Submission to Coastal Shipping Reforms: Discussion Paper

May 2017

This document has been prepared by the Freight on Rail Group (the Group). The Group is a rail freight focussed industry group established to engage with Government and key stakeholders on major public policy issues. It consists of the seven major rail freight businesses in Australia:

Aurizon
Aurizon has rail and road-based freight and infrastructure operations across Australia. Aurizon operates above-rail freight services from Cairns through to Perth, and manages the Central Queensland Coal Network made up of approximately 2,670km of heavy haul rail infrastructure.

Australian Rail Track Corporation (ARTC)
ARTC has responsibility for the management of over 8,500 route kilometres of standard gauge interstate track across Australia. ARTC also manages the Hunter Valley coal rail network, and other regional rail links.

Brookfield Rail
Brookfield Rail manages and operates a 5,500 kilometre open access, multi-user rail freight network extending throughout the southern half of Western Australia, providing access for intermodal, iron ore, grain, alumina and various other bulk commodities.

Genesee & Wyoming
G&W is a global vertically integrated rail freight company with a large Australian presence in SA, NT, Victoria and NSW. G&W owns nearly 5,000 kilometres of track in SA and NT, including the 2,200-km Tarcoola-to-Darwin railway.

Pacific National

Pacific National is one of the largest providers of rail freight services in Australia, providing intermodal, coal and bulk rail haulage services throughout Australia.

Qube
Qube is Australia's largest integrated provider of import and export logistics services. It offers a broad range of logistics services with a national footprint and a primary focus on markets involved in international trade in both the bulk and container markets.

SCT Logistics
SCT is a national, multi-modal transport and logistics company. It operates its own intermodal rail services along the Eastern seaboard and from the eastern States to Perth, while also providing bulk rail haulage services. It has facilities in Brisbane, Sydney, Parkes, Melbourne, Adelaide and Perth.

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EXECUTIVE SUMMARY

This submission outlines the position of the Freight on Rail Group (FORG) in relation to the Coastal Shipping Reforms Discussion Paper (the Discussion Paper) released in March 2017.

The implications of the proposed amendments in the Discussion Paper are critically important to our industry as a number of our major domestic intermodal freight routes in Australia compete directly with coastal shipping.

FORG is primarily concerned with the Discussion Paper amendments relating to the removal of cabotage requirements (amendment 1), and flexibility in tolerance provisions (amendment 5). These changes, if implemented in a way that effectively provides foreign flagged ships with exemptions from Australian regulations, will create an uneven playing field for Australian companies by increasing what is already an unreasonable competitive advantage to foreign owned shipping companies that choose to compete in Australia's domestic markets.

The FORG submission is focussed on domestic transport lanes where rail (and road) competes directly with domestic and foreign shipping companies. It is the FORG position that the Government needs to carefully consider, evaluate and address the full impacts of any coastal shipping legislative reform on our domestic markets. Given the significance of the proposed reforms to the freight transport industry, it is important the Government is fully informed of the potential impacts to the entire sector.

In summary, the key points discussed in this submission as part of the FORG position are:

- Foreign flagged vessels, even under the current legislation, already have a cost advantage in Australia and some vessels are effectively 'dumping' their services at very low prices to fill capacity. On the East West corridor, sea rates are already around 40 per cent cheaper than their rail competitor. The proposed deregulation if accompanied by exemptions from domestic laws and regulation will allow foreign shipping companies to further benefit from substantially lower wages and conditions.
- The proposed reforms will result in the Australian rail industry experiencing up to 2,000 direct and indirect jobs being lost from intermodal rail freight operations, support services and suppliers.
- If foreign shipping companies are given an exemption from regulations that rail freight companies operating in Australia have to fully comply with, this will cost the Government and nation significant tax, including GST, and track access revenue which it currently receives.
- Major investments in rail terminals, infrastructure and rolling stock have been made by rail freight companies in Australia. Changes in legislation, if they do provide exemptions from regulation for foreign flagged vessels that choose to participate in domestic coastal shipping, could seriously jeopardise these investments and would have a negative impact on the the recent federal budget commitments in rail infrastructure. Further, the incentive to invest in infrastructure by Australian rail companies significantly diminishes.
- A modal shift towards sea will result in rail companies reducing their latent capacity, creating a significant reliance on foreign shipping companies in moving our domestic cargoes between capital cities.

