



B A R A

Board of Airline
Representatives
of Australia Inc

BARA submission to the Productivity Commission – Australia's international tourism industry: trends, drivers and barriers to growth

Overview of BARA



The Board of Airline Representatives of Australia (BARA) is the industry body promoting the safe and efficient operations of international airlines serving Australia for the benefit of consumers, businesses and tourism.

BARA's members provide 90% of all international passenger flights to and from Australia.

BARA's role is to provide a collective voice on major issues that affect international aviation. The sustainable growth and potential of Australia's international aviation industry depends on the right economic policy framework and legislative and regulatory arrangements.

As a 'hands on' industry body, directly supporting its members' operations, BARA takes a collaborative and practical approach to its work. BARA has authorisation from the Australian Competition and Consumer Commission to collectively negotiate on behalf of its members with international airports, Airservices Australia and other providers of essential aviation services.

At an operational level, BARA engages with airport operators and border agencies to improve the experience, efficiency and safety outcomes for international passengers.

BARA's vision and outcomes

To guide BARA's work and clearly articulate its ideals, BARA's members have developed a *Vision and Outcomes for International Aviation in Australia*, available at www.bara.org.au. The vision for international aviation in Australia is 'High quality, adaptive and efficient'.

Underpinning this vision, BARA has identified the following four key outcomes to boost competitiveness, productivity and the financial performance of industry participants:

Outcome 1: Timely and reasonably priced airport infrastructure

Outcome 2: Competitive supply of jet fuel

Outcome 3: Safe and efficient air navigation

Outcome 4: Environmentally sustainable growth

The Australian Government's role extends to both setting the industry's overarching economic and regulatory frameworks and the delivery of services at international airports, including customs, immigration and biosecurity procedures. As such, the Australian Government plays a critical role in shaping the international aviation environment and fostering BARA's identified industry outcomes.

Executive Summary

A key driver of Australia's inbound international tourism industry is the provision of safe and affordable air travel. Over the last decade, the number of short term visitors to Australia has increased each year by about 3% to the current 6.7 million per year. Sustained improvement in the aviation industry's productivity has delivered real reductions in airfares, making travel to Australia increasingly affordable for overseas visitors.

While the Productivity Commission's (PC) review focuses on Australia's inbound international tourism industry, BARA considers that the outbound international travel by Australians also generates substantial economic and social benefits to the Australian economy and its people. BARA considers that the PC should also give consideration to measuring the economic and social benefits of this activity, such as the total consumer surplus associated with the current 9 million short term overseas trips by Australians each year. BARA's submission covers issues that affect both Australia's inbound international tourism and outbound international travel.

Industry reform and current supply cost pressures

Australia's aviation industry has undergone significant reform since the 1990s, with deregulation and changes in the ownership structure of major airlines. The Government's negotiation of bilateral air services agreements and associated arrangements have enabled international airlines to offer the range of services available today. Competitive reform and increased competition has delivered significant benefits to international tourism.

Australia's aviation industry, however, is facing a number of supply cost pressures from its 'aviation infrastructure' over the coming decade. They include:

- the cost of expanding capacity at Australia's major international airports,
- overcharging of international aviation by Airservices Australia for air navigation services and aviation rescue and firefighting services,
- an uncompetitive supply of jet fuel at the major international airports.

Collectively, these cost pressures will increase industry costs per passenger, ultimately limiting or reversing the scope for the industry to continue to improve its overall productivity. For its part, BARA is seeking to implement a range of initiatives aimed at improving the efficiency and productivity of Australia's aviation infrastructure.

Efficient provision and pricing of border protection services

The Australian Government also influences the productivity and quality of Australia's international aviation through the provision and pricing of border protection services. The primary services provided at the major international airports relate to the clearance and screening of passengers and crew entering and departing Australia, and regulation and clearance of the goods they bring with them, as well as biosecurity controls.

The lack of an effective service delivery model limits the ability of the Australian Government to support a growing international aviation industry. Service delivery appears unable to adequately cope with changing airline demand patterns or unplanned issues (such as weather delays, persons of interest and so forth that affect necessary staffing resources).

