

INQUIRY INTO THE OPERATION, REGULATION AND FUNDING OF AIR ROUTE
SERVICE DELIVERY TO RURAL, REGIONAL AND REMOTE COMMUNITIES

SENATE STANDING COMMITTEES ON RURAL AND REGIONAL AFFAIRS AND TRANSPORT

OVERVIEW OF SUBMISSION

Airlines for Australia and New Zealand (A4ANZ) welcomes the opportunity to provide a submission to the Rural and Regional Affairs and Transport Reference Committee's inquiry into the operation, regulation and funding of air route service delivery to rural, regional and remote communities, and acknowledges that this is an important issue which affects a number of Australian communities.

In response to the terms of reference outlined by the Committee, A4ANZ has undertaken to provide a submission with particular reference to the following aspects the Committee is considering:

- a. social and economic impacts of air route supply and airfare pricing;
- b. different legal, regulatory, policy and pricing frameworks and practices across the Commonwealth, states and territories;
- c. how airlines determine fare pricing;
- d. the determination of airport charges for landing and security fees, aircraft type and customer demand;
- e. pricing determination, subsidisation and equity of airfares; and
- f. airline competition within rural and regional routes.

ABOUT AIRLINES FOR AUSTRALIA & NEW ZEALAND

Airlines for Australia and New Zealand (A4ANZ) is an industry group, established in 2017, to represent airlines based in Australia and New Zealand. Member-funded and representing international, national, regional, full service and low cost carriers, A4ANZ advocates on key public policy issues such as airport operations and efficient access to domestic airport infrastructure.

AIRFARE PRICING

Publicly available data collected by the Department of Infrastructure, Regional Development and Cities demonstrate that domestic airfare prices are in fact lower, in real terms, than a decade ago.¹ Despite this, airlines have been accused of "ripping off" consumers living in regional, rural and remote communities in Australia², with no evidence to support this proposition. A4ANZ appreciates that the cost and accessibility of flights can be an emotive issue, however the solution does not lie in simplistic threats to airlines to drop fares or "other carriers will be brought in".³

Airfare pricing in regional Australia is not an issue of competition as is often suggested⁴, nor are the factors affecting it unique to the major airlines. All carriers face the same viability challenges when operating flights to regional and rural Australia. Fare pricing reflects the variability in passenger

¹ Department of Infrastructure, Regional Development and Cities. 2018. Domestic Air Fare Indexes. At: https://bitre.gov.au/statistics/aviation/air_fares.aspx

² Walton S (2018, 20 January), Katter calls 'airline secrecy'. *North West Star*. pp 3.

³ Walton S, op cit (2).

⁴ <http://www.centralwesterndaily.com.au/story/5146194/push-for-more-airlines-and-cheaper-fares-to-boost-tourism/>

loads, airport and fuel charges. These factors plus high operating costs mean the opportunities for low cost carriers to enter the market and operate sustainably are in fact limited. The difficulties in operating regional routes in a sustainable way have been starkly demonstrated by the cessation of a number of routes operated, for example, by *Airnorth* and *Jetgo*, with some even struggling to commence, despite predicted demand.^{5,6} The challenge of operating these routes comes back to the same key factors – a lack of demand, and high airport charges.

While there is a tendency to draw comparisons between the cost of airfares on regional routes with metropolitan routes such as Melbourne-Sydney, such comparisons are flawed due to dissimilar economies of scale and underlying fundamental differences between route economics. For example, in previous submissions to Government, airlines have cited the high cost of fuel at regional airports compared with major Australia airports as a significant contributor to increased prices.⁷

Airport charges

Airport charges represent a significant proportion of airfares – particularly on regional and rural routes. In some cases the charges add more than 30% to the base ticket price. Indeed, one of biggest roadblocks to the airlines' ability to introduce new and grow existing routes is high airport charges. In stark contrast to the reducing airfares offered by domestic airlines, Australian airports are now collecting more revenue per passenger and generating significantly higher profits than their international benchmarks.^{8,9} And whilst they may not be as profitable as the major airports, the majority of the most expensive airports in Australia are in northern regional Australia. In some ports, the costs are more than five times those of the major airports in southern states.¹⁰

It is evident that airport charges are directly affected by infrastructure investment decisions. One regional council commenced an upgrade at the local airport on the basis that it would cater for new aircraft technology and increased passenger numbers. The council was also quoted as stating the additional benefits of 'potential extra passenger flights' and 'increased opportunities for additional charter services' as justifications for the upgrade. However, it is the airlines and their customers that generate the demand, and the demand is simply not there. There is also a growing trend for local councils to grant long-term lease arrangements and management rights of an airport to a third-party operator, again leading in some cases to over-investment in infrastructure, the costs of which are then passed on to their airline customers.

