



AUSTRALIAN
AIRPORTS
ASSOCIATION

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Select Committee on Commonwealth Bilateral Air Service Agreements
PO Box 6100
Parliament House
Canberra ACT 2600

Via email: cbasa.sen@aph.gov.au

AAA submission to the Senate Select Committee on Commonwealth Bilateral Air Service Agreements

The Australian Airports Association (AAA) is pleased to provide this submission to the Committee for its inquiry into Commonwealth Bilateral Air Services Agreements (the Inquiry). The AAA is the national voice for airports, representing the interests of more than 340 airports and aerodromes across Australia. The AAA also represents more than 150 corporate members supplying products and services to airports and the aviation industry.

Setting the scene: The aviation sector has become one of the most concentrated markets in Australia, both domestically and internationally. This has resulted in a lack of competition, higher airfares and a lower level of service for the travelling public.

As airports and the sectors of the economy reliant on aviation such as tourism and international education are volume businesses, a more liberalised Bilateral Air Services Agreement (BASA) framework would significantly improve outcomes for both the aviation sector and downstream sectors of the economy by improving Australia's connectivity into the global aviation network and enhance service levels and competition on price and service quality.

While the market share for international aviation in and out of Australia is not as concentrated as the domestic aviation market, Qantas Group (Qantas and Jetstar) remain the single largest carrier on inbound and outbound international routes. In Calendar Year 2022, Qantas Group carried almost 23% of all international passengers. A further 21% were carried by Singapore Airlines (Singapore Airlines and Scoot Tigerair). The remaining top five international carriers a further 27 percent of market share (Emirates – 11%; Air New Zealand 8.6%, and Qatar – 7.4%). Collectively, the top 5 airlines carry over 70% of all passengers entering or leaving Australia.¹

The structure of the international aviation market represents how Australia engages the global aviation network, connecting to Europe and Asia through regional hubs in Singapore and the Middle East, along with significant trans-Tasman and trans-Pacific flows to North America. There are also significant outbound flows of leisure traffic to Asia and the Pacific islands.

¹ Bureau of Infrastructure, Transport and Regional Economics (2023), *International Airline Activity 2021-22*. Statistical Report, November. Viewed on 15 September 2023 at:
https://www.bitre.gov.au/sites/default/files/documents/International_airline_activity_FY2022.pdf

Airfares are a function of supply and demand: Once Australia's borders were fully reopened in February 2022, Australians took the opportunity to travel overseas. Suppressed demand from two years of closed borders and high household incomes meant that many travellers were less sensitive to price than usual when travelling to visit friends and relatives or leisure travel. Airfares were high, compounded by the slow return of capacity on international routes.

Since the Reserve Bank of Australia began increasing interest rates in May 2022 to control inflation, cost of living pressures including the price of international airfares has taken a toll on the economy. Consumer research undertaken by the AAA indicates that over the last 18 months, as the confidence of Australians to travel overseas has increased, the cost of airfares has been a growing deterrent to international travel. From being a secondary concern (after health risks) in March 2022 (42%), the cost of airfares escalated as a concern through subsequent surveys in July 2022 (50%) to become the most significant factor in October 2022 (61%), March 2023 (69%) and at a high of 77% in August 2023.²

A key driver of high international airfares is an undersupply of seats on international routes serving Australia. This is in part due to fewer airlines flying in and out of Australia and less capacity from airlines servicing Australia compared to pre-pandemic levels. Undersupply of international capacity is a key reason behind the 'two-speed recovery' of Australia's aviation sector which, as shown in Figure 1 below. This demonstrates how international capacity has not yet returned to pre-pandemic monthly averages in the 13 months since Australia's borders re-opened, with the most recent data showing the number of international airline seats offered in and out of Australia in March 2023 were only 81.7% of the 5-year pre-pandemic average for the month of March.



Figure 1: International seats offered Feb 22 – Mar 23 compared to 2015-2019 average.
(Source: AAA analysis of BITRE data)

Network structures matter: The structure of the global aviation network plays an important role in both the negotiation of BASAs and the number of carriers that serve Australian airports. There are three key elements:

- Australia's geographical position at the periphery of the global aviation network,

² Data compiled from: Zing Insights for the Australian Airports Association, *Traveller Insights Report*, waves 5-9.

- a 'hub-and-spoke' design which remains the dominant aviation network form, and;
- The 'alliance' system which groups carriers together for mutual benefit.

Australia's geography places it at the ends of the global aviation network, which is a disadvantage for many Australian destinations, even for access to fast-growing travel markets in North-east, South-east and South Asia. The long distances and high costs for international carriers to serve Australia from global aviation hubs means capacity has returned faster and earlier in easy to serve markets in Europe, the Middle East and the Americas.