Executive Summary

The impact of this lack of flexibility in service delivery is to:

- reduce passenger experience through delays and especially missed connecting domestic flights for inbound tourists,
- increase airline costs through both the cost of accommodating passengers that miss connecting flights and lost on time performance.

BARA also considers the Australian Government is taking undue advantage of the international airlines' productivity and efficiency gains to raise its own revenues by charging well in excess of the costs of the services it provides. By doing so, it is directly increasing the aviation industry cost base through its fees, charges and taxes, principally through the Passenger Movement Charge (PMC) levied on departing international passengers.

While the industry strives to improve its productivity, the benefits are being eroded through arbitrary increases in the PMC. The revenues from the PMC now exceed the combined cost of border protection services and airport and security services provided to international aviation at the major international airports.

BARA supports the Australian Customs and Border Protection Service's *Blueprint for Reform 2013 – 2018*. However, to support a growing international aviation industry underpinned by continual productivity improvement, there is a critical need for the Australian government to further modernise the provision and cost recovery of border protection services.

The planning and provision of border protection services at the international airports should follow the same process as applied by the airport operators and Airservices Australia. They develop five-year plans that detail forecast demand, service standards and necessary capital and operating costs. Such plans should be developed in close consultation with industry. The plans also need to detail the resourcing and flexibility to cope with changing airline demand patterns and unplanned occurrences.

There are well established cost recovery principles that could be applied to determine the PMC rate necessary to fund the delivery of necessary border protection services. What is required is a willingness by the Australian Government to modernise the provision and pricing of border protection services. The much needed reforms should be consistent with maximising the contribution Australia's international aviation industry can make to the Australian economy and its people.

1. Australia's international aviation

A key driver of Australia's international tourism industry is the provision of safe and efficient international aviation. Sustained improvement in the aviation industry's productivity has delivered real reductions in airfares, making Australia a more affordable tourism destination.

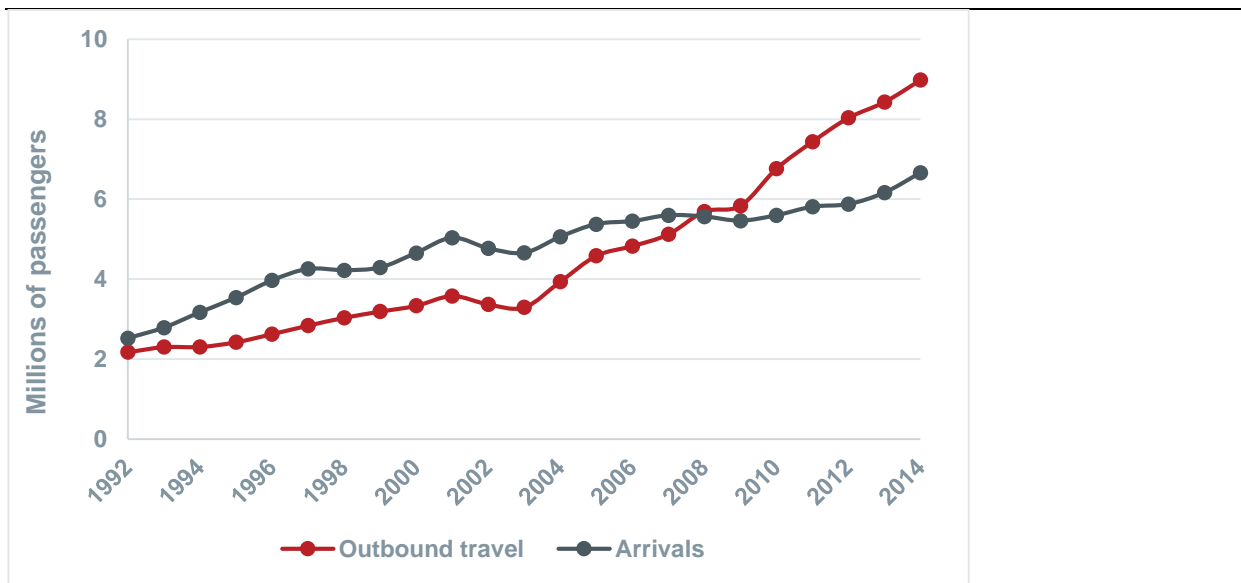
BARA is committed to the delivery of safe and efficient international aviation in Australia as outlined in this submission. This section describes some industry trends, including the importance of ongoing improvements in productivity and lower real airfares.

