QANTAS

22 August 2008

Mr John Carter
Secretary
Foreign Affairs Sub-Committee
Joint Standing Committee on Foreign Affairs Defence and Trade
Parliament House
Canberra ACT 2600

Dear Mr Carter

Re Australia's Relationship with ASEAN

In response to your letter of 15 July 2008, Qantas is pleased to submit the attached views to the above Inquiry.

Our submission outlines Qantas' close and continuing association with the region dating back over 70 years, our views on the importance of Australia's aviation relationship with ASEAN members, and the prospects for growth and change, which will be of fundamental importance to the Group.

Qantas would be pleased to provide any further information of interest to the Committee, and to appear at Committee hearings if invited to do so.

Yours sincerely

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Joint Standing Committee on Foreign Affairs, Defence and Trade
Foreign Affairs Sub-Committee

Inquiry into Australia's Relationship with ASEAN

Submission by Qantas Airways

Qantas and ASEAN Background

Qantas' long history and close engagement with South East Asia is reflected in the fact that its first international operations involved flights between Australia and countries that are now members of ASEAN.

In February 1935, Qantas' DH86 biplane aircraft flew Darwin-Kupang-Batavia-Singapore as part of the pioneering airmail route between Australia and London. This was followed two months later by Qantas' first overseas passenger flight from Brisbane to Singapore – at the time a four-day trip. Post World War II, Qantas rapidly expanded operations between Australia and South East Asia, with services to and through Indonesia, Singapore, Malaya, Thailand and the Philippines by the early 1950s.

By the 1960s, around the time of ASEAN's establishment in 1967, local airlines were being aggressively expanded in all these countries and most soon provided serious competition to Qantas, especially following the advent of "wide-bodied aircraft" (B747, DC10, L1011) from the early 1970s. The competition was not only for the carriage of passengers between Australia and their home ports, but between Australia and UK/Europe through the "hubbing" or "sixth freedom" opportunities bestowed on these airlines by their favourable geographical location.

The ability to tap into third country traffic flows to/from end of route markets was especially important for the development of Asia's emerging hub carriers at a time when disposable incomes within ASEAN member countries remained low.

Qantas had long been a shareholder in Malayan Airlines, which became Malaysian Airlines in 1963, when the Federation of Malaysia (Malaya, Sarawak, Sabah, North Borneo and Singapore) became independent from the UK. In May 1966, following Singapore's split from Malaysia, it became Malaysia-Singapore Airlines. Qantas maintained a strong and supportive relationship with the airline, whose General Manager at the time, Keith Hamilton, would later become Qantas' CEO. In 1972, Malaysia-Singapore Airlines split to become two entities – Singapore Airlines and Malaysian Airline System.

Current Aviation Links

With Cambodia and Laos being the only countries not covered, Australia has formal aviation agreements with eight of the ten ASEAN members.

Embracing Qantas and Jetstar, nearly two-thirds of the Qantas Group's international passenger flying operations, as measured by available seat kilometres, are linked to ASEAN member countries.

The Group operates to and through seven ASEAN ports in Indonesia, Singapore, Thailand, Vietnam and the Philippines, with a total of 27,526 seats on 95 weekly services. While 67 of these services turn around at their ASEAN destination, 28 continue on via either Singapore or Bangkok to Frankfurt and London.

The Group's offering compares with the combined strength of the nine ASEAN-based carriers that operate to Australia from seven countries, currently offering a total of 76,352 seats on 259 flights per week.

While the majority of air freight to/from Australia continues to be carried in the belly hold space of scheduled passenger services, a number of dedicated freighter services operate between Australian and ASEAN countries.

Qantas currently operates a once weekly Bangkok-Sydney freighter service, which is the inbound leg of a round the world routing, using a B747-400 freighter wet-leased (ie aircraft and crew) from Atlas Air of the US.

Singapore Airlines and Malaysia Airlines are the only airlines from ASEAN member countries currently operating scheduled freighter services to Australia.

The Australian Government has generally been successful in negotiating bilateral outcomes with ASEAN based countries which meet the needs of airlines. In most of these arrangements, capacity for passenger services has been negotiated well ahead of demand. However, additional flexibility would be welcome in terms of rights for dedicated freighter operations from some ASEAN partners.

Australia / ASEAN Aviation Market

The importance of the air links between Australia and ASEAN can be gauged both from the number of services operated, as highlighted above, and by the volume of local passenger traffic currently carried by the airlines of both sides.

In the year ended 31 May 2008, nearly 4.4 million passengers uplifted or discharged by airlines at Australian ports originated in, or were destined for, ASEAN countries. This figure represented a healthy 15 percent increase in Australia-ASEAN passenger traffic compared with the previous 12-month period, and nearly 19 percent of all international passenger traffic to/from Australia. The passenger share increased from the 17 percent attributed to ASEAN traffic in the year to May 2007. Burma was the only ASEAN country showing a decline.

