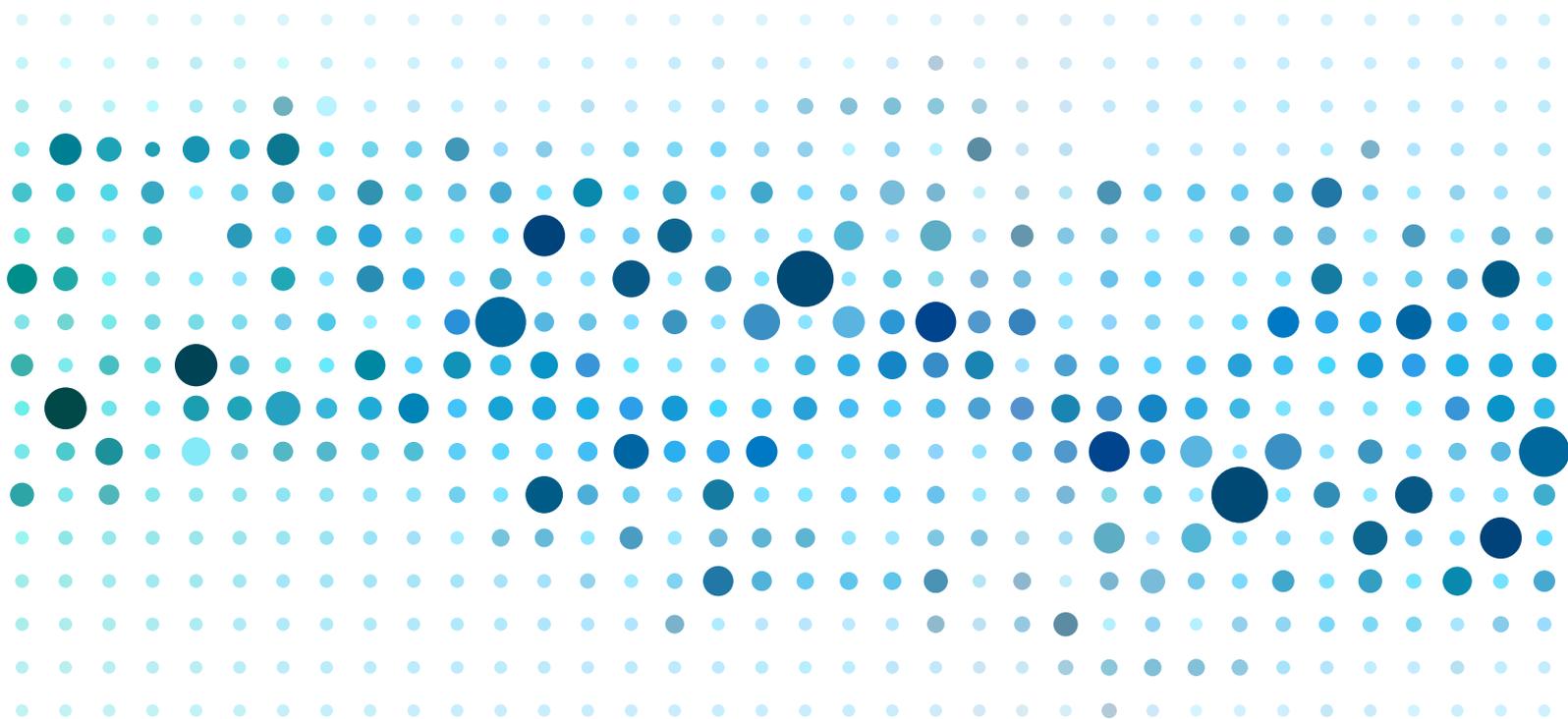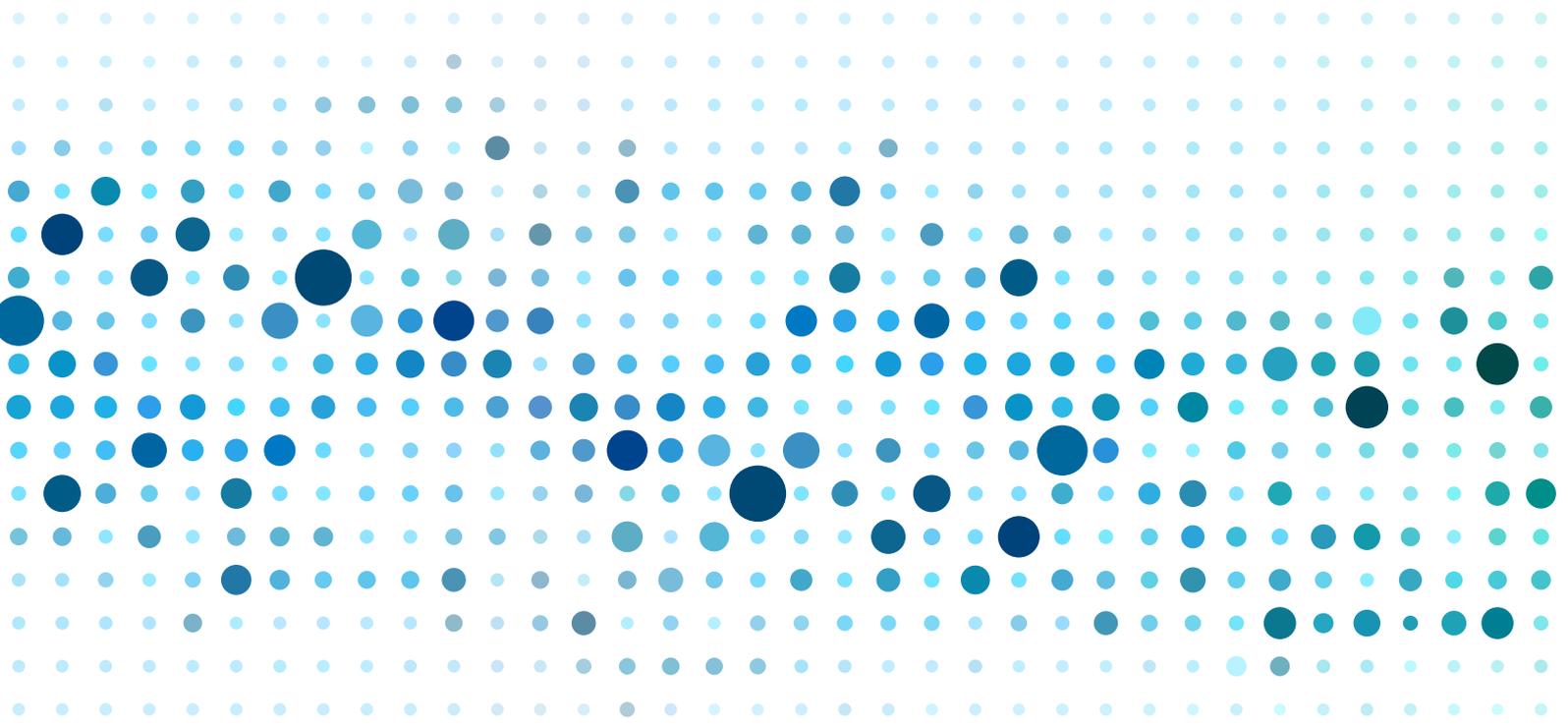# AAA SUBMISSION

TO THE RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Inquiry into the operation, regulation and funding of air route service delivery
to rural, regional and remote communities
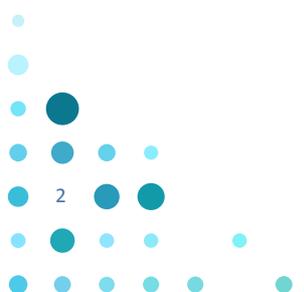
ABOUT THE
AUSTRALIAN AIRPORTS ASSOCIATION

The Australian Airports Association (AAA) is a non-profit organisation that was founded in 1982 in recognition of the real need for one coherent, cohesive, consistent and vital voice for aerodromes and airports throughout Australia.

The AAA represents the interests of over 380 members. This includes more than 260 airports and aerodromes Australia wide – from the local country community landing strip to major international gateway airports.

The AAA also represents more than 120 aviation stakeholders and organisations that provide goods and services to airports.

The AAA facilitates co-operation among all member airports and their many and varied partners in Australian aviation, whilst contributing to an air transport system that is safe, secure, environmentally responsible and efficient for the benefit of all Australians and visitors.

The AAA is the leading advocate for appropriate national policy relating to airport activities and operates to ensure regular transport passengers, freight, and the community enjoy the full benefits of a progressive and sustainable airport industry.

CONTENTS

EXECUTIVE SUMMARY

Australians are the largest per capita users of scheduled aviation services in the world.

This is a reflection of many things, including our affluence, high levels of urbanisation and the large distances that separate our major population centres. It also underpins our cultural commitment to ensuring the 30 per cent of Australians living in regional and remote Australia have access to the same economic and social outcomes as the 70 per cent living in cities.

There has been growing concern about the cost of airfares for travel to regional and remote destinations. The Parliament of Western Australia's Economics and Industry Standing Committee recently conducted an inquiry into these issues, and struggled to answer the fundamental question – are airfares reasonable? The Committee noted the "general resistance" of airlines to provide the Committee with the information needed to form a view one way or another.

On the other hand, the Committee found that airport charges, whilst varying from route to route, were a relatively small component of airfares in regional Western Australia. This was consistent with similar findings by the Productivity Commission on a national basis. The Committee also found airports and councils had been open and transparent regarding their setting of charges.

The Australian Airports Association (AAA) submission is made in that same spirit of openness and transparency. It is based on facts in the public domain and the activities and experiences of our nationwide membership of airports, large and small.

Many comparisons are made between regional airfares and much cheaper fares on major domestic or international routes. While there may be reasons for this, the AAA does not have access to detailed knowledge of the various airline operating cost structures to make this analysis. As such, we offer no view on the appropriateness of airfares.

We can, however, offer a definitive view on the impact of the charges airlines pay for the services they use at airports on airfares. That view, shared by the Western Australian Parliamentary Committee and the Productivity Commission, is that airport charges have little impact on the overall level of airfares. Moreover, claims that regional airfares are high because airports are "gouging" are not borne out – regional airports simply lack the capacity to do this.

Indeed, it is likely that for the majority of council owned airports, airlines are effectively receiving a subsidy from councils (and through them their regional ratepayers). Many councils have not increased prices in real terms for many years, and are diverting general revenues to support the operation and maintenance of their airports. Further, there is evidence that some airlines use their market power to obstruct investments at airports that would facilitate greater competition and generate other benefits for regional communities.
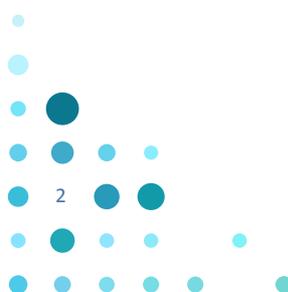
1. INTRODUCTION

The AAA is the national industry voice for airports in Australia. The AAA represents the interests of more than 300 airports and aerodromes Australia-wide – from local country community landing strips to major international gateway airports.

It has a further 130 corporate members who provide goods and services to airports. Of particular interest to this inquiry, the AAA represents the 150 regional airports providing Regular Passenger Transport (RPT) services throughout Australia, as well as major capital city airports where most regional services start or end.

Regional aviation provides a wide range of services critical to the social and economic viability of regional communities. It ensures people can access health services, businesses can access skilled labour and tourists can visit iconic locations. However, the terms of reference of the Committee's inquiry are clearly directed at "air routes". The AAA interprets this to mean RPT services, namely those services that operate on a regular timetable and are freely available for use in exchange for the payment of advertised fares.

As such, this submission does not address a range of issues including aerial work (crop dusting, livestock management, forestry, firefighting), military aviation, the operations of the Royal Flying Doctor Service (RFDS), aviation training and manufacturing, charter operations and recreational flying. We are happy to provide information on these matters at the Committee's request.

We have defined a regional service to be any service that either starts or ends at any airport other than Sydney, Melbourne, Brisbane, Perth and Adelaide, and a regional airport as any but these five. The AAA believes that issues regularly confronted by Canberra, Darwin, and Hobart are very similar to those confronted by Cairns, Launceston and Newcastle, and as such these airports are appropriately seen as regional airports.

This submission concentrates on issues relating to regional airports and their operations that affect the supply and price of RPT services to regional communities. It is structured as follows:

» Section 2 examines the social and economic importance of RPT services in regional Australia (item (a) in the terms of reference);

» Section 3 examines the structure of the regional RPT sector from an airline and airport perspective;

» Section 4 examines issues relating to airport funding (item (d));

» Section 5 examines what influences airport charges and how they are set (items (c), (d) and (g)); and

» Section 6 examines legal and regulatory issues relating to the setting of airport charges (item (b)).

The AAA has no particular observations to make in relation to items (h) and (i) although the operating and capital costs associated with airports ensuring compliance have some relevance to items discussed in section 4.

2. Impacts of regional services

2.1   Social impacts

Regional aviation plays a vital role in connecting individuals, families and communities with the rest of Australia and the world. Overcoming remoteness is one of the key challenges of sustaining regional communities. Obviously, people's ability to access regional aviation services depends critically upon its affordability.

Most importantly, RPT services to regional Australia keep our nation together. Without access to RPT services, families and friends would become more fragmented, grandparents would see less of their grandchildren and regional Australians could not access the leisure activities available to their city cousins. Importantly, RPT services provide essential access to healthcare, education and the legal system for regional residents.

Whilst acknowledging the role of the RFDS in providing lifesaving medical services throughout regional Australia, RPT services also play a vital role in ensuring Australians living in regional areas have access to quality health services. Every day throughout Australia, medical professionals board aircraft in capital cities to travel to regional centres to provide a wide range of specialist services. Similarly, Australians living in regional areas board flights, mainly to capital cities, so they may access medical services. Such trips are either self-funded or supported by the Patient Assisted Transport Scheme (PATS). Without access to RPT services, many people would not have access to these forms of healthcare.

While new technologies have the potential to revolutionise education for regional and remote students, this is still some way off. As a result, many children still need to travel to capital cities and major regional centres to complete their school education. After that, those who wish to undertake tertiary education or many TAFE courses also need to travel and live away from home to pursue their careers. Beyond private road transport, RPT services provide the only access to education for these young Australians. Equally, these services ensure students can remain in contact with their families, in both good times and bad. RPT services are also vital for ensuring specialist teachers, often in STEM disciplines, can travel to schools in regional areas to offer specialist classes.

In many parts of Australia there simply are no lawyers – the Chief Justice of Western Australia, the Honourable Wayne Martin AC QC, told the 2014 Productivity Commission inquiry into Access to Justice that there were no solicitors in private practice in Western Australia living between Geraldton and Broome[1]. Access to RPT services ensures people can travel to major centres to see their lawyers, and lawyers and courts may travel to regional communities to dispense justice and protect the rights of citizens.

Box 2.1 Connecting Indigenous communities

Gove Airport in the Northern Territory serves the mining town of Nuhlunbuy and nearby Indigenous communities. RPT services from Air North provide critical links to large centres such as Darwin and Cairns as well and linking the community to Groote Eylandt. The airport is operated by the Nuhlunbuy Corporation which consists of a team of 30 people overseeing four strategic areas:

» Finance;

» Aviation and compliance;

» Strategic infrastructure; and

» Community engagement.

The Nhulunbuy Corporation facilitates a community advisory committee, known as the Nhulunbuy Town Board, to provide feedback to the Corporation on how to improve services and facilities it is responsible for, such as Gove Airport.

The airport also provides the gateway to the East Arnhem Land Region, a growing tourism area offering true outback adventure and four-wheel drive experiences, as well as fishing and bird watching opportunities. The value of the tourist dollar to communities like Nuhlunbuy goes beyond the small business owner and deep into the Indigenous community.

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1   Productivity Commission (2014) *Access to Justice Arrangements,* Transcript of Proceedings, p588.

2.2　Economic impacts

2.2.1　Facilitating market access

Regional air services facilitate access to larger national and international markets. The wider availability and falling price of international air transport has enabled trade with distant markets for many more businesses in recent years, driving economic growth and raising living standards. Regional communities rely on air services to carry freight such as fresh produce and flowers to capital cities for export or consumption there. The growing number of regional airports now supporting international services to provide producers access to overseas markets is discussed in section 3.2.

Reliable air links to regional areas makes it easier for businesses to visit customers, suppliers, subsidiaries or parent companies in other locations. In a majority of cases, services linking a region with their state capital is essential. However, in recent years, key regional centres have also started linking with interstate capital cities. For example, Dubbo in NSW also has links to Melbourne and Brisbane. Most of these new services are the result of collaboration between airports and airlines that are not part of the domestic aviation duopoly, such as JetGo and Fly Corporate.

Employment opportunities attract people to regional areas. This was evidenced during the resources construction boom in the late 2000s when regional airports such as Karratha, Newman and Port Hedland in WA, and Gladstone, Moranbah, and Mackay in Queensland all became hubs for FIFO workers. The influx of resource and construction workers to towns saw a surge in economic benefits before slowing from 2011 onwards. However, the resident workforce remains the backbone of these regions, especially as the resources boom moves into the production phase, and continues to rely on RPT services to provide connectivity and ensure their community is an attractive location for people to work and raise families long after the boom has ended.

Box 2.2　Australia's newest freight hub

Toowoomba Wellcamp Airport provides a unique opportunity to connect local Queensland markets directly to Asia and the Middle East.

Australia's first privately funded and built airport opened in November 2014 and initially operated a handful of flights to domestic destinations. However the airport's location in one of Australia's most valuable food producing regions, and unparalleled aviation and road transport access, offered significant operational efficiencies and possibilities to the international air cargo sector.

The owners, the Wagners, have created a multi-modal transport hub, able to facilitate wide body, long range international jet aircraft. This has opened up new freight opportunities, such as the weekly Cathay Pacific freighter service to Hong Kong with connections throughout Asia.

In 2016 the Queensland Government allocated strategic status to Toowoomba Wellcamp Airport with the Deputy Premier stating:

> *"This strategic status will ensure the airport's operation is not impacted by future development such as buildings, industries which generate outputs like smoke and lighting, or those which attract wildlife.*

> *"Protecting Wellcamp's assets will help to support the growth of the Darling Downs region, its local economy and tourism industry. This strategic listing also recognises the important opportunities for economic development this airport provides the region."*

The airport is already creating opportunities for the region. Dairy farmers in nearby South Burnett will soon benefit from the development of a milk formula factory at Wellcamp. Toowoomba Premium Milk Managing Director Steve Laracy said, *"Our strategic advantage is being able to fly out of Toowoomba. No one else has that capacity."*

The Oakey Beef meatworks, located 30km west of Toowoomba, shifted its export focus to China following the signing of a free trade agreement between China and Australia in 2015. The introduction of dedicated freight services from Toowoomba Wellcamp Airport to Hong Kong, with onward connectivity to China and North Asia, has further boosted the business' opportunities for growth. As a result, its beef processing production will double from 300,000 cattle to 570,000 head a year, while jobs will rise from 730 people to 1,300.

2.2.2 Tourism

Tourism is a key driver of the economic prosperity of many regional communities. Our vast distances mean road access to many of our iconic destinations is only viable for our most time-rich travellers. These people are typically retired Australians, while high value international tourists rely more fully on air travel. A Tourism Research Australia survey of international travellers to NSW found 57 per cent claimed a lack of time limited their ability to travel regionally, and 20 per cent rated travel by train, coach or air 'hard' or 'very hard' in the survey[2]. A further survey in 2017 showed that the millennial tourist market has perceptions of higher cost of travel as well as potentially large distances between locations that are key barriers to visiting regional Australia, including regional NSW[3]. Air access is therefore vital to encourage regional dispersal of the tourism dollar to communities that arguably depend on it more than larger cities.

Many regional areas of Australia provide unique tourism attractions and experiences. Tourism Australia works closely with its state partners to encourage international tourists to travel to regional destinations, sharing the economic benefits of overnight visitation and increased expenditure. In 2016-17, 8.6 million international tourists to Australia spent 44 per cent of their nights in regional locations.