Clearly, investment in infrastructure and upgrades is necessary, however A4ANZ believes that investment must be fit for purpose; that is, aligned with the needs of passengers using the facilities and demand for air services. The best way to determine requirements and ensure this fit is through industry consultation. This would reduce overcapitalisation, such as creating international airports where there is little current or predicted demand. Prioritising efficient operations would ensure that consumers are not the ones ultimately paying for the infrastructure through high charges.

In other cases, the increased charges are driven solely by an airport's monopoly position. One regional airport exercised this when it sought to include assets funded by a Government grant in its

⁵ <http://www.abc.net.au/news/2016-04-19/air-north-axes-pilbara-flights-to-the-kimberley-and-darwin/7339294>

⁶ <https://www.frasercoastchronicle.com.au/news/jetgo-cancels-flights-from-hervey-bay-to-melbourne/3200301/>

⁷ https://www.accc.gov.au/system/files/2015-16%20AMR%20revised%206%20March_0.pdf

⁸ [http://www.parliament.wa.gov.au/parliament/commit.nsf/\(InqByName\)/Inquiry+into+regional+airfares+in+Western+Australia](http://www.parliament.wa.gov.au/parliament/commit.nsf/(InqByName)/Inquiry+into+regional+airfares+in+Western+Australia)

⁹ <http://www.aci-asiapac.aero/news/main/14/>

¹⁰ These figures are based on cost/passenger, including security charges. Data source: QF and VA submissions.

http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Northern_Australia/TourismIndustry/Submissions

asset base used for pricing purposes which would have therefore enabled it to earn a return on investment funded by the Government. The airport justified its position on the basis that the money was gifted to the Council (the airport owner) for the benefit of the local community and that the investment should be recovered from airlines (through aeronautical fees) to enable investment in other community projects.

On regional routes where services are already marginal due to the poor economies of scale, there is no ability to pass on such costs to passengers and as a result the increased airport costs are a direct impact to the airlines' bottom lines, which in turn directly affects the viability of the air services to these communities.

Unfortunately, services at such airports have not generally improved in line with increased costs and charges.¹¹ This can be attributed to an imbalance in the bargaining power between airlines and airports, with commercial negotiations between the parties often not conducted in accordance with the Government's Aeronautical Pricing Principles, which include sharing of risks when there are changes in passenger traffic.¹²

COMPETITION

Competition between airlines does exist on some regional and rural routes in Australia, with certain routes being serviced by multiple carriers. However, as highlighted earlier in this submission, in order for competition to exist and particularly for low cost carriers to enter the market, these routes must be efficient and financially viable.

It is not viable for an airline to indefinitely maintain a service on a route for which revenues earned are insufficient to offset costs. Therefore, if operating costs exceed revenue on a particular route for an extended period, airlines may be forced to relinquish services and deploy aircraft onto higher-yielding routes, as noted above. For the impacted routes, this may result in fewer air services, a duopoly or monopoly situation and potentially higher airfares. A4ANZ members have previously cited intrastate routes in Western Australia as examples of this occurring following the downturn in the mining industry.¹³

Cabotage

In two recent parliamentary inquiries, the Western Australian Government's *Inquiry into Regional Airfares in Western Australia* and the Federal Government's *Inquiry into Opportunities for and Methods for Stimulating the Tourism Industry in Northern Australia*, Committee members raised the concept of allowing foreign airlines to operate domestic routes – or Cabotage – as a potential means for increasing competition and improving pricing on regional routes in Australia.