'Hub-and-spoke' networks were a development from the deregulation of air travel in the United States from the 1970s, where US domestic carriers developed significant hubs at 'key' airports to reduce the number of direct flights, while creating more multi-leg journeys between a greater number of origin and destination 'spokes'. At the same time, economic development policies pursued by governments in Asia (Singapore, Hong Kong) and the Middle East (Dubai, Doha, Abu Dhabi) began to develop hubs connecting Europe to the Asia-Pacific. The hub-and-spoke model has both advantages and disadvantages:

- The model helps airlines rationalise networks and improve passenger load factors through better utilisation of aircraft, crews and other assets. It also modifies an airline's network as hub airports are connected to several spokes, which allows airlines to achieve regional market dominance and improve service frequency and connectivity for travellers between hubs and spokes through agglomeration economies, often with a benefit of lower fares.
- The increasing agglomeration of global aviation networks also creates opportunities for airlines to develop new point-to-point routes, particularly as new aircraft technology allows longer non-stop flights, bypassing intermediate hubs. Non-stop flights from Singapore, Manilla and Auckland to New York, or from Sydney to Dallas and Perth to London are examples of this trend.
- However, as hub-and-spoke networks mature, it becomes increasingly difficult for non-dominant airlines to compete at both hub and spoke airports, as the dominant airline can use its increasing market power to control service levels and airfares on specific routes to reduce competition. It also means that places not on an airline's network lose connectivity to national and international aviation networks.
- The model also means governments compete against each other to ensure their destinations are added to an airline's global network. Over \$320 million in post-pandemic 'aviation attraction' funding from Australian state and territory governments could be seen as an example of this strategy.
- For airports, this means hub airports can hit capacity limits, either through the number of gates and the availability of take-off and landing slots, making these networks vulnerable to disruption. There is also potential for dominant airlines to use their market power at both hub and spoke airports to dictate prices of landing fees and other costs, driving down airline costs at the expense of airports and provide disincentives for infrastructure investment.

In Australia, the hub-and-spoke network is also evident, with airports articulating into hubs serving destinations within the Indo-Pacific region.

- Major airports in Queensland (Brisbane, Cairns, Townsville) are strongly positioned towards the islands of the Melanesian and Polynesian Pacific,
- East Coast airports (Brisbane Gold Coast, Sydney, Melbourne) are strong hubs for trans-Tasman traffic between Australia and New Zealand and beyond.
- Existing and emerging hubs at internationally-capable airports across western and northern Australia are also notable, linking Indian Ocean nations in South Asia, Indonesia and Timor Leste.

Another long-term trend in the global aviation market has been the development of the 'alliance' system. Airline alliances are cooperative agreements between two or more airlines that aim to enhance connectivity, streamline operations, and provide a seamless travel experience to passengers. These alliances involve code-sharing, allowing airlines to sell seats on each other's flights, pool common resources and provide benefits to travellers such as lounge access.

Since the formation of the first significant alliance (Star Alliance) with five initial airline partners in the late 1990s, the concept of airline alliances has evolved and expanded into three significant blocs (OneWorld³, SkyTeam⁴ and Star Alliance⁵), along with a range of code sharing agreements between individual carriers (such as the Qantas-Emirates agreement) and a significant bloc of carriers unaligned with the three major alliances.

The split between carriers operating in and out of Australian airports by alliance are:

- Qantas Group and Qatar members of OneWorld,
- Singapore Airlines and Air New Zealand belonging to Star Alliance,
- While the fifth large carrier (Emirates) is not aligned to any alliance.

As a result, OneWorld is the dominant international alliance accounting for almost half (48.3%) of all passenger movements through Australian airports. Star Alliance accounts for another 28.6% meaning more than three out of every four passengers travels on carriers of both alliances. The remainder travel on either the smaller SkyTeam alliance (6.5%) or non-aligned carriers (16.6%).