There is no better example of this than Uluru, for which air access is critical. More recently Kingscote Council (SA) has identified the difference that improved air links can make to visitation of Kangaroo Island, extending its runway to accommodate larger aircraft, increasing the capacity for tourism growth and economic development on the island.

Airports work actively with local and state tourism authorities and businesses to promote and facilitate regional tourist destinations. For example, Mackay Airport is the headline sponsor of the iconic annual Mackay Beach Horse Races.

In many cases, the council is both the chief promoter of regional tourism and the operator of the airport. This means councils developing often sophisticated operational business cases based on aircraft types, expected patronage and yields which airlines can expect. The decision by an airline to commit services to an airport has often been years in the making, with airports front and centre in helping make the case successfully.

Box 2.3 Council airport owners lead regional tourism

Newcastle Airport is owned by the Port Stephens and Newcastle City councils. Both councils play an active role in promoting tourism to the region by funding key tourism bodies.

Destination Port Stephens is a non-profit, incorporated body owned by members and autonomously managed by a board of industry representatives. It's marketing activities are primarily funded by the council and other strategic partners. Similarly, the Newcastle Tourism Information Group works closely with Newcastle City Council to drive the local visitor economy.

On a regional basis, the Hunter Joint Organisation of Councils promotes tourism across the region, providing visitor centres and funding for key events. The collaborative body consists of 11 LGAs, including airport owners. It has attracted events such as the Port to Port MTB mountain bike competition, traversing Port Stephens, Newcastle, Cessnock and Lake Macquarie, and the Port Stephens NSW Pro Surfing tournament. This approach is a good example of the work of airport owners to support regional tourism growth.

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2   Tourism Research Australia (2012) *Destination Visitor Survey: Strategic Regional Research – New South Wales.*
3   Tourism Research Australia (2017) *Strategic Regional Research Report : Attracting Millennials to Regional Australia.*

2.3 Economic contribution of regional airports

Regional airports make significant economic contributions to local and regional economies, both through their direct expenditures and the associated flow-on effects. These are enclosed with this submission and available on our website[4]. ACIL Allen estimates the total expenditure by the operators of all regional airports was approximately $185.4 million in 2014-15[5].

Regional airports themselves generate significant employment directly and through associated industries. This represents a significant injection into regional economies and communities across Australia.

At the individual airport level, ACIL Allen estimates that a typical regional airport with RPT services induces approximately $830,000 in spending in the rest of the Australian economy per annum, while a non-RPT regional airport induces approximately $64,000.

ACIL Allen estimated expenditure of regional airport operators induced an additional $83.4 million in spending in the rest of the Australian economy.

2.3.1 Value added

Deloitte, in a forthcoming report on the contribution of airports that the AAA will release in March 2018, estimates that regional airports contributed $477 million in value-add directly from their operations in 2016-17, as shown in Table 2.1[6].

Table 2.2 shows that in addition to core airport activities, regional precinct level activities at regional airports were estimated to contribute a further $1.9 billion. This includes businesses located in airport precincts, such as office parks, retail, logistics operations and airlines.

Table 2.1   Total economic contribution of airport core activities, 2016-17

Total Economic Contribution	GOS ($m)	Value Added ($m)	Wages ($m)	FTEs
Major airports	3,572	4,411	839	7,097
Major regional airports[7]	194	303	109	945
Regional airports	43	144	100	485
Remote airports	10	30	20	195
Total	**3,820**	**4,888**	**1,067**	**8,722**

Source: Deloitte Access Economics (2018)

Table 2.2   Economic contribution of airport precinct activities, 2016-17

	Direct value added ($m)	Indirect value added ($m)	Total value added ($m)
Major airports	15,388	12,500	27,888
Major regional airports	943	424	1,366
Regional airports	318	124	443
Remote airports	25	22	47
Total	**16,673**	**13,070**	**29,744**

Source: Deloitte Access Economics (2018)

4   https://airports.asn.au/airportfile/https://airports.asn.au/web/dev/uploads/others/AAA%20regional%20airport%20study%20final%20report%20(September%202016).pdf.
5   Note, these reports treat Canberra, Hobart and Darwin as capital city airports, not regional ones as we have generally in this submission.
6   Deloitte (2018), Connecting Australia: *The economic and social contribution of Australia's airports 2018* – forthcoming
7   These include general aviation airports in capital cities, some of which (such as Essendon) are again providing services to RPT operations. The observations in footnote 5 also apply to this report.

2.3.2   Employment

Similarly, Table 2.3 shows economic activity at regional airport precincts was estimated to support the employment of a further 14,179 FTEs.

Table 2.3   **Contribution of airport precinct activities to employment (FTEs), 2016-17**

	Direct	Indirect	Total
Major airports	97,241	86,270	183,511
Major regional airports	6,092	4,186	10,279
Regional airports	2,409	1,146	3,555
Remote airports	186	159	345
Total	**105,929**	**91,761**	**197,690**

Source: Deloitte Access Economics (2018)
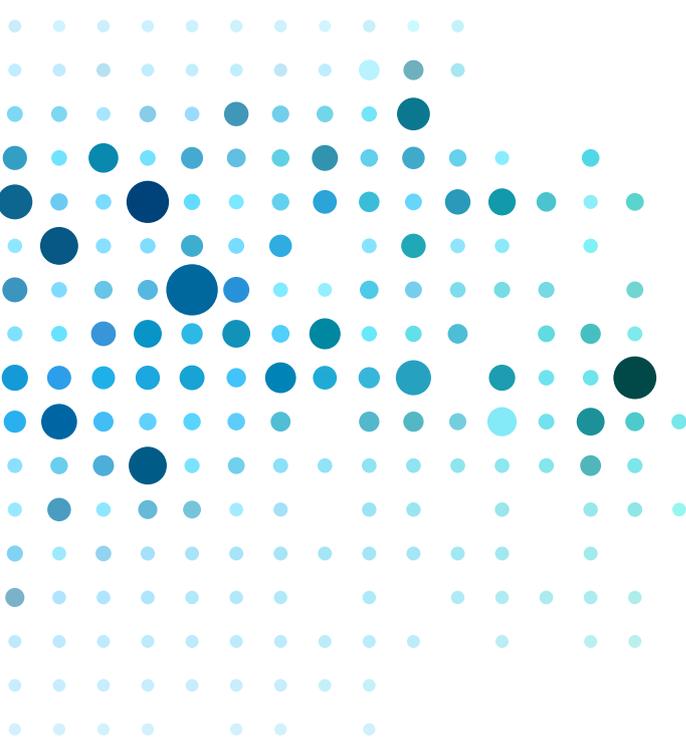
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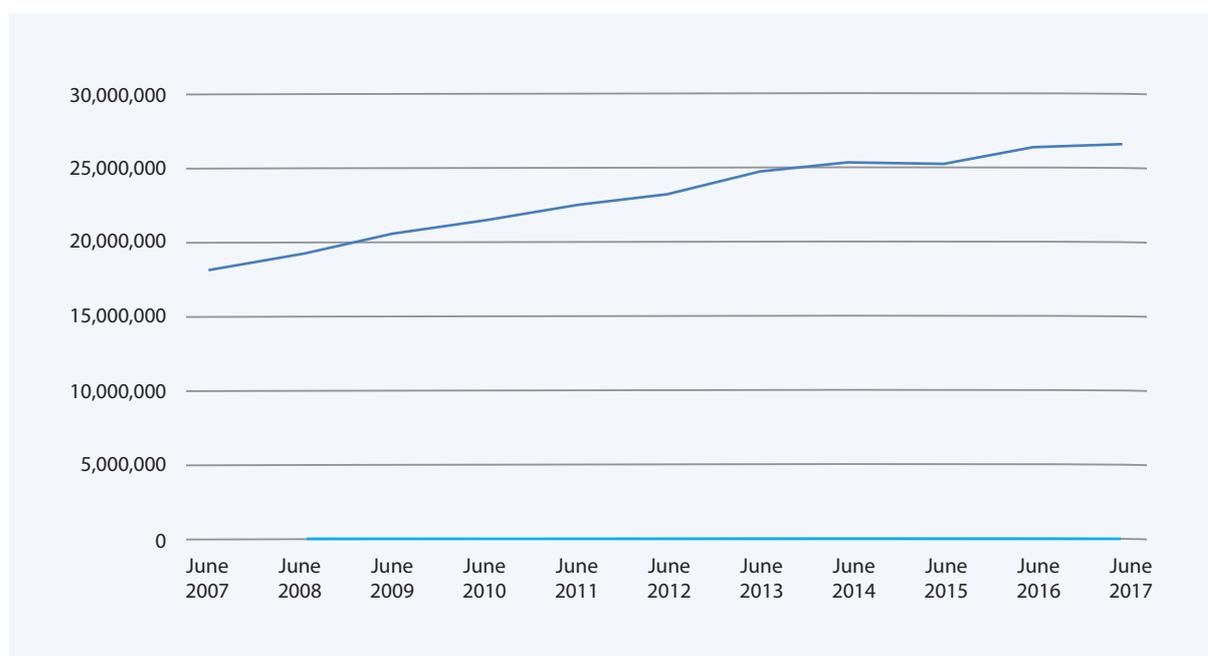
3.1 Domestic regional routes

According to the Bureau of Transport Infrastructure and Regional Economics, there were over 26.3 million domestic passenger journeys on RPT services across the 55 most significant routes to or from regional Australia in the year ended 30 June 2017[8]. This represented around 50 per cent of total domestic RPT activity. Of the top 20 routes in Australia, nine were regional.

Figure 3.1 shows the 10-year trend of the densest regional routes in Australia. Of these routes, the top 10 make up over half of the total passenger volume[9]. The figures show 47 per cent growth over the period, with annual average growth of about 4 per cent. Passenger numbers rose from 17.9 million in 2006-07 to 26 million in 2016-17.

Recent slowing of growth is largely associated with contractions on routes in Queensland and Western Australia as a result of the end of the resources construction boom.

Table 3.1 describes the top 55 regional routes and identifies the carriers serving them. Qantas (Qantas, Qantas Link and Jetstar) and Virgin (Virgin Australia, Virgin Australia Regional Airlines and Tiger) groups tend to dominate the densest routes with the strongest and steadiest growth rates. Rex is prominent in smaller routes with below 225,000 annual passengers. New entrant carriers such as JetGo and Fly Corporate tend to operate thinner routes.

Figure 3.1   **Passenger numbers on major regional routes (year ending 30 June)**

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8   Individual routes restricted to those with an average exceeding 8 000 passengers per month where two or more airlines operate in competition.

9   Charter services are not a substantial feature in either domestic or regional aviation markets with one exception, Western Australia. During the resources construction boom, intrastate charter passenger numbers through Perth Airport grew from almost none in 2011, to 700,000 in 2012 and over 1 million in 2013. By 2017, the number had fallen to 660,000. Many of these services operated in competition to RPT services, used the same airport infrastructure and paid the same airport charges. Indeed, there are suggestions that where mining companies or their contractors had surplus capacity on flights, they would sell this on the open market via the aircraft operator.

Table 3.1   **Top 55 regional routes in Australia**

City-Pair	Jun 2016	Jun 2017	% Change	No Carriers 2017	Carriers
Gold Coast - Sydney	2 702 341	2 712 659	0.4	4	Jetstar, Qantas, Tigerair, Virgin
Gold Coast - Melbourne	1 898 578	1 992 211	4.9	4	Jetstar, Qantas, Tigerair, Virgin
Hobart - Melbourne	1 526 148	1 598 679	4.8	4	Jetstar, Qantas/QantasLink, Tigerair, Virgin
Brisbane - Cairns	1 333 793	1 359 595	1.9	4	Virgin, Qantas, Jetstar, Tiger
Cairns - Sydney	1 075 721	1 124 765	4.6	4	Virgin, Qantas, Jetstar, Tiger
Canberra - Melbourne	1 000 550	1 078 732	7.8	3	Virgin, Qantas, Tiger
Brisbane - Townsville	983 907	958 587	-2.6	3	Jetstar, Qantas,Virgin
Canberra - Sydney	949 346	955 015	0.6	2	Qantas,Virgin
Launceston - Melbourne	908 849	912 850	0.4	3	Jetstar, Virgin, QantasLink
Cairns - Melbourne	802 231	829 970	3.5	4	Virgin, Qantas, Jetstar, Tiger
Brisbane - Mackay	700 013	675 117	-3.6	3	Jetstar, QantasLink, Virgin
Hobart - Sydney	583 492	634 415	8.7	4	Jetstar, Qantas/QantasLink, Tigerair, Virgin
Brisbane - Newcastle	556 576	586 982	5.5	3	Jetstar,QantasLink, Virgin
Brisbane - Canberra	562 033	585 472	4.2	3	Virgin, Qantas, Tiger
Sunshine Coast - Sydney	513 619	558 533	8.7	4	Alliance, Jetstar, QantasLink, Virgin
Brisbane - Rockhampton	572 318	540 278	-5.6	2	QantasLink, Virgin
Melbourne - Newcastle	439 186	469 082	6.8	2	Jetstar, Virgin
Karratha - Perth	549 536	461 470	-16.0	2	Qantas/QantasLink, Virgin
Melbourne - Sunshine Coast	427 132	458 099	7.2	3	Jetstar, QantasLink, Virgin
Brisbane - Darwin	402 798	408 705	1.5	4	Jetstar,Qantas,Virgin, Tiger
Ballina - Sydney	370 366	393 888	6.4	3	Jetstar, Rex, Virgin
Perth - Port Hedland	357 993	344 067	-3.9	2	Qantas/QantasLink, Virgin
Coffs Harbour - Sydney	336 977	342 202	1.6	3	QantasLink, Tigerair, Virgin
Darwin - Sydney	318 605	320 099	0.5	3	Jetstar,Qantas,Virgin
Darwin - Melbourne	290 963	306 263	5.3	3	Jetstar,Qantas,Virgin
Brisbane - Gladstone	367 934	303 038	-17.6	2	Qantaslink,Virgin
Newman - Perth	319 450	292 479	-8.4	2	Qantas, Virgin
Launceston - Sydney	288 935	290 566	0.6	2	Jetstar, Virgin
Broome - Perth	301 646	289 223	-4.1	2	Qantas, Virgin
Kalgoorlie - Perth	225 886	235 636	4.3	3	Qantas, Virgin
Hamilton Island - Sydney	249 173	233 511	-6.3	3	Jetstar,Qantas/Qantaslink,Virgin
Brisbane - Proserpine	236 804	228 757	-3.4	3	Jetstar,Tigerair,Virgin
Albury - Sydney	221 798	224 425	1.2	3	QantasLink, Rex, Virgin
Adelaide - Gold Coast	222 750	216 459	-2.8	2	Jetstar, Virgin
Melbourne - Mildura	202 149	207 387	2.6	3	QantasLink, Rex, Virgin
Brisbane - Hobart	202 848	207 056	2.1	2	Jetstar, Virgin
Brisbane - Emerald	204 572	197 338	-3.5	2	Qantaslink,Virgin
Port Macquarie - Sydney	190 704	192 860	1.1	2	QantasLink, Virgin
Darwin - Perth	182 715	190 426	4.2	2	Virgin, Qantas
Ayers Rock - Sydney	170 972	190 390	11.4	3	Jetstar, QantasLink, Virgin
Dubbo - Sydney	187 724	189 378	0.9	2	QantasLink, Rex
Sydney - Wagga Wagga	188 484	186 578	-1.0	2	Rex, QantasLink
Sydney - Tamworth	165 788	181 291	9.4	2	Qantaslink, Virgin
Adelaide - Canberra	169 533	175 251	3.4	2	Qantas, Virgin
Adelaide - Port Lincoln	182 356	175 237	-3.9	2	QantasLink, Rex
Brisbane - Bundaberg	167 112	174 394	4.4	2	Qantaslink,Virgin
Sydney - Townsville	158 941	158 110	-0.5	2	Jetstar, Virgin
Brisbane - Hamilton Island	141 985	141 670	-0.2	2	Qantas/Qantaslink, Virgin
Cairns - Townsville	138 332	139 911	1.1	2	Qantas, Rex
Armidale - Sydney	127 323	126 758	-0.4	2	QantasLink, Rex
Adelaide - Alice Springs	120 853	122 104	1.0	2	QantasLink, Virgin
Brisbane - Mount Isa	124 408	121 236	-2.5	2	Rex, JetStar
Brisbane - Moranbah	124 524	119 101	-4.4	2	Qantaslink,Virgin
Alice Springs - Darwin	119 886	116 372	-2.9	2	Qantas, Virgin
Geraldton - Perth	117 709	114 085	-3.1	2	QantasLink, Virgin
Total domestic network	**25 986 365**	**26 348 762**	**0.7**		

Australia's regional aviation route structure is also shown in a series of maps in Appendix A.

The strongest growth rates were on the Hobart to Sydney and Sunshine Coast to Sydney routes, fuelled by strong tourism growth. Routes to and from Karratha, Gladstone and Newman have experienced significant declines following the end of resources construction boom.

3.1.1 Regulated routes

State governments regulate a number of routes within regional Australia. They grant specific airlines the rights to operate a route for a defined period, with more certainty and less fear of competition. This helps guarantee a level of service to destinations that might otherwise be vulnerable to cuts in air services.

Only Western Australia, Queensland and New South Wales have regulated routes and, over time, the number of regulated routes has decreased. Table 3.2 provides a list of the routes currently regulated in each state.

Table 3.2   Regulated routes

Western Australia
Perth – Albany
Perth – Derby
Perth – Esperance
Perth – Laverton – Leonora
Perth – Learmonth (Exmouth)
Perth – Monkey Mia – Carnarvon
Perth – Mount Magnet – Meekatharra
Perth – Wiluna (Mt Keith) – Leinster

Queensland
Brisbane – Roma – Charleville
Brisbane – Barcaldine/Blackall – Longreach
Brisbane – Toowoomba Wellcamp – St George – Cunnamulla – Thargomindah
Brisbane –Toowoomba Wellcamp – Charleville – Quilpie – Windorah – Birdsville – Bedourie – Boulia – Mount Isa
Townsville – Winton – Longreach
Townsville – Hughenden – Richmond – Julia Creek – Mount Isa
Cairns – Normanton – Mornington Island – Burketown – Doomadgee – Mount Isa

New South Wales
Sydney – Broken Hill
Sydney – Narrandera
Sydney – Bathurst
Sydney – Moree
Sydney – Grafton
Sydney – Parkes
Sydney – Lord Howe Island

Whilst arrangements between states differ, the process is fairly similar. The state will call for interested parties to bid on a fare and subsidy basis to provide capacity on a certain route (typically from a capital city to a regional centre) in exchange for a monopoly on the route.

It is apparent that growth has been stronger on unregulated routes where more airlines are operating than regulated routes where there is arguably less incentive to innovate and compete in terms of price and scheduling. This has been one driver behind the NSW Government's move to deregulate. Airfares also tend to be higher on regulated routes. That said, where there is no prospect of a commercially viable service, regulation and subsidisation of routes may be an appropriate policy response.

3.1.2 Market concentration

One important feature of Australia's regional aviation market is its high level of concentration. Only nine routes in Table 3.1 feature four airlines, and only one of those has a participant outside the domestic airline duopoly. Of the 15 routes where there are three airlines, only three of those have a true 'third carrier'. Data recently published by the Centre for Asia Pacific Aviation shows that over the period 2007 to 2016, the market share of airlines not part of the domestic duopoly fell from 9.2 per cent to 5 per cent[10].

Rex's network is also very concentrated. As at 21 January 2018, Rex was the sole operator on 78 of the 92 routes it operated. It had one competitor on a further 11 routes, and two competitors on four others. In some cases, this is because Rex is the only operator prepared to fly the route. In others, its position is protected by regulation, at least until the next tender.

High levels of concentration in any market raise questions of market power and this as true for buyers as it is for sellers. This issue is discussed further in Chapter 6.

3.2 International services to regional Australia

Some 2.2 million international passengers arrived in or departed from regional airports in the year ending 30 June 2017. Table 3.3 provides details on passenger numbers and the airlines providing international services to regional Australia.

