

NATIONAL JET SYSTEMS GROUP

Thursday, 26 February 1998

International Air Services Inquiry
Locked Bag 2
Collins St East Post Office
MELBOURNE VIC 8003

Dear Sir,

re: INQUIRY INTO INTERNATIONAL AIR SERVICES

The enclosed submission on international air services is forwarded for consideration by the Commissioners.

Since little is known of the National Jet Systems Group it is appropriate to provide a brief overview of the group and the nature of its business activities.

Firstly it is a wholly and privately owned Australian Group with its head office situated in Adelaide. Whilst aviation remains the core business activity, the Group is diversifying into road transport, primary and secondary industry.

Key aviation activities include contracts with: Qantas Airlink for the operation and maintenance of 12 British Aerospace 146 (BAe146) four engined jet aircraft; Australian Air Express (AaE) for the operation of 3 BAe146 freighter aircraft; Norfolk Jet Express for the operation of 1 BAe146 from Brisbane and Sydney to Norfolk Island with current plans to extend these services to New Zealand mid 1998; fly-in fly-out contracts with numerous leading resource based companies utilising BAe146 and DHC-8 aircraft; domestic and international BAe146 scheduled services linking Perth to Christmas and Cocos Islands and Christmas Island to Singapore (approval is awaited for the restoration of services to Jakarta); the introduction and operation of initially 1 BAe146 into service with Merpati Nusantara Airline in Indonesia; and the Coastal surveillance contract with the Australian Customs Service.

The Qantas and AaE contracts alone see National Jet operating BAe146 services to all Australian capital cities plus: Canberra; Rockhampton; Mackay; Proserpine; Cairns; Gove; Alice Springs; Yulara; Kalgoorlie; Karratha, Port Hedland and Broome. The Company has substantial infrastructure to support the core aviation business at Adelaide; Perth; Broome; Darwin; Cairns and Brisbane.

Whilst the Company is a duly licensed and designated (Singapore and Indonesia) Australian carrier, National Jet's contribution and involvement to international services

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(e.g. 4 weekly services to Singapore) are relatively insignificant. Nevertheless, as a relatively small (800 plus employees), dynamic private company it is able to offer a somewhat unique appraisal on the regulation of international air transport as it affects Australian aviation companies. Whilst National Jet had extensive skills and experience arising from the operation of non-scheduled international air services, the necessary administrative skills required for the planning, regulatory compliance and organisation of scheduled international air services had to be quickly developed within the Company's resources. In this regard it must be clearly stated that, without exception, all Government bodies charged with responsibilities in international aviation gave their unfailing and willing support and this was particularly helpful during the start-up phase.

The original services which embraced Singapore and three ports in Indonesia required that Company address the problems associated with fifth freedom and cabotage rights and those associated with own stopovers. Although cabotage rights were known to be out of the question, fifth freedom and own stopover rights proved elusive and unobtainable.

The enclosed submission therefore reflects the experiences arising from National Jet's involvement in international operations. Whilst the comments made largely reflect regional considerations, some observations are drawn that are particularly relevant to large national carriers and their regulators.

Forwarded for on and on behalf of, National Jet Systems.

Captain P.L.Clark

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SUBMISSION TO THE INQUIRY INTO INTERNATIONAL AIR SERVICES

Basis of Regulation

The International Civil Aviation Organisation (ICAO) was constituted at the Chicago Conference, 1944, (commonly referred to as the Chicago Convention) and amongst other things was formed to provide the fundamental legal foundation for the regulation of world civil aviation.

As a member State of the United Nations, Australia is bound to recognise the regulations and decisions of ICAO.

Each member State then constructs its own organisation and laws for the **National Regulation** of international air transport (e.g. for Australia: Department of Transport and Regional Development, the Civil Aviation Safety Authority, Customs, Quarantine, Immigration, Air Navigation Act, Civil Aviation Act and Regulations etc.etc)

The third tier of regulation necessary for international services requires the creation of **Bilateral or Multilateral Regulation**. Australia has some 50 Bilateral treaties.

