SUBMISSION NO. 93

# REGIONAL AVIATION ASSOCIATION OF AUSTRALIA

ABN 23 008 568 054



28 August 2002

Mr P Melville MP
House of representatives
Standing Committee on Transport and Regional Services
Parliament House
Canberra ACT 2600
C/- Email trs.reps@aph.gov.au

Dear Sir,

**Re: Inquiry into Commercial Regional Aviation Services in Australia and Transport links to major populated islands**

By way of introduction the Regional Aviation Association of Australia (RAAA) is a not for profit industry association representing fifty-one members of the regional aviation industry of Australia.

Some members are operating regional airlines, some provide valuable charter operations and some provide services to the aviation industry.

Some of our members will respond to your inquiry by way of independent submissions, and we would draw the Standing Committee's attention to the submission from Mr. Michael Bridge, Chief Executive of Airnorth Regional, and a member airline of the RAAA.

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## The Adequacy Of Commercial Air Services In Regional And Rural Australia

It is recognised that the regional aviation industry in Australia today is a strong reflection of the Governments competition policies over time.

The last review of air transport policy was the "Domestic Air Transport Policy Review" which was completed in 1978 and from a regional perspective led to the removal of the charter operator REG203 exemption and the ultimate introduction of the High and Low Capacity Airline Licensing system, which exists today.

Most regional operators today operate within the Low Capacity license regime.

At the time of writing the Domestic Air Policy Transport Review in 1978, there were two major domestic airlines (Ansett and Trans Australia airlines); 5 regional airlines (Ansett Airlines of South Australia, Ansett Airlines of New South Wales, MacRobertson Miller Airline Services, East West Airlines and Connair), and 36 Commuter airlines (CH2p, 154-164).

Of the two major domestic airlines – neither exist today albeit that TAA became Australian Airlines, which the government of the day sold to Qantas.

Of the 5 regional airlines – none exist.

Of the 36 commuter airlines only 4 exist in their same name today.

Over the past 20 years, more than 73 domestic airlines have gone into demise through liquidation, bankruptcy, receivership, merger or the subject of a takeover (DoTaRS figures).

The 1978 Domestic Transport review also identified that in June 1976, 200 communities received commuter airservices (p157) and that over 50 Communities had already lost airservices due to a lessening of demand, a downturn in the rural economy or the improvement of the roads (p158).

Today there are currently 31 domestic Regular Public Transport air operators in Australia traveling between 172 cities and towns Australia-wide (DoTaRS figures)

Many communities in regional and rural Australia would argue that air services are inadequate.

With deregulation, the competitive "market place" environment where one size fits all is not the answer to sustainable, viable, regional air services.

Governments in Australia appear comfortable with the idea of subsidising roads, ports, power stations and other infrastructure developments but appear reluctant to subsidise regional aviation. Subsidies need not take the form of a cash payment, but may be nothing more than the purchase of full fare tickets by Government departments, instead of seeking discounted fares based purely on market power.

It is recognised that some state governments provide limited subsidies, route protection or licensing protection to assist the regional operator.

Government policy (particularly Federal Government) has done little to deter the ever-increasing costs being forced by regional operators. Government taxes and levies (Federal, State, and Local) now account for between 25 – 45% of many average airfares.

For example, the $10 Ansett ticket levy is a severe impost on regional and rural Australia, with the beneficiaries of this levy being predominantly in Melbourne and Sydney.

Other government policies that have created additional costs for the regional aviation industry are: -

- Privatisation of airports without costs constraints.
- Increased compliance costs associated with the CASA Regulatory Reform Process. This reform process began in 1998-99 at government direction, and will not be completed until 2005. The cost, already, to operators, spent in reading, evaluating and responding to the avalanche of change is substantial. The cost of educating, training and implementation of the new regulations over the next few years is still yet to come.
- The cost of compliance to the new National Airspace System is yet to be determined, although industry has been led to believe that a cost benefit analysis will be completed prior to implementation. Commencement of the N.A.S. will begin in December 2002.
- Location specific pricing especially with regard to control towers and fire fighting services – both of which are not required at some airports e.g Port Headland and Albury.
- The principal that aviation is a full cost recovery industry has a detrimental effect on regional aviation as many of the services paid for, are not required by the industry.

Regional aviation is vital to the commercial wellbeing of many rural and regional communities.

It is a necessary transport link to the overall wellbeing of the nation as a whole.

**Policies And Measures Required To Assist In The Development Of Regional Air Service Including: -**

- Regional hub services
- Small scale owner operator services
- The deployment of the most suitable aircraft type

Historically, the major domestic carriers using jet aircraft operate on the trunk routes.

The large regional operator services, the larger regional communities using various sizes of turbo prop and small jet aircraft connecting them to the cities and allowing hubbing into the trunk system.

The level of these air services has been determined entirely by the market place.

The removal of many basic services (medical and commercial) from regional centres has led to a migration of the population from the country to the cities, thus making some regional services unviable.

