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STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION

Inquiry into Port Phillip Bay: channel deepening

Melbourne — 6 June 2008

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Mr S. O'Connor, economic adviser; and

Mr C. Smyth, marine campaigner, Australian Conservation Foundation.

The CHAIR — I welcome Mr Chris Smyth and Mr Simon O'Connor from the Australian Conservation Foundation. All evidence taken at this hearing is protected by parliamentary privilege as provided by the Constitution Act 1975 and further subject to the provisions of the Legislative Council standing orders. Any comments made outside the precincts of the hearing are not afforded parliamentary privilege. All evidence is being recorded by Hansard, and witnesses will be provided with a proof version of the transcript in the next couple of days. I now invite you to make an opening statement, if you like, or proceed to questions.

Mr O'CONNOR — Thank you. Just a brief opening statement from us, just referring directly to our submission and highlighting some of our key points: as a point of clarity from the outset I would also like to disclose my own personal association with Economists@Large, who presented here yesterday. Prior to joining the Australian Conservation Foundation in December I worked with Economists@Large last year to produce a submission to the SEES panel hearing and the expert witness report that we submitted there. I now work predominantly with the Australian Conservation Foundation, four days, and I still do some part-time consultancy with Economists@Large — just as a point of clarity.

The CHAIR — Thank you.

Mr O'CONNOR — Just reiterating some of our key concerns that we have raised in our submission, the two major areas are that in the business case as presented within the SEES documents and particularly within the cost-benefit analysis by Meyrick and Associates, there are some major concerns there, but also we would like to highlight that since the approval of the project through the SEES process the business case has changed quite dramatically, so I would just like to highlight some of those issues.

Most particularly the capital cost estimates for the project have increased around 65 per cent in the few months since the approval of the project, and on the basis of that you obviously have a lot of implications for the benefit-cost ratio and the net project benefits, so you are really talking about a very different financial basis for this project now.

In particular the impacts on the benefit-cost ratio have decreased from about 3.3 to 2. Net project benefit is down to about 967 million without the inclusion of sunk costs and delays on the project, and the return on investment has decreased further than — basically we are looking at the project not really meeting a commercial rate of return of around the 17 per cent mark until 2023, so we are looking at a project with pretty low returns and very high risks. Clearly the opportunity cost of this investment therefore is quite dramatic. We would advocate therefore that this really is not prudent management of finances.

Importantly our analysis looks at the — the project is based largely on the forecast trade through the port. Our analysis indicates this is highly optimistic, particularly projecting this trade growth out 27 years. Clearly the impacts of oil price fluctuations, climate change and indeed the short history of shipping from which to make forecasts indicate that there is high risk of volatility in this projection. We have already seen the Port of Melbourne downgrade its forecast for container throughput in trade in this current year, projecting that that is decreasing from about 6 per cent to somewhere between 3 to 4 per cent.

What is quite important here is that there was actually no sensitivity analysis undertaken on this forecast growth of containers through the port, which is absolutely easy to do for an economist, to manipulate the model to change the forecast growth in TEUs going through the port.

These points are very critical, because in order to gain the public support for this particular project these are really the factors that are the basis of what has been put out there in public. One particular figure that is quoted often in public and was used in Shipping Australia's submission to this hearing was that 44 per cent of ships currently arriving at the port are not able to load to full capacity due to draught constraints. I would argue from my reading of the SEES documents that in fact it is highly irresponsible to use this figure, that it is misleading and in fact we do not have data to substantiate this, as far as I have seen in any of the documentation.

In fact the SEES states that the number of ships coming through the port that use tide assistance is as low as 2 per cent. If this figure of 44 per cent is in fact true, I would ask the Port of Melbourne to actually name the vessels as they arrive and leave the port to give us an indication of exactly which vessels have these constraints.

