

EMERSON ECONOMICS

Expert economic and policy advice for businesses and governments

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Aviation White Paper
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Dear Director

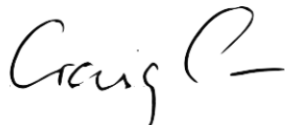
I welcome the opportunity to make this submission responding to the Aviation Green Paper released in September 2023.

By way of introduction, I am a former Minister for Trade and Competitiveness, a former Minister for Small Business, the Service Economy, Competition Policy and Consumer Affairs, and a former chair of the Productivity Committee of Cabinet.

During the 1980s, I was a microeconomic adviser to Prime Minister Bob Hawke and in the mid-1990s I was CEO of the South East Queensland Transit Authority.

[REDACTED]

Kind regards



Craig Emerson

28 November 2023

Submission Responding to the Australian Government's Aviation Green Paper

Emerson Economics welcomes the opportunity to make this submission to inform the Australian Government's Aviation White Paper. [REDACTED]

Recommendations for reform of the aviation industry

Emerson Economics recommends that:

- 1. Resumed ACCC monitoring of the Australian airline industry be made permanent;*
- 2. In all future negotiations for bilateral air services agreements, consultations occur with the ACCC, domestic airlines, major and regional airports and the tourism industry, and that greater transparency in decisions be provided;*
- 3. Advice be sought from government agencies responsible for tourism, trade and international education to inform all future air services agreements prior to their finalisation;*
- 4. Reforms to the slot allocation system at Sydney Airport be implemented, based on the review conducted by Peter Harris and the further work of the Department of Infrastructure, Transport, Regional Development, Communications and the Arts in collaboration with stakeholder working groups and the ACCC;*
- 5. Foreign airlines flying directly into under-serviced regional locations be permitted to take on domestic passengers bound for major city destination; and*
- 6. Foreign airlines arriving in Australia be permitted to transport domestic cargo to onward Australian destinations.*

The importance of competition in the airline industry

Competitive markets are more conducive to allocative efficiency and welfare maximisation than concentrated markets.

In competitive markets, firms are ever mindful of the behaviour of their actual and potential rivals, which informs how they set their prices and service their customers.

Although many firms in a market is a strong indicator of competitive behaviour, it is possible that a smaller number of firms will behave competitively if entry into their market is relatively unrestricted; that is, if the market is highly contestable.

However, if barriers to entry are high – owing, for example, to economies of scale or government regulations that restrict new entrants – firms will tend to behave non-competitively.

This appears to have been the case with Qantas, based on evidence from recent parliamentary inquiries and the ACCC’s action against Qantas in relation to alleged fares for no service. Evidence of slot hoarding at Sydney Airport by Qantas and Virgin further supports the contention that the Australian airline industry lacks contestability.

The state of competition in the airline industry

In its submission to the House of Representatives Standing Committee on Economics’ *Inquiry into Promoting Economic Dynamism, Competition and Business Formation*, the Productivity Commission (2023) observes that competition in the Australian airline industry mainly relies on rivalry between Qantas and Virgin, and Rex in regional areas, together with the threat of entry by new airlines such as Bonza.

The ACCC (2023a) found that in April 2023, the industry cancelled 3.9 per cent of flights. Only 71.8 per cent of flights arrived on time, well below the long-term average of 81.5 per cent.

More recent statistics from the Bureau of Infrastructure and Transport Research Economics (2023) reveal a cancellation rate in October 2023 of 3.8 per cent, still well above the long-term average.

The ACCC has concluded that the domestic airline industry is one of the most concentrated industries in Australia. It observes that the expansion of Rex and the entry of Bonza have created the opportunity for a more competitive era, but they would need to grow significantly to become more-meaningful competitors to Qantas Group – including Jetstar – and Virgin.

The new, low-cost airline, Bonza, is now providing services on all 27 routes within its planned initial network, having commenced regular services in February 2023. Bonza is offering low airfares and direct connections on new regional routes.

The ACCC found that despite the expansion of Rex and the entry of Bonza, the market remains highly concentrated. Over the 12 months to April 2023, Qantas Group and Virgin Australia consistently accounted for around 95 per cent of the domestic passenger market.