The intermodal rail freight industry directly competes with both road and coastal shipping on the East-West corridor (east coast to Perth) and the North-South corridor, between Melbourne, Sydney, Brisbane and Cairns.

These intermodal rail freight services (i.e. not including bulk services):

- Perform an annual freight task of 24.3 million net tonne kilometres (NTK) from 2014-15 data, noting that this is less than the 27.6 million NTK performed in 2012-13;
- Employ up to 10,000 people both directly and indirectly across Australia;
- Contribute more than $850 million each year to the Australian economy; and
- Pay access charges of more than $350 million to rail infrastructure managers that use most of these funds to maintain and invest in the infrastructure.

INTRODUCTION

FORG appreciates the opportunity to comment on the Department of Infrastructure and Regional Development's (the Department) March 2017 Discussion Paper on Coastal Shipping Reforms (the Discussion Paper).

One of the objectives of FORG is to contribute to government policy and strategy in the freight sector, particularly where there is an impact on the rail industry. The efficiency of the freight transport network is critical to the competitiveness of Australia's industries in domestic and international markets and, therefore, contributes to the ongoing development and growth of the Australian economy.

As the Department may be aware, FORG provided a submission[1] on the Government's previously proposed Coastal Shipping legislation to the Senate in August 2015, outlining our concerns including the lack of consultation with our industry.

We appreciate the current consultation process that has been undertaken by the Department in the form of seeking industry submissions in response to the discussion paper.

Our submission is primarily focused on areas where land freight competes directly with shipping (such as freight haulage on the east – west and north - south rail corridors). FORG appreciates that in some circumstances a lack of competitive alternative may exist for companies looking to move goods around Australia. In some cases there are significant freight tasks where there may be no viable land based alternatives thus sea transport is the only option, e.g. freight services to Tasmania, or locations where there is poor or non-existent road and/or rail infrastructure.

One of the key concerns with the proposed coastal shipping reforms is that it has adopted a blanket approach to what is clearly a myriad of different competitive circumstances across the entire domestic freight sector. As an example, a company moving freight or iron ore out of the Pilbara into the Eastern states may have limited transport options under the current legislation whereas a company moving a container between Sydney and Perth might have several alternatives including road, rail and sea.

FORG is unaware of any economic feasibility study undertaken which seeks to quantify the economic benefit and costs that would result from the introduction of this legislation, and ultimately provide exemptions for foreign flagged vessels. We feel a comparison should be made against the consequences on jobs, local business and government revenue, through company and income taxes over the entire rail intermodal industry. FORG is of the view that the full impact of any proposed changes should be determined in consultation with land

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[1] Freight on Rail Group, 2015, *Submission by FORG to Senate Enquiry into the Shipping Legislation Amendment Bill [Provisions].*

freight transport operators that compete with coastal shipping services to carry domestic freight.

The Australian rail intermodal industry is at present facing a likely consolidation of competitors which may result in job losses. The attrition in this instance is on corridors where rail currently competes with sea. This in itself demonstrates the fragility of the sector.

The proposed legislation will encourage foreign shipping companies to fill their vacant capacity with Australian domestic containers further increasing the price 'dumping' of freight services that is already occurring. As an absolute minimum foreign shipping companies should be required to comply with regulatory requirements that are consistent with land-based Australian owned or based transport operators and their Australian work forces. This would include workplace relations, health and safety laws, as well as environmental regulation and taxation laws.

FORG submits that similar to the rail freight industry, consideration should also be given to ensuring that international shipping companies competing in our markets make a cost-reflective contribution to the cost of infrastructure provision, including ports, shipping lanes and channels and communications and signals infrastructure relating to coastal shipping in Australia. We believe that contributing to the cost of infrastructure is an important consideration and one that is central to the principle of competitive neutrality, recognising that rail freight operators meet the cost of rail infrastructure provision through access charges which are increased annually.