Additionally, a significant number of Australian originating or destined passengers pass through ASEAN ports en route to longer-haul destinations in

Europe, the Middle East and North Asia, either in direct transit or by connection to onward services.

The Australian Tourism Forecasting Committee (ref Forecast 2008 - Issue 1) has recently estimated compound annual rates of inbound passenger growth to Australia from 2008 through to 2017. Growth is forecast at 2.3 percent from Singapore, 5.5 percent from Malaysia, 10.6 percent from Indonesia, 4.7 percent from Thailand, and 7.8 percent from "the rest of Asia", which includes the other ASEAN countries.

These figures are predicated on continued regional stability and factor in the current high oil prices. However, the Committee enters a note of caution, highlighting that continued high oil costs could result in 2008-09 numbers falling further, which would affect the longer term outlook.

Many of the major ASEAN airlines remain in government ownership and benefit from various advantages that contribute to aviation's uneven playing field. These include the ability to borrow funds at sovereign risk rates, less onerous taxation and aircraft depreciation regimes, strictly controlled labour laws, favourable airport access and charging arrangements, and government policies sometimes directed to advantage national carriers.

The primary international carriers of Singapore (Singapore Airlines), Thailand (Thai Airways), Malaysia (Malaysia Airlines), Indonesia (Garuda), Vietnam (Vietnam Airlines), Brunei (Royal Air Brunei), Burma (Myanmar Airways), and Laos (Lao Airlines) are all under majority - in some cases total - government ownership.

While most of the fast growing LCC airlines are private companies, Philippine Airlines remains the only non-government controlled "flag carrier" in ASEAN.

ASEAN Aviation

With rising living standards and a total population of around 550 million, ASEAN economies will be a strong contributor to the wider Asia Pacific region becoming the world's largest aviation market, probably by the end of the current decade.

Asia alone will grow into the largest single world aviation market within the next twenty years, outstripping the current powerhouses of North America and Europe. Airbus estimates that carriage by Asian airlines will triple by 2026 - resulting in them being responsible for 27 percent of world aviation at that time.

While there has been ongoing discussion for more than 10 years of an ASEAN wide multilateral air services agreement to underpin broader trade and economic liberalisation and single market initiatives within the region, it has yet to eventuate.

A full range of aviation bilateral arrangements still exist in South East Asia – ranging from those that are highly protective to "open skies" approaches – which reflects a so-far piecemeal approach to liberalisation.

Thailand, Malaysia, the Philippines, Indonesia and more recently Vietnam have made progress toward opening up their domestic routes to low-cost carriers (LCCs), improving service levels and lowering costs. In many cases, growth of the LCC sector has placed pressure on established carriers, spurring their efforts to adapt to change, and become more efficient.

This is demonstrated by the success of the LCC Air Asia, which has leveraged joint-venture arrangements to expand its brand from being a strictly Malaysian entity to create successful affiliates in both Thailand and Indonesia, with plans to carry the brand to Vietnam. Air Asia-X also operates to Australia.

Air Asia's success has generated benefits for the Malaysian economy, and the Malaysian government has allowed it to compete with state-controlled Malaysia Airlines in domestic and long-haul markets from Kuala Lumpur. Following an agreement between the governments of Singapore and Malaysia in late 2007, this includes the key Kuala Lumpur-Singapore route. Having been dominated for over 27 years by Malaysia Airlines and Singapore Airlines (the only third-fourth freedom operators allowed on the route from either side) this is now opened to competition from Air Asia and Singapore's Tiger and Jetstar Asia.

The opening of this route ahead of the proposed December 2008 timing of ASEAN capital city liberalisation has been read as a positive sign that wider ranging liberalisation amongst ASEAN members may be achieved.

Previous ASEAN commitments have envisaged the staged liberalisation of passenger and cargo operations within ASEAN, with major steps due in December 2008, leading to a single aviation market by 2015 when all ASEAN based airlines would have the right to carry any traffic between any points in the ASEAN area.

In May 2008, ASEAN senior transport officials announced that they had agreed to recommend signing the ASEAN Multilateral Agreement on full liberalisation of air freight and passenger air services. It will be up to a meeting of ASEAN transport leaders in November to formally ratify the agreement in time for the implementation of the regional integrated air transport services by December 2008.

Ratification requires sign-off from at least six member nations, after which route specific commitments may be implemented. For any fifth freedom rights to be implemented, at least three countries are required to sign. Despite the officials' recommendation, it is not yet certain that the timetable will be adhered to, as opt-out provisions remain on individual commitments prior to 2015.

Whether this will in turn lead to further liberalisation along the lines of the European Union (EU) model remains to be seen. Unlike its EU counterpart, the ASEAN Ministerial body lacks the power to enforce joint decisions by imposing penalties for non-compliance. In addition, as the ASEAN liberalisation timetable does not provide any commitments on cross-border ownership of airlines within the ASEAN region, and as ASEAN members retain limits on permitted levels of foreign investment in their airlines, full emulation of the EU model is most unlikely in the medium term.