The ACCC concludes: “The duopoly market structure of the domestic airline industry has made it one of the most highly concentrated industries in Australia, other than natural monopolies” (p. 2).

In the ACCC’s view, a lack of effective competition is a key reason why the industry has generally underperformed in terms of meeting the needs of the travelling public and those parts of the economy that rely on domestic air travel (p. 23).

When analysing the Australian airline industry, it is useful to consider two markets: the heavily populated, eastern seaboard market comprising Sydney, Melbourne, Brisbane, and the Gold Coast; and the rest of Australia.

Competition policy approaches to the two markets might differ in some respects. For example, policies to deal with slot hoarding at Sydney Airport would not be relevant to airports at Darwin, Alice Springs and Mt Isa. Similarly, proposals for foreign airlines to carry domestic passengers within the eastern seaboard might be assessed differently to foreign airlines transporting domestic passengers from lightly serviced Australian airports to the eastern seaboard.

Tourism

As the ACCC (2023b) has pointed out, airports are essential to tourism which, before COVID-19, contributed 6 per cent of Australia's GDP and was Australia's fourth-largest export industry.

Tourism is especially important to the economies of regional Australia. In addition to airports in capital cities, Australia has more than 130 airports serving regional areas. Many of these areas are tourist destinations, including Cairns, the Whitsundays, the Sunshine Coast and the Gold Coast, Coffs Harbour, Merimbula, Alice Springs, Uluru, Port Lincoln, Launceston, Devonport, Shark Bay and Geraldton.

Tourism-related businesses in these cities and towns employ substantial proportions of the local workforce and have an interest in regular air services at the lowest-possible cost.

Australia is among the most urbanised countries in the world. Employment in regional and remote tourist locations helps ease the pressure on the major cities that is causing high housing and rental costs.

When governments are considering the employment benefits of various policies relating to airline competition and airports, they should include the related benefits to tourism and to the decentralisation of employment opportunities in Australia.

Strategic considerations

Australia's population remains heavily concentrated on the eastern seaboard. Most of the rest of the continent is sparsely populated. Government policy for international airports outside the eastern seaboard might appropriately be different in some respects from policy for the major airports.

For example, employers in Darwin have experienced difficulty in attracting and retaining staff, owing to its remoteness and limited air services to the eastern seaboard. Yet, there are advantages for the nation in having a sustainable population centre in Darwin.

Policy proposals to promote competition in the Australian airline industry

Resumed ACCC monitoring

From June 2020, the ACCC had been funded to conduct regular monitoring of the Australian airline industry. The funding ended with the ACCC's June 2023 report. The Australian Government has since announced that it will resume funding the ACCC for regular monitoring of the Australian airline industry.

Emerson Economics welcomes the resumption of ACCC monitoring of the Australian airline industry and recommends such monitoring be made permanent.

Negotiation of bilateral air services agreements

It is evident that the Department of Infrastructure, Transport, Regional Development, Communications and the Arts received representations from Qantas during recent negotiations over a potential new bilateral air services agreement with Qatar Airways. It is reasonable for a competing *producer* of international air services – in this case, Qantas – to be consulted when the department considers the costs and benefits of new bilateral air services agreements.

Equally, it is reasonable that *consumers* of international air services – domestic airlines, major and regional airports, and the tourism industry – along with the ACCC, be consulted by the same government department.

Emerson Economics is not suggesting that all producer and consumer interests be present at every departmental meeting with an overseas proponent, but that representatives of consumers, together with the ACCC, should be properly consulted when the department is assessing applications for greater access to the Australian market.

Emerson Economics recommends that in all future negotiations for bilateral air services agreements, consultations occur with the ACCC, domestic airlines, major and regional airports and the tourism industry, and that greater transparency in decisions be provided.

Reform of slot allocation at Sydney Airport

The ACCC (2023a) points out that airlines can exploit the slot-allocation scheme at Sydney Airport by acquiring and hoarding slots for strategic reasons, such as to prevent the access of competitors to slots. A specific recommendation of the ACCC (2023a, p. 1) is that the Australian Government could promote competition by implementing reforms to help new and expanding airlines obtain slots at Sydney Airport. It warns that without these slot changes, there would be no material improvement in domestic airline competition in Australia in the foreseeable future.

