Submission to the Productivity Commission's Research Paper on Australian International Tourism Industry – Trends, Drivers and Barriers to Growth.

Submitted by NQA (the North Queensland Airports group operating Cairns and Mackay Airports).

28 November 2014

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1. TRENDS IN AUSTRALIAN TOURISM

1.1 Changing patterns

The composition of international visitation to Cairns and Tropical North Queensland has changed dramatically over the last decade. The visitation patterns was once dominated by the Japanese, North American, the United Kingdom and Europe. Whilst these markets are still large the Chinese market has emerged over the last five years and based on the forecasts from the Tourism Forecasting Committee is expected to grow to approximately 300,000 visitors to the region by the year ending June 2023.

In FY2006 the Japanese visitor market share was 28% and this has dropped to 12% in FY2014. Most of the large Japanese decline happened prior to the GFC. It was linked to the closure of the Australian Airlines hub in Cairns and consolidation of Cairns-Japan flights to Tokyo and Osaka only.

The Chinese markets has increased from 5% of visitors to Cairns in FY2006 to 21% in FY2015. Due to the lack of year round services between China and Cairns, the rapid growth has been achieved through travel on domestic flights to Cairns after Chinese enter at another Australian gateway

The UK and Europe has started to recover after reaching post GFC lows in FY2012, but like the Chinese they are dependent on domestic flights to reach Cairns. There are limited services to global hubs aviation hubs with strong connections to Europe like Dubai or Singapore. This is one reason why its share of Cairns visitors has dropped from 38% to 33% in the past 9 years.

The New Zealand market fluctuates but arrivals are dependent on the capacity on non-stop Auckland-Cairns flights. The New Zealand share of visitors to Cairns has ranged between 5% and 7% in the past 9 years.

The only market to have grown since the start of the GFC has been arrivals from Asia. This includes markets like Korea, India or Singapore. Like other Asian markets, limited flights to Asia mean this growth is being channelled through the Cairns domestic network. Aside from a 19% increase in arrivals, the market share in Cairns has risen from 3% to 5%.

Table 1. Historic and Forecast[1] Visitation to Cairns and the Great Barrier Reef[1]

	UK & Europe	China	North America	Japan	Other Asia	Rest of world	New Zealand	Total	Annual growth rate
FY2006	332	40	121	242	52	29	50	865	0.0%
FY2007	334	44	131	211	55	30	38	842	-2.7%
FY2008	323	54	124	185	52	38	43	818	-2.9%
FY2009	310	36	112	123	51	35	37	703	-14.1%
FY2010	294	54	101	94	44	33	34	655	-6.8%
FY2011	267	73	99	94	46	33	35	647	-1.2%
FY2012	218	92	100	85	44	31	44	614	-5.2%
FY2013	245	134	104	94	54	32	44	707	15.1%
FY2014	226	143	105	86	61	36	32	689	-2.5%
FY2015	251	170	116	94	67	42	36	777	12.7%
FY2016	260	186	121	96	71	45	37	816	5.0%
FY2017	269	202	126	98	75	47	38	856	4.9%
FY2018	278	218	131	101	79	50	38	896	4.7%
FY2019	285	234	135	104	83	52	39	933	4.1%
FY2020	291	250	139	106	87	55	40	968	3.8%
FY2021	299	266	143	106	90	57	41	1 004	3.7%
FY2022	306	283	148	107	94	60	42	1 039	3.5%
FY2023	313	300	152	108	97	62	43	1 076	3.6%
Historic growth									
FY2006 to FY2014	-32%	261%	-13%	-65%	18%	27%	-37%	-20%	
FY2009 to FY2014	-27%	299%	-6%	-30%	20%	4%	-13%	-2%	
Forecast growth									
FY2014 to FY2023	38%	110%	44%	26%	60%	72%	34%	56%	
FY2014 to FY2019	23%	53%	24%	18%	31%	38%	20%	30%	

2.0 FACTORS IMPACTING ON TOURISM

2.1 The relationship between aviation connectivity and economic growth

Air transport plays a key role in economic development and in supporting long-term economic growth. Direct connectivity to the global air transport network facilitates a region's integration into the global economy by taking business travellers to meet existing and new customers, building inbound tourism, expanding trade markets, generating economies of scale and scope, and proving greater access to international investors and capital markets.