The other thing about the forecast of container trade through the port that is particularly important is this impact of the levy, which has not been assessed in any of the modelling. What does the levy do to demand for trade through the port of Melbourne? That was something that was not raised in the SEES documentation, and I would say that there are certainly impacts on demand at the port due to increased pricing, just an elasticity of demand which needs to be modelled to really impact, how that affects the projected benefits over time.

Finally, we just raise the issue in our submission that there are a number of environmental costs that have not been costed by the economic consultant in the SEES documentation. This is entirely inadequate. There are definitely techniques that exist these days for evaluating environmental costs and environmental risks, as have been employed by the *Exxon Valdez* incident — that is, a contingent valuation technique, an environmental economic technique of valuation.

This is a method of valuation that has been prescribed in fact by Kenneth Arrow, a Nobel prize-winning economist, who asked that for the *Exxon Valdez* incident this be a valuation technique employed. So we really do need to be asking Victorians through a contingent valuation what is the bay worth to Victorians, what is the value of the bay, and then hold that up against the benefits and costs of the project.

Our position is that the Australian Conservation Foundation sees that there is not a strong enough business case to justify this project, considering the considerable risks to the fragile ecosystem. That is our opening statement. Thank you.

The CHAIR — Thank you. One of the points you make in your written submission on the second page is the reference to the benefit-cost ratio deteriorating from the original figure of 3.3:1 to 2:1. You then make the comment ‘in industry terms, an infrastructure project at less than 3:1 is deemed nonviable’. Can you explain on what basis anything less than 3:1 is not viable?

Mr O’CONNOR — Yes. This is an issue I guess in much the same way that there are many discussions around discount rates. These are the kind of back of the envelope figures that, if you are an infrastructure investor in an investment bank, you would have to achieve to proceed with a commercial investment. This kind of figure has been thrown around in the press and between discussions with investment banks — my own personal discussions with Macquarie Bank — so that is what that is based on.

The CHAIR — I do not know if you are aware of the evidence this morning from the Department of Transport, and indeed VECCI yesterday, who essentially said anything better than 1:1 is viable for a large infrastructure project.

Mr O’CONNOR — A large public infrastructure project or a private infrastructure project?

The CHAIR — An infrastructure project.

Mr O’CONNOR — I would argue obviously that as we saw in the discussions yesterday, this is a private investment I guess from the Port of Melbourne as a government business enterprise, a corporatised business. So it needs to be achieving commercial rates of return, yes.

The CHAIR — The other point I would like to ask you about is the issue of the lack of modelling of the impact of the surcharge in the business case. One of the previous witnesses helpfully included a bill of lading in their submission for a 40 foot container, 2 TEU, the total cost from Hong Kong to Melbourne was just over $3700. Given the impact of the surcharge would be $60 on that — 2 TEU — do you believe that is significant in terms of needing to model that for the business case?

Mr O’CONNOR — I do not think that is something that I as not being an exporter out of the port can answer. I think it was quite astute of the submission from the Australian Horticultural Exporters Association to say that they were not asked whether their businesses can actually bear those cost impositions. I think that is a critical point.

The CHAIR — Wouldn’t the critical point be whether that cost impost will change behaviour?

Mr O’CONNOR — Absolutely.

The CHAIR — And at just on 2 per cent, whether that would change behaviour?

Mr O'CONNOR — It depends largely on the margins of that business, I would expect. It may well do. I cannot answer that, not being an exporter out of the port.

The CHAIR — Okay.

Mr VINEY — You mentioned that you did not believe the project costed in the potential environmental costs. What are they? What environmental issues did you think were not costed?

Mr O'CONNOR — In particular Meyrick's report stated that it did not cost the impacts of waste discharge, mobilisation of contaminants and turbidity amongst other things. But there is a section in their report that says we have not quantified these risks.

Mr VINEY — Why did you give the *Exxon Valdez* example?