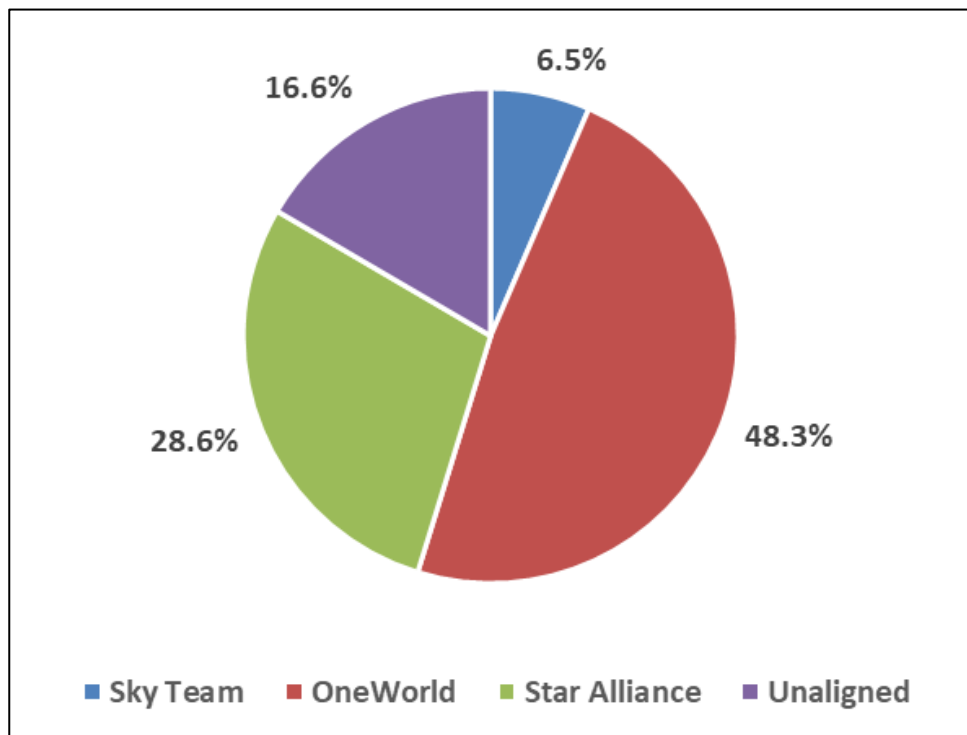


Figure 2: Breakdown of Australian international passenger movements by alliance 2022.
(Source: AAA analysis of BITRE and airline alliances data)

As we indicated earlier, Australia's international airline routes are increasingly concentrated both between carriers and in alliances. Recent research by aviation economist Dr. Tony Webber highlighted the high levels of market concentration on almost all international routes except for Australia-US and Australia-China as shown in Figure 2 below.

³ OneWorld, 'Members'. Accessed on 18 September 2023 from: <https://www.oneworld.com/members>

⁴ SkyTeam, 'Our Members'. Accessed on 18 September 2023 from: <https://www.skyteam.com/en/about/our-members/>

⁵ Star Alliance, 'Members'. Accessed on 18 September 2023 from: <https://www.staralliance.com/en/members>

Dr Webber's research used the Herfindahl–Hirschman index (HHI) to plot the levels of market concentration. It is an accepted, commonly used measure to determine competitive markets by the size of the HHI score. A market with an HHI of less than 1,500 is considered competitive, an HHI of 1,500 - 2,500 is moderately concentrated, and an HHI of 2,500 or greater is highly concentrated. Key routes to outbound and inbound tourism growth markets (China, Japan, Malaysia, India, South Korea, Sri Lanka, Vietnam) are highly concentrated, as are key trunk routes to global aviation hubs such as Singapore and Qatar.⁶

To promote more competition in the international aviation sector, there needs to be more international carriers flying into and out of Australia. More comprehensive BASAs are part of this solution with a negotiating stance that offers greater choice of origins and destinations. When multiple carriers can operate the same route, the competitive tension created can also lead to improved service quality and pricing options for passengers.