[1] Forecasts based on applying Tourism Forecasting Committee national inbound forecasts to Cairns historic visitation.

The 21st century has become an aviation-based economy. 65-75% of global economic value in trade (including consulting) is carried by air; the standard and often quoted 35% ratio is just for 'products'.

Appraisals of the regional economic benefits of increased access to the global air transport network generally focus on the direct contribution to Gross Regional Product (GRP) through local employment and expenditure, as well as indirect benefits to industries such as tourism. The traditional approach to appraisal does not quantify the significant additional economic benefits created by aviation, those that cannot be replicated by other industries in the absence of air transport.

The International Air Transport Association (IATA) has explored the relationship between air connectivity and regional productivity – that is, the advantages that connections to the global air transport network provide for businesses. IATA's research highlighted the significant wider economic benefits that are created through improved links to the global air transport network. Its survey of firms in five different countries showed the importance of good air transport links for a region's efficiency, productivity and investment attraction. In particular, greater connections to the air transport network provided potential benefits through:

A. Facilitating international trade and tourism

Air transport connects businesses to a wide range of global markets, providing a significantly larger customer base for their products than would be accessible otherwise. It is particularly important for high-tech and knowledge-based sectors, suppliers of perishable or time-sensitive goods and the tourism and hospitality industries.

B. Boosting productivity across the economy

By expanding the customer base, air transport allows companies to exploit economies of scale and to reduce unit costs. By exposing domestic companies to increased foreign competition, it also helps to drive efficiency improvements among domestic firms in order to remain competitive.

C. Improving the efficiency of the supply chain

Access to extensive air transport links allows domestic firms to identify and manage investments in foreign-based assets and encourages foreign firms to invest in the regional economy.

D. Acting as a spur to innovation

Extensive air transport links facilitate effective networking and collaboration between companies located in different parts of the globe. Access to a greater number of markets also encourages greater spending on research and development by companies, given the increased size of the potential market for future sales.

E. Indirect impacts

Includes the economic activity fostered by the supply chain of industries servicing airport operations, and the consumer spending of wage earners associated with an airport, its supply chain industries and regional tourism.

Summarily, IATA's research found that:

> ***There is a statistically significant and positive link between connectivity, productivity and long-term economic growth[2]***

[2] IATA 2007, Aviation Economic Benefits, IATA Economics Briefing No 8 p. 25

2.2 Barriers to Growth

2.2.1. *Impediments to growing northern Australia's air connectivity - Lack of population base and economic diversity*

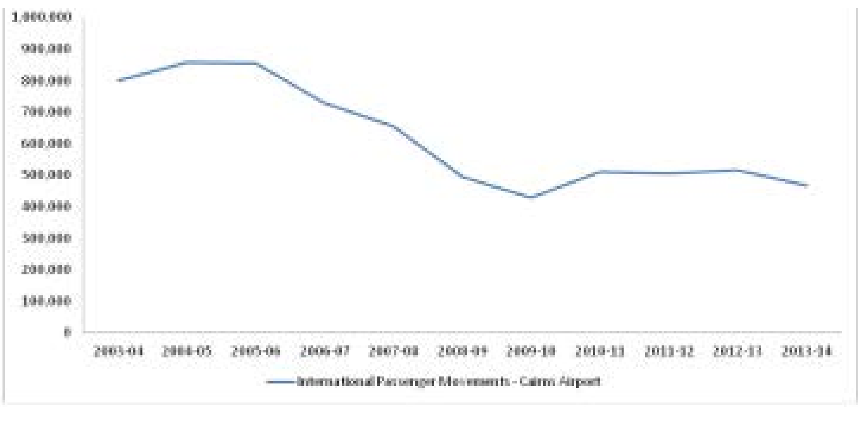
Even the larger urban centres in northern Australia (Cairns, Townsville, Mackay and Darwin) lack the permanent population that would normally be required to attract and maintain international air services using wide-bodied aircraft.