Inbound arrivals and outbound travel

The focus of the PC's research paper is on inbound tourism to Australia. However, for international aviation, this is not a separable market in the sense of the provision of aviation services. The number of international trips comprises visitors to Australia (arrivals) and Australians travelling overseas (outbound travel). The efficiency gains by the aviation industry that have boosted inbound tourism have also delivered more affordable international travel for Australians. Outbound travel by Australians has in turn driven the growth and efficiency of the industry, with all international passengers benefiting through improved services and lower airfares.

ABS data show how the composition of Australia's international aviation is changing. The striking feature over the last decade has been the strong growth in Australians travelling overseas for holidays and business (Figure 1).

Figure 1: Short-term international visitors and outbound travel (departing Australian residents), millions, financial years



Source: ABS

From 2004 to 2014, total outbound travel increased by more than 130% (8% annual growth), compared with a 30% increase (3% annual growth) in overseas arrivals. Given the sustained increase in outbound travel, the number of Australians travelling overseas exceeds that of overseas visitors by about 2.4 million passenger trips per year.

Industry productivity and real airfares

A key driver of the growth in international air travel has been the sustained improvement in the aviation industry's productivity that has reduced real air fares. For example, in 1994, the cost of a one-way economy flight from Sydney to Singapore was about \$2,100 in today's terms¹, representing about two and a half weeks of average weekly earnings. Now the same flight ranges from about \$350 (low cost airlines) to \$850 (full service airlines), equivalent to less than one week of average weekly earnings.

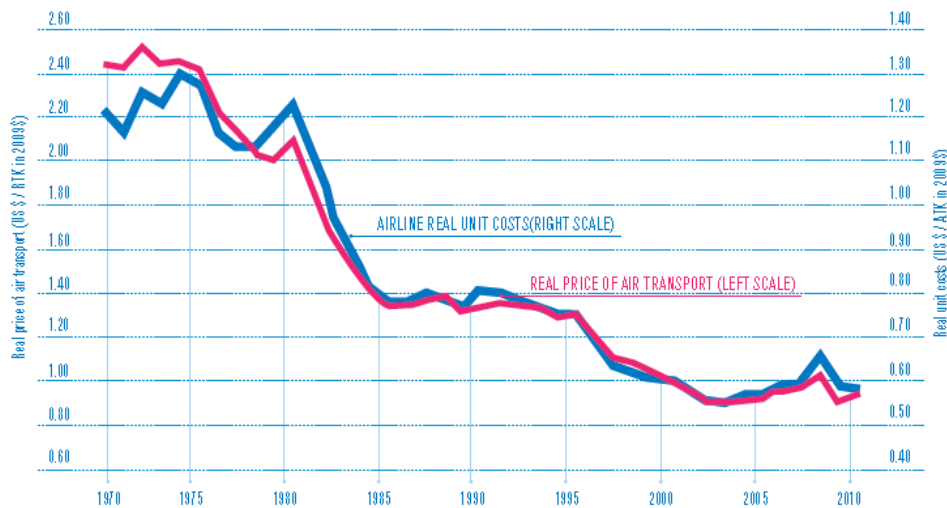
Factors contributing to gains in productivity include:

- a 30% increase in fuel efficiency over the last decade
- deregulation of the industry and reform resulting in new market entrants and increased competition between airlines
- greater economies of scale achievable through increased passenger numbers
- more efficient use of existing infrastructure eg. airport facilities and air navigation services.

Notably, the productivity improvements have been achieved in an environment of increased Australian Government-mandated security requirements and therefore higher costs for security services.

Analysis by the International Air Transport Association (IATA) shows that globally, airlines have passed on the full benefit of industry productivity improvements through lower real airfares (see Figure 2).

Figure 2: Real price of air transport and real unit costs



Source: Reproduced from IATA (June 2013) *Profitability and the air transport value chain*.

International airlines have been responsible for delivering a large proportion of the cost reductions in international travel to and from Australia. Looking forward, it is clear that other contributors to the costs of airfares need to do more in terms of improving efficiency and productivity if Australia is to enjoy continued strong growth in its international tourism sector.