A Productivity Commission report on the economic regulation of airports released in 2019 recommended that the Australian Government commission a public review of the Sydney Airport Slot Management Scheme, including considering the net impact of current and alternative slot-allocation arrangements on passengers and the community more broadly (Productivity Commission 2019, Recommendation 7.5).

It was this recommendation that led to a review of the Sydney Airport Slot Management Scheme conducted by Peter Harris, a former Chair of the Productivity Commission

(Harris 2021). The Harris report recommended various reforms to improve the operation of the Sydney Airport Slot Management Scheme.

Further work on this has been done by the Department of Infrastructure, Transport, Regional Development, Communications and the Arts in collaboration with stakeholder working groups, including the ACCC.

This work has identified ways of making the slot-allocation scheme more robust through identifying and taking action where airlines are misusing their slots, such as by hoarding slots and then selectively cancelling flights in a way that still meets the ‘use-it-or-lose-it’ rules. They have also identified possible improvements to the way that slots are allocated, such as removing a preference currently given to incumbent airlines seeking to change the time of an existing slot ahead of new entrants requesting a new slot allocation.

The report by Peter Harris observed that pressure on the demand management scheme and the operational movement cap at Sydney Airport is likely to be reduced by the opening of Western Sydney International Airport, but that this impact will be only marginal in view of the likely commercial preference of most airlines to use an inner-city gateway.

The implementation of the identified reforms would create meaningful benefits for consumers and the economy by improving access to slots for new and expanding airlines, leading to more competition.

Emerson Economics recommends that reforms to the slot allocation system at Sydney Airport be implemented, based on the review conducted by Peter Harris and the further work of the Department of Infrastructure, Transport, Regional Development, Communications and the Arts in collaboration with stakeholder working groups and the ACCC.

Other legislative and policy measures

The Productivity Commission’s inquiry into the economic regulation of airports (2019) concluded that, on balance, airports have not systematically exercised their market power in commercial negotiations with airlines (p. 13) and supported the current regulatory regime.

It found, however, that:

“Some agreements between airport operators and airlines contain anticompetitive clauses that: restrict an airport operator’s ability to offer lower charges or other incentives to airlines other than the signatory airline — these ‘no less favourable’ clauses seek to limit competition in both domestic and international markets, and protect the incumbency of an airline that has negotiated these favourable terms” (p. 14).

The ACCC has indicated there might be an argument for a prohibition on these types of clauses in circumstances where they entrench the preferential treatment of large incumbent airlines.

Cabotage

The ACCC (2023a) observes that:

“Australia prevents foreign airlines from picking up domestic passengers on a domestic leg of an international flight, which is known as air cabotage. Removing these restrictions could potentially promote competition on some domestic routes” (p. 30).

Where airports in locations outside the eastern seaboard are under-serviced by domestic flights, consideration should be given to permitting international airlines flying into those airports to pick up domestic passengers and take them on the airlines’ onward domestic journeys. This would improve the attractiveness of these locations for Australians considering moving out of the eastern seaboard for employment and lifestyle reasons.

Emerson Economics recommends that foreign airlines flying directly into under-serviced regional locations be permitted to take on domestic passengers bound for major-city destinations.

Similar considerations apply to freight. It is in Australia’s economic interests, and those of regional locations, that freight be transported at the lowest possible cost.

Emerson Economics recommends that foreign airlines arriving in Australia be permitted to transport domestic cargo to onward Australian destinations.

Conclusions

Qantas Group and Virgin Australia account for around 95 per cent of the domestic passenger market. The ACCC has found that the duopoly market structure of the domestic airline industry has made it one of the most highly concentrated industries in Australia, other than natural monopolies.

In preparing the Aviation White Paper, the Australian Government should consider ways of introducing greater competition into the domestic airline industry. Meanwhile, the Australian Government is undertaking a broader review of competition policy. That review includes the domestic airline industry. The recommendations in this submission are as relevant to the competition policy review as to the Aviation White Paper exercise. Emerson Economics is forwarding this submission to the Competition Taskforce within Treasury and to its Expert Panel being chaired by Rod Sims and Danielle Wood, for its consideration.

References

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