However, there is no business case for making changes to the current cabotage restrictions and no international precedent for doing so. Productivity Commission research has shown that allowing international entrants to operate domestic routes would be unlikely to lead to efficiency gains.¹⁴ Moreover, the results of lifting the restrictions in terms of the impact on Australia's aviation network

¹¹ https://www.acc.gov.au/system/files/2015-16%20AMR%20revised%206%20March_0.pdf

¹² <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2007/032.htm&min=phc&DocType=0>

¹³ [http://www.parliament.wa.gov.au/parliament/commit.nsf/\(InqByName\)/Inquiry+into+regional+airfares+in+Western+Australia](http://www.parliament.wa.gov.au/parliament/commit.nsf/(InqByName)/Inquiry+into+regional+airfares+in+Western+Australia)

¹⁴ <http://www.pc.gov.au/research/completed/international-tourism/international-tourism.pdf>

have been outlined previously and would be widespread, with negative effects on investment, employment and safety standards.¹⁵

Furthermore, A4ANZ's members have cautioned that implementing a varied policy for one region, could create the opportunity to expand this to other regions and cause material damage to domestic airlines. A4ANZ would like to reiterate that it is unequivocally opposed to any changes to the current cabotage restrictions in place in Australia.

REGULATORY & POLICY INFLUENCES

Governments have a role to play in supporting regional regular public transport services; in Queensland and WA, the state Governments subsidise a number of routes to support competition or sustain services, as revenues earned by airline operators on such routes are often insufficient to offset costs. Reforms expected from the Federal Government's Red Tape Reduction Programme¹⁶ may also have the potential to facilitate expansion of both aviation and tourism.

A4ANZ believes that there is a role for State and Territory Governments to collaborate with airlines on competitive fares and to engage in innovative marketing to drive domestic visitors to take short breaks, beyond traditional locations. Tourism marketing should not be left to the airlines; Governments need to invest in promoting the attractions of regional, rural and remote areas of Australia as a point of difference from other international destinations. The latest Tourism Research Australia figures show that domestic tourism to regional Australia is growing at less than half the rate of international tourism, in terms of both spend and visitor nights.¹⁷

While not located in rural or regional Australia, the Federal Government's approach to regulation of the major Australian airports is absolutely a factor in the overall costs borne by travellers out of those communities to major cities and by the airlines overall. The light touch regulatory model under which the major airports operate is, by the ACCC's own words, "*limited in its ability to address behaviour that is detrimental to consumers. As it is not regulation, [price] monitoring does not directly restrict the airports from increasing prices and allowing service quality to decline. In particular, it does not provide the ACCC with a general power to intervene in the airports' setting of terms and conditions of access to the airports' infrastructure.*"¹⁸

What this means in practice is that the opportunity for a genuine commercial negotiation between airlines and airports is lacking as there is very little, if any, threat of intervention to force the airports to shift from their monopoly position. The negative consequences of this were highlighted in a recent Grattan Institute report into competition which clearly stated that "*where profits are high because firms face little competition, they are earned at the expense of customers or suppliers. They are also associated with inefficiencies.*"¹⁹

Greater oversight by Government to encourage and, where required, force constructive, commercial engagement is needed to minimise the negative impact of the airports' monopoly powers. The

¹⁵ <http://www.northernaustralia.gov.au/sites/prod.office-northern-australia.gov.au/files/files/NAWP-FullReport.pdf>

¹⁶ <https://infrastructure.gov.au/departments/deregulation/index.aspx>

¹⁷ <https://www.tra.gov.au/Research/Domestic-tourism-by-Australians/domestic-tourism-statistics>

¹⁸ https://www.accc.gov.au/system/files/2015-16%20AMR%20revised%206%20March_0.pdf

¹⁹ <https://grattan.edu.au/wp-content/uploads/2017/12/895-Competition-in-Australia-Too-little-of-a-good-thing-.pdf>

threat of regulation would result in a genuine commercial negotiation, greater investment by airlines and improved efficiency in the allocation of resources. A closer examination of airport charges is needed to protect and allow growth in air services to, from and within regional, rural and remote Australia in the long term. The anticipated 2018 Productivity Commission Inquiry into the Economic Regulation of Airports is welcomed by A4ANZ.

CONCLUDING COMMENTS

Australia's rural, regional and remote communities are important to our nation and A4ANZ's members are proud to collectively offer close to 3000 services to and from these regions every week.

Weak or uncompetitive Australian airlines will be less able to meaningfully contribute to Australia's economy through tourism, employment and investment. There is no simple solution to the challenges faced by airlines operating services to rural, regional and remote communities. A multi-faceted approach that involves genuine industry engagement and consultation is required to ensure that both the community needs of regional Australia and those of the broader economy are met, through sensible policy and a regulatory environment that encourages innovation and efficiency.

A4ANZ would welcome the opportunity to further discuss the issues addressed in this submission with the Committee.

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