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10   www.anna.aero/2016/10/20/qantas-is-averaging-30-percent-passenger-share-in-its-top-international-markets

In addition, the following services have commenced or been announced since 30 June 2017:

» Canberra – Doha service by Qatar Airways commencing in February 2018;

» Karratha – Singapore service by JetGo planned in 2018;

» Broome – Singapore charter services by Silk Air will operate from 22 May to 2 June 2018; and

» A daily Singapore – Canberra service will replace Singapore Airlines' existing Singapore – Canberra – Wellington service from 1 May 2018.

Singapore Airlines' changes to its Canberra services highlight the dynamic and competitive nature of these markets, with the existing Canberra to Wellington service being re-routed via Melbourne. Since 30 June 2017, the following services have ceased, or plans to cease the service have been announced:

» Jetstar will cease its Townsville – Bali service from March 2018 after more than two years of operation;

» Malaysian Airlines will withdraw its Darwin – Kuala Lumpur service, the Northern Territory's only direct link to Malaysia, from March 2018;

» Philippine Airlines will remove the Darwin transit stop for its Manila – Darwin – Brisbane service in favour of a direct flight in March 2018, further reducing Darwin's trade and tourism links to Asia;

» Air Asia ended its Darwin – Bali service in January 2018; and

» Air Asia X will transfer its Kuala Lumpur flights from Melbourne (Tullamarine) to Avalon Airport (Geelong), making it Victoria's second international airport by the end of 2018.

In addition to Karratha Airport, the AAA understands a number of other regional airports including Hobart and Newcastle have stated aspirations to develop international services.

Table 3.3   **International services to regional airports**

| Airport	Total international passengers for the year ended 30 June 2017	Airlines
Canberra	63,932	Singapore (Wellington, Singapore)
Townsville	45,206	Jetstar (Denpasar) Air Niugini (Port Moresby)
Gold Coast	1,104,987	Jetstar (Tokyo, Auckland, Wellington, Christchurch, Queenstown) Scoot (Singapore) Air Asia X (Kuala Lumpur, Auckland) Hong Kong Airlines (Hong Kong) Air New Zealand (Auckland, Christchurch) Virgin Australia (Auckland)
Darwin	284,136	Philippine Airlines (Manila) Silk Air (Singapore) Jetstar (Singapore, Denpasar) Air Asia (Denpasar) Air North (Dili)
Cairns	648,064	Jetstar (Tokyo, Osaka, Denpasar) Jin Air (Seoul) China Eastern (Shanghai) China Southern (Guangzhou) Cathay Pacific Airways (Hong Kong) Hainan Airlines (Shenzhen) Silk Air (Singapore) Air Niugini (Port Moresby) Philippine Airlines (Manila)
Port Hedland	7,556	Virgin Australia (Denpasar)
Sunshine Coast	13,728	Air New Zealand (Auckland)

Box 3.1 **Sunshine Coast – International success at a regional airport**

After several years of negotiations, Sunshine Coast Airport welcomed direct services from Auckland with Air New Zealand in 2012, initially a twice-weekly charter operated for a three month winter season. The airport funded a terminal upgrade to meet international standards and border agencies were 'bussed in" from Brisbane, with significant extra cost borne by the airport.

The services were popular and have since increased in frequency to four flights a week over a longer season. In 2018, the season will commence on Friday 6 July, with the last service to operate on Sunday 28 October. As a result, the airport has been designated a full international airport and now has a dedicated border force presence.

This success has led to a planned major redevelopment of the airport, primarily to allow larger international aircraft in the future. The $347 million expansion project will include a proposed 2.45km long and 45m wide runway, expected to be operational by 2020 allowing the airport to handle larger aircraft including Boeing 787s and Airbus A330s. The expansion will be financed in part by a Federal Government loan of $181 million and an innovative public-private partnership between the Sunshine Coast Council and Palisade Infrastructure Partnerships. The upgrade is forecast to produce $4.1 billion in economic benefits and generate 2,230 direct and indirect jobs by 2040.
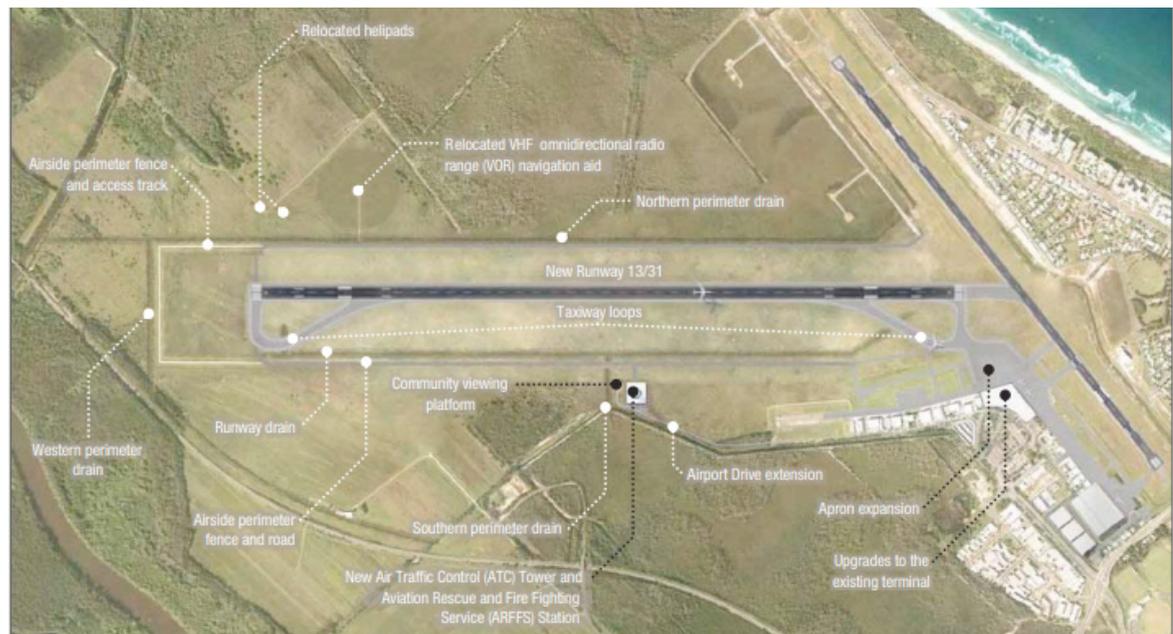
3.3   Airlines

Like all aviation markets, Australia's regional aviation market has shown a significant degree of dynamism. Carriers have entered, some have failed and others have been absorbed by bigger airlines. Some routes have been abandoned whilst others have opened up. Appendix B shows the entry and exit of Australian regional carriers over many years. The AAA has identified 24 regional RPT operators currently operating in Australia. However this number masks the fact that airlines that are owned by the participants in the domestic aviation duopoly carried around 95 per cent of regional passengers in the year ending 30 June 2017.

Further, it seems that the growth of low cost carriers in Australia by the domestic incumbents has been more aimed at reducing costs and competing with each other on established routes rather than providing new services to regional, and particularly non-tourist, destinations.
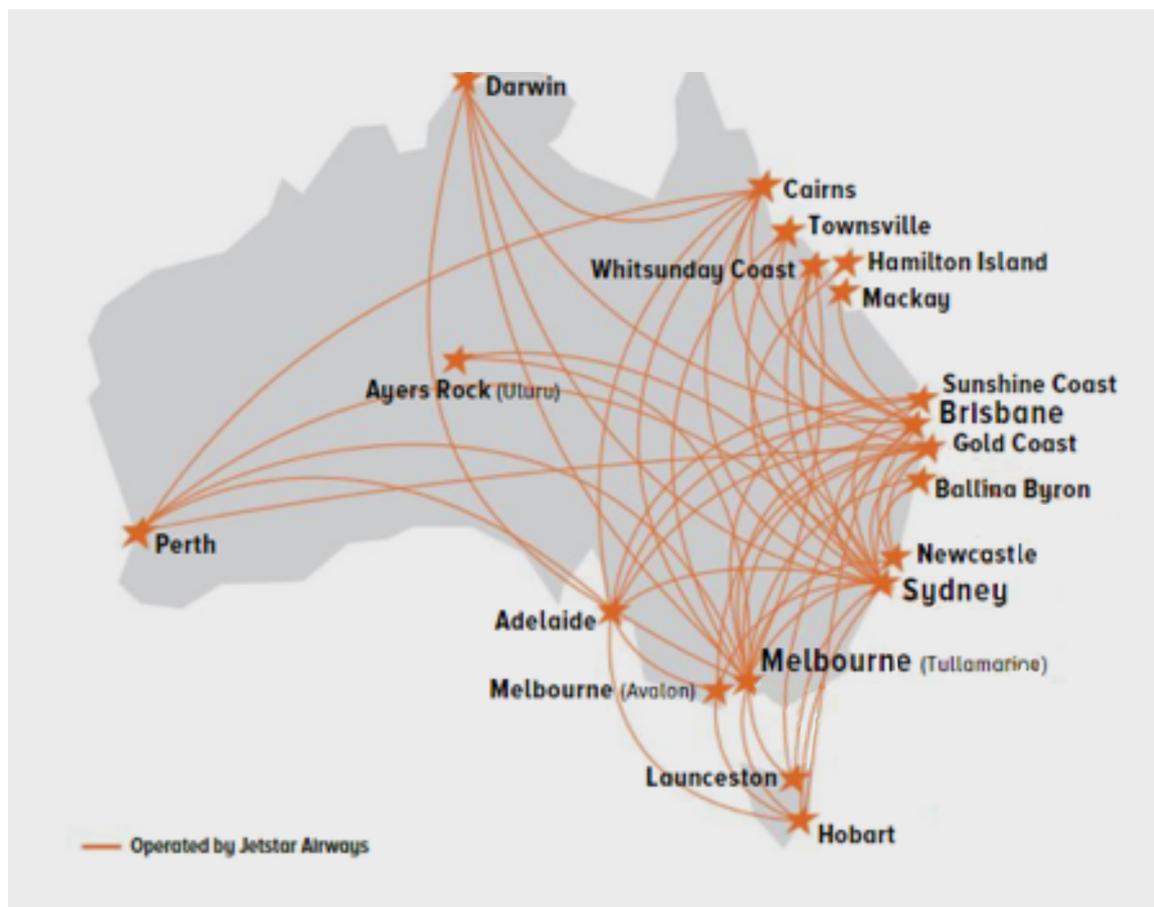
This view is enforced by the absence of low-cost activity on resource related routes during the construction boom, and a continuing absence on routes such as Canberra-Sydney, where higher costs could simply be passed on to price insensitive customers.

Box 3.2 Qantas morphs into Jeststar

Qantas introduced Jetstar in 2004 with a fleet of narrow body B717 (acquired through the Qantas group's acquisition of Impulse Airlines) and A320 jet aircraft that would fly to key existing regional leisure destinations such as the Whitsundays, Gold Coast, Sunshine Coast, Cairns and Hobart from bases in Sydney, Melbourne and Brisbane. With lower costs than Qantas (stemming from lower wage and in-flight service costs), it was able to compete head-to-head with Virgin Blue offering affordable and available flights to more people. However, new routes to regional Australia in particular were relatively slow to emerge.

Qantas progressively grew the Jetstar network with flights to Perth, Alice Springs, Ayers Rock, Darwin, Broome, Townsville and Adelaide, mainly on pre-existing routes. In 2006, Qantas closed its Cairns-based leisure operation Australian Airlines and focused on growing the North Queensland hub as a Jetstar base and launch pad into international operations to Japan. This allowed Qantas to focus its mainline network on higher yielding schedules and routes, without a real competitor in the business sector. Over time, Qantas reduced and ceased operation to destinations such as Sunshine Coast, Gold Coast and Launceston, and reduced services to Hobart significantly.

This strategy also preserved the Qantas brand in high yielding corporate markets such as Canberra, limiting Jetstar to mainly interstate, not intrastate services. Over time, the Qantas brand has been reintroduced to some markets as they've evolved into higher yielding regional leisure markets, such as the Gold Coast and Sunshine Coast, and has re-established services to Tasmania. Their return to the Qantas mainline route map has allowed the growing interest in these destinations to be marketed to a global audience, supported by Qantas' long-haul networks and international partners such as Emirates and American Airlines.

Source: Jetstar inflight magazine

3.4   Airports

More than 26.35 million domestic passengers travelled through regional airports in the year ending 30 June 2017, 1.4 per cent higher than the previous year. Toowoomba Wellcamp Airport recorded the strongest passenger growth of the top 55 regional airports, with a 57.6 per cent increase. The largest decrease was at Roma Airport, which was down 22.2 per cent. As mentioned earlier, passenger numbers grew 47 per cent across the top 55 routes in the last decade.

3.4.1   Ownership

Table 3.4 identifies the 21 airports across Australia that were formerly operated by the Federal Airports Corporation (FAC) and leased under the *Airports Act 1996* (Cth) to private operators between 1997 and 2001.

Table 3.4 Privatised airports

ACT	NSW	QLD	NT
Canberra	Sydney	Brisbane	Darwin
	Bankstown	Gold Coast	Alice Springs
	Camden	Townsville	Tennant Creek
		Archerfield	
		Mt. Isa	

VIC	TAS	SA	WA
Melbourne	Hobart	Adelaide	Perth
Essendon	Launceston	Parafield	Jandakot
Moorabbin			

In addition to the airports listed in Table 3.4 above, there are a number of other airports either owned or operated by the private sector:

» Broome International Airport was purchased from the Commonwealth Government in the early 1990s by a group of local business people who formed the Broome International Airport Group;

» Avalon Airport (north of Geelong) is leased by the Linfox Group from the Department of Defence – it is the site of old Commonwealth Aircraft Corporation;

» Cairns and Mackay are leased from the Queensland Government by the Northern Queensland Airports Group and were previously operated by the relevant port authorities;

» Port Hedland International Airport was leased by a group of investors led by AMP Asset Management from the Town of Port Hedland (box 3.4);

» Toowoomba Wellcamp Airport was constructed and is owned by Toowoomba-based infrastructure, construction and materials company Wagners (box 2.2);

» Sunshine Coast Airport is majority owned by Sunshine Coast Council and is leased to Palisade Investment Partners (part owners of Alice Springs and Tennant Creek airports) (box 3.1);

» Mt Hotham and Halls Creek airports are operated by private management companies;

» Gove Airport is operated by the Nhulunbuy Corporation, a NFP company established under a service agreement with Rio Tinto (box 2.1);

» Olympic Dam Airport is owned and operated by BHP Billiton and links Olympic Dam with Adelaide;

» Moranbah Airport is owned and operated by the BHP Billiton Mitsubishi Alliance;

» Paraburdoo Airport is owned by the Rio Tinto Group and operated by Pilbara Iron, a wholly owned subsidiary of the Rio Tinto Group;

» Middlemount Airport is privately owned and operated by Anglo Coal (Capcoal Management) Pty Ltd, with JetGo services to Brisbane; and

» Groote Eylandt Airport is operated by Groote Eylandt Mining Co with RPT flights linking to Gove, Darwin and Cairns.

In addition, there are 19 bases operated by the Australian Defence Force and some privately owned airstrips. However, the vast majority of the remaining 322 certified and registered aerodromes are owned and operated by local government for the community they serve[11].

Most of these airports were developed during WWII and were transferred to the Commonwealth Department of (Civil) Aviation when no longer required for military purposes.

During the late 1980s, around the time of the establishment of the FAC, they were gradually transferred to the ownership of the relevant local government authorities under Aerodrome Local Ownership Plans (ALOP), whilst a few were sold to private interests[12]. The ALOP agreements under which these transfers took place imposed obligations on the recipient local government to maintain and operate the airport as an airport, and in many cases provided some funding for upgrade or essential asset refurbishments. However, they failed to recognise the need for an ongoing funding source for maintenance, operation and renewal.

Box 3.4 Town of Port Hedland turns to private sector to fund growth

AMP Capital and Infrastructure Capital purchased Port Hedland International Airport for $165 million, in addition to a sale condition of spending a further $40 million on upgrades over the first five years of private operation. Plans for a runway lighting upgrade, new terminal and other infrastructure work have been announced, with construction to begin soon.

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11   Newcastle Airport is owned and operated by Newcastle Airport Pty Limited in which Newcastle and Port Stephens councils are both 50% shareholders. It operates on a leasing arrangement from the Department of Defence.

12   Burnie, Devonport, Cairns and Mackay were transferred to the relevant state government owned port authority.

3.4.2 The role of major airports in the provision of regional services

The data contained in Table 3.1 shows 99 per cent of passengers travelling on the 55 busiest regional routes in Australia will pass through either Adelaide, Brisbane, Melbourne, Perth or Sydney airports. These five airports advised the AAA they handled over 10 million passengers travelling to destinations within their state in the year ending 30 June 2017.

Many regional services pose operational challenges for major airports:

» Inbound travellers may come from airports where security screening is not required, either requiring inbound screening or segregation from other domestic passengers;

» Passengers walking on aprons present additional safety risks;

» The smaller aircraft used on many regional services require more apron area per passenger than larger domestic aircraft;

» Slots are allocated on an aircraft basis, with regional aircraft carrying less passengers per slot than a larger one; and

» Smaller aircraft move more slowly and are more affected by turbulence, so will typically need greater separation distance than other large aircraft.

All these issues taken together mean regional operations tend to reduce the overall operational efficiency of an airport. That said, major airports recognise their obligations to provide efficient and cost-effective services to the entire Australian community and do not seek to discriminate against regional airlines.

In fact, airports have a long and established track record in supporting the regional network. When Ansett collapsed in 2001, Melbourne Airport kept the terminal used by Ansett open to ensure Rex (formed from the merger of Hazelton and Kendall Airlines) could continue to operate. This was despite the fact that it would have been more profitable for Melbourne Airport to close the terminal at the time.

Today, major airports invest in specific facilities to support the operations of regional carriers. Many domestic terminal development projects incorporate purpose-built facilities that improve the travel experiences of regional passengers and the operational outcomes for the airlines that serve them. There is no better example of this than Terminal 2 at Perth Airport.

Box 3.5 A purpose built regional terminal

Regional destinations serviced by flights from Perth Airport include Exmouth, Broome, Kununurra, Kalgoorlie, Geraldton, Albany, Onslow, Esperance, Port Hedland, Karratha, Newman, Leinster and Leonora. Other mine sites and resource centres are serviced by charter flights.

Over 35,000 services departed Perth Airport last financial year from all of Perth Airport's terminals and the general aviation precinct. Since 2011 Perth Airport has invested over $320 million in infrastructure that supports regional services and connects them to the rest of Australia and the world.

The new Terminal 2, the only purpose built regional terminal at a major Australian airport, includes 16 check-in counters, centralised passenger security screening zone, dedicated pick-up and drop-off lanes at the front of the terminal, and room to park 56 aircraft accessible by eight boarding gates. Regional services also use Perth Airport's new Terminal 1 Domestic Pier. This new capacity has provided regional airlines affiliated with Qantas room to grow in terminals 3 and 4.

Despite this record investment in regional aviation infrastructure, the number of passengers flying between regional centres and Perth has fallen from just over 4.8 million to just under 4.0 million in the last four financial years.

Data current as at year ending 30 June 2017

3.5   The airport and airline relationship

The AAA conducted a survey of all regional RPT airports in November 2017[13] to assess, among other things, the relationship between airlines and regional airports. The airlines have often complained of high airport charges, poor engagement by airport operators and the building of terminal and other airport infrastructure they do not require (so called "gold plating"). These accusations are generally not borne out by the survey.

Some complaints by airlines about airport engagement and negotiations relate more to matters of personal style than to issues of substance. These matters are not ones for regulation but are resolved in the normal course of ongoing commercial relations.

However, it is important to note that the level of engagement by airports with airlines is strong. Over 74 per cent of regional airports surveyed have regular meetings with airlines. About 86 per cent give airlines three to six months' notice of changes to airport charges, while the remainder provide 12 months or more. About 45 per cent consult with airlines prior to major capital works entailing increased airport charges.