¹ Data provided by Qantas Airways.

Implications for Australia's economy

Ongoing productivity gains have allowed lower real international airfares. This has contributed to the growth in Australia's international aviation industry, including a growing international tourism sector and greater opportunities for Australians to travel overseas.

The benefits of inbound tourism to Australia are generally well documented. They include the output, employment and revenues of Australia's international aviation and tourism industries. International tourism contributes about \$25 billion per year to Australia's economy. In addition, over one fifth of Australia's trade by value is carried by international aviation, worth over \$100 billion each year.

While much is made of Australia's international tourism sector, BARA considers that there is a significant policy gap in understanding the benefits of Australia's outbound travel. Australia's multicultural society has embraced international travel as residents increasingly head overseas to visit family and friends. Current favourable exchange rates for the Australian dollar have also made overseas travel more attractive. Travel for business purposes has similarly contributed to the growth, with airfare affordability facilitating international commerce and enabling Australians to maintain a greater presence in overseas markets.

BARA, therefore, believes that the PC should also consider measuring the economic and social benefits of this activity, in either this review or as part of its ongoing research. The primary measure of benefit would be an estimate of the total consumer surplus (difference between actual prices paid and willingness to pay) associated with the current 9 million overseas short term trips per year, ie annual outbound travel. It would also include consideration of the output and employment outcomes in Australia in providing international aviation services.

The following section outlines the challenges Australia's international aviation will face over the coming decade in seeking to maintain and improve industry productivity.

2. Challenges for future growth

While the industry has achieved substantial productivity gains to date, it is facing significant supply cost pressures as a result of the prices charged by its 'aviation infrastructure' (airports, jet fuel supply, air traffic management and fire services), an unresponsive provision of border protection services and taxes imposed by the Australian Government on international travel.

Combined, these supply cost pressures will ultimately limit the scope for the industry to improve its productivity and improve air travel affordability as a key growth driver. BARA understands that some of the elements of cost increase are not part of this review (i.e airport charges). BARA, however, considers that it is worth highlighting the main cost pressures. BARA's recommended reforms to the supply of jet fuel at the major international airports, Airservices Australia and the provision and pricing of border protection services are then briefly described.

Cost increases

Figure 3 on the following page shows the following main supply cost pressures:

- airport prices have doubled in real terms over the past 12 years
- Australia pays some of the highest 'differentials' globally for the supply of jet fuel
- Airservices Australia increasingly overcharges international travel to subsidise regional aviation
- the Passenger Movement Charge levied by the Australian Government on outgoing passengers has increased in real terms per passenger by about 30% since 2000.

This upward trend in supply costs clearly cannot continue if Australia's international aviation industry is to maintain airfare affordability as a key growth driver. BARA is particularly concerned by some industry suppliers downplaying their increases in costs as just a 'small part' of overall airfares. It is the combined cost impact of multiple suppliers (often with substantial market power), including the Australian Government, which is contributing to the overall pressure on industry costs.

The cost challenge requires suppliers to recognise the need to improve productivity so that airfares remain competitive to support future industry growth. This growth ultimately benefits all suppliers and the Australian Government in the long run through greater trade, industry revenues and employment opportunities.

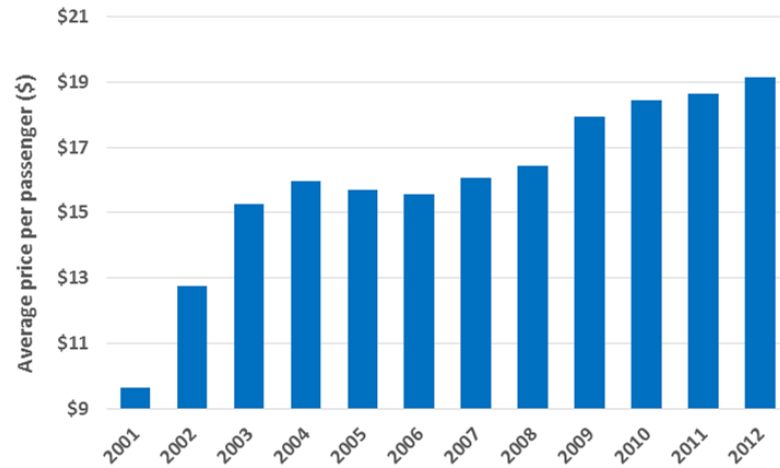
Further efficiencies through industry reform