Mr O'CONNOR — Because we look at methods of valuing a natural environment, something that is unpriced in the market. Environmental economic techniques are developed to value what is traditionally unpriced much in the way that carbon is an externality that has not been priced in the market in the past, and an emissions trading scheme is an attempt to price that. It shows that often when we look at a natural asset we undervalue it because it does not have a price in the market. It does not have an immediate price to the multiple users. To do an effective assessment of the risks of a project such as this, we really need to know the full valuation of that asset that is at risk and to do that, a contingent valuation would be a useful tool.

Mr VINEY — I ask you: you raised what is a fairly significant environmental disaster as an example — —

Mr O'CONNOR — Yes.

Mr VINEY — I am just interested whether you think channel deepening will increase the risk of an *Exxon Valdez*-type incident in Port Phillip Bay?

Mr O'CONNOR — That is not what I am advocating by making that statement. I am saying that we need to know the value to Victorians of that asset before we take an investment that has risks associated.

Mr VINEY — So it is not your evidence that there is an increased risk of an *Exxon Valdez*-type disaster in Port Phillip Bay as a result of this project?

Mr O'CONNOR — That is not what I am advocating in my submission.

Mr VINEY — I just want to be clear because it is a fairly emotional suggestion that you made. I have no other questions.

Mr SMYTH — No, I think Simon has used an example as more about the economic valuation not about whether in fact there was going to be a break up of a ship and an oil spill.

Mr VINEY — That is great. That is fine. I just want to be clear about the reason for the example being raised.

Mr HALL — Thank you for coming in this morning. The first question is — and it is probably to you, Simon — would you regard channel deepening as a public infrastructure or a private infrastructure being developed?

Mr O'CONNOR — I think this is a discussion that as I came in yesterday I noted as being a point of much debate. But I think as the Port of Melbourne presents itself as a GBE, this would therefore have to be assumed to be a private infrastructure investment. What we can really see is that you can compare the opportunity cost of such an investment so we can say that this same investment could achieve a certain rate of return elsewhere. I would say that this is a private infrastructure investment.

Mr HALL — In the same category you would say maybe rail would also be private infrastructure?

Mr O'CONNOR — I would probably draw the link more directly to a toll road or a — —

Mr HALL — Is that one of the reasons why you say it is inappropriate for the government to make a contribution of $150 million to this project?

Mr O'CONNOR — I think it is inappropriate until we see that the benefits are clearly established here and what exactly is the government getting as a return for that investment of $150 million.

Mr HALL — So that is why you do not believe the cost benefit work has been rigorous enough or inclusive enough of a whole range of issues, including some costs that you mentioned here?

Mr O'CONNOR — Yes, and I just think when some of the key assumptions beneath can be questioned quite easily and the dramatic impact that has on the returns from this project, then it really does, yes exactly, support what you have said there.

Mr BARBER — To be clear, was your point about the *Exxon Valdez* that it took an *Exxon Valdez* to get those responsible for shipping to start valuing the environment for what it is really worth? Otherwise it has not really been done, has it?

Mr O'CONNOR — It is a methodology that has been applied in other areas. I believe it was applied in Kakadu early in the establishment phase of the national park up there, the contingent valuation.

Mr BARBER — But you cannot find examples from other ports around the world where they have valued the environment in which they operate?

Mr O'CONNOR — That is right.

Mr BARBER — Yesterday we had a submission from the freight and logistics council, where they attempted to value, I think, the avoided greenhouse gas emissions, and they handed over at the time a spreadsheet. If the basic parameters are there would be a fourfold increase in container movements, according to the port's evidence, and ships may become somewhat more efficient, can you from that speculate about how you might go about analysing the greenhouse gas benefits of this project, adding those in?

Mr O'CONNOR — Yes. Certainly theoretically we could do some analysis around that to ascertain the benefits from a greenhouse gas emissions perspective. I think there are probably a lot of assumptions behind their modelling as to loading and unloading time on the side of the ports, but theoretically that could definitely be calculated.