While the experience of individual airports vary and can be quite positive, Rex seemed to attract the most complaints in terms of an aggressive approach on airport charges and new airport investment, followed by Qantas and its subsidiaries. Virgin tended to attract more favourable comments from a significant number of airports. Ownership structures also affected responses, with privatised airports tending to be more engaged with airlines than council-owned operations.

What regional airports say about airlines

As part of the AAA's survey of regional airports, we asked airport operators to share their insights on their relationships with airlines. The following is a selection of quotes from the survey responses.

 "I think the current Qantas Group negotiation would be an excellent case study of bullying……."

"We find them aggressive and dismissive. We are currently in negotiations with them on a wide range of matters including a major capital development. They currently have a clear message in the public arena that airport charges at every regional airport are the highest in the country with no accountability on them making these unfounded statements. This is big brother at work, an organisation 30,000 strong being intimidating to regional airports with a staff of 12."

"….We have in the past extended discounts of up to 50% but airfares were not impacted at all whilst the community had to borrow large amounts to provide infrastructure to enable airline business models and artificial pressures created by capacity wars."

"Rex descended to threats to cut services "

"Jetstar very difficult to deal with, with threats to reduce services…."

 "Virgin is a good operator but Rex plays hard ball – getting aggressive on airport charges and sustaining its services."

"Rex is more community minded with some sponsorship of community events, while QL has pulled back on these aspects which are very important in the community."

"Rex are our sole RPT… no reduction in airfares has ever been offered…."

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13   This survey covered regional RPT airports

4   Funding regional airports

Australia's major airports, including a number in regional Australia, are privately financed diversified businesses that fund the operation and development of their aviation activities through the collection of charges from airlines (as discussed in section 5) to generate returns for their investors. Income generated from other business activities such as retailing, car parking and property development diversify their revenues and reduce their funding risk and cost of capital.

Box 4.1   Parkes

Located 350km west of Sydney, Parkes Regional Airport is owned and operated by the Parkes Shire Council and serves a number of nearby communities in the Forbes, Lachlan, Weddin and Cabone shires. Its 900 RPT flights to Sydney each year carry over 25,000 passengers. There are also around 2,000 charter flights each year, including freight services. Around half of the passengers travel for business purposes, including to nearby mines and regional government offices.

The airport has a significant deficit which is expected to remain at current levels into the future. Around 90 per cent of its revenue is sourced from RPT charges, with the remainder received from the lease of land. With revenue expected to remain constant, the airport must rely on grants and borrowings to finance capital works.

A terminal upgrade and expansion is currently being undertaken to allow for the possibility of introducing security screening of passengers and bags if required. This project was funded through borrowings and a grant from the Commonwealth Government. This year, a taxiway and apron upgrade to help better handle RPT services and allow larger planes to land will be completed, funded by a NSW Government grant. An upgrade to the road network servicing the airport will be undertaken next financial year, subject to a successful grant application which will need to be matched by borrowings.

However most regional airports are owned and operated by local councils. Whilst most that provide RPT services have revenue sources other than charges to airlines – typically small car parks, rents for hangars and other aviation related business – these are usually small. Moreover, whilst many manage to cover their operating costs, for many periodic maintenance and compliance investment cannot be funded from airport charges alone, leaving ratepayers to divert funds from other purposes. The same applies to investment in new capacity and security enhancements that often require direct support from the Australian and/or state governments, as well as increases in airport charges.

4.1   The financial position of regional airports

ACIL Allen's 2016 study provides an analysis of the financial challenges regional airports face in operating and maintaining their facilities. The findings of that report and the AAA's 2017 survey confirmed what the industry has known for many years – that despite being critical infrastructure for regional communities, on average regional airports across Australia do not have adequate funding to maintain or improve their existing infrastructure, with the problem only becoming worse as time goes on.

ACIL Allen found:

» RPT regional airports surveyed had an average of $2.28 million in revenue in 2014-15 compared with an average expenditure of $2.36 million. This equates to a 3.4 per cent funding gap, which means these airports do not have the funds to invest in new capacity or meet any new security requirements;

» Nearly 40 per cent of Australia's regional airports expect persistent budget deficits over the next 10 years; and

» The cost of operating a regional airport is expected to rise by 38 per cent over the next decade, adding to the already difficult financial environment.

Simply maintaining a regional airport in a compliant condition often creates significant financial stress. This can be further compounded by upgrades to meet future aviation needs or new security requirements. The actual extent of the financial challenge facing the sector is likely to be even greater than is indicated in the ACIL Allen report, which assumes assets will simply be maintained at the status quo. However, for many airports, infrastructure upgrades will be required as aircraft fleets evolve and regulatory standards change, combined with runways, aircraft parking aprons, taxiways and lighting systems reaching end-of-life.

Some regional airports experiencing persistent funding gaps will find themselves under increasing financial pressure that might ultimately result in their closure and cessation of operations and service provision.

4.2   Investment

There are no reliable estimates of the volume of investment undertaken by regional airports in Australia. Table 4.1 demonstrates the scope and size of some projects undertaken by regional airports recently, or that are proposed. This sample amounts to over $1.5 billion over a relatively short period of time.

These projects have been financed by a combination of private sector equity, public and private sector debt, retained earnings and government grants. But ultimately, the ongoing sources of funds will be users, ratepayers and in the case of grants, taxpayers.

Table 4.1   **Selected recent regional aeronautical related projects (about $10 million and above)**

Airport	Project	Cost ($m)	Date
ACT			
Canberra	Airport precinct redevelopment	500	2009-2014
NSW			
Armidale	Airport expansion	11	2017
Moruya	Airport improvement	10	2017
Newcastle	Terminal expansion including international facilities	14	2015
NT			
Darwin	Terminal expansion	75	2015
QLD			
Cairns	Domestic terminal redevelopment	88	2011
	T2 expansion	15	2018-19
Gold Coast	Low Cost Carrier terminal	100	2010
	Runway and taxiway extension	26	2016-17
Mackay	Runway overlay	12	2011-12
Rockhampton	Airport terminal upgrade	13	2016-18
Sunshine Coast	Runway and terminal project	347	2018
Townsville	Runway, taxiway and apron overlay, and other works	10	2008-14
	New terminal (planned)	70	See box 6.2
Whitsunday Coast Airport	Airport upgrade	40	2018 commence
SA			
Kangaroo Island	Landside and airside terminal expansion	18	2017-2018
Tas			
Hobart	Terminal upgrade	25	2016
	Runway extension (planned)	40	2017-18
Launceston	Airport terminal expansion and reconfiguration; runway and apron overlay	22	2009-2017
Vic			
Bendigo	Runway upgrade project	15	2017
Mildura	Runway upgrade	10	2016-2017
WA			
Karratha	Airport terminal expansion and redevelopment	35	2015
Port Hedland	Airside infrastructure	9	2014

One should not underestimate the importance of smaller investments, which can make a significant difference to the efficiency and passenger experience at regional airports. Examples include:

»   Albury Airport is completing a $5 million terminal upgrade in 2018;

»   Dubbo Airport's recently completed $7 million runway strengthening project was followed by a $7 million airport and aero-medical facilities upgrade, currently underway;

»   Roma Airport completed a $5 million runway upgrade in 2017;

»   Emerald Airport completed its $5 million runway upgrade in 2017;

»   Cloncurry Airport completed a $4 million terminal upgrade in 2016 to support increased passenger numbers;

»   Port Macquarie is expected to commence its terminal upgrade at a cost of $7.5 million in 2018;

»   Port Augusta recently completed a $1.2 million terminal upgrade; and

»   Ballina-Byron Bay has a $5.5 million terminal precinct expansion underway in 2018.

Typically these investments are funded by a combination of council and government grants and low-interest loan program funds.

4.2.1   Airport investment is risky

Predicting future use at regional airports is inherently difficult and uncertain, because demand for RPT services is strongly influenced by general economic conditions and unforeseen events, such as the discovery of nearby mineral resources or the development of a new tourist attraction. The need to upgrade terminal facilities and conduct runway maintenance has increased over time as a result of the trend towards larger and heavier aircraft on regional routes. Airports are required to identify and commit to periodic expansion investments well in advance to facilitate the timely broader economic development from tourism, resources development or other industries.

Indeed while airlines have benefitted from improvements in efficiency from innovation in aircraft, the technologies in airport assets have not provided the same cost savings. Airstrips are still essentially the same as they were 70 years ago, about the time many regional airport runways were built during WWII. The introduction of larger aircraft on regional routes can provide advantages to airlines through cost reductions in labour, maintenance or fuel. Passengers also benefit from improved travel experiences in more modern aircraft, however these advantages require more costly airport infrastructure.

Airlines are reluctant to commit to particular activity levels and may withdraw from a route due to lower than anticipated demand, well before the cost of any upgrade has been recovered. Airlines will not enter into "take or pay" contracts that have been used to finance other infrastructure development, such as gas pipelines and coal loaders.

A number of regional airports have committed to expansions in response to demand driven by the resources construction boom, only to find services reduced or withdrawn altogether at its end. For example, from 2007 to 2013, the annual passenger throughput at Port Hedland grew from 159,000 to 512,000 but, by 2017 the number of passengers using the airport has fallen 30 per cent to around 360,000.

This means there is a considerable risk that regional airport investment can become "stranded" and lie idle for many years before its cost has been recovered by the airport operator.

4.2.2 Security

In the AAAs recent regional airport survey, 53 per cent of airports reported incurring additional capital costs to comply with security requirements. While airports with larger passenger volumes seemed to achieve higher rates of cost pass-through, the AAA understands some airports have not passed on any of these costs. This suggests many airports lacked market power to recover legitimate cost increases from airlines; or their owners may have chosen not to do so.

Complying with aviation security requirements at regional airports represents a significant cost for both airports and their council owners. There are 50 regional airports with some form of security screening for passengers and bags, and a further 31 regional and remote aerodromes that are security controlled but do not facilitate services requiring passenger and baggage screening. The AAA has estimated that under the current arrangements, capital and operational expenditures associated with meeting aviation security requirements at airports across Australia (major and regional) probably exceeds $500 million per annum.

Regional airports generally cover these costs from operating income revenue streams, including screening charges (where applicable), which is recovered through a budget neutral costing model. Other than recovery of actual screening costs, there is no specific revenue stream that can be applied to support the cost of aviation security. This is a critical issue given 60% of regional airports already operate at a financial loss. Significant cost imposts, in the worst case, may result in cessation of air services linking regional centres, impacting regional economic development.

Smaller airports have invested significantly to comply with security requirements. For example, the City of Albany and the Shire of Esperance invested in terminal redevelopments to accommodate aviation security screening (over $3 million and $6 million respectively) only to have the services requiring screening cancelled.

As the Government considers new approaches to airport security screening, it is important to recognise industry trends in air travel. The natural evolution for airlines to move towards larger, higher-capacity aircraft will result in more services requiring security screening (based on the current regulations).

Should new screening requirements at regional airports be considered, it needs to be understood that this cannot be accommodated without significant financial assistance. The AAA is of the view that airlines will use their market power to prevent airports from recovering these additional costs, to the detriment of council ratepayers and, to a lesser extent, investors who have invested significant capital in infrastructure that is vital to both the connectivity and safety of regional communities.

5.   Airport charges

Airports are like any another business – they set their prices on the basis of what their customers are prepared to pay at a level to ensure they cover their operating and capital costs (including an appropriate return on capital). Because the bulk of an airport's cost base is associated with long-lived assets such as runways and terminals, airports take a long-term view on how they set their prices.

The pricing of airport services in Australia has been subject to review by the Productivity Commission on three occasions – 2002, 2006 and 2011 – with the next review scheduled in 2018. The purpose of these periodic reviews is to assess the market conduct of Australia's airports and provide guidance as to how airports should conduct their commercial affairs. The AAA supports these ongoing reviews so all Australians can have confidence that their airport industry is operating in their best interests.

Figure 5.1 provides evidence of the reasonableness of airport charges in Australia by international standards, recently published by Standard and Poors[14].

In each review, the Productivity Commission has considered the market power of Australian airports. Its 2011 review found only four airports – Sydney (Kingsford Smith), Melbourne (Tullamarine), Brisbane and Perth – possessed sufficient market power to warrant some form of regulatory oversight and recommended the monitoring of prices, quality and financial performance by the ACCC. This recommendation was accepted by the Commonwealth Government, and successive governments have supported this basic policy approach on a bipartisan basis since 2002.

All major airports, and many smaller regional ones, enter into long-term agreements with airlines regarding prices and other terms and conditions of airport access. A recent AAA survey found 72 per cent of regional airports have agreements in place or are in the process of renegotiating them. These contracts provide a degree of certainty for both parties and further constrain whatever market power an individual airport may possess during the life of the contract. But these contracts do not guarantee the number of passengers the airline will bring to the airport. If passenger numbers are lower than expected, airlines do not experience an increase in price, but airport revenues are reduced.

Figure 5.2   Global indicators of airport incomes
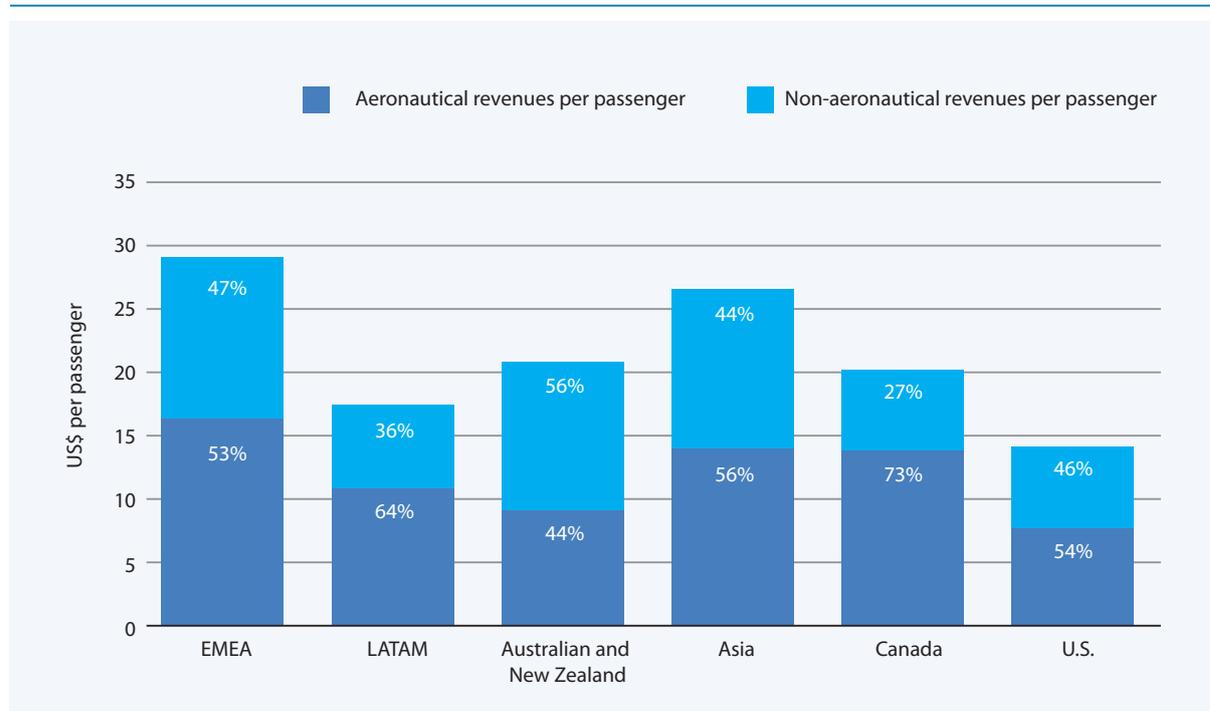
14   Standard and Poors (2017) *Are Airports Ready for Airlines, Retail and Mobility Disruption.*

Airport charges are a cost that airlines must meet from their passenger revenue, just like wages, fuel and the cost of their aircraft. The share of airfares accounted for by airport charges on any route varies considerably depending on the charges themselves, the length of the route, the level of competition on the route and the business model of the airlines involved. That said, research currently being conducted for the AAA suggests that, on average across Australia, airport charges account for less than 10 per cent of fares. As such, even significant movement in charges, to say 20 per cent, would not materially affect fares and the volume of services provided in the unlikely event they were passed on in full to passengers.

No two airports face the same costs and therefore should not be expected to levy the same charges. When considering airport charges in a global context, a range of wider issues such as taxation and regulatory policy complicates comparisons of airport charges. In most relevant comparator jurisdictions (United Kingdom, New Zealand, Canada and the United States) most regional airports are owned and operated by local or state governments, so structural issues regarding the role of governments in service provision and fiscal policy render such comparisons largely irrelevant[15].

That is not to say the issue of regional airport charges is not an important consideration for the Committee. So, in this chapter, we provide some commentary on what affects airport charges, how they are determined and their likely impact on airfares and the demand for air travel.

5.1 Determinants of airport charges

Airports are capital-intensive businesses which means the cost of production typically does not vary when demand changes. This is particularly the case with regional airports – the length of the runway (a primary cost driver) is determined by the needs of the largest aircraft using the airport. Most runways have a capacity to handle in excess of 25 movements per hour whilst most regional airports are lucky to handle 25 RPT movements a day.

There is a range of factors that impact on airport capital costs:

» The returns required by owners are a function of the level of interest rates and the riskiness of the businesses. Guidance issued by the Commonwealth Competitive Neutrality Complaints Office suggests an average risk commercial activity conducted by a government entity should earn a pre-tax return of 5 per cent over the government bond rate – for more risky activities, the margin over the bond rate should be 7 per cent[16];

» Asset construction costs. A runway will be more expensive if a swamp needs draining and a terminal building more expensive if it is in a cyclone prone area. Construction costs in remote areas will typically be higher as a result of the need to transport materials and labour. Cyclical factors such as the elevated civil and building construction costs experienced in Western Australia and Queensland during the resources construction boom will increase costs for assets constructed during such periods;

» Consumer preferences change over time and between locations. Terminals serving a resources destination may be built to a different standard to that of a tourist destination or the nation's capital, properly reflecting the expectations of the relevant passenger market. But in any event, communities have a legitimate expectation of a reasonable level of amenity from public facilities such as airport terminals; and

» Regulatory issues. Over time regulatory requirements in areas such as safety, security, disability access and environmental protection have increased the cost of airport infrastructure, especially in terminals and securing airport perimeters.

Operating costs also tend to be fixed over a wide range of output. Other than security staff, it is unlikely that a regional airport handling 250,000 passengers a year would have a significantly greater operating cost than an airport handling half that number and indeed many functions, such as pavement maintenance, might be performed by the general council workforce.

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15   The AAA has been in contact with overseas airport industry associations and it economic advisors and has been unable to identify any comparative studies of regional airport charges.

16   Australian Competitive Neutrality Complaints Office (1998) *Rate of Return Issues,* CCNCO Research Paper.

Typically, when asset values are used in calculations to inform airport charges, depreciated historic cost (book value) is used, often because this is the only value that is objectively available and the costs associated with more sophisticated valuation techniques are not justified. Thus if the cost of finance remains constant, growing asset utilisation (assuming there is passenger growth) and depreciation will place downward pressure on prices until additional capacity is required. As indicated in Figure 5.2, when that infrastructure is installed, prices will need to rise to fund the new investment and the process starts over again.

Airport investment programs are a key determinant of their cost and the prices they charge airlines for services. In cases where there are no incremental passengers to contribute to investment, airports will be faced with the option of either increasing their charges or seeking contribution from their owners. In many cases, if regional airports cannot increase their prices, this will involve calling on the resources of already cash-starved local authorities.

Figure 5.2 also demonstrates the importance of economies of scale. Between major investments, costs fall with increased volumes. This means that for two airports *with the same cost structure* the one with the higher throughput should have lower prices. The data presented in Appendix C demonstrates this general proposition. However, as noted above, no two airports have the same cost structure. Despite its size, Sydney Airport has higher charges than other major capital city airports in large part because of the cost of land in Sydney and the fact that the land for one runway, and a large part of another, had to be reclaimed from Botany Bay. The general take-out however should be that we might expect airport charges at regional airports to be higher than in major centres but there is no hard and fast rule, especially as we know that many council owned airports do not recover their costs and therefore set prices artificially low.