BARA considers that changes and improvements made in the supply of aviation services and border protection services will be critical to achieving the growth forecasts for international passengers. Key reforms include:

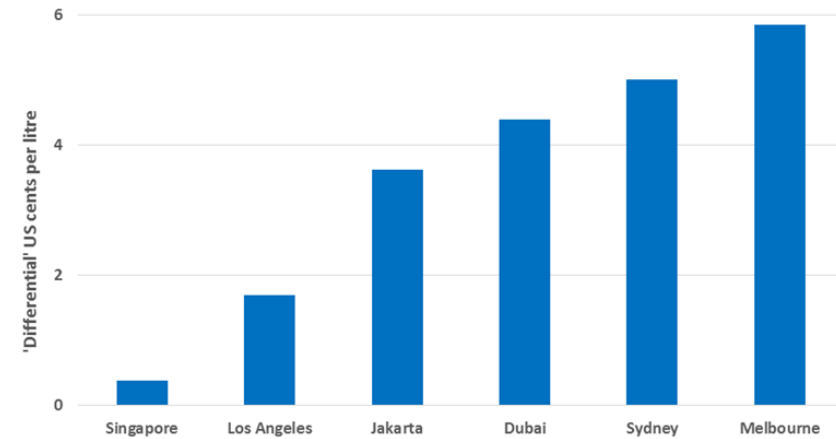
- opening up the 'jet fuel supply infrastructure chains' to enable effective competition between jet fuel suppliers at Australia's major international airports
- efficient price structures and pricing outcomes for air navigation and aviation rescue and firefighting services provided by Airservices Australia.
- improvements in the services provided by border protection agencies to international passengers and a reduction in taxes levied by the Australian Government, principally the Passenger Movement Charge (PMC) that funds border protection services.

Figure 1. Rising industry costs: Aviation infrastructure and Australian Government taxes

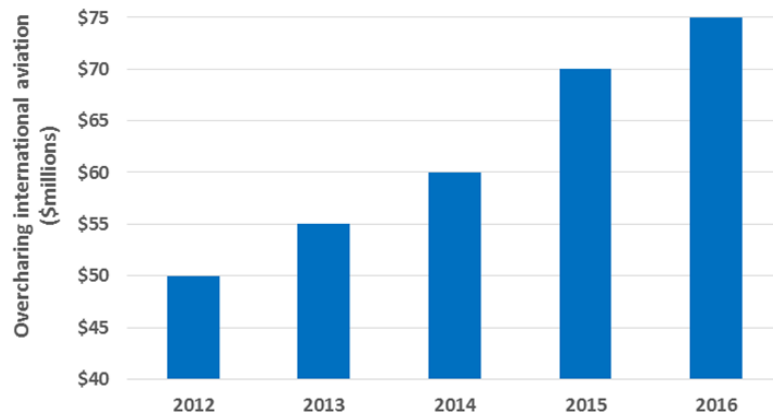
Rising airport prices



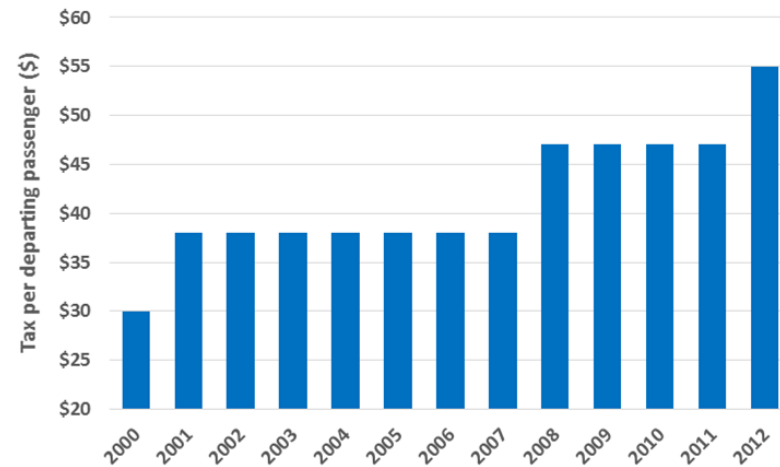
Excessive jet fuel differentials



Overcharging by Airservices



Overcharging by Government



Airport services and infrastructure investment

Australia's major international airports are crucial assets in providing safe and efficient international aviation. Their management influences safety, costs, industry productivity and passenger experience.