Mr BARBER — Are greenhouse gas emissions from international shipping the responsibility of any particular country under the Kyoto protocol?

Mr O'CONNOR — They are exempt.

Mr BARBER — Completely exempt, which means it would make it very hard to put a value on them, given that nobody is going to end up paying for them?

Mr O'CONNOR — That is correct. At this point in time there is no inclusion of shipping in any emissions trading scheme.

Mr TEE — I want to pick up on a couple of points that you made. You talked about the impact of the levy. I think you were saying, as I understand it, that not enough work had been done in terms of that issue. I suppose I am not sure on what basis you make that statement. Yesterday we had evidence from VECCI and the VFF, who essentially say that their members will wear the cost of that. Obviously they would prefer government to pay for it. They prefer government — —

Mr BARBER — No, they did not. They said they want to be exempted from it.

Mr TEE — They said they would prefer government to pay for it, but if they were required to — which is the scenario at the moment — then the benefits of the project were such that they would wear those costs. I suppose in that sense if the business community thinks that the levy is worth the benefits of the project, on what basis does the Australian Conservation Foundation challenge what really the business community is telling this committee?

Mr O'CONNOR — I would say they represent a portion of the business community. I think the Australian Horticultural Exporters Association would argue that they do not represent all the business community, and that is not a consensus perspective. I think that is a really important point. Like I said before, I think that levy is going to impact different businesses at different rates, and it is not something that I can really establish exactly who is going to be hurt from it. But I think the point raised by the Australian Horticultural Exporters Association probably hit the nail on the head in that predominantly, due to the large proportion of imports compared to exports using the ports, it is going to be predominantly a penalty on exporters disproportionate to those who actually gain the benefits from the dredging. I think that is probably the important point there — that in fact when you have exporters who are not asking for this project to go ahead, of which there are many, then they are in fact being penalised for what they do not perceive to be any benefits accrued.

Mr TEE — But they are just trying to focus on the cost.

Mr O'CONNOR — Yes.

Mr TEE — Again, it is a matter for the committee to weigh up the various views that we have heard, but I suppose part of that is that our biggest exporter is agriculture. The VFF says it is worth $7 billion compared to the $500 million from the Australian Horticultural Exporters Association, so we have got small but important versus the large. I suppose the other point I wanted to make or question is again on this issue where the business community say, through VECCI with its 15 000 members, that most infrastructure projects require a BCR of one to proceed — sometimes less if the piece of infrastructure is strategic. On what basis is the Australian Conservation Foundation challenging that view?

Mr O'CONNOR — Specifically the benefit–cost ratio.

Mr TEE — Yes. One to one is what the business community is telling this committee. On what basis are you challenging that view?

Mr O'CONNOR — I would like to see which infrastructure project has gone ahead with private funding and a benefit–cost ratio of one to one. I am not aware of any. If I am wrong, that is fine, but I am not aware of any. Perhaps they have the ability to say that because they are not wearing the risk of that direct investment. They are not having to raise the finance privately, particularly not in the environment we have currently of raising finance. I am not sure. That is the only response I can provide for that.

Mr VINEY — How many have gone ahead with more than three?

Mr O'CONNOR — More than three?

Mr VINEY — Yes; infrastructure projects.

Mr O'CONNOR — Any one that has been financed by Macquarie, Babcock and Brown, Transurban, ConnectEast Group — all of these have gone ahead with a benefit–cost ratio over three.

Mr VINEY — And you are putting the port in exactly the same category as the tollway?

Mr O'CONNOR — I am saying they need to raise finance in the same environment and repay finance in the same environment. In effect, they need to be able to demonstrate sufficient returns to be able to service that debt.