India, Korea China and Japan have apparently expressed interest in signing up to a single aviation market should ASEAN eventually move to a bloc approach. Whether such an arrangement would be of any practical value to Australia would require detailed evaluation. However, given the generally liberal arrangements governing Australia's aviation relations with ASEAN members, additional gains are unlikely to be of great value.

Australia-ASEAN Free Trade Agreements (FTAs)

The FTAs in place between Australia and Singapore and Australia and Thailand, that currently under negotiation with Malaysia and the nearly complete plurilateral FTA between Australia, New Zealand and ASEAN do not include aviation specific commitments.

This reflects a recognition that the bilateral air services agreements currently in place deliver outcomes that provides sufficient flexibility to progress air services liberalisation in line with policy and commercial objectives. Qantas supports this approach and, more broadly, the negotiation of FTA's for the wider economic and investment benefits they produce, with associated positive impacts for travel and tourism.

Qantas Investment in ASEAN

The Qantas Group maintains representative offices, either in its own right or through arrangements with affiliated General Sales Agents in Singapore, Bangkok, Phuket, Jakarta, Bali, Kuala Lumpur, Manila, Hanoi and Ho Chi Minh City, with a total of around 170 locally employed and posted staff.

Qantas is the majority shareholder in a major Singapore-based travel company, Holiday Tours and Travel (HTT). The HTT group is a major retailer and packager of all-inclusive product for passengers originating in Asia travelling to Australia.

In April 2007, Qantas announced the formation of a new inbound tourism business, Tour East Australia Pty Limited. Based in Sydney, this wholly-owned subsidiary of HTT, opened for business on 1 July 2007. It provides land content, including sightseeing tours and accommodation, for packaging by travel wholesalers and travel companies worldwide and a comprehensive travel service for the inbound meetings, incentives, conferences and events market.

The Qantas Group is leveraging Jetstar to expand its brand reach in the ASEAN region through investment with local partners to establish short haul airlines.

As most bilateral aviation agreements in the area continue to require that "substantial ownership and effective control" of airlines remains in the hands of citizens of an airline's home country, partnership arrangements will have to continue to be the basis for Jetstar's brand expansion, rather than establishment in its own right.

<u>Singapore</u>

Singapore based Jetstar Asia was started in 2004, with Qantas holding 49 equity, the Singapore government's investment company, Temasek, holding 19 percent and two Singaporean businessmen holding 22 percent and 10 percent respectively.

The airline differentiated itself from its competitors by flying further - anywhere within a five-hour radius from Singapore - while its competitors flew to destinations within a four-hour radius from Singapore. The airline proposed routes to Shanghai, Hong Kong, Taipei, Pattaya, Jakarta, Surabaya and Manila. Services on the first three routings to Hong Kong, Taipei and Pattaya commenced in December 2004, with flights to Manila added in 2005.

However, previously unknown regulatory hurdles meant that planned routes to Shanghai, Jakarta and Surabaya could not be started. To protect local airlines, China's aviation authority prohibited foreign LCCs from flying to Shanghai, Beijing and Guangzhou airports. The Indonesian government similarly barred further LCC access to Jakarta, Surabaya and Denpasar, despite existing flights by Singapore based low fare airlines Valuair and Tiger being permitted to continue.

The emergence of three Singapore-based LCCs within the same year increased pressure for rationalisation and, in July 2005, Jetstar Asia and Valuair merged in the first major consolidation of South East Asia's crowded LCC industry. Both airlines determined to operate their normal routes under their own brands, but a realignment of shareholder interests resulted in Valuair's founders becoming minority shareholders in the merged company, now named Orange Star. After the merger, Qantas equity in the combined entity became 42.5 percent.

<u>Vietnam</u>

In July 2007 the Qantas Group acquired 18 percent in Vietnam's second largest, and principally domestic, carrier Pacific Airlines. Jetstar subsequently entered into a strategic and commercial partnership with Pacific Airlines to grow the airline under the Jetstar brand. On 23 May 2008, Pacific Airlines completed its transformation to become Vietnam's first low cost, value based airline and was renamed Jetstar Pacific.

The Qantas Group will increase its investment in Jetstar Pacific to 30 percent in 2010. Under an agreement between Jetstar and Jetstar Pacific, the Group is supporting new commercial and distribution arrangements, the development of a Vietnamese website at jetstar.com, and the introduction of a fleet of up to 30 Airbus A320 aircraft by 2014.

A number of Qantas and Jetstar executives have been seconded to key management roles within Jetstar Pacific, and the Qantas Group will continue to supply of a range of aviation services to the airline.

The first A320 is proposed to enter Jetstar Pacific's operations in August 2008 - initially within Vietnam, before expanding later this year into markets such as Thailand, Singapore, Malaysia and Cambodia.