The following paragraphs provide a brief and simple overview of some of the key milestones that must be achieved to comply with national and international regulation of scheduled international air services.

National Regulation

In order to operate scheduled international services, an Australian aviation company or airline must:

- Possess a valid Air Operator's Certificate which amongst other things permits:
 - operation of the desired aircraft type
 - the class of operation required (scheduled regular public transport)
 - operation to specified aerodromes
- Possess an approved Aviation Security Program.
- Possess a valid international airline licence.
- Be allocated sufficient passenger capacity and traffic rights by the IASC for the proposed services.
- Meet all the requirements of the relevant bilateral treaty or treaties.
- Be issued with a Timetable Permit to operate the desired services.

Bilateral Regulation

In order to operate the desired scheduled services, the airline must:

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- Be duly designated and recognised as an international carrier by the respective Treaty partners.
- Operate an aircraft type which is recognised by the appropriate aircraft substitution formula contained in the Air Service Agreement (method of regulating the total capacity of passengers and / or freight to an agreed maximum between the Treaty partners).
- Possess passenger capacity entitlements to operate the services strictly and only in accordance with the permitted passenger freedoms (traffic rights).
- In most cases be allocated specific take off and landing times (airport traffic management) in order to operate the desired schedule.
- Possess a timetable (schedule) approved by each State.

The purpose of the above simple overview is to enforce the fact that the essence of the Chicago Convention has been successfully adopted and refined to provide a workable basis for the regulation of international air transport that is understood and complied with by Member States, their governments and airlines alike.

It also has to be fully recognised that ICAO has produced a large range of documents that strive to set suitable standards to the world-wide aviation industry. These documents cover a diverse range of key subjects such as: the standardisation and design of aircraft instrument approach and landing charts; air traffic control procedures and services; instructions for the safe carriage of dangerous goods by air and many others.

At this time there is clearly no alternative basis for the regulation of international air transport other than that provided by ICAO. Accordingly, it is submitted that this Inquiry's deliberations should be limited to the extent that it is consistent with the guidance provided by the Chicago Convention.

Pervasive Factors

Whilst the primacy of the Chicago Convention is acknowledged, Member States are still free to exercise discretion and initiative with bi-lateral or multi-lateral partners to create unique or liberalised aviation markets.

In considering such options, this submission proposes that there are a number of pervasive factors that frame any move towards liberalisation. They are either consciously or unconsciously considered in this process.

Technology. It is asserted that the introduction of wide body aircraft (e.g. B747) has been the only significant breakthrough in aircraft design in the last thirty years. The introduction of these types produced, for the first time, really affordable travel to all levels of society. Since then improvements have largely been limited to aerodynamic and engine efficiency, equipment reliability and maintainability, and passenger comfort. Whilst these "fringe" improvements, coupled with increased competition, have resulted

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in a gradual reduction in the cost of travel their impact compared with that resulting from the introduction of the first wide body is relatively insignificant. It is therefore concluded that expectations expressed by this Inquiry or by the general public that the cost of air travel can be continually reduced can not be fulfilled by current technology.

Profitability. Whilst airlines have a strategic value to their host countries in times of tension or conflict, virtually all are compelled to operate on a business basis. In this regard profitability is an essential goal. Given the massive capital and infrastructure costs of a global airline coupled with the huge raft of levies, fees and charges payable for every flight, it is a demanding task to provide the necessary return on investment in line with stakeholders expectations. External forces that attempt to drive down profitability or overzealous attempts to reduce airline costs will attract consequences for the industry.

Geography. It is an act of Creation that some countries happen to be perfectly situated mid way along a heavy air traffic route. For example Thailand, Malaysia, Singapore and Indonesia all lie in a position of great advantage when considering the UK/Europe to Australasia and vice versa route compared with airlines operating from the extremes of the route (e.g. Australia or UK/Europe). The governments of these intermediate countries attempt to exact this advantage to the maximum extent possible during the negotiations on the relevant Air Service Agreements. Liberalising markets such as these will be a difficult proposition in that some countries will be asked to relinquish their advantages arising from geography in return for no apparent benefit to their own carriers.