Population and economic growth of the communities within which NQA's airports (Cairns and Mackay) operate is constrained by an over-reliance on the fortunes of one industry. For Mackay this industry is mining; for Cairns it is tourism. While other industries certainly exist within these communities, as with any other of a similar size, the effect of a downturn in mining employment on Mackay has brought into stark relief the dominance of mining within the regional economy, just as for Cairns the tourism downturn for almost the decade to 2012 saw regional unemployment rise to among the highest in Australia.

Darwin's proximity to South East Asia brings it within narrow-body jet range of a number of major Asian hubs, including Singapore, Kuala Lumpur and Manila, and as a result Darwin Airport has been successful in attracting new international services operated by smaller aircraft. Although this has provided benefits to the tourism economy of the Northern Territory, the inability of narrow-bodied aircraft to carry commercially-viable volumes of cargo has meant that these services have provided no growth in the region's exports of goods by air.

Cairns' reliance upon inbound tourism demand to attract new international services has failed to attract new services over the past decade, with a 45% decline in the number of passengers through the international terminal between FY 2004-05 and 2013-14.[3]

Figure 1. Cairns Airport international passenger movements



This decline in international connectivity has led to long-term stagnation of Cairns' tourism industry and the regional economy as a whole, attended by the concomitant effects of high youth

[3] Australian Government, BITRE Airport Traffic Data: <www.bitre.gov.au/publications/ongoing/airport_traffica-data.aspx>

unemployment, limited population growth, and under-investment in the infrastructure necessary for economic recovery.

Part of the challenge of attracting new international services to Cairns is that the revenue model of most international airlines relies upon the sale of business class fares to offset the low-yielding economy class seats. As a predominantly tourism driven destination which is not home to any significant government agencies or corporate headquarters, Cairns provides little demand for business class travel.

Diversification of the Cairns economy through growth in export of goods and services, attracting regional offices of multi-national corporations, locating large government offices in the north, and increasing international student enrolment in regional education and training institutions would greatly enhance the viability of direct international air services to the region.

The competition for the global international tourism spend has increased dramatically. For example, Australia was one of the first country in the world to have Approved Destination Status for the China market. There are now over 140 countries with Approved Destination Status and they are all competing for the international market from China.

3. ROLE OF GOVERNMENT

3.1 Government Funding of Tourism Agencies

The presence of market failure in the marketing of a destination has been well documented over the years. This has resulted in the support of tourism marketing bodes by all levels of government. Despite the level of private sector investment in marketing there is still a case of market failure. NQA is supportive of the continued government funding of tourism marketing agencies.

3.2 Tourism Research

The collection of tourism data is crucial to inform business decisions. NQA actively uses data from the Tourism Research Australia, International Visitor Survey and National Visitor Surveys. These surveys provide crucial data on the changing patterns of tourism visitation. NQA is supportive of the continued government funding of these surveys through Tourism Research Australia.

3.3 Role of Government in Public Infrastructure

There is an important role for all levels of government in the provision of public infrastructure to support the tourism industry. This includes the provision of public infrastructure that is crucial in attracting visitors to a region. This includes infrastructure such as Convention Centres which are vital in attracting international delegations and conferences to a region that are high yielding visitors.

The Government can also play a role in the provision of infrastructure that adds to the overall amenity of the destination and that is attractive to both the local resident and visitor population. The Cairns' lagoon facility on The Esplanade is an example of such public infrastructure.

NQA is supportive of the continuation of government investment in public infrastructure.

3.4 Role of Government in Events

The investment of government funds in event attraction and retention can support tourism visitation to a destination. A targeted events can attract visitors to a region during the low and shoulder seasons. A large scale event can help to sustain employment during this period when visitation would otherwise be lower. The Cairns Adventure Festival which helps build market in the shoulder season before the mid-year peak is an example of this.