Figure 5.2   How investment and airport charges interact
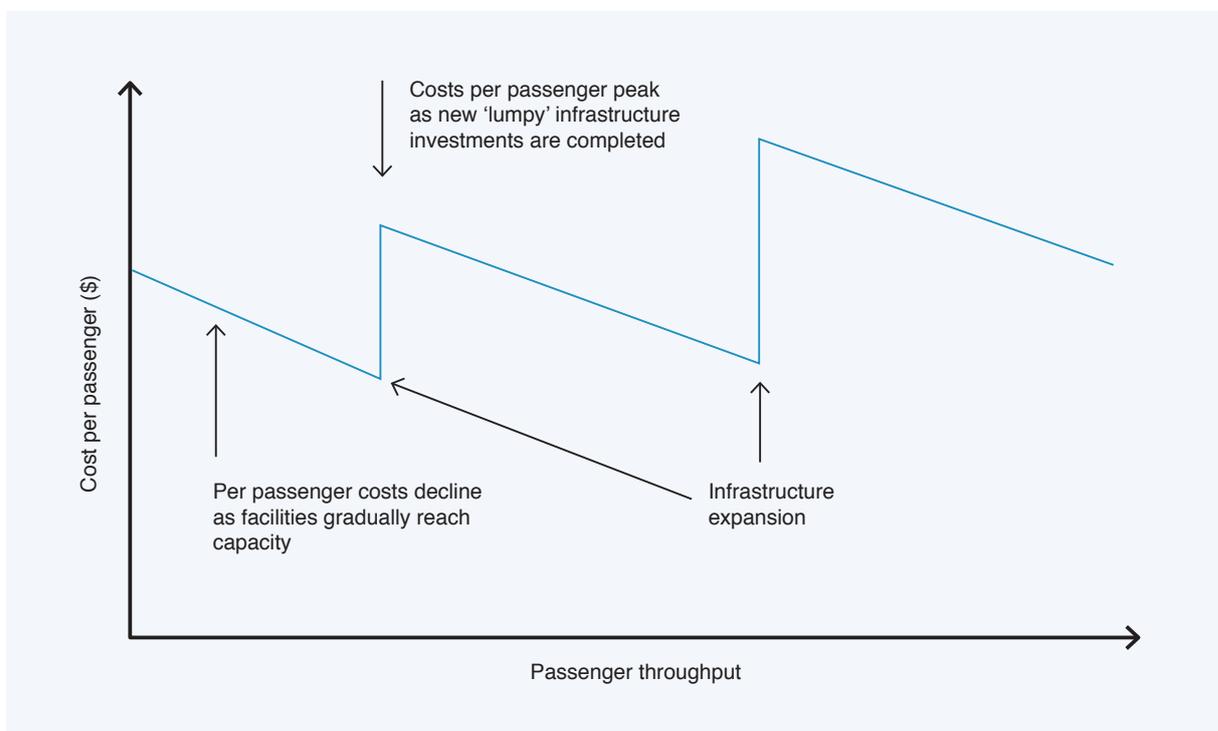
5.2 Structure of airport charges

Airports provide a range of services to airlines (primarily airfield, aircraft parking, terminals and security services), the travelling public (car parks, retailing) and other aviation businesses (airfield and aircraft parking services, hangars). Airservices Australia also levies charges at those airports where it provides terminal air navigation and aviation rescue and firefighting services as well as charges for enroute services in controlled airspace.[17]

It is the practice in Australia that charges relating to the processing of arriving and departing passengers by airports (for example terminal use and security screening) as well as charges for the use of airfield assets such as runways, taxiways and aprons, are levied upon and paid by airlines, even if the amount to be paid may in part or whole be calculated in reference to the number of passengers on the aircraft.

Most regional airports have a pricing structure that consists of:

» A landing charge levied on the maximum take-off weight (MTOW) of the aircraft, for use of the airfield;

» A passenger services/facilitation charge levied on a per-passenger basis, for use of the terminal; and

» One or more security charges, usually levied on a per departing passenger basis, to recover the costs incurred by the airport in screening passengers and their bags, and perhaps other matters, in accordance with the relevant aviation security standards.

In the period immediately after the privatisation of the FAC, major Australian airports used similar structures to that described above – in fact during this period international terminal charges were also based on a tonnage basis as airports did not have passenger data to levy charges on. However after the removal of price controls in 2002, major airports (including those is regional Australia), in large part due to requests from both Qantas and international airlines, moved to a pricing structure that also levied airfield charges on a per passenger basis. An example of such a pricing structure is to be found at Townsville Airport that currently levies an airfield charge of $5.85 per domestic passenger (including GST) for RPT services and a tonnage-based charge of $12.87 per tonne MTOW (including GST) for non-passenger aircraft.

Box 5.1 The cost of using Mackay Airport

Since 1 October 2016, the following charges (exclusive of GST) have applied to passenger services using Mackay airport:

» Landing charge of $10.30 per tonne MTOW;

» Passenger charge of $10.50 per passenger; and

» Security charges:

  − Security charge (passenger screening) of $4.15 per departing passenger;

  − Security infrastructure charges of $0.16 per departing passenger; and

  − Checked bag screening infrastructure charge of $2.02 per departing passenger.

So how much does an airline pay to use Mackay airport? The best way to make comparisons is in terms of the total cost of an aircraft turnaround (that is an arrival and departure) and the cost per passenger.

This requires knowledge of the aircraft being operated and an assumption of the load factor (percentage of seats occupied) of the aircraft. Consider a Qantas Q400 aircraft with a load factor of 75 per cent – this aircraft has an MTOW of 28.998 tonnes and a seating capacity of 74.

	Arriving aircraft cost	Departing aircraft cost	Total cost
Landing charge	298.86	-	298.86
Passenger charge	582.75	582.75	1,165.50
Security charge		112.11	112.11
Security infrastructure charge		8.88	8.88
Checked bag screening infrastructure charge		230.33	230.33
TOTAL	881.43	934.07	1,815.49

So the total amount paid to the airport by the airline for the turnaround of this aircraft is $1,815.49. On the assumption of 55.5 passengers arriving and departing (74 x 0.75) *sic*, the average cost per arriving and departing passenger is the turnaround cost divided by 111, namely $16.36.

Source: www.mackayairport.com.au/assets/Uploads/9003-MKY-MAPL-Airport-Conditions-of-Use-V2-website-copy.pdf; AAA analysis

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17 Details of Airservices Australia charges can be found at www.airservicesaustralia.com/services/charges-and-costing.

The AAA understands from its members that airports' primary motivations at the time were to attach their revenues to a faster growing cost base (passenger numbers tend to grow more quickly than landed tonnage) and promote more efficient use of airfield assets. Airlines were seeking to avoid paying commissions on part of the ticket cost and transfer some passenger volume risk to airports, especially in relation to the establishment of new services and those which exhibited significant seasonality.

There is significant academic, regulatory and industry literature on the structure of airport prices that largely relates to the efficient use of infrastructure (often highly congested) at major airports. It is the AAA's view that this debate is of little consequence for understanding RPT services in regional Australia. To the extent that airport charges are relevant to regional airfares and demand, the predominant issue is the per passenger cost incurred by airlines.

5.3   How are airport charges set?

In markets with many buyers and sellers, sellers set their prices in the knowledge of what their customers are prepared to pay and their own costs. In markets with few sellers, purchasers require additional information to satisfy themselves of the reasonableness of the prices they are being charged. In cases of extreme market power, usually where there are very many buyers with few resources and only one seller, such as electricity distribution, regulators and/or even Ministers determine what is a reasonable price.

On advice from the Productivity Commission, successive Australian governments have formed the view that because of the relative bargaining power of airlines and airports, weak incentives for airports to use their market power in a way that might harm the economy, and the past conduct of airports, direct intervention in the setting of airport charges by the ACCC is not warranted. The ACCC currently collects data on those airports the Government considers have the greatest market power.

Further, the Commonwealth Government has established Pricing Principles (box 5.2) to judge the conduct of those monitored airports against and has indicated these principles should also be seen by all Australian airports as strong guidance for their pricing behaviour. The AAA is confident that the vast majority of Australian airports comply with these principles. Indeed, as many regional airports are not even profitable, it is impossible under the Principles for them to be seen to be levying excessive charges.

5.3.1   Building block models

The building block model (BBM) was developed by Australian and overseas regulators to calculate the maximum allowable revenue of regulated utilities. In Australia, major airports and airlines use these models to motivate their discussions about long-term price paths for aeronautical prices, especially when large capital programs are involved. It is important to note that the outcomes of these models are not binding but rather act as a tool for exploring the relationship between capital and operating costs and prices.

Essentially, the maximum allowable revenue is the sum of:

» Efficient operating costs;

» Return of capital (depreciation);

» Return of capital (the amount of capital multiplied by the weighted average cost of capital (WACC); and

» An allowance for tax (including in Australia the impact of dividend imputation).

Once revenue is determined, it is allocated to pricing categories on the basis of expected demand. For example, if there is only one category, expected demand is 20 and the allowable revenue is $100, then the price will be $5. In practice, there are usually multiple charging categories (see box 5.1 above) and prices are set to deliver revenues over a number of years. A diagrammatic representation of the model which includes inflation adjustment of the asset base (which is standard practice) is provided in Figure 5.3[18].

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18   Wikipedia provides a reasonable explanation of the building block model and issues associated with its implementation https://en.wikipedia.org/wiki/Building_block_model

Box 5.2 Australian Government Pricing Principles

Pricing principles relate to prices for aeronautical services and facilities (defined in Part 7 of the *Airports Regulations 1997* (Cth)). The principles originated with Productivity Commission's 2002 inquiry and include amendments introduced over time, including after its 2006 inquiry. No changes were made as a result of the 2011 inquiry

The current principles are:

a) that prices should:

    i be set so as to generate expected revenue for a service or services that is at least sufficient to meet the efficient costs[18] of providing the service or services; and

    ii include a return on investment in tangible (non-current) aeronautical assets, commensurate with the regulatory and commercial risks involved and in accordance with these Pricing Principles;

b) that pricing regimes should provide incentives to reduce costs or otherwise improve productivity;

c) that prices (including service level specifications and any associated terms and conditions of access to aeronautical services) should:

    i be established through commercial negotiations undertaken in good faith, with open and transparent information exchange between the airports and their customers and utilising processes for resolving disputes in a commercial manner (for example, independent commercial mediation/ binding arbitration); and

    ii reflect a reasonable sharing of risks and returns, as agreed between airports and their customers (including risks and returns relating to changes in passenger traffic or productivity improvements resulting in over or under recovery of agreed allowable aeronautical revenue);

d) that price structures should:

    i allow multi-part pricing and price discrimination when it aids efficiency (including the efficient development of aeronautical services); and

    ii notwithstanding the cross-ownership restrictions in the Airports Act 1996, not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher;

e) that service-level outcomes for aeronautical services provided by the airport operators should be consistent with users' reasonable expectations;

f) that aeronautical asset revaluations by airports should not generally provide a basis for higher aeronautical prices, unless customers agree; and

g) that at airports with significant capacity constraints, peak period pricing is allowed where necessary to efficiently manage demand and promote efficient investment in and use of airport infrastructure, consistent with all of the above Principles.

Productivity Commission (2011), *Economic Regulation of Airport Services, Inquiry Report 57*, p159.

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19 For determining aeronautical prices through commercial negotiations, these should be long-run costs unless another basis is acceptable to the airports and their customers.

Figure 5.3 An example of a building block model
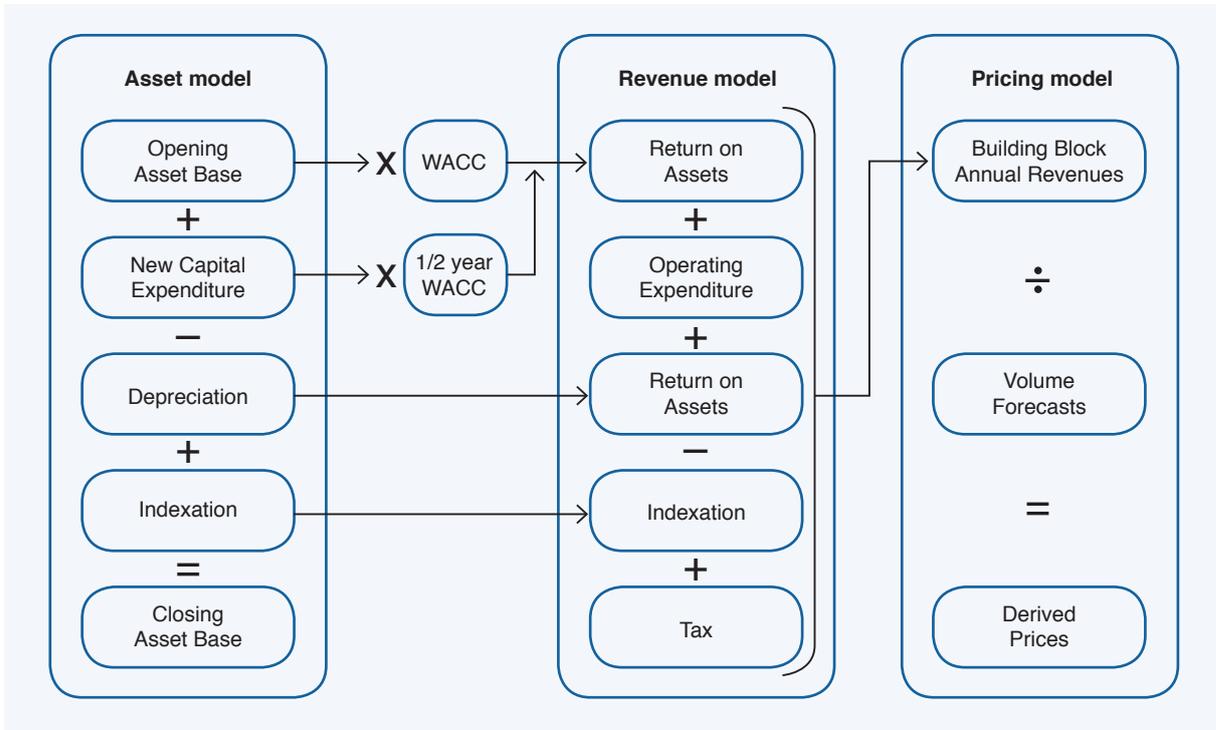
5.3.2 Real and nominal price maintenance by councils

The implementation of a BBM is a complex task. Major airports often retain specialist consultants to develop and/or validate such models as well as provide advice on its various inputs. The AAA understands that for major airports the cost of such advice can run to in excess of $1 million to support negotiations that can take up to a year to conclude. This should not necessarily be seen as a failure or abuse of processes (although poor behaviour can delay the process and increase cost) but rather as a thorough examination of proposals involving hundreds of millions of dollars of revenue and billions of dollars of nationally significant infrastructure investment.

Whilst some regional airports, especially those that are privately operated, use such models (often with support from their shareholders to mitigate costs), the majority of regional airports tend to set their prices using much simpler methods. Around 70 per cent of respondents to the AAA's survey rely on existing council processes to set and publish airport charges. Overall, communications with the airlines appear to be robust with 47 per cent of airports discussing charges periodically with airlines (without detailed modelling) while 32 per cent provide more detailed modelling of cost and revenue data. Only 22 per cent set charges without detailed discussion.

The AAA's recent survey indicated around 50 per cent of airports index their charges to inflation whilst more than 25 per cent have not had a price increase in the last five years. This represents a real price reduction in excess of 10 per cent over that period. A small number of airports reported they had reduced charges in nominal terms under pressure from airlines to maintain existing services or incentivise new ones. Some airports reported moving to charging on a full cost recovery basis to help fund airport improvements but have been encountering airline resistance, following years of charges being held constant in nominal terms.

In its recent survey of regional airports, the AAA learned that 68 per cent of the airports surveyed had been approached by airlines to provide some form of discounting. This was for a variety of reasons. Around 25 per cent of regional airports reported they had been asked for a reduction in charges on the back of a threat to reduce services. A further 22.5 per cent were asked for reductions as part of a new services incentive, while 22.5 per cent were also asked to help airlines reduce airfares. Regional airports are generally very active innovators in the air services space.

5.3.3 Discounts

Research undertaken by the AAA indicates that in the year ending 30 June 2017 the range of discounting against the rates published on airport websites (so called 'rack rates') for international services of Australia's largest 10 airports was 1 per cent to 55 per cent, and for domestic services 1.6 per cent to 48 per cent. This is a higher level than was the case in 2012. The structure of discounts varies but their existence indicates not only the growing commerciality of access arrangements at Australian airports, but also the ability of airlines to exercise leverage to extract price concessions from even Australia's largest (and therefore most powerful) airports. Some of the forms of this behaviour that are present in the market include:

» Temporary discounts to support the establishment of new routes or the expansion (either by increased frequency or larger aircraft) of existing routes – these are more common on international than domestic routes;

» Discounts for total passenger volume delivered by an individual airline or all airlines to the airport – these typically operate on a sliding scale and are more common in the domestic markets; and

» Discounts in the form of penalties for poor service quality or late delivery of infrastructure.

Box 5.3 Discounting at Dubbo Airport

Dubbo is a relatively small airport serving just over 200,000 passengers in the year ending 30 June 2017. Its charges are outlined in Dubbo Regional Council's 2017-18 Operating Plan (p346). The Council has not increased the base passenger fee from the previous year.

It appears Dubbo Airport has adopted many of the discounting habits of much larger airports:

» Qantas and Rex/Airlink receive a discount of around 50 per cent against the base charge for all passengers in excess of 75,000;

» Fly Pelican has received fee holidays for the establishment of new routes to Newcastle and Canberra; and

» JetGo receives a 100 per cent discount on its services to Brisbane and Melbourne for their first year of operation.

Source: Dubbo Regional Council *2017-18 Operating Plan (incl. Revenue Policy)*

5.4 Airline cost structures and airfares

Airlines regularly suggest that high levels of airport charges are the reason for high airfares and claim if fares could be lowered, more people (and particularly tourists) would travel[20]. However, evidence to this effect has in the past been rejected by the Productivity Commission[21]. In 2011 the Productivity Commission found that airport charges accounted for 5 to 8 per cent of airfares between Sydney and Melbourne, one of the most heavily trafficked aviation routes in the world. But more significantly the Productivity Commission found, "in practice, aeronautical charges only have a marginal effect on airfares"[22].

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20 www.theaustralian.com.au/business/aviation/jetstar-ceo-jane-hrdlicka-more-regulation-will-hurt-tourism/news-story/1870759c73867b7669ec43070a9eefb7?from=htc_rss; www.afr.com/business/barnaby-joyce-asked-to-tackle-sydcan-flight-cancellations-20180116-h0iz8e

21 Productivity Commission (2006), *Review of Price Regulation of Airport Services, Inquiry Report No. 40*, pp29-30.

22 Productivity Commission (2011, p xxvi)

In 2000, the ACCC allowed Sydney Airport to increase its charges by just less than 100 per cent to fund investment associated with the Sydney Olympics and to enable its shareholder, then the Commonwealth Government, to earn a reasonable return as determined by the ACCC. When price controls were removed in 2002, other major airports, and large regional airports also increased their prices substantially. Figure 5.4 replicates a chart from the Productivity Commission's 2006 report[23].

Figure 5.5 shows the total passenger movements in Australia since 1986. In considering these data, it is important to remember that Ansett collapsed on 13 September 2001 and events in New York two days earlier had a substantial short-term impact on international traffic. The earlier "dip" is associated with the pilots' strike in 1989. However, what is clear is that a substantial price increase across Australia's major airports shown in Figure 5.4 had no lasting effect on the level of demand.