Safety. Safety is the fundamental expectation and goal of the aviation industry. ICAO has recognised this and has done an enormous amount of work to establish and document standards, practices and procedures that all enterprises associated with aviation should aspire to as a minimum. Safety is undoubtedly both an emotive and an objective issue. It is often argued from both angles. Whilst Australia can be undoubtedly proud of Qantas's leading achievement in this regard, other nations and their airlines have much to answer for their poor safety records. Clearly the principals and practices that underpin aviation safety are not equally applied on a global basis. Moreover the pervasive factors described above coupled with the stated or unstated expectations of this Inquiry and those of the public for a "better way" (reduced costs) of conducting the business of aviation, globally, can exert pressures that may have a negative impact on safety in the industry. Safety is not an assumption; it is an unfailing commitment to people, resources, practices and discipline.

Matters Relevant to this Inquiry

Some Lessons from a Small Operator

As previously stated, National Jet's involvement in this arena is limited in scope, range and frequency of activity. For the most part, comments offered are relevant to the regional SE Asian environment and to national regulation. It also will be shown that the

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Company's services are distinctly different in nature to those provided by the major carriers.

National Jet's entry into the international aviation market was enabled by the change in Australian Government policy that allowed for multiple designation of carriers.

The initial services were created to satisfy developing niche markets in Australia as follows:

- Broome - Bali vv,
- Bali - Surabaya - Christmas Island vv,
- Christmas Island - Singapore vv,
- Christmas Island - Jakarta vv, and
- Christmas Island - Jakarta - Lombok - Darwin vv.

Some of the lessons learnt from these early services included:

- Positive and helpful support at all times from all Australian Government regulatory agencies.
- Capital investment by Customs to upgrade facilities at Broome to facilitate its use as a gateway and the investment by Territories to upgrade tarmac space at Christmas Island.
- Inability of Australian tourism / travel organisations to understand that narrow body aircraft such as the 70 seat BAe146 used on the services are far more expensive on a seat / kilometre basis to operate than their wide body counterparts. These industries promoted the expectation that cheap wide body fares would be available.
- Institutions that stood to benefit from the services continued to charge high prices for nominal services - for example landing fees at Broome and Christmas island were exorbitant.
- Initial dealings with the Indonesian government were made difficult by a breakdown in communication between the Directorate General of Air Communications and the Department of Justice (Immigration) which severely disrupted the services and ultimately forced a schedule change which resulted in the aircraft flying a fifth freedom sector between Bali and Singapore for which fifth freedom rights could not be gained.

From the above the following points are relevant to the Inquiry:

- Whilst the regulation of international air transport can appear complex to a new entrant, Australian regulatory authorities can be relied upon to provide willing and timely advice at any time to help overcome any problems that arise.
- The creation of new services over thin routes to emerging gateways is an expensive exercise. This, coupled with the use of narrow body types means that the public and interested industry expectation of wide body seat cost efficiency can not be achieved.
- New activities or concepts (e.g. National Jet was the first Australian airline to operate to two ports in Indonesia, namely Bali and Surabaya, on the one rotation) can prove a difficult proposition for our bi-lateral partners to grasp and approve. The apparent inertia by our treaty partners in matters such as these can be extremely frustrating for both the airline and its host country's regulatory authorities.

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ICAO and Regional Bi-lateral Treaties

As stated earlier, as a member State of the United Nations, Australia is bound to recognise the regulations and decisions of ICAO. There is no viable alternative to form the basis for the regulation of international air transport.

Notwithstanding this, Member States are still free to exercise discretion and initiative with bi-lateral or multi-lateral partners to create unique or liberalised aviation markets.