BARA understands that the PC does not intend to address airport services in this review following its 2012 report on the effectiveness of the economic regulatory regime for these services.

However, in considering the drivers to increased international tourism, the potential impact on airfares of significant new infrastructure investment for airport services cannot be ignored. A leading example is the decision to build a second airport for Sydney, but other major airports will also need to increase capacity over the next decade. These large-scale investments will ultimately increase the industry's total cost base given the often high cost of the marginal or incremental capacity increases.

Effective planning to ensure capital efficient investment will be critical. This will involve balancing the scale and timing of capacity expansions, taking into account the cost impacts and the benefits to passengers and airlines. Input by the international airlines and other key stakeholders will be important to inform decision-making by the major airports on the optimum investment levels required for new infrastructure and services.

Jet fuel supply

The cost of jet fuel is especially critical in Australia, with international aviation defined by very long distances between ports, leading to high fuel consumption. Jet fuel is an international airline's highest cost item, often representing over 40 per cent of operating costs. BARA's members purchase over four billion of litres of jet fuel annually in Australia, costing over \$4 billion.

BARA has been concerned for a long time over the lack of effective competition between jet fuel suppliers at Australia's major international airports. BARA considers that international airlines pay more than necessary for this critical cost input.

Globally recognised suppliers of jet fuel have been stifled in their efforts to bring competition and lower priced jet fuel to Australia. Principally, the barriers to competition have been the difficulties in transporting jet fuel from Australia's ports to the aircraft at the airports – known as the 'jet fuel infrastructure supply chain'. These supply chains are largely owned by existing fuel companies.

BARA has detailed the jet fuel supply issues in its submission to the Competition Policy Review, available at <http://competitionpolicyreview.gov.au/issues-paper/submissions/>.

In its draft report, the Review Panel noted that the competition in jet fuel supply should be an area of focus of further reforms in the aviation sector.

BARA maintains that reform of Australia's jet fuel markets and infrastructure supply chains will deliver significant benefits, including:

- a lower price for jet fuel compared to the current arrangements by encouraging,
 - jet fuel imports to take maximum advantage of favourable global market conditions over the supply and demand for jet fuel and
 - suppliers to ensure efficiencies across the entire industry supply chain
- more flexibility on non-price commercial terms from suppliers, such as credit conditions, exchange rates, package deals (where multiple locations are agreed in one tender) and contract length

- reduced impact of market shocks, which may adversely affect pricing outcomes. Price shocks include supply restrictions, refinery maintenance, exchange rate fluctuations and revised market conditions
- supply reliability and industry resilience. More suppliers with differing supply routes can support a more robust and resilient supply chain for the airport.

BARA will release its policy paper on a competitive supply of jet fuel at the major international airports later this year. This paper will describe a reform path to give importers of jet fuel the opportunity to compete on merit at Australia's major international airports. The new path involves unlocking the jet fuel supply chain through open access and fair pricing. Where necessary, it requires establishing new supply chains owned and operated by companies that do not supply jet fuel to airlines.

The reforms identified are designed to foster a high quality, adaptive and efficient industry. This will have flow-on benefits to the broader economy by promoting growth in the international aviation sector, leading to more affordable business and leisure travel and air freight services to and from Australia.

Air navigation systems and aviation rescue and firefighting costs

Aviation navigation services and aviation rescue and firefighting (ARFF) services represent a large component of industry costs. Airservices Australia (Airservices) is the monopoly supplier of these essential aviation services. It facilitates safe and efficient air passenger and freight transport services across Australia's flight information region. Airservices' annual revenue requirement is expected to exceed \$1 billion in 2015-16.