Figure 5.4 **Price changes at selected Australian airports (average revenue per passenger)**
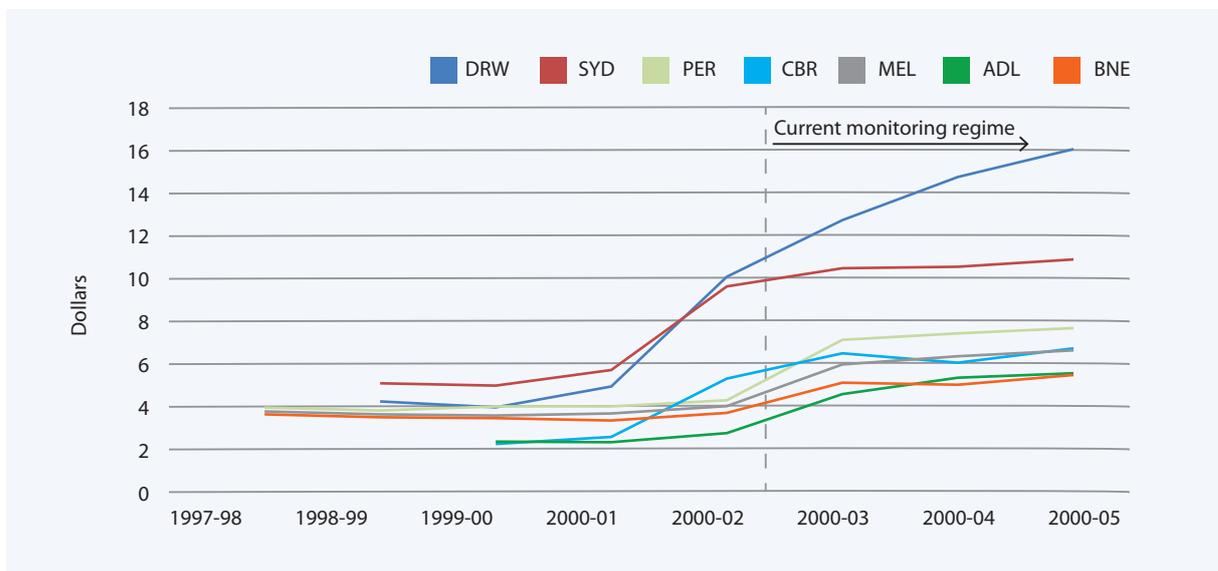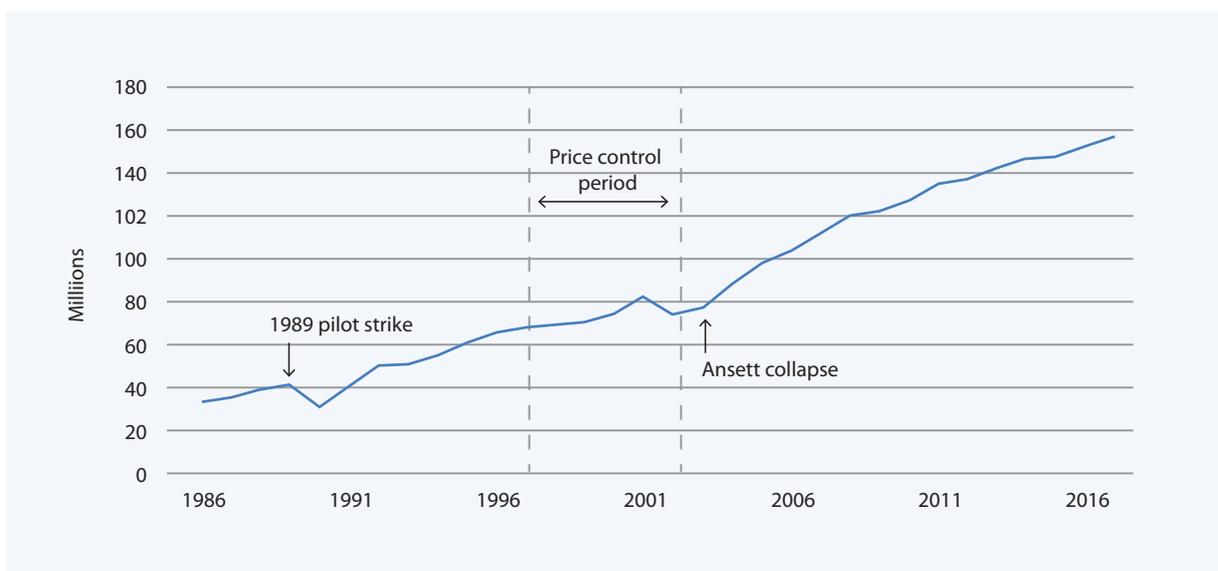

Figure 5.5 **Total RPT passenger movements through Australian airports**


23   Productivity Commission (2006, p xvi)

The reasons for this are essentially twofold.

1. Whilst there is variation across jurisdictions, routes and airline business models, airport charges make up a relatively small component of airline costs.

2. Because there is significantly wide variation between the preparedness to pay across airline passengers, it is possible to recover a greater proportion of costs from the less price sensitive passengers in a way that does not materially impact on demand. This means that any change in airport charges will typically not be fully passed on to more price sensitive consumers by way of increased fares.

Airline cost structures vary depending on a wide range of factors – their business model, markets serviced and so on – and are not generally made publicly available by individual airlines. Moreover, they will vary over time, especially as a result of movements in interest and exchange rates and fuel prices. However, the following graphic provided by the International Air Transport Association (IATA) – the international airline industry association, gives the broad picture[24].

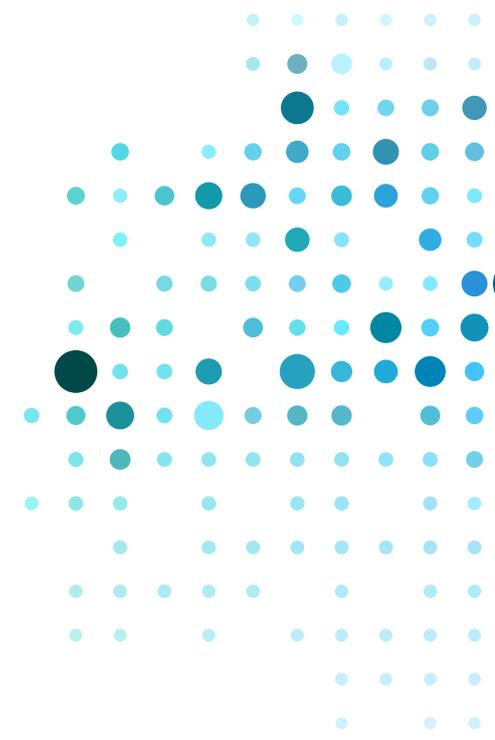**Figure 5.6   Airline cost structure**
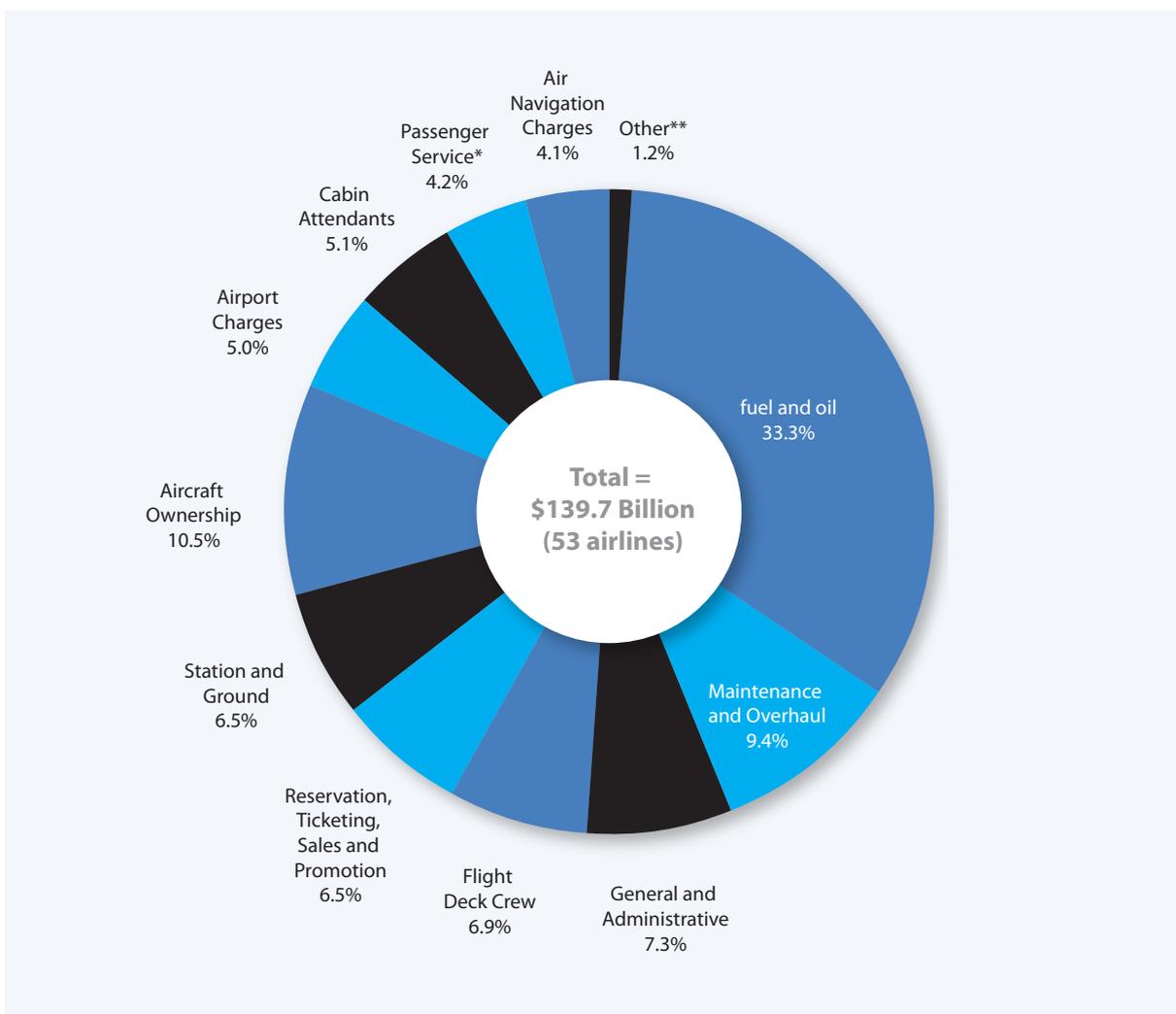
24   www.iata.org/whatwedo/workgroups/Documents/ACC-2014-GVA/aoctf-dev-FY2013-report_IATA.pdf.

It is important to remember that Figure 5.6 relates to the costs of service provision, not the airfares charged by airlines. It is not uncommon to see airfares in the market that are below the cost of provision – Tiger recently offered $1 fares between Canberra and Melbourne[25]. Care must be taken when comparing airport charges with airfares – in the Tiger case, airport charges would have been more than the advertised fare but what is not known is how many tickets were sold at this price or what arrangements had been entered into with the two airports involved to support this marketing exercise.

Also, with airlines increasingly levying passengers for "ancillary services", care must be taken not to underestimate the passenger's cost of travel, especially when comparisons are being made between different markets – globally, these revenues are estimated to exceed 10 per cent of total airline revenues[26]. In Australia, the primary amenities broken out of the base fare are checked baggage, seat pre-selection and meal options. These are offered as optional services that passengers can choose to add to their airfare – passengers may also make on-board decisions in relation to the purchase of food and drinks. In the past, a fuel surcharge has also been added when fuel prices are high, though this is not an optional purchase and should be considered an airline fee[27].

To assist the Committee, Appendix C contains a number of charts showing the level of airport charges relative to airfares on a number of regional routes in Queensland, Western Australia, New South Wales and South Australia.

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25 www.canberratimes.com.au/act-news/tigerair-offers-1-return-flights-on-melbournecanberra-route-20170509-gw14ew.html.
26 Idea Works Company, Press Release 29 November 2016.
27 Airline fuel surcharges are no longer in effect, though they had been used in the past and represented about 10% of the "all-in" airfare. See example from: Australian Business Traveler, *Fees and Charges Exploded: where your airfare actually goes*, Dan Warne, 17 March 2011.

6.   Regulation and market power

It is often claimed by airlines and their representative bodies that airports are monopolies and have unfettered capacity to increase their charges to the detriment of airlines and the travelling public. It is suggested that airlines even as large as Qantas are forced to enter into agreements that give airports the right to unilaterally increase prices[28]. The solution advanced to this problem, even by the Chairman of the ACCC, is the imposition of a typically unspecified regulatory framework to apply to an unspecified group of airports without any reference to the costs and benefits of such an approach[29].

In three systematic public inquiries, the Productivity Commission has on each occasion recommended that the number of airports subject to regulation be reduced: from 12 to seven in 2002, from seven to five in 2006 and from five to four in 2011. Moreover, since 2002, price control by the ACCC has been replaced by a light-handed monitoring regime that sees the annual publication of data by the ACCC, with periodic reviews of the industry as a whole by the Productivity Commission. Further, the Productivity Commission has on several occasions rejected calls for an industry specific access regime or "deemed declaration" under the National Access Regime – such an arrangement would give airlines an automatic right to have a dispute with an airport arbitrated by the ACCC and reduce the incentive to negotiate reasonably.

At no time has the Productivity Commission suggested any need to regulate regional airports of any size. Perth is currently the smallest airport subject to price monitoring.

The AAA will be an active participant in the next Productivity Commission review scheduled for 2018. We expect that review will focus mainly on those airports currently monitored (Brisbane, Melbourne, Perth and Sydney) and their dealings with international and major domestic airlines, as well as ground access issues at those airports. As such, we do not feel it is necessary to canvass issues about the regulation of those airports here but suffice to say, the AAA has every confidence that the monitored airports, and indeed all others, have not acted in a manner inconsistent with the Government's Pricing Principles set out in box 5.2.

Indeed, it is the AAA's view that private airport investors have acted as good stewards of public assets by investing heavily in vital infrastructure and through that, and other initiatives, encouraged unprecedented levels of airline competition. This view is shared by long-serving departmental secretary Mr Mike Mrdak AO[30].

Notwithstanding this, the AAA supports the continuation of the current economic regulatory regime (perhaps with some detail changes) as a framework that delivers for the Australian community.

6.1   Economic regulation of airports

It should be understood that airports do not have free reign and are legally restrained from excessive conduct in a number of ways:

» Airports are subject to the normal application of contract and common law;

» All airports (including those owned by local governments) are subject to the application of Part IV of the *Competition and Consumer Act 2010* (Cth) which requires them not to act in ways that might damage competition or in an unconscionable way;

» The National Access Regime contained in Part IIIA of the Act that provides a mechanism for an access seeker to gain access to nationally significant infrastructure under terms and conditions determined by the ACCC if competition would be enhanced as a result;

» Airports leased from the Commonwealth Government cannot deny access to users unless they can establish that a debt is due and payable – in practice this would involve litigation in the relevant Supreme Court. This effectively prevents unilateral behaviour by these airports;

» Sydney, Melbourne, Brisbane and Perth airports are subject to prices and quality regimes constructed under Part 7 and 8 of the *Airports Act 1996* (Cth) and the *Competition and Consumer Act 2010* (Cth) and instruments made under those Act;

» Some states have general legislation that can be applied to the pricing of any goods and services in their state, such as the monitoring provisions in Part 3 of the *Queensland Competition Authority Act 1997* (Qld); and

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28   Productivity Commission, (2011, p160).
29   See www.abc.net.au/news/2017-03-06/accc-says-consumers-gouged-through-poor-airport-privatisations/8327196.
30   http://airportprofessional.asn.au/interview-with-mike-mrdak-secretary-of-dird/.

» Regional airline access to Sydney Airport is regulated in two ways:

- The *Sydney Airport Demand Management Act 1997* (Cth) limits the number of movements at Sydney Airport to 80 movements an hour subject to some exemptions. In 2003, the so-called "regional ring fence" was established that ensures if an airline operating an intra-state service in New South Wales failed to use a slot 80% of the time, when the slot was returned to the pool, it could only be reallocated to an airline operating an intrastate service in New South Wales; and

- Declaration 94 made under section 95X of the *Competition and Consumer Act Act 2010* (Cth) requires Sydney Airport to provide a price notice under Part VIIA of the Act whenever it proposes to increase the price of certain aeronautical services (as defined in Part 7 of the *Airports Regulations 1996* (Cth)). Direction 35 made under section 95ZH of the Act has the effect of allowing Sydney Airport to increase the weighted average price of these services by no more than inflation between 1 July 2016 and 30 June 2019.

Despite the above points, the reality on the ground for many regional airports is they have very little bargaining power when dealing with airlines. It is interesting to note that despite most regional airports being able to enforce their charges under general local government laws[31] or specific state 'aerodrome fees' legislation[32], there appears to be no examples of such legislation being used to force an airline to pay charges it feels are justified. The AAA is aware of circumstances where airlines have refused to pay price increases for significant periods of time. The AAA's view is either that the cost of enforcement is seen as too high relative to the amounts that might be in question, or airports are concerned about retaliatory action by the airline concerned, by way of service reduction or withdrawal.

6.2   Airline market power

The question of airline countervailing power was considered at length by the Productivity Commission in its 2002 inquiry, along with its relevance to the need and design of airport regulation. Of relevance to this inquiry, this issue goes to the question of whether an airline (or group of airlines) has the capacity to resist price increases proposed by an airport even though the airport has a local monopoly.

Professor Stephen King (now a Commissioner at the Productivity Commission) described countervailing market power in the following way in advice for the ACCC that was provided to the Productivity Commission:

"*To determine if countervailing power is relevant, the analyst needs to consider the bargaining position of buyers and sellers. In particular, it is important to consider which parties will lose most from any failure to reach an agreement to trade the relevant product. For countervailing power to exist in a market that otherwise is deficient in competition, any losses from a break-down in bargaining need to be predominantly borne by the seller*[33]."

In the case of many regional airports, a single airline provides services and it is quite uncertain whether another airline would step in if that service was withdrawn. This empowers both small and large airlines – as noted in section 3.1.2, Rex is the sole operator on 85 per cent of its routes. Whilst the airport may have some other revenue sources, the revenue from the airline is likely to be much larger and without it, the airport could become financially unviable or require substantial supplementation from council at the expense of other services. Indeed, as shown in box 6.1, that loss of revenue may inhibit the ability of the airport to finance facilities needed for the operations of a replacement carrier. Further, if the service is withdrawn the community may lose its only means of accessing essential services and any tourist activity is likely to be harmed. From the point of view of the airline, the aircraft involved will be deployed on another, albeit perhaps a slightly less profitable, route. Clearly, the seller of services in this circumstance is bearing the bulk of the costs.

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31 For example ss 608 and 695 *Local Government Act 1993* (NSW) and ss 134 and 262 of the *Local Government Act 2009* (Qld).

32 Such legislation exists in Tasmania, South Australia and Victoria, see *Aerodrome Landing Fees Act 2003* (Vic); *Aerodrome Fees Act 1998* (SA); *Aerodrome Fees Act 2002* (Tas).

33 Productivity Commission (2002) *Price Regulation of Airport Services, Inquiry Report No. 19*, p192.

Box 6.1 Airlines trying to prevent entry

Rex is the sole airline to provide services to the south-coast of New South Wales through Bega Valley Shire's Airport at Merimbula.

A major runway renewal was conducted in July and August 2013, when the runway was near the end of its design life. The renewal works catered for Rex's existing SAAB aircraft and RPT schedules for over 20 years, or larger turboprop aircraft noting that aircraft technology and carrier fleets are likely to alter over that time.

The Council is looking to progress a number of other elements in the Airport Master Plan. Foremost among these is the expansion of the existing passenger terminal. The terminal could expand to have a footprint of approximately 500m^2 at a limited cost to accommodate up to three simultaneous Saab 340 or Jetstream 41 aircraft (assuming 50% load factor). When there is demand for the operation of more than three simultaneous 30-50 seat aircraft or equivalent or the operation of larger aircraft, such as the ATR72 or Q400, the Master Plan proposes relocation of the passenger terminal precinct. The new terminal location would provide sufficient space facilitate expansion to 1,500 m^2, accommodating 250,000 passengers per annum.