The small-scale owner operator, operates links between regional centers, and provides some linkages to major regional centres and in some cases to the cities, often using older piston engined aircraft.

The improvement in road systems and the quality of motorcars has lead to some routes becoming marginal, but tax laws prohibit the operators from moving from their old piston engine aircraft into faster, efficient, more passenger acceptable turbine aircraft.

Small regional RPT operators must be able to vacate ageing light twin piston engine aircraft and move into modern technology turbine aircraft.

For example: -

Aircraft Depreciation And Capital Gains Tax

Prior to the tax changes of 1999, a country operator could purchase, say, a Piper Chieftain (9 seats, piston engine) for $300000, financed over 5 years with a 30% balloon payment at an interest rate of 10%. Using a 20% prime cost depreciation

| | | |
|---|---|---|
| Cost | | 300,000 |
| 1st Year | Depreciation | $60,000 |
| | | $240,000 |
| 2nd Year | | $60,000 |
| | | $180,000 |

| | | |
|---|---|---|
| 3rd Year | | $60,000 |
| | | $120,000 |
| 4th Year | | $60,000 |
| | | $60,000 |
| 5th Year | | $60,000 |
| Written Down Value | | NIL |

At the end of five years, $90,000 is still owed to the finance company, but the aircraft has been very well maintained and is now worth $350,000.

The operator decides to upgrade to a larger second hand turbine aircraft, sells the Chieftain for $350,000, pays the finance company $90,000 and has $260,000 cash.

During the 5 years of operation, the bank has been paid at the rate of $5211.89 per month and there isn't much surplus after running costs of crew, fuel, enroute charges, insurance, repairs, maintenance, administration etc.

The profit is in ownership of the aircraft at the end.

In moving up to the larger turbine aircraft costing, say $1,000,000 the operator recoups the $300,000 depreciation and starts depreciating at $700,000.

Tax would be calculated on the $50,000 Capital Gain but with inflation at 4% over the five years – no capital gain – no tax

The $260,000 is used as a deposit on the borrowing for the new aeroplane, reducing the borrowing cost and hopefully making the business more cash positive, but more importantly a good credit risk to financiers.

Since the 1999 taxation changes.

The same operator buys the same piper chieftain at $300,000, financed over 5 years with a 30% balloon payment, an interest rate of 10% and the new depreciation rate of 12.5%

| | | |
|---|---|---|
| Cost | | $300,000 |
| 1st Year | Depreciation | $37,500 |
| | | $262,500 |
| 2nd Year | | $37,500 |
| | | $225,000 |
| 3rd Year | | $37,500 |
| | | $187,500 |
| 4th Year | | $37,500 |
| | | $150,00 |
| 5th Year | | $37,500 |
| Written Down Value | | $112,500 |

Again sells the aircraft for $350,000, pays out the finance and has $260,00 in cash. However the operator now has to pay tax on the $350,00 less the written down value of $112,500, leaving $237,500 taxable at 30%, ($71,250), leaving $188,750 as deposit instead of $260,000 under the old tax regime.

The end result may be financial struggle to upgrade, so the operator keeps operating the ageing piston aircraft and ultimately pushes it up against a fence when it is no longer economical to run and a small community may lose it air service as a result.

This Association believes that the Governments of Australia (collectively) need to determine whose responsibility it is to oversee, develop, implement and if need be, subsidise regional aviation.

Regional aviation is vital to the wellbeing of the nation as a whole and the Federal government needs to review the needs of the industry from a "whole of country" perspective.

Issues that need to be addressed by the Federal Government are: -

- Depreciation – refer example P 4
- Taxes and Charges e.g. $10.00 Ansett Ticket Levy, Location Specific Pricing.
- Fuel Prices e.g. a reduction in fuel excise would provide a significant boost to regional operators, in particular, the smaller operator whose aircraft use Avgas.
- Financing Costs
- Insurance e.g. proposals to possibly extend carriers liability provisions under the Montreal Convention (Convention of the Unification of Certain Rules for International Carriage by Air) to domestic carriers in particular to the small regional operator, would have an immediate effect on viability.
- Australian dollar e.g. the current low value of the Australian dollar has a significant impact on costs for all regional airlines, in particular the purchase price of new aircraft and equipment, including spare parts which leads to higher operating costs which cannot be offset by higher fares due to (a) elasticity of demand, and (b) additional government charges.

- The cost of Regulatory Compliance. Refer to comments P3. This Association would strongly urge Government to insist on a full Cost Benefit Analysis for each and every regulatory change as per the U.S.A. requirements on the F.A.A.

State Governments (in conjunction with the Federal Governments) need to address issues such as the: -

- State's regional aviation requirements
- Isolated Communities
- Supply and Demand
- Route Protection
- Competition Policies
- Subsidies (if necessary).

While recognizing State's Rights, it is time for both Federal and State Governments to work hand-in-hand to address the regional aviation needs of this country.

Rural