In theory it should be possible to develop a liberalised aviation market within the ASEAN group and Australasia. In the brief description on the pervasive factor of “geography” it can be seen that the creation of such a market would provide substantial opportunities for Australian carriers but would offer little, if anything, to the ASEAN members. Clearly they would be offering up a position of advantage for no apparent benefit. The likelihood of developing such a market in this region is therefore assessed to be zero.

From a bi-lateral perspective, the concept of liberalisation does not appear any better. For some time representatives of the governments and industries of Australia and Indonesia have been meeting under the auspices of a transport contact group with a view to improving the transport infrastructure particularly in East Indonesia. For over a year Qantas has been attempting to inaugurate services between Australia and Timika in West Irian Jaya. Despite the fact that the proposed services are consistent with the goals of the contact group, no useful progress towards the commencement of services appears to have been made.

A similar situation exists between the NT government and its efforts to be included in the BIMP-EAGA development area.

One can only conclude that our regional neighbours are not yet prepared to allow Australia to play an enhanced role in the development and conduct of expanded aviation services in the region. Our advice or guidance may be willingly accepted, but it is premature for our airlines to actually participate in such a program.

It also follows that Australia will be compelled to pursue its aviation policy initiatives solely on a bi-lateral basis. In this regard the pervasive factors of “geography” and “profitability” indicate that our regional bi-lateral partners will continue to negotiate with Australia on a basis that preserves the advantage for their own carriers. An example of this is the fact that negotiations with Indonesia have repeatedly stumbled or broken down over the matter of Australian carriers seeking an increase in fifth freedom rights beyond Indonesia.

It is therefore concluded that aviation activities within our region can only continue on a “business as usual”, bi-lateral basis. Every improvement in traffic rights for Australian

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carriers will be transacted inch by inch with our regional partners probably seeking disproportionate concessions in favour of their own carriers.

De-regulation of a Global Market

Globalisation of the world's aviation market is a futuristic concept which will undoubtedly parallel progress towards a global economy and mankind's notion of a "world at one" wherein nationhood and race are largely irrelevant.

Such a concept begs the question as to whether aviation can take a leading role in such a movement. The shipping industry provides an useful analogy in this regard whereby commercial shipping companies exerted considerable financial advantage by pursuing the benefits arising from registering their ships under flags of convenience. Airlines operating under such flags of convenience would be characterised by some of the worst traits adopted by their nautical cousins. (It is often said that seamanship is airmanship at ten knots.)

The inevitable result at this point in time would be a serious and totally unacceptable diminution of aviation safety as a result of flag of convenience airlines situating themselves in those countries that simply do not provide the required resources to the safety regulation task.

As previously mentioned, it can be concluded that not all airlines and associated enterprises (including regulatory authorities) apply the same resources to aviation safety with the consequence that some have poor, if not unacceptable, safety records. Moreover it is most difficult for international business or government pressure to be applied in an attempt to uplift the standards of these poor safety achievers. Globalisation of the aviation market would be beset by these difficult issues and hence could not be countenanced at this time. It is an event that is likely to occur naturally and at a rate consistent with the pace of achievement of mankind's global ideal.

Notwithstanding this there is scope for efficiencies in the global market through the innovative creation and adoption of flexible interline, code share or franchise arrangements. Since treaties invariably limit the number of gateways that may be serviced by a foreign carrier, airlines can only offer seamless travel to the wide range of destinations sought in some countries by entering into some form of arrangement with another carrier. There is simply no alternative.

Another example might be along the following lines. Singapore's sixth freedom advantage over Australian carriers arising from its ability to draw passengers from the relatively affluent population of UK/Europe and carry such traffic on to Australasia via a Singapore could be minimised by an arrangement whereby an Australian carrier, in conjunction with an European/UK carrier, are allowed to exchange passengers at Singapore. The Australian airline would carry passengers bound for Singapore and points beyond as would the partner airline in reverse. The exchange of "beyond"

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passengers between the partner airlines occurs at Singapore and each airline then returns to its own country with its load factor improved as a result of the carriage of the other airline's "beyond" passengers.