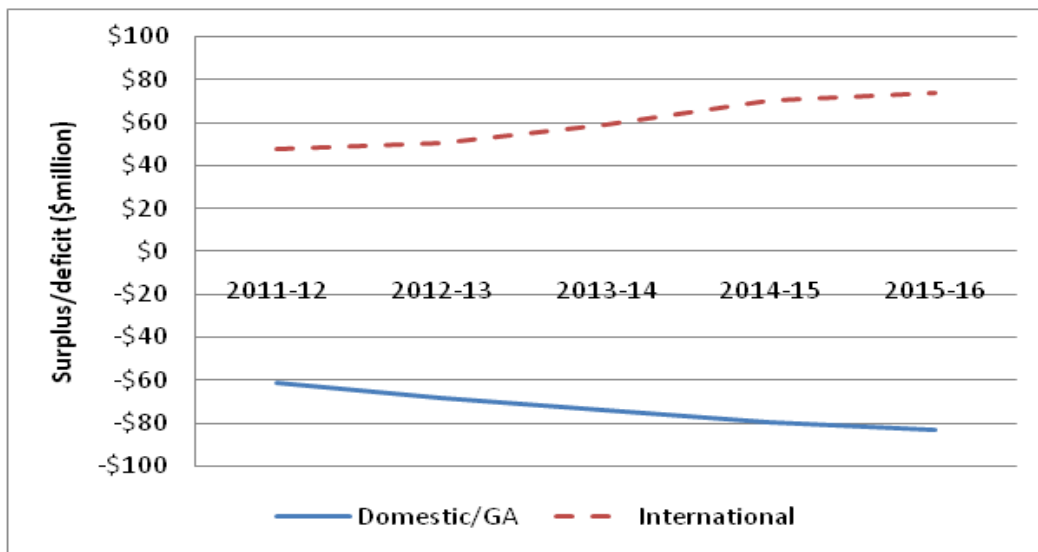
New technologies implemented by Airservices have contributed to efficiency savings in airline operations, for example through improved scheduling of aircraft, fuel costs are minimised through reduced fuel burn times.

However, there are significant opportunities for Airservices to improve the efficiency of investment and pricing outcomes. BARA considers that current pricing structures are designed to promote various regional development and social objectives. Specifically, BARA estimates that these price structures result in the international airlines being currently overcharged some \$70 million annually to subsidise the provision of services at regional and general aviation (GA) airports. Figure 4 indicates this growing cross subsidy for terminal navigation (TN) and aviation rescue and firefighting services (ARFF).

This situation has prevailed for some time. It was a key finding of the former Industry Commission in its inquiry into Intrastate Aviation in 1992. Although the Industry Commission recommended that Airservices' prices were set on a location specific basis, any move in this direction has since been overtaken by subsidised assistance to services provided at regional locations.

BARA considers that policy-induced price distortions are reducing the productivity and cost-efficiency of Australia's aviation industry by encouraging uneconomic services. These uneconomic services are sustained through overcharging international aviation for the provision of essential air navigation and ARFF services.

Figure 4: Net financial position, TN and ARFF services, \$millions



Source: BARA estimates.

In its June 2014 submission to the Competition Policy Review, BARA recommended that the PC should be given the task of developing a set of principles for the pricing of en-route, terminal navigation and ARFF services. This should become a prescribed pricing structure for Airservices when it lodges its draft prices notification with the ACCC. Airservices would then apply pricing structures that were consistent with promoting the efficient development of Australia's aviation industry.

In its draft report, the Review Panel indicated that the reform of Airservices should be a priority focus for Australia's aviation sector. However, BARA notes that despite widespread calls for improvements to Airservices investment and pricing practices, no tangible initiatives have been put forward to deliver the needed changes.

Border protection services and pricing

The Australian Government provides for a range of border protection services deemed necessary to protect Australia's security and economic interests. For international aviation, the primary services provided at the major international airports relate to the clearance and screening of passengers and crew entering and departing Australia, and regulation and clearance of the goods they bring with them, as well as biosecurity controls.

The quality and pricing of these services directly influences the industry's productivity, cost base and service quality outcomes.

BARA and its members have been concerned for some time that inefficient service delivery unnecessarily increases the cost of providing international passenger and freight services to Australia. Poor service outcomes also increase the cost of international aviation, either through reduced on-time performance by airlines or missed connections by passengers. They also reduce the quality of passenger experience, which can have longer-term impacts on industry growth, especially international tourism into Australia.