Because lengthening their runway would enable competitors with larger aircraft to compete in the market, Rex descended to threats to cut services, threatened defamation proceedings when Rex's reluctance was reported in the media and directly lobbied the ratepayers association to resist the proposal.

Rex shelved its expansion plans in August 2017, citing the council's "flip-flopping on its position several times". Bega Valley Shire Council does not consider this an accurate description of the chain of events. However on 30 October, the number of Saturday flights between Merimbula and Sydney was reduced, and the airline's morning Sydney-Merimbula return service weekdays was rerouted via Cooma.

Bega Valley Shire Mayor Kristy McBain has said the Council was continuing to try to talk with Rex to find a way around the problems, which stems from plans to extend the Merimbula airport and a dispute on an increase in fees which was admitted to as an error by the Council, but would have been the first CPI increase on fees in over 15 years. It is further noted that the $7.8 million development project is primarily funded by grants for the state and federal governments.

It is the AAA's view that airlines possess significant countervailing power over most, if not all, regional airports in Australia. This is consistent with:

» The fact that many airports have not increased their charges in real or nominal terms despite rising costs and in many cases, particularly in Western Australia and Queensland, falling traffic volumes;

» Airports have not been prepared to pursue airlines for unpaid charges even though they have available to them relatively simple legal mechanisms to do so; and

» Despite significant support from their communities and other airlines, airlines have sought and been able to obstruct investment by refusing to pay a modest increase in charges.

Box 6.2 Airline obstruction of investment at regional airports

The civilian operations at Townsville Airport were leased by the Commonwealth Government in 1998. Townsville Airport is owned by Queensland Airports Limited, which also operates Mt Isa, Gold Coast and Longreach airports. QAL is owned by a group of sophisticated institutional investors.

On 5 July 2017, the Joint Standing Committee on Northern Australia received evidence regarding delays associated with redeveloping the Townsville terminal. The Committee was told the terminal was undersized by around 40 per cent. The project is being supported with concessional funding from the Queensland Government to assist with necessary airfield development and Virgin Australia agreed to the development plan and to pay a price increase in September 2015.

Mr Kevin Gill, the Chief Operating Officer of QAL, indicated the company would have liked to have started work on the redevelopment "years ago" and that the only reason this had not happened was because Qantas would not agree to an increase in charges of $3 per passenger. The Committee was informed by the Deputy Mayor of Townsville that "Qantas said they would not pay whatever the charge was".
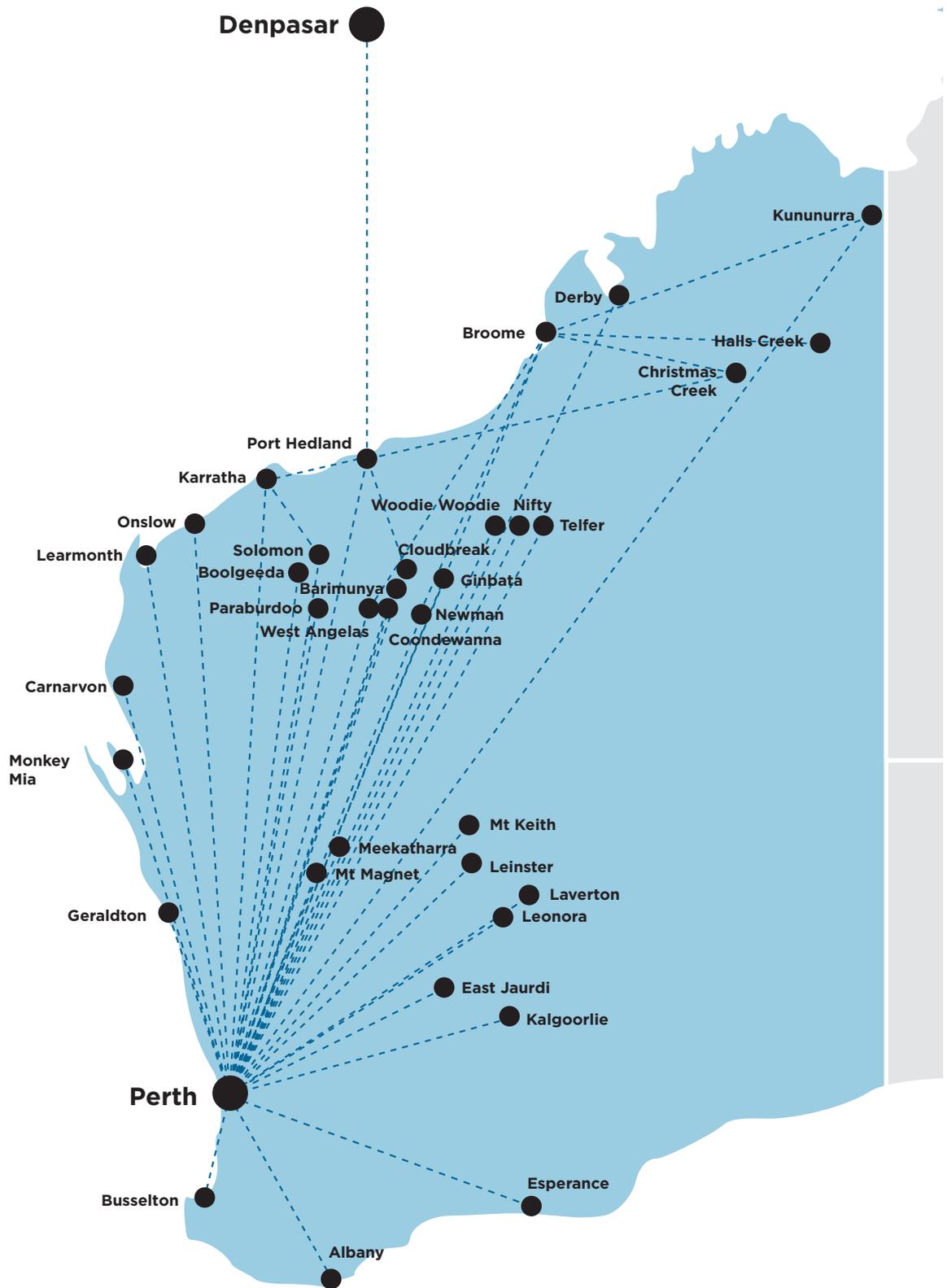
On 30 August 2017, in response to public criticism by the Mayor of Townsville, Qantas was reported in the *Townsville Bulletin* to be considering reducing services to Townsville.

Clearly Qantas has power and preparedness to resist modest price increases even from very large regional airports; and even when its competitors are prepared to pay them. On 2 January 2018, the lowest fare for travel from Townsville to Brisbane quoted on the Qantas website was $212.

Further information: www.townsvillebulletin.com.au/news/the-facts-of-the-townsville-airport-redevelopment/news-story/28053ef7c35ed75975267c3c6ff723b3
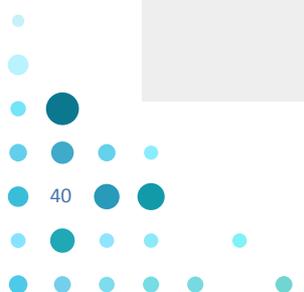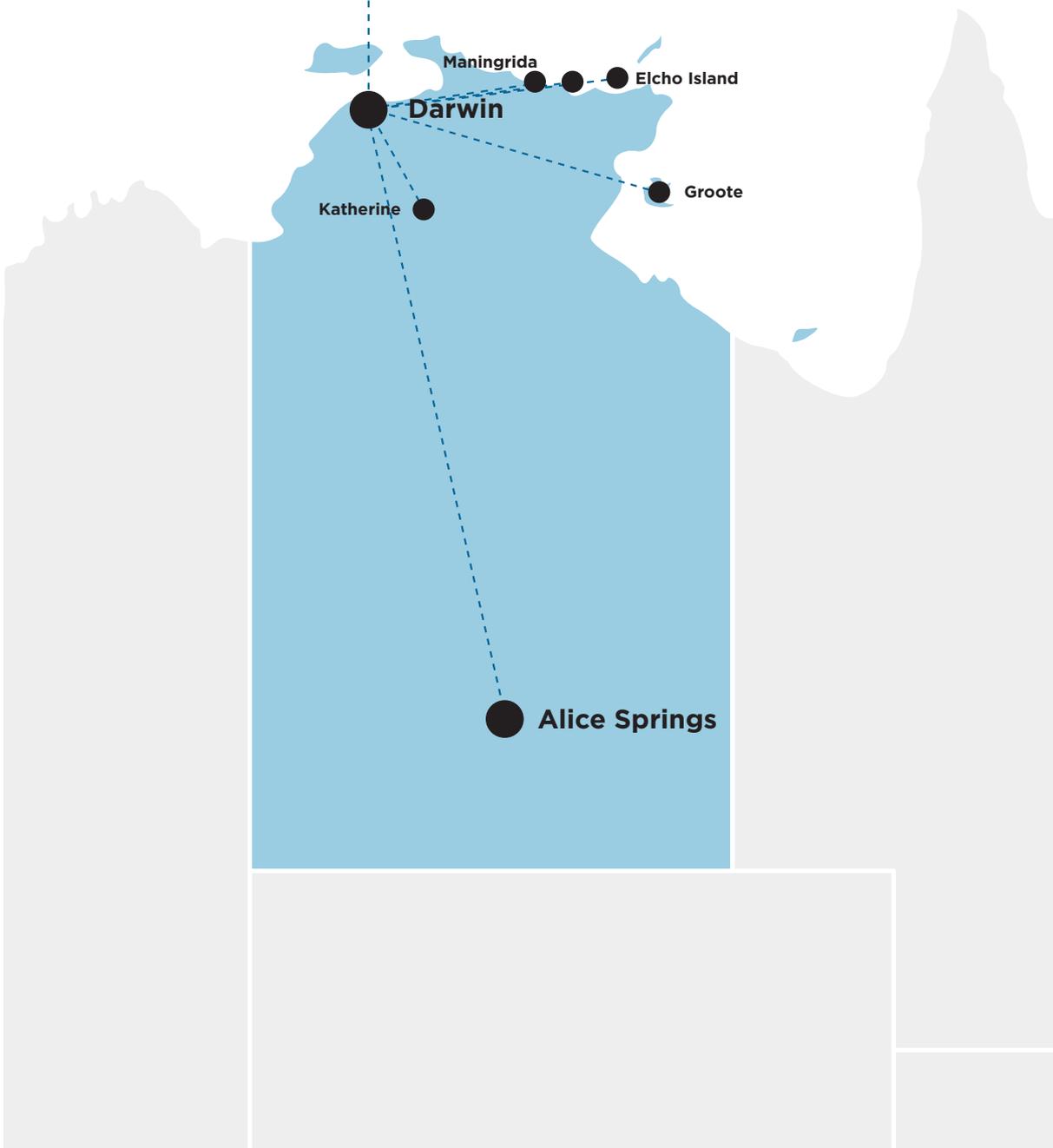
Appendix A

Australia's regional airline route structure

Western Australia

Manila

Singapore

Denpasar

Dili (East Timor)

Maningrida

Elcho Island

Darwin

Groote

Katherine

Alice Springs

South Australia

- Moomba
- Coober Pedy
- Prominent Hill
- Olympic Dam
- Ceduna
- Port Augusta
- Whyalla
- Port Lincoln
- Adelaide
- Kingscote
- Mount Gambier

Queensland

Horn Island
Bamaga
Weipa
Aurukun
Lockhart
Coen
Pormpuraaw
Lizard Island
Kowanyama
Cooktown
Mornington Island
Cairns
Burketown
Karumba
Doomadgee
Normanton
Townsville
Mount Isa
Cloncurry
Hamilton Island
Proserpine
Mackay
Moranbah
Longreach
Barcaldine
Emerald
Rockhampton
Gladstone
Biloela
Blackall
Bundaberg
Birdsville
Windorah
Hervey Bay
Quilpie
Roma
Miles
Sunshine Coast
Charleville
Thargomindah
Cunnamulla
wellcamp
Toowoomba
Brisbane
St George
Gold coast
Norfolk Island

Hong Kong
Osaka
Tokyo
Seoul
Manila
Singapore
Shenzhen
Port Moresby
Denpasar
Shanghai
Auckland

Denpasar

Tokyo
Hong Kong
Kuala Lumpur
Singapore
Auckland
Wellington
Christchurch
Queenstown

Auckland

New South Wales

Mildura

Albury

Melbourne

Burnie
Devonport

Launceston

Hobart

Appendix B
Entry and exit of Australian regional airlines

Table B.1   **Operating regional airlines**

CURRENT	Entry	Exit	Ownership	Region
Air Link	2005	-	Regional Express	Regional NSW
Airlines of Tasmania	1978	-	Sharp Airlines	Regional TAS
Airnorth	2002	-	Bristow Helicopters	Regional Domestic NT/QLD
Alliance Airlines	1989	-	Alliance Aviation Services Ltd	Australia Domestic and FIFO
Cobham Aviation Services	2002	-	Cobham PLC	Domestic including services on behalf of QantasLink
QantasLink	2002	-	Qantas Airways Ltd	Domestic/Regional
Fly Corporate	2016	-	Vee H Aviation Pty Ltd	Regional NSW/QLD
Fly Pelican	2014	-	Private	Regional NSW
Fly Tiwi	2008	-	Hardy Aviation	NT/Tiwi Islands
Free Spirit Airlines	2015	-	West Wing Aviation	Regional VIC/NSW
Hinterland Aviation	1984	-	Broome Aviation Services	Regional QLD
JetGo	2011	-	JetGo Australia Holding Pty Ltd	Regional NSW/QLD/VIC
Jetstar	2004	-	Qantas Airways Ltd	Domestic and International Low Cost Carrier
King Island Airlines	-	-	Matakana Nominees Pty Ltd	King Island/VIC
Qantas	1921	-	Qantas Airways Limited	Domestic and International
Regional Express Airlines	2002	-	Regional Express Holdings	Domestic/Regional
Sharp Airlines	1990	-	Sharp Aviation Pty ltd	Regional SA/VIC
Skippers Aviation	1999	-	Stan Quinlivan	Regional WA
Sky trans	1993	-	Collings Aircraft Holdings	Regional QLD
Tigerair Australia	2007	-	Virgin Australia Holdings	Domestic Low Cost Carrier
Toll Aviation	1989	-	Toll Holdings	Domestic airfreight network
Virgin Australia	2000	-	Virgin Australia Holdings	Domestic and International full service airline
Virgin Australia Regional Airlines	2013	-	Virgin Australia Holdings	Domestic/Regional
West Wing Aviation	2000	-	Collings Aircraft Holdings	Regional QLD

Table B.2   Exited regional airlines

Airline	Entry	Exit	Ownership	Region
Aero Tropic Air Svs	2000	2008	Private	North QLD
Air Australia	2008 (as Strategic)	2012	Private	QLD/VIC/WA
Ansett Australia	1936	2001	Private/News Corp/Air NZ	Domestic/NZ and Asia Pacific
Australian Airlines	2002	2006 (merged into QF group)	Qantas Group	Domestic and Asia
Big Sky Express	2004	2006	Community (Council and Business)	Northern NSW
Brindabella Airlines	1994	2013	Private	Regional NSW
Aeropelican Air Services	1968	2013	Private	Regional NSW
Fly West Airlines	1987	2001	Private	Regional QLD
Hazelton Airlines	1975	2001 (taken over by Regional Express in 2002)	Private/Ansett	Regional NSW
Impulse Airlines	1992	2004 (taken over by QF to form Jetstar)	Private	East Coast Domestic
Kendell Airlines	1967 (as Premiair Aviation)	2001 (taken over by Regional Express in 2002)	Private/Ansett	Domestic Intra/interstate
O'Connor Airlines	1973	2007	Private	Regional SA/VIC
Regional Pacific Airlines	2001	2010	Private	Regional QLD
Tasair	1998	2012	Private	Tasmania
Yanda Airlines	1998	2001	Private	Regional NSW
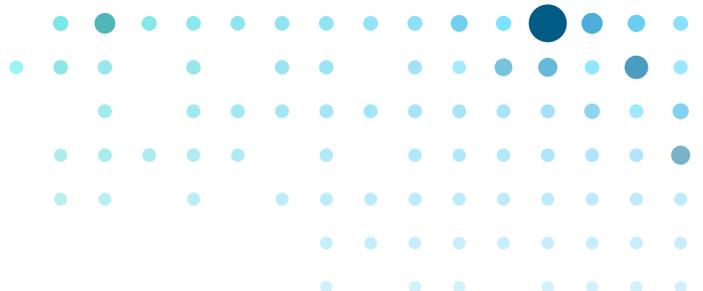
Appendix C
Regional airfares and airport charges

The following charts show a breakdown of economy class airfares from the nominated regional destination to the relevant state capital city on the morning of 10 January 2018. These charts identify a number of cost components – the costs associated with the regional and capital city airports and those attributable to services provided by Airservices Australia – and the relevant airfare. The security component represents total identifiable security costs at both airports involved.

The AAA acknowledges fares may vary according to how far in advance a booking is made however for the purposes of this comparison all fares are subject to the same timeframe. Airport charging data has been sourced from the relevant websites. It has been assumed:

» Aircraft have been assumed to have a seat occupancy of 80 per cent;

» There are no children on board (who are often attract lower airport terminal charges);

» There are no relevant peak hour surcharges; and

» There are no volume based discounts provided by airports, although these are regularly applied by major airports.

The charts relating to Western Australia on face value seem to indicate that Qantas pays significantly less than Virgin Australia for access to Perth Airport. Whilst both airlines are subject to a common charge for use of the airfield[34] Qantas has access to its main terminal, Terminal 4, under a 30 year lease that was entered into by its predecessor Trans Australian Airlines with the Commonwealth Government in 1988. Under this lease, Qantas is responsible for the maintenance and operation of the terminal, including the provision of passenger and baggage security screening. The lease arrangements between Perth Airport and Qantas are private to those parties and Qantas' terminal operation costs are private to it.

As such, it is not possible for the AAA to estimate with any precision an equivalent amount to that paid by users of Perth Airport's other domestic terminals. However, given the ages and conditions of the terminals, it would be expected that any estimate would be lower than that being paid for the use of Terminals 1,2 and 3. The presence of terminal leases and other commercial arrangement in Brisbane also make comparisons between Perth and Brisbane airports highly problematic.

Airservices Australia is a Commonwealth statutory authority of the Commonwealth that provides services to the aviation industry on a cost-recovery basis. Data on its charges can be found on its website[35]. Three charges are relevant:

» Terminal navigation charges – these apply to aircraft using air traffic control services at a towered airport during operational hours, or where a service is requested outside standard operational hours. Of the airports in the sample, these are levied at Perth, Brisbane, Sydney, Tamworth, Broome, Karratha, Townsville and Mackay airports.

» Enroute charges – these apply for flights, either partially or entirely completed under instrument flight rules; and

» Rescue and fire fighting charge (RFC) – these charges apply to aircraft weighing 5.7 tonnes or more that use an aerodrome where regulated aviation rescue fire fighting services are available.

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34   In addition to the runways and taxiways, charges of this type will typically recover the costs of airport wide infrastructure such as road, electrical and water networks as well as corporate overheads.