In addition to the issue of competitive neutrality, the current context for international shipping capacity should be carefully considered.

As McKinsey and Company has identified, one of the major developments in shipping over the past decade has been the international shipping industry 'has been building capacity that it appears will be mostly unneeded'[2]. The oversupply of international shipping capacity continues to be driven by the production of larger capacity ships.

International Container ships already have an imbalance of imports over export capacity. With the emergence of larger vessels, the capacity to offer services into the Australian market at prices that are effectively 'dumping' could be substantially increased.

FORG strongly recommends before any changes to the regulation of coastal shipping is undertaken, the potential economic and community impacts, both positive and negative, for the whole national supply chain should be fully assessed through an impact statement prepared for the Australian Government. The preparation of the report must involve consultation with both the rail freight and road freight industries in order to evaluate the full impact.

Within the context of the Discussion Paper this submission should be taken as a response to Questions 2 and 3 as outlined the Discussion Paper. FORG has also raised its concern about the proposed funding option for seafarer training, specifically around the complexity of administering and achieving the intended outcome from this policy option.

FORG would welcome further consultation on the matters raised in this submission.

[2] McKinsey and Company, *The Hidden Opportunity in Container Shipping*, November 2014

THE PROPOSED AMENDMENTS

The proposed amendments to the Coastal Trading Act would be a significant change to the current framework, removing the existing minimum five voyage requirement and volume variation restrictions from the temporary licensing regime for domestic shipping. This would provide a blanket exemption under Ministerial determination and remove the application of the Fair Work Act to coastal freight. This change would allow organisations to apply for single voyages instead of the current five. As part of the changes, we are concerned that foreign-flagged ships competing in the domestic freight market will avoid paying Australian wages and conditions to their crew a significant cost saving and competitive advantage that is obviously not available to competitor rail freight or road freight companies.

If this were to occur it would provide foreign flagged ships with a competitive advantage compared to all land-based freight transport operations who have no exemptions from domestic regulations and taxes.

The position of FORG is that such a competitive advantage should not be provided under any changes to coastal shipping regulation. The application of laws and regulation should be consistent for all freight operators competing in the domestic freight market, a point recognised by most countries around the world.

As such, FORG is not in favour of the proposed amendments as outlined in the Discussion Paper:

- **Amendment one - remove the five voyage minimum requirement for a Temporary Licence; and**
- **Amendment five - amend the tolerance provisions for nominated cargo for Temporary Licences**.

The remaining amendments, are not considered to have as a material impact on rail freight and are not considered to impact on competitive neutrality between transport modes, and competitive neutrality between all businesses whether domestic or foreign.

FORG has no concerns with the need for the Government to address the administrative issues within the Coastal Trading Act to help streamline processes and reporting requirements for shipping companies and businesses.

SEAFARER TRAINING INITIATIVE OPTIONS - (RESPONSE TO QUESTIONS 6,7 AND 8)

Investing in the skills base of the freight industry is important to ensure standards are maintained and that there is training that contributes to a suitably experienced employee base to meet the demands, operating requirements and future growth of the industry.

FORG does have reservations about the effectiveness of creating a fund derived from payments by the ship-owners equivalent to wages that would normally be paid to foreign seafarers under Part B of the Seagoing Industry Award 2010, to be redirected to support Australian seafarer training. This option presents complications in monitoring the use of the fund and how it is allocated to training activities in the future. Under the current reform proposal it can be expected the inclination of vessels will be to hire cheaper foreign workers, at the expense of domestic crew – reducing the need to access training and development funding for Australian seafarers. As the demand for the fund diminishes so too will the need to continue contributing to the fund; presenting potential problems for its future administration.

COMPETITION BETWEEN ROAD, RAIL AND SEA FRIEGHT

Road, rail and shipping compete to carry domestic freight on a number of long-haul corridors including the east-west corridor, i.e. freight services between the capital cities of the eastern states, Adelaide and Perth, the north-south corridor connecting Victoria, New South Wales and Queensland, and the central corridor from Adelaide to Darwin. Any future reduction in volumes along these key rail routes will place rail operations along these routes at risk.

FORG notes that in relation to the regulation of coastal shipping, the Senate Rural and Regional Affairs and Transport References Committee, following an inquiry on Flag of Convenience Shipping, made the following recommendations:

- that the Australian Government undertake a review of the Australian maritime sector, with a view to building on the 2012 reforms aimed at growing the Australian-flagged shipping industry in the future,

- that the Australian Government immediately tighten the provisions for temporary licences in Australian maritime law, to flag of convenience vessels being used on permanent coastal freight routes if they fail to pay Australian award wages their crew,

- that the Australian Government continue to work with international agencies, including the International Labour Organisation (ILO), to improve the working conditions, safety standards, and rates of remuneration for seafarers working in international shipping,

- that the Australian Government look for ways to support the Maritime Labour Convention (MLC) to make flag of convenience shipping more accountable to international law and, when in Australian waters, to our national regulations, and

- that the review of the Australian maritime sector specifically include a review of risks to the marine environment of flag of convenience shipping and specifically include consideration of how shipping can be more responsive to Australian environmental laws.

FORG recognises that the Australian Government did not support some of these recommendations in the current context. However, FORG is of the view that these issues, as outlined, would become central to our concerns about competitive neutrality if consideration were given to allow foreign flagged ships increased access to the domestic freight market. Therefore, we submit that they should be carefully considered in the context of the potential impacts on land-based freight transport market and the economic contribution of both the road and rail freight industries.

THE ECONOMIC CONTRIBUTION OF INTERMODAL RAIL FREIGHT OPERATIONS

The intermodal rail freight industry directly competes with both road and coastal shipping on the East-West corridor (east coast to Perth) and the North-South corridor, between Melbourne, Sydney, Brisbane and Cairns. These intermodal rail freight services (i.e. not including bulk services):

- perform an annual freight task of 24.3 million net tonne kilometres (NTK) from 2014-15 data, noting that this is less than the 27.6 million NTK performed in 2012-13,
- employ up to 10,000 directly and indirectly across Australia,
- contribute more than $1 billion each year to the Australian economy, and
- pay access charges of more than $350 million to rail infrastructure managers that use most of these funds to maintain and invest in the infrastructure.

Rail freight businesses competing in the domestic freight market have made major investments in long-haul freight operations where there is direct competition with both road freight and with coastal shipping services.

These investments by rail freight operators have been made on the basis of the current regulatory arrangements. With substantial investments and ongoing costs associated with rail freight provision, the industry generates efficiencies when it is able to build scale in its operations.

Given this, it will be important any reform does not act counter to the focus and investment strategy by the Commonwealth, state and private sector in rail freight. This includes recent new investments in infrastructure made by both the Federal and State Governments. These investments, along with other rail and intermodal investments, are made based upon rail's competitiveness against other transport modes.

FURTHER CONSIDERATIONS - POTENTIAL IMPACTS TO RAIL FREIGHT (RESPONSE TO DISCUSSION QUESTIONS 2 & 3)

If reforms to coastal shipping were introduced, and the reforms do provide exemption to foreign flagged vessels from Australian laws and regulations, and do not require comparable contributions to meeting the costs of infrastructure, this would present an unreasonable competitive advantage to foreign ships operating in the domestic freight market.

FORG submits that efficient freight transport services require an integrated network involving all transport modes; however, it is also important all freight transport is regulated on the basis of competitive neutrality.

Transport policies that do not aim to achieve competitive neutrality can result in distortions in the market. It is important the proposed reforms are assessed based on their potential impact on the entire freight transport sector – rather than an individual component of it. Any reforms should aim to achieve a more integrated and competitively neutral transport network – promoting efficient and sustainable economic outcomes for the benefit of all freight customers and the Australian economy.

FORG is concerned the proposed changes to coastal shipping regulation will not require foreign ships to fully comply with Australia's workplace relations regulations, including the payment of Australian wage rates and associated entitlements and conditions.

The proposed amendments (amendment 1) to remove cabotage requirements would give foreign ships a significant additional cost advantage in the form of regulatory exemptions that would not be available to the road and rail freight industries.

The price difference between operating an Australian flagged vessel when compared to a foreign flagged vessel under International Transport Worker's Federation wage rates is significant. The difference is estimated to be in the order of AUD $5 million per ship per year. In fact, shipping operators have indicated that if Australian labour legislation is not applicable to all vessels involved in coastal trading it will result in a dramatic reduction in operating expenditure. Maersk Line Australia, in its 2014 submission to the Government's Coastal Shipping Reform Options Paper, suggested this would reduce the costs of its weekly route from Brisbane to Fremantle by AUD $60,000.

The average expenditure for a rail employee is around AUD $96,000. Rail freight operators in Australia are subject to Australian legislation, and this should be no different on sea freight transport routes which directly compete with Australian land transport routes.

There is a risk that shipping companies operating foreign ships may choose to participate in the Australian domestic freight market using regulatory exemptions when there is a sufficient supply of shipping capacity available for them to do so, (reducing the commercial viability of land transport options). Similarly, they may then choose to withdraw if international demand increases in other markets, but the land transport options may then not be available if their continued existence is not commercially viable). In other words, the potential impact could fluctuate depending on demand for international shipping services. These fluctuations should be considered by the government given their potential to impact on the freight supply chain.

Rail is reliant on economies of scale to remain competitive and sustainable. Any loss in the rail freight market on long haul rail freight corridors, such as the east-west corridor between the east coast and Western Australia, will adversely impact the sustainability of the freight rail industry and employment levels within it.

Rail freight pricing reflects fixed costs, such as track infrastructure and rolling stock. This requires a degree of stable demand to set pricing. If rail freight revenue were to reduce as a result of a drop in market share and reduced, this could trigger a cost increase to users in the supply chain in order to cover ongoing fixed costs.[3]

In relation to the intermodal freight market, where shipping is a competitor with rail, rail freight will be vulnerable to customers considering switching non-time sensitive goods to sea. There is also the significant risk that frequency and flexibility of foreign ships picking up domestic cargo will reduce their transit times allowing them to infiltrate significantly into the 'time sensitive' freight market which is the lion share of rails volume.

Summarising the above, the proposed amendments 1 and 5 in the Discussion Paper, if they are confirmed as providing exemptions for foreign flagged vessels from Australia's laws and regulations, are likely to have the following key impacts to the freight rail industry:

- Cause a reduction in the market share of rail freight for long haul movements, particularly those between the east coast and Perth and adversely impact the freight rail industry (which is cost competitive, like shipping, over long distances);
- Encourage dumping practices, i.e. transport services are provided at a price lower than those provided in their home nation, damaging freight pricing and causing a downturn in land transport volume growth
- Reduce transit times on sea by increasing the frequency of ships contesting for our domestic volumes.
- Significantly damage the domestic land freight industry through a loss of volume and revenue stability, and a reduction in the capacity of the rail freight industry to invest in capital
- Increase to rail freight pricing due to the reduced rail volumes and rail efficiency which requires volume/ critical mass in order to recover its fixed operational costs as a result of reduced rail volumes.

As stated, if the proposed reforms were introduced the rail freight industry could expect to see substantial job losses.

[3] Gargano, S. 2015, *Rail Freight Transport in Australia*, IBISWorld Industry Report I4710, pages 3-10.

If changes to coastal shipping do not require foreign flagged ships to meet reasonably equivalent regulatory requirements to land-based operators, then this would risk:

- **the loss of up to 2,000 direct and indirect jobs from intermodal rail freight operations, support services and suppliers**
- **the loss of at least $80 million in access revenue for rail infrastructure managers (i.e. annual access revenue for rail infrastructure providers would fall from about $350 million per year to $270 million per year or lower)**
- **reduced investment from rail freight operators.**

Given the significance of these potential effects on the rail freight industry, as outlined earlier in this submission and those provided to the Senate Enquiry on this matter in August 2015, if these proposed amendments are to be pursued by Government, a regulatory impact statement that considers the impact to the whole freight network, including job losses and Government revenue loss should be undertaken to ensure the Government is properly informed of the potential impacts on land transport freight. Furthermore, the regulatory impact statement process should involve consultation with the rail freight industry and the road freight industry on potential impacts from any changes to coastal shipping regulation.

OVERSUPPLY OF CAPACITY IN INTERNATIONAL SHIPPING

In addition to the issue of competitive neutrality, the current context for international shipping capacity should be carefully considered.

McKinsey and Company has concluded that one of the major developments in international shipping over the past decade has been the international shipping industry ‘has been building capacity that it appears will be mostly unneeded’[4]. The oversupply of international shipping capacity continues to be driven by the production of larger capacity ships.

As stated earlier in this submission, there is a risk that the oversupply in international shipping could result in international shipping companies effectively ‘dumping’ their capacity into the domestic Australian market. In other words, in order to utilise excess capacity, shipping companies could offer services for prices below that provided in their country of origin, using the definition of dumping applied to physical goods.

The risk of international shipping companies ‘dumping’ freight services in Australia will be substantially higher if they are allowed increased access to the Australian domestic freight market without also being required adhere to a reasonably equivalent level of regulation as that which applies to land freight transport operations.

Lessons Learnt from Other Jurisdictions

There may be valuable lessons that can be learnt from international examples, where the importance of cabotage protections has been recognised to be in their national interests. The Unites States is strongly regulated with *the Jones Act* to protect their ship building industry and the jobs of maritime workers.

In Canada, where domestic shipping has prospered by having a cabotage system, coupled with an introduction of a range of financial incentives for ship owners/operators engaged in coastal trading.

[4] McKinsey and Company, *The Hidden Opportunity in Container Shipping*, November 2014

Another example can be found in Brazil, where they country has addressed a decrease in its domestic vessels by introducing a flexible cabotage regime, which retains the requirement for coastal trading ships to be owned and operated by Brazilian based companies. The flexibility permits major international shippers (e.g. Maersk) to invest in domestic flagged companies, thus buying into the Brazilian shipping market.

Australia should look to these examples and explore how these transport policies could be adopted to improve the domestic shipping industry. The possibility of adopting select elements of the Brazilian (e.g. foreign participation rules) and Canadian (financial incentives for ship owners/operators) systems could prove to be advantageous for the productivity and sustainability of the Australian freight industry across transport modes.

CONCLUSION

FORG is concerned that the amendments proposed in the Discussion Paper would provide exemptions to foreign flagged vessels from Australian laws and regulation when competing in the domestic freight market, and would not require comparable contributions to those provided by rail freight operators in meeting the cost of infrastructure. If these exemptions are provided to foreign flagged vessels, they would have major impacts on rail freight businesses in Australia, their employees, and revenue received by Government and private rail owners through track access and taxes.

On a number of major domestic freight routes in Australia, there is direct competition between rail freight and coastal shipping and the proposed amendments have the potential to introduce an unreasonable competitive advantage to foreign ships that may choose to compete in the domestic freight market. This unreasonable competitive advantage arises as the proposed amendments allow foreign shippers to compete in the domestic freight market against land freight transport operators that have to comply will all laws regulations. In particular, exemptions would allow foreign ships to incur substantially lower wages, conditions and associated workplace relations costs when compared to rail, road and Australian-based coastal shipping companies.

FORG recommends that foreign flagged ships should be required to comply with the same laws and regulations as Australian based transport businesses if they choose to compete in the domestic freight market. We believe that they should be regulated consistent with the principle of competitive neutrality between the transport modes. The proposed reforms outlined in the Discussion Paper would not meet this principle.


RAILWAY
CROSSING
STOP
LOOK
FOR
TRAINS