The costs to airlines of missed connections are also substantial. Such costs include overnight accommodation and alternative flights for passengers. BARA is concerned that such costs are not adequately taken into account in considering the staffing resources allocated to passenger facilitation

activities. This means that the 'savings' claimed by the border protection agencies is actually just a form of cost shifting onto international airlines through delays and missed connecting flights.

Passenger Movement Charge

In addition to an inadequate service delivery model, the Passenger Movement Charge (PMC) that is levied on departing international passengers is adding to the growth in the aviation industry's cost base. This charge was introduced in the 1995 Budget, and replaced the previous departure tax. The then government initially introduced the tax as a cost-recovery measure to recoup the full accrual costs of Customs, Immigration and Quarantine processing for international passengers and the cost of issuing short-stay visitor visas. The charge was initially \$27.

Now \$55, the PMC has been increased several times. The Australian Government will likely collect about \$1 billion from the PMC in 2015–16, or about four times the funding provided to its border protection agencies to provide services at international airports². As a comparison, the major international airports will collect about \$790 million in 2015–16 in 'aeronautical charges' to provide airfield, terminal and security services to international airlines.

A government tax not linked to service levels

There is now a very large disconnect between the revenues collected through the PMC and the provision of border protection services. The growth in the rate of the PMC has increased the industry's cost base, eroding or overtaking the productivity gains achieved by other industry participants. The current 'freeze' on the PMC provides no comfort that the government recognises it is overburdening Australia's international aviation industry with taxes. Without a significant shift in government policy, BARA considers there is a real risk that a 'catch-up' increase in the PMC will be imposed at some point in the future.

Impact on industry and international tourism

The economic harm the PMC brings to Australia's international aviation industry has been widely documented and repeatedly presented to the Australian Government in submissions from industry stakeholders. In summary, the effects of the PMC are to:

- reduce the size and contribution of Australia's international aviation industry
- distort efficient patterns of market development
- focus industry lobby effort and resources into the political process of seeking to influence the rate of the PMC rather than supporting the efficient development of the industry
- encourage lobbying to modify how the PMC is applied and promote certain industry segments at the expense of others.

All of these negative outcomes are a constant drain on the efficiency and productivity of Australia's international aviation and tourism industry.

² Tourism and Transport Forum, Passenger Movement Charge Explained.

Joint Review of Border Fees, Charges and Taxes

The PMC is one of a number of charges currently subject to the Joint Review of Border Fees, Charges and Taxes by the border protection agencies. In its submission to the Joint Review³, BARA argues that the PMC's current setting reflects the outcome of political processes, which seek to balance a range of economic and budgetary objectives.

Reforms needed

In its submission to the Joint Review, BARA called on the Australian Government to modernise the provision and pricing of border protection services at the international airports. Changes required to facilitate the growth of international aviation include:

- developing comprehensive five-year plans, in consultation with industry, of the services provided and necessary operating and capital funding costs
- developing infrastructure and resourcing plans to allow border protection agencies to adapt to changing demand patterns, especially changes in the peak demand periods and in response to unplanned events (such as weather disruptions, persons of interest and so forth), and
- application of the Australian Government's cost recovery principles to reduce the level of the PMC.

By implementing BARA's proposed modern service delivery and cost recovery model, the long-run outcome would be a more productive international aviation industry with greater trade and revenues.

³ BARA submission to the Australian Customers and Border Protection Services Joint Review of Border Fees, Charges and Taxes (available on request)

BARA's Members

AIRCALIN

AIR CANADA

AIR INDIA

AIR MAURITIUS

AIR NEW ZEALAND

AIR VANUATU

ASIANA AIRLINES

CATHAY PACIFIC AIRWAYS

CHINA SOUTHERN AIRLINES

DELTA AIR LINES

EMIRATES

ETIHAD AIRWAYS

EVA AIR

FIJI AIRWAYS

GARUDA INDONESIA

JAPAN AIRLINES

KOREAN AIR

MALAYSIA AIRLINES

PHILIPPINE AIRLINES

QANTAS AIRWAYS

QATAR AIRWAYS

ROYAL BRUNEI AIRLINES

SINGAPORE AIRLINES

SOUTH AFRICAN AIRWAYS

THAI AIRWAYS

TURKISH AIRLINES

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