35   www.airservicesaustralia.com/wp-content/uploads/20170110-2017-01-03-Contract-for-Aviation-Facilities-and-Services-publ....pdf

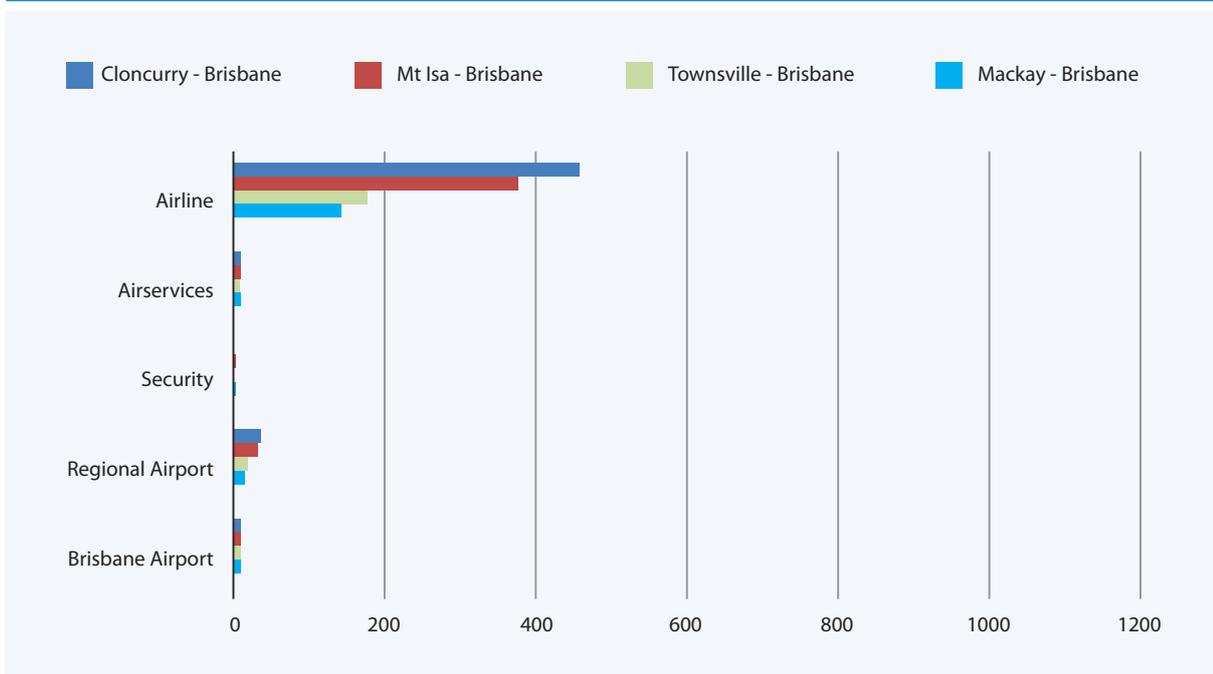**Figure A1   Queensland regional routes – Virgin Australia**

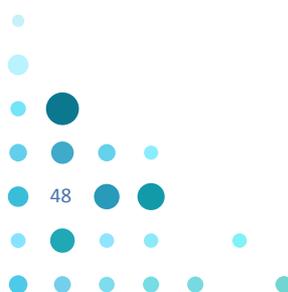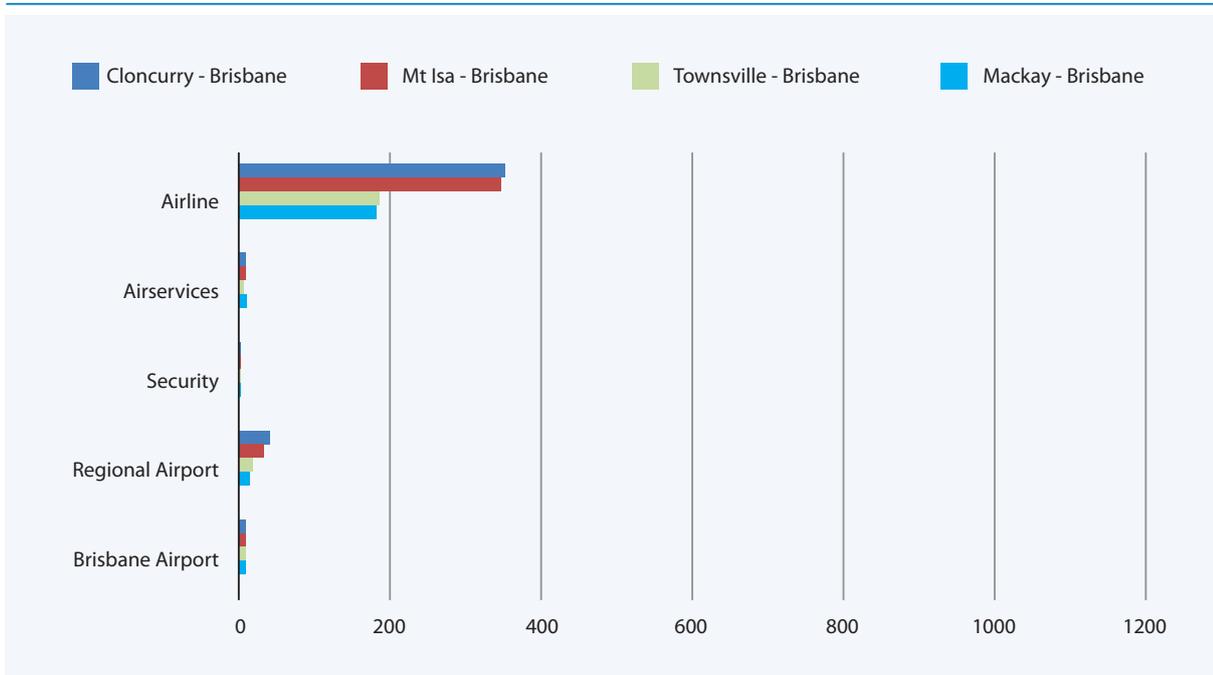**Figure A2   Queensland regional routes – Qantas**

Figure A3   Western Australia regional routes – Virgin Australia

Legend: Kalgoorlie - Perth, Broome - Perth, Geraldton - Perth, Karratha - Perth, Newman - Perth
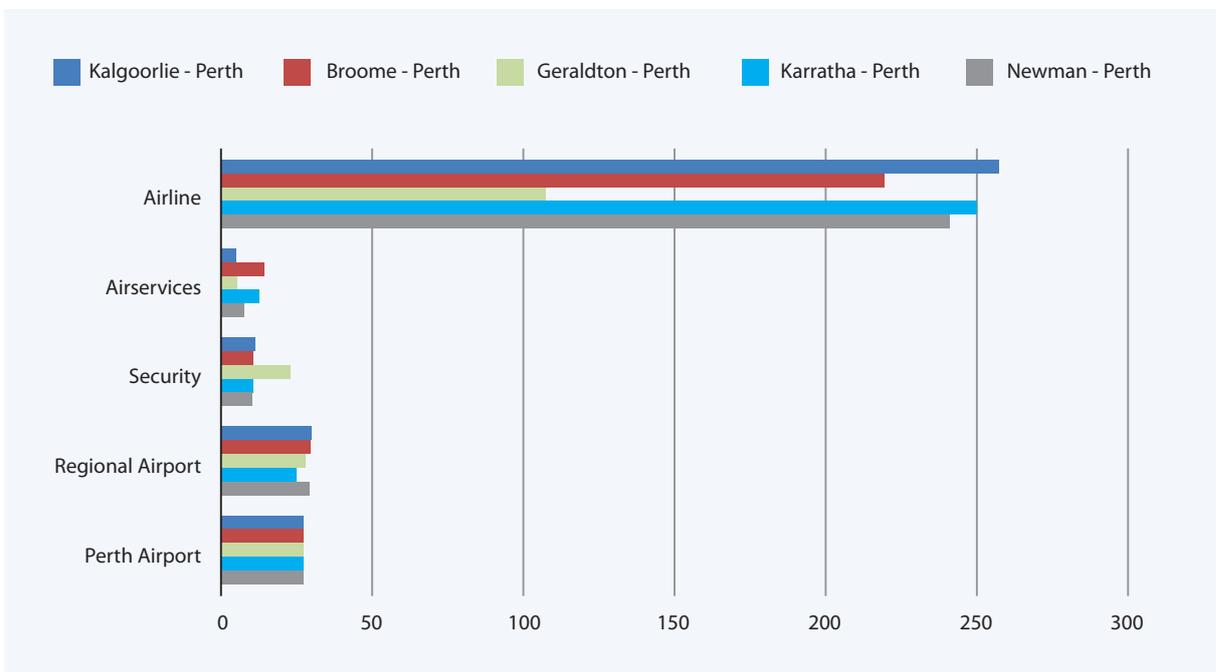
Figure A4   Western Australia regional routes – Qantas

Legend: Kalgoorlie - Perth, Broome - Perth, Geraldton - Perth, Karratha - Perth, Newman - Perth
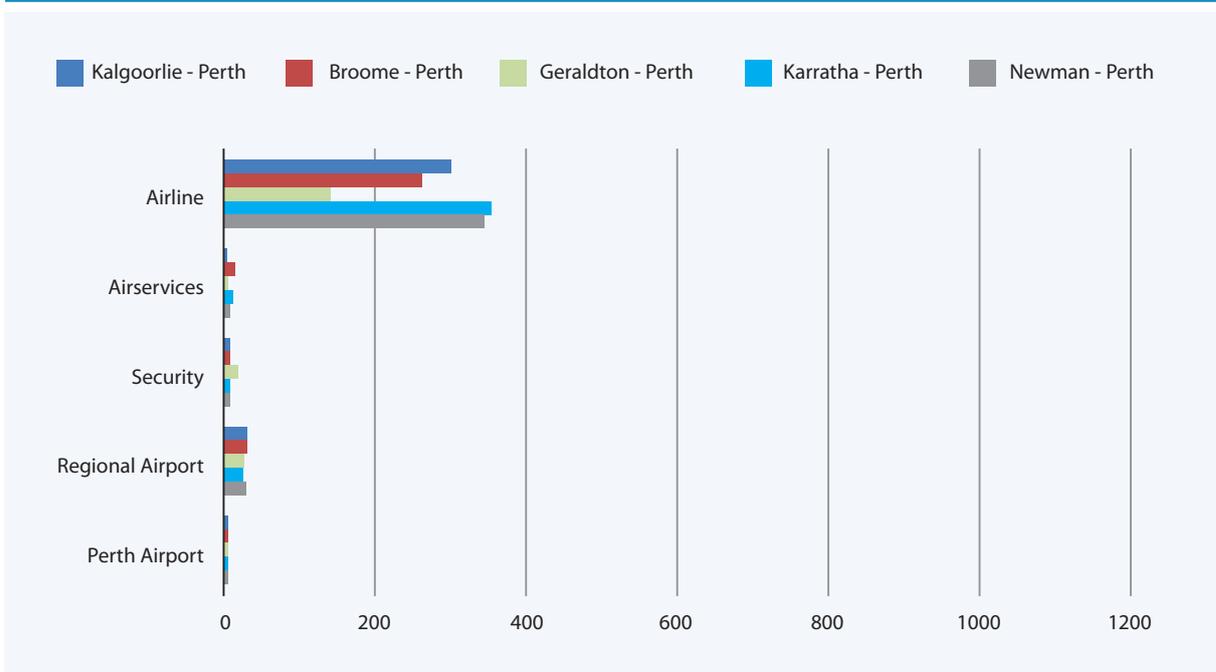
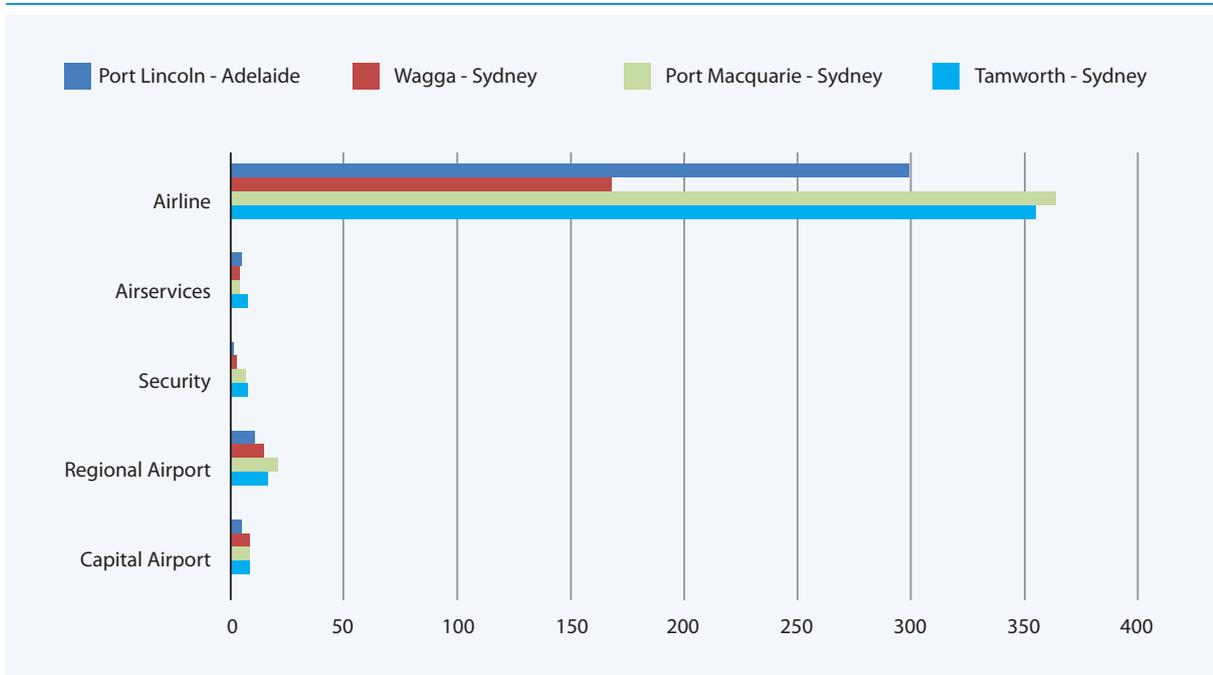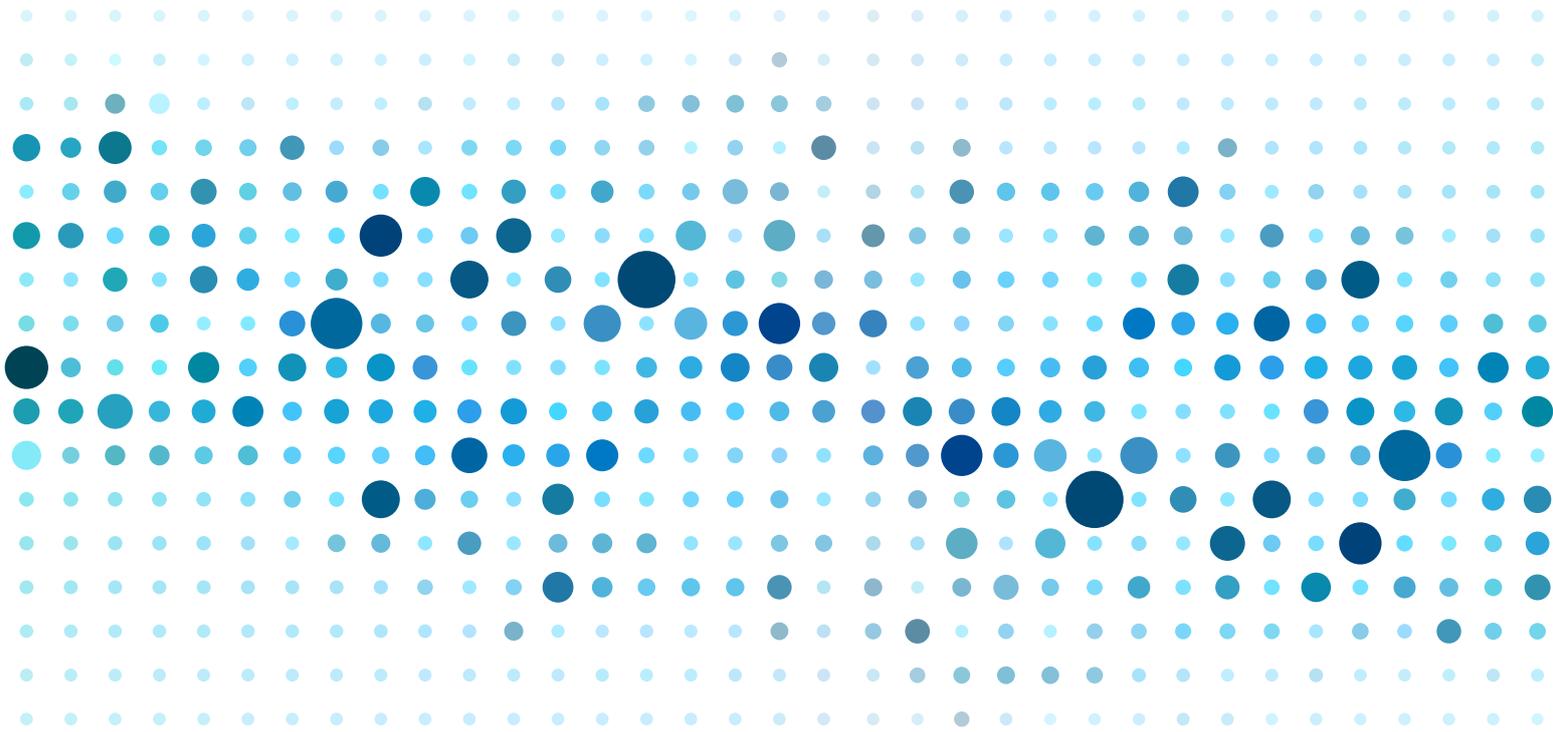**Figure A5**   NSW and South Australian Regional Routes – Regional Express and Virgin Australia
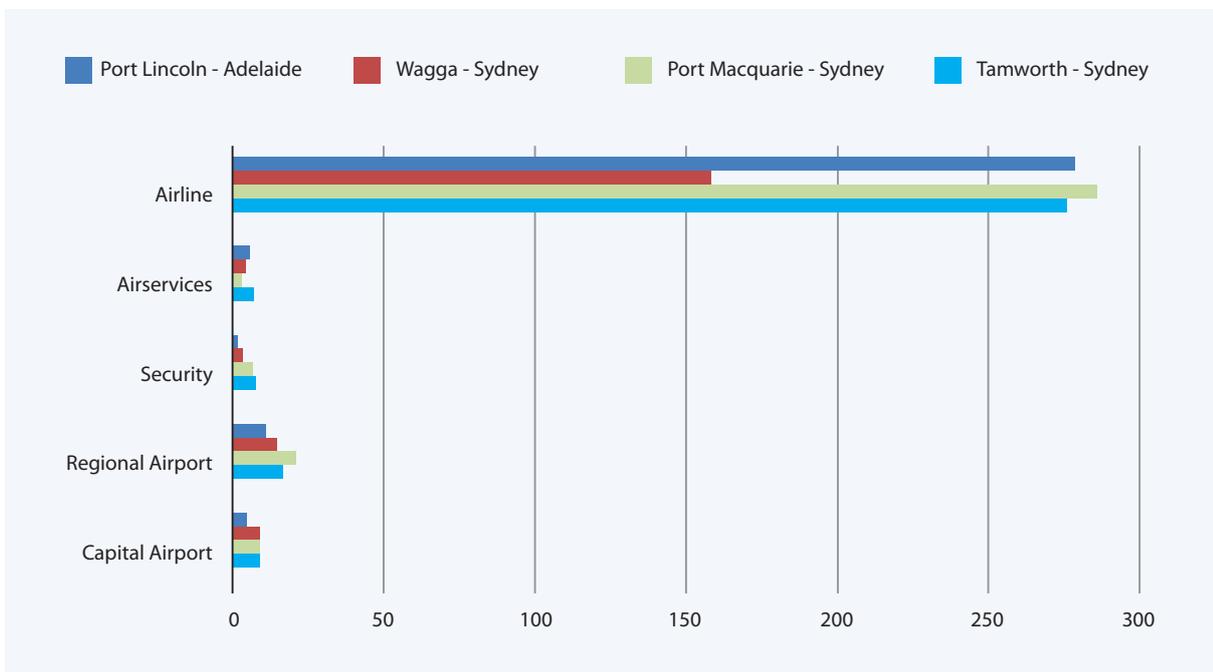
Figure A6   NSW and South Australian Regional Routes – Qantas
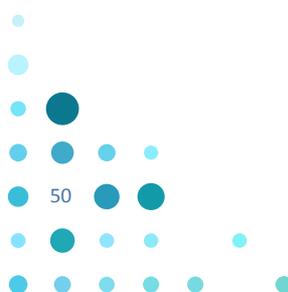
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