements are being replicated, in terms of ship size and ports utilised, a case needs to be made for subsidising one operator rather than those existing ones. Further, loss of the benefits of an integrated transport service (vertical integration) currently enjoyed by a part of the industry could increase road costs and deprive consumers of the opportunity to have lower prices.
- 2.6.4. The scale of the Tasmanian freight task is about 250 000 TEUs per annum in each direction. This will impose a limit on any benefits achievable from economies of scale that could theoretically accrue from having a single operator, or from using large capacity ships. NSF-T noted in its earlier submission that container ships exceeding 10 000 TEU capacity are common on international routes, but such, highly efficient ships of that size are infeasible for the Bass Strait run. Port capacity imposes a constraint on ship size (in the absence of large capital expenditures), and it is not feasible to reduce the number or frequency of sailings which might accomplish the freight task in the most efficient way, because of the time-sensitive nature of much (over 25%) cargo.

- 2.6.5. The Report (p3) **observes that there is a 'pervasive involvement of government in many aspects of the Tasmanian economy', and cites the government activity in the freight industry owning and operating infrastructure assets including shipping, ports, road and rail.** The Report raises the issue whether these settings stifle innovation and private sector involvement. The proposal to replace multiple private and public operators with a single, government-subsidised, monopoly operator appears counter-intuitive to the Commission's implicit aim of promoting innovation, increased private sector involvement and enhancing a competitive environment.
- 2.6.6. NSF-T has an intrinsic belief in the industry having a competitive structure to provide the necessary services, even if this structure is essentially an oligopoly. Competition, although not as intense as some might wish, does exist within the current system. We look forward to increased contestability in Bass Strait services.

3. Concluding Comments

- 3.1. To conclude, we briefly comment upon several topics that were skirted in its assembly, given the focus was on issues with which NSF-T is more familiar. We begin with several aspects of a possible switch to lower TFES assistance.
- 3.1.1. Should there be envisaged a substantial reduction in TFES payments per TEU, there would need to be a transition period extending beyond the suggested 2-3 years. The reason for this proposal is that business models of those receiving assistance would be structured on the presumption of a medium to long-term continuance of existing arrangements, and it is possible that a decrease in TFES assistance received would make some operations marginal.
- 3.1.2. Consider a medium level shipper, say 3000 TEU p.a., with an average freight rate receiving \$720 per TEU in freight equalisation assistance, a total of \$2.16 m p.a. Should a flat rate of \$600 per TEU be decided upon (following the 2006 Productivity Commission recommendations), this firm could potentially lose up to \$360,000 pa in freight assistance. The firm might be able to withstand such a lessening of support if its overall operating margin is relatively high, but if the margin is small, as is the case for many primary producers, the loss of support would be more traumatic.
- 3.1.3. We estimate that 99% of the approximately 1600 TFES claimants would be worse off under a flat rate regime if the set rate were as high as \$750, i.e. greater than the mooted \$600. It would be conceivable that many of these would exit their industry. Such an outcome may well be deemed to be laudable if the exercise is **designed to hasten the diversion of those firms' resources to more productive employments**, but the efficiency gain would be bought at a comparatively high political price. For reasons such as these, we recommend a much longer transition period if any changes are likely to be deleterious to current recipients.
- 3.1.4. It is not expected that introducing an export subsidy would require a transition period.

3.2. Comments on other Recommendations

- 3.2.1. We support enthusiastically those Recommendations that encourage the greater coherence of infrastructure investment in Tasmania, particularly around long-term

freight strategies, as envisaged in Recommendations 14 and 15. NSF-T is a member of the Tasmanian Freight and Logistics Coordination Team and these recommendations support the findings of that Council.

- 3.2.2. A matter of concern in seeking greater efficiencies within the overall sea-freighting industry must be the relatively high number of empty containers (of a variety of types) that have to be shipped in each direction. Several causes of the mismatch in supply of and demand for containers have been discussed in the 2013 Aurecon Tasmanian Empty Container Movement Study. The phenomenon, akin to the problem of differing Australian rail gauges, causes increased costs to the industry that in turn are passed to clients.
- 3.2.3. Another source of mismatch is the nature of the trade imbalance – more loaded domestic containers enter Tasmania than leave – and there are seasonal irregularities in trade volume – more containers arrive in the latter half of each year. Further, there is a greater demand for international containers for northbound trade. A possible long-term solution to the size mismatch issue would be to provide incentives that promote a gradual replacement of Australian pallets and containers with their international counterparts.
- 3.2.4. As an island state, coastal shipping regulations strongly affect Tasmania. We welcome a review of policies, as suggested in Recommendation 1, towards a more competitive business landscape, but suggest prudence around safety and environmental concerns. We believe that appropriate regulation could be beneficial in attracting an international carrier offering shipping services directly from Tasmania.
- 3.2.5. Similarly, we welcome any benefits that should result from adopting Draft Recommendations 6 and 7. Improved transparency and scrutiny as well as maintaining efficient technology assists in providing a quality service.

4. For Further Comment

For further comment on any aspect of this paper, NSF-T's primary contact is:

Steve Henty
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