NQA is supportive of the continuation of government investment in event attraction and retention.

4. THE EFFECT OF AVIATION POLICY AND REGULATION

4.1 Domestic Aviation

Australia's domestic civil aviation market is one of the most liberal in the world, with Australia being one of only a few countries which have no ownership restrictions on domestic carriers. This liberalisation has not, however, created a highly-competitive domestic aviation market.

Despite the abolition of the Two Airline Policy in 1990, Australia's domestic airline industry is still dominated by two airline groups—the Qantas Group comprising Qantas, Jetstar and Qantaslink; and the Virgin Group comprising Virgin Australia, Tigerair Australia and Skywest Airlines.

Within each airline group the decision for any airline within the group to establish a new service is made at the group level, taking into consideration the broader strategy and objectives of the entire group. A case in point is Canberra Airport. Despite having a catchment population of almost one million people, a demographic with the highest average income in Australia, and investing around $480 million on its terminal precinct from 2009-2013[4], neither Australian airline group has commenced services to/from Canberra Airport with its Low Cost Carrier brand (Jetstar or Tigerair). It is widely held that this is a strategic decision by each airline group to protect their high-yielding business and government traffic through Canberra Airport.

4.2 International Aviation

International aviation traffic rights are governed by thousands of bilateral air services agreements (AsAs) that were first developed according to the principles of the 1944 Convention on International Civil Aviation (the Chicago Convention). The bilateral system places some constraints on the ability of airlines to operate on a fully commercial basis, due to:

A. Operational (or product market) restrictions:

An AsA can include restrictions on the number of airlines permitted to operate on a certain route, restrictions on the frequency of flights and restrictions relating to the fares charged on such routes.

B. Ownership (or capital market) restrictions:

An AsA can give country *A* the right to reject country *B*'s airline carrier if the carrier is not "substantially owned and effectively controlled" by nationals of country *B*. These restrictions are often supplemented by statutory provisions in a country.

True liberalisation must therefore address both forms of restriction; through product market liberalisation to provide greater freedom on operations, and capital market liberalisation to provide greater freedom of ownership and control.

It is, however, recognised that it is not within the authority of the Australian Government, nor the government of any other nation, to unilaterally grant a foreign airline access to Australian airports. The bilateral agreements are formed between States, and it is up to each State to designate those of its airlines that will receive the rights and capacity to operate services under an agreement. This means that although a bilateral Air Service Agreement may exist between Australia and Hong Kong,

[4] Canberra Airport website < http://www.canberraairport.com.au/>

for example, this does not automatically mean that any airline based in Hong Kong may operate services between Hong Kong and Australia (or vice versa).

Ownership and control restrictions in national designation of international airlines may be restricting growth in international services from northern Australia's airports under Australia's bilateral system. According to the Productivity Commission:

> ***Of all of the bilateral system's constraints on efficiency and competition, probably the most fundamental is the requirement that national flag carriers be locally owned and controlled.***[5]

The justification used for ownership and control restrictions imposed on Australia's international airlines is that Australia should exercise its entitlements under the bilateral system through its own flag carrier(s). Australia's Productivity Commission found, however, that "*local ownership and control is not a necessary condition for the bilateral system to function. It is national designation, rather than ownership and control, that is necessary*."[6]

The Productivity Commission further found that "*When there are clear lines of accountability between airlines and the countries designating them, it should not matter where they are owned, any more than in other industries.*"[7]

Within the current market conditions in Australia, and as evidenced by Jetstar Australia's withdrawal of international services from Darwin, it is highly unlikely that an Australian-designated international airline will establish new international services using aircraft based at an airport in northern Australia any time in the foreseeable future. The CEO of the Qantas Group has foreshadowed a period of limited growth for the group by stating:

> ***"We must defer growth and cut back where we can, so that we can invest where we need to."*** *(Qantas Group CEO Alan Joyce - Feb 27, 2014)*[8]