Mr TEE — What we have received obviously are the views of PricewaterhouseCoopers, and then the other views that have been put to the committee are that those figures that they have used are conservative in terms of the trade through the port, which has been 8 per cent on average for the last 16 years and 10 per cent last year. They were conservative in the sense that the freight logistics council said that the cost of not proceeding was $8 billion. They were conservative in terms of the $15 billion that VECCI said was the ballpark range for benefits. I suppose I am just trying to see how the other evidence is conservative, but you have got a different view. You are saying that those figures are not conservative and that they are risky. I am just trying to fit all that together.

Mr O'CONNOR — The PWC report is clearly raised often as some pretty strong evidence. It clearly states that its forecast projections for container growth through the port come directly from the Port of Melbourne Corporation. We would question that they have been overly optimistic about that forecast and trade projections.

Mr TEE — Even though they have had 8 per cent over the last 16 years and 10 per cent last year?

Mr O'CONNOR — Yes, and they have stated in the *Age* earlier this year that they are restating their forecast for this current year down to 4 per cent from 6 per cent, so already. We are projecting out 27 years in an economy that is going to change dramatically, globally. They are very courageous projections and forecasts. The other thing I would like to just refer to is, you mentioned the Victorian Freight and Logistics Council saying that they have seen an opportunity cost of not proceeding with the project of $8.5 billion, which was evidence they raised in their submission.

Mr TEE — Yesterday. I thought it was $8.1 billion but it might have been — —

Mr O'CONNOR — Sorry, it may well be. I did have a look at that submission. I was interested to note that they added this report at this time in this hearing. It was a report that was dated December 2005. It was eight pages without anyone's name on it. It said that it had been independently reviewed. It did not state who had reviewed it independently, and it was produced at this time. It was not provided to the SEES inquiry. I would say that is nearly enough to dismiss that as evidence. I would not put too much faith in those figures from that perspective.

Mr TEE — I think they had the economist here.

Mr VINEY — They did it right here, giving the evidence.

The CHAIR — We might move on to Mr Guy. We can come back, Mr Tee.

Mr GUY — Thank you. I just have one area of interest and that is the infrastructure around the port and as you say on, I think, page 3 of your submission, accessing the port and the bottlenecks and the congestion and crowded roads around the suburbs if the channel deepening project proceeds. Does ACF have any alternative views, if we will have increased handling or usage of the port, as to what we should be doing long term with Melbourne's container port traffic?

Mr O'CONNOR — Yes, I think it needs to be part of an integrated transport strategy but we have not assessed it. Any investment on this scale in the port infrastructure in Melbourne needs to be compared to an alternative. In any cost-benefit analysis an alternative should have been provided; it was not. Whether that is a port of Hastings or a Portland or land bridge in between Brisbane and Victoria, I do not know, we have not done the analysis, but I would say that that is a really, really integral part of this process, and that should have done.

Mr SMYTH — Just to add to that, certainly ACF would see this as being part of a national transport strategy. We really do need to be looking at how our ports, our roads, our rails all link up nationally rather than trying to see states competing with each other for the best port, the deepest port or whatever. That starts to really create some inefficiencies. I also think the point that Simon has alluded to is that some of the trade growth statistics are quite heroic in terms of what they are suggesting in terms of trade over a long period of time, and we need to take into account things like the cost of fuel, how that will influence shipping, movements around Australia, whether they may in fact start to use rail coming into certain ports rather than coming down this far south. All those sorts of things need to be taken into account when looking at, I guess, the economic output in terms of the analysis.

Mr GUY — Is it cheaper to keep a container on a ship and bring it all the way down to Melbourne as opposed to taking it off and handling it in Brisbane where the costs are higher then putting it on a train?

Mr SMYTH — When fuel possibly reaches $200 a barrel I think they will be starting to think very seriously about how they actually start to move containers around. I think that is something which will need to be questioned by the transport industry.

Mr GUY — Yes, no more questions. Thank you.

Mr BARBER — Where carbon emissions have been formally traded, such as the emissions in the European market or even some of these other more futuristic trades that have gone on, what has been the price of emissions in dollars per tonne?