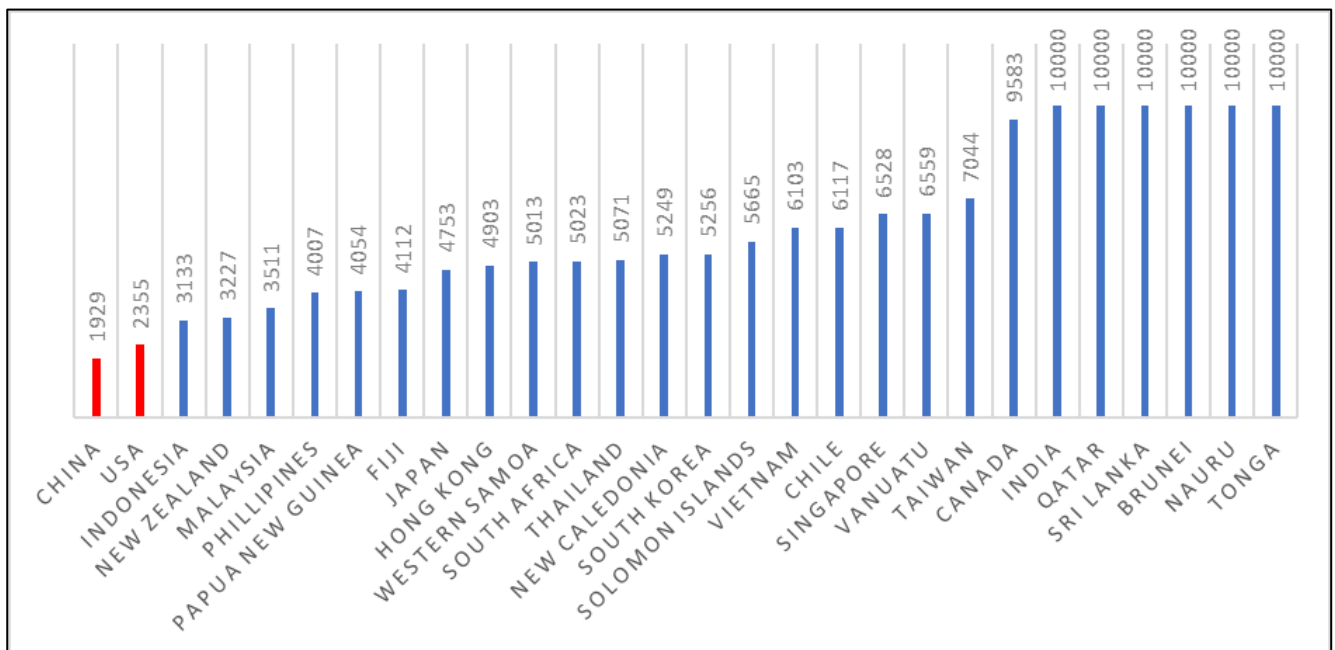


Figure 3: Herfindahl–Hirschman index scores for Australian international aviation markets.
(Source: Dr Tony Webber)

Another potential lever to promote competition in international aviation markets would be to empower the Australian Competition and Consumer Commission (ACCC) to better scrutinise Co-ordination Agreements (CA) between international carriers flying in and out of Australia. A CA allows carriers to co-ordinate their passenger, air cargo and ground operations across their networks for a set period. The most recent CA approved by the ACCC was renewal of the Qantas-Emirates CA for a further five years to 2028.⁷ In recent days, the ACCC also issued a draft decision to deny authorization of a Joint CA between Qantas Group and China Eastern Airlines on Australia-China routes.⁸

⁶ Dr Tony Webber. LinkedIn post. Viewed on 15 September 2023 from: https://www.linkedin.com/posts/drtonywebber_a-journalist-from-the-afr-rang-me-this-afternoon-activity-7104716167486873600-h9IT?utm_source=share&utm_medium=member_desktop

⁷ ACCC (2023a), 'Qantas Airways Limited & Emirates'. Public Register 17 August. Viewed on 12 September 2023 from: <https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/qantas-airways-limited-emirates-0>

⁸ ACCC (2023b), 'The ACCC proposes to deny coordination between Qantas and China Eastern', Media Release 15 September. Viewed on 18 September 2023 from: <https://www.accc.gov.au/media-release/the-accc-proposes-to-deny-coordination-between-qantas-and-china-eastern>

Renewed focus on the Australian Government's BASA negotiations: Improving the efficacy of the BASA process managed by the Department of Infrastructure, Transport, Regional Development, Communication and the Arts (the Department) to ensure its forward negotiation approach is:

- in line with Australia's broader migration, education, tourism and foreign policy objectives
- future focused as opposed to a 'just-in-time' approach would also help liberate more capacity and reduce barriers to competition.

The BASA system should be able to effectively manage inbound and outbound capacity for both hub-and-spoke and emerging point-to-point models. There is usually sufficient excess capacity in the system to accommodate new or expanded routes. However, the current framework produces an environment encouraging parties to tactically amend or alter the BASA to enable expansion of international services every couple of years instead of incentivising parties to take a more coordinated and forward-looking approach to attracting international carriers.

Liberalising BASAs through an 'Open Skies' approach would help develop and maintain Australia's connectivity with the global aviation network. Certainty in aviation routes (capacity) are enhanced when bilateral agreements are negotiated ahead of time (demand). Additionally, capacity should be to any internationally capable airport, and not prescriptive on limiting capacity to any single airport. Forecasting bilateral capacity ahead of demand provides the certainty for airlines to plan procurement and deployment of aircraft as well as for airports to plan improvements to infrastructure and terminal capacity. Increasing competition also promotes best value for customers and allows international airlines to compete to provide enhanced service levels, reliability and connections for customers.

Better co-ordination between levels of Australian governments: As the Australian Government negotiates BASAs, better coordination across all levels of Australian governments on attracting and retaining international air routes could spur greater growth in air services to Australia and reduce competition for the limited numbers of landing slots. It could also better coordinate the use the considerable funding from State and Territory governments (at least \$320 million over the past two years) earmarked for international airline route attraction and retention in pursuit of each jurisdiction's economic development and tourism strategies.

The ability of Australia's targeted skilled migration policy to meet present and future skills needs is also dependent on aviation capacity into Australia from relevant countries. Similarly, Australia's international education industry also requires sufficient aviation capacity to and from key international student markets.

The AAA appreciates the opportunity to contribute to the Inquiry.

Yours sincerely

James Goodwin
Chief Executive