The Virgin Group faces similar constraints in growing international capacity. Whereas the Virgin CEO has flagged the airline's intention to increase penetration into Asian markets, this strategy appears to focus more on developing broader codeshare agreements with the region's own airlines rather than greatly increasing the number of international services operated by Virgin itself. This is evidenced by Virgin's forward orders for aircraft, that are weighted heavily towards narrow-bodied jets (Boeing 737-800 and 737MAX) targeted at replacing and growing current fleet serving the Australian domestic and trans-Tasman markets. Virgin has yet to announce its choice of next-generation wide-bodied aircraft, with only two Airbus A330s to join the fleet by 2016.[9]

Acknowledging that these airlines are, quite appropriately, free to make this decision based on commercial grounds consistent with their respective strategies and in the interests of their shareholders, it is nonetheless a major impediment to the economic wellbeing of northern Australia. Whereas Australia's airlines have the option to grow their business by establishing foreign subsidiaries

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[5] Productivity Commission, International Air Services, Inquiry Report (Report No.2) (Ausinfo, Canberra, 1998).p. XXX.

[6] *Supra,* p. 213.

[7] *Supra,* p. 214.

[8] Alan Joyce, Feb 27 2014: <http://www.qantasnewsroom.com.au/media-releases/qantas-group-strategy-update-2>, accessed on 11/8/2014.

[9] Australian Aviation <http://australianaviation.com.au/2013/08/no-rush-for-virgin-australia-fleet-plans/>, accessed on 11/8/2014.

in high-growth markets, airports and the communities they support have no such option available to them.

The international connectivity, and by extension the economy, of northern Australia could benefit greatly by the airports in northern Australia having the freedom to pursue the establishment of a foreign carrier's operations base for international operations, without the requirement for the carrier to establish an Australian subsidiary in accordance with the current ownership and control provisions. Australia's bilateral agreements could be renegotiated to provide this carrier with Australian designation to operate international services (effectively unlimited seventh freedom rights) only from specified airports in northern Australia. Without the current restrictions on foreign ownership of domestic airlines this airline would be free to operate domestic services to feed traffic into its international services from a large catchment.

Unilateral liberalisation of ownership and control restrictions by the Australian Government would not, *ceteris paribus*, be enough to compel an Asian airline to establish a base in northern Australia. The airline would still make its decision based on commercial feasibility, and any new service would be subject to the destination state approving the designation of a foreign carrier for the purposes of securing Australia's traffic rights, but this liberalisation of airline ownership and control would at least give secondary international airports such as Cairns far broader scope for securing international services.

4.3 Passenger Movement Charge

Australia currently applies a Passenger Movement Charge of AUD $55 to all departing international passengers to offset the cost of government-provided services. Australia is one of only a few countries in the world to apply such a levy, and even within the group of OECD countries that do apply departure tax, Australia's is the highest for short-haul international flights and the second-highest for long-haul flights. In the World Economic Forum's Travel and Tourism Competitiveness Index for 2013, Australia was ranked number 130 out of 140 countries for competitiveness of Taxes and Airport Charges.[10]

BARA submitted that the Australian government collects $1billion in the PMC which is four times the funding provided to border protection services.

The impacts for regional destinations can be significant. In FY15, 35% of Cairns international passengers were to regional destinations- New Zealand, Papua New Guinea and Guam. The average fare to region destinations from Cairns was $375, and the $55 PMC represented 15% of the fare paid.

IATA price elasticity modelling in the Asia Pacific region shows that every 1% of airfare reduction results in a 0.95% passenger growth. Therefore, excessive pricing hampers growth potential by increasing fares.

The rate of the Passenger Service Charge is a very significant barrier to attracting new international passenger services to Cairns. Cairns' proximity to South-East Asia makes it a viable destination for short-to-medium-haul leisure traffic from that region if fares are competitive, but with many low cost carriers in South East Asia charging less than AUD $200 each way on short-to-medium haul flights within the region, Australia's PMC forces airlines to charge fares that are less attractive than those to competing leisure destinations.

[10] World Economic Forum, *Travel and Tourism Competitiveness Report 2013*.