By inference, a developing or new market is regarded as being "thin" in terms of traffic density. Such destinations are also often characterised by a lack of infrastructure to accept and handle wide body aircraft and indeed that such aircraft provide too much capacity in the early days. Since frequency of service is a dominant factor in promoting any new destination, it follows that there will be continuing opportunities for airlines operating narrow body aircraft. This provides for code share and/or franchise opportunities for smaller airlines to interact and hub with their bigger brothers. Properly organised, this has the effect of minimising the sector length flown by the more expensive narrow body aircraft and hence provides the best outcome for the passenger in terms of the cost of travel.

At first glance it appears that national regulators seem to view such arrangements as the purview of only the major international carriers and this causes concern for the ultimate "creation" of fewer airlines that exert an overly dominant force in the marketplace. The challenge is therefore that if industry can evolve innovative solutions that improve efficiency and profitability, then regulators must find equally innovative, manageable solutions to regulate such activities so that their concept of a balanced and competitive industry is maintained.

It is therefore submitted that Australian government policy should be further developed to accommodate such innovations by the aviation industry. Without such policy the International Air Services Commission will face the difficult task of fairly managing the consequences of innovative precedents within the industry as a whole and the Department of Transport and Regional Development will lack the necessary guidance for the negotiation of amendments to treaties.

It is important to add a caveat here to the effect that Australia's major carriers may not yet be ready to consider or implement such innovations. Given that the Inquiry's aim is "to improve the overall performance of the Australian economy", it is considered appropriate that Government and industry jointly agree on such innovations, their methods of regulation and the appropriate timing for their implementation.

Currency Crisis

Whilst the current SE Asian currency crisis should not be permitted to overshadow the aims of this Inquiry, there are some useful lessons to be learnt from it.

Firstly it was difficult for even the most astute organisations to predict the crisis. Secondly financial experts from the IMF and other "guru" financial enterprises can not agree on the appropriate treatment for the ailing economies. The only common ground is

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that it appears that everyone seems to disagree with Japan's management of its endemic economic problems. Can a similar crisis evolve in the global aviation market?

The dramatic devaluation of some regional currencies has created even cheaper labour markets. To what extent this can be exported in terms of goods and services remains to be seen as does their impact on regional economies such as Australia's. It is submitted that the lesson here for Australia is to proceed with caution and in an incremental fashion when proposing a liberalisation of markets.

It is also worthy of note that business is often done in what the west perceives to be strange ways within our region, and international companies often find this an insurmountable stumbling block. Their unwillingness to accept the ways of their host country has often left them empty handed after months and sometimes years of effort (e.g. the Ford Motor Company's efforts to build the Indonesian car.)

History shows that the leading families of the Philippines and Indonesia have exerted enormous influence on the conduct of business in their own countries. The families may come and go, but this type of influence will continue to be characteristic of the region for some time yet. It has always been an interesting allegation that Sempati Air, which is 40% owned by the presidential family, was not required to pay for fuel and catering. Without doubt a distinct advantage in aviation.

Our region is different to the rest of the western world. Our relationships within it need to be developed with patience, understanding and caution.

Conclusion

This submission reflects the experiences of a relatively small privately owned Australian company operating scheduled international services in our regional neighbourhood.

It concludes that the ICAO model and the attending bi-lateral treaties should be the only basis for the further development of aviation services in the region. Whilst Australia may promote a notion of liberalising this marketplace, both experience and the evidence suggest that whilst our neighbours may show a willingness to talk about it, they are most unlikely to implement any part of such a concept at this time. To do so would be to give away their position of advantage arising from geography for no apparent benefit.

Notwithstanding this "business as usual" conclusion, there remains opportunities for airlines and their regulators to jointly develop innovative solutions based on code share, interline or franchise arrangements that may produce some benefit to the consumer.

Until such time that technology allows for the production of cheap, fast and reliable transport aircraft that run on air, the best we can hope for is a gradual or marginal improvement in benefit to the consumer and to the economy of Australia.

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Submitted Thursday, 26 February 1998