Mr O'CONNOR — Of a certified emissions reduction unit, for example, in the EU? They tend to be modelled on about $25. I think in phase 2 of the EU emissions trading scheme they are currently projected at around the equivalent of A$40–45.

Mr BARBER — Thank you.

Mr VINEY — You made some criticisms of the projections for growth of the models that the business case is assessed on. Have you got projections that you would base your models on?

Mr O'CONNOR — No, but what I would probably say — I have not done that analysis of projections because we do not have access to the model that Meyrick used, in which we would need that model to manipulate to do that, but the sensitivity analysis should have been done in that cost-benefit analysis.

Mr VINEY — So what are you saying is going to happen to trade in the port?

Mr O'CONNOR — We are saying that there is massive room in a 27-year forecast period for volatility around that projection that has been forecast.

Mr VINEY — Is it reasonable though to ultimately make a judgement? You have to make a judgement as to how you see it in order to assess the project.

Mr O'CONNOR — I could definitely do the modelling for you under a climate change scenario or a high oil price scenario that would dip the container trade into Melbourne dramatically due to that. There are a number of assumptions and we can do the modelling in that way.

Mr VINEY — But you cannot give this committee advice as to what you think it should be.

Mr O'CONNOR — I would say that under a climate change scenario where we have a 50 per cent reduction target by 2050 in Australia and oil price projections where it could be, as analysts have said recently, up to $200 per barrel, we would see lower growth in container trade through the port of Melbourne than what has been presented.

Mr VINEY — Will it still grow?

Mr O'CONNOR — It will still grow, I would assume.

Mr GUY — You would have to factor population growth into that as well, too.

Mr O'CONNOR — Yes, that would be a factor we would include in the model.

The CHAIR — Thank you. Just in the minute or two left, can I ask you to comment. At the bottom of page 4 of the submission, you have made the statement:

> ACF urges the inquiry to recommend that the project is inappropriate for Victoria and should cease immediately because the project's economic arguments cannot clearly demonstrate a benefit to Victorians.

Now that is, I would have to say, beyond the scope of what this committee can recommend, but does the ACF stand by that position given there has been $190 million in sunk costs so far, the port tells us they are 15 per cent into the project so roughly $300 million has been spent to date. Is it still the ACF's position that the project should cease immediately?

Mr O'CONNOR — I think that would still be the ACF's position.

Mr SMYTH — Yes, basically the submission we have given today is around about the economics of the project. We see it as having three elements to it: social, economic and environmental. Certainly in terms of the environmental risk, we still see a very big risk to the bay in terms of the affect on things like sponge gardens and seagrass meadows, the movement of toxic materials around the bay as well. There are certainly some big risks associated with the dredging. When you look at the environmental risks and the social impacts — for instance, in terms of recreational fishing or commercial fishing or just people using the bay more generally — I think there are certainly some risks there. So when you put all these three elements together — there are some major concerns we have with the project, and we would argue that it should not go ahead because of, I guess, the weaknesses in the way in which the project is being managed in terms of environmental management, in terms of its environmental controls and so on, the lack of evaluation of some of those environmental and social assets, and the need to really look more closely at the economic arguments.

We would certainly suggest that this is something which probably the Auditor-General should look at in terms of trying to come to grips with the nature of the project from an economic point of view. We think there are some really serious questions that can be raised about the economic processes being followed in terms of developing the benefits and the cost benefit arguments. The sort of work that Simon has been doing and projected today I think certainly adds a lot of weight to that.

The CHAIR — Thank you very much for your appearance here this morning, Mr Smyth and Mr O'Connor. The committee appreciates your evidence and also the written submission that we received. We will provide you with a draft version of the transcript in the next couple of days. Thank you very much.

Mr O'CONNOR — Thank you.

Mr SMYTH — Thank you.

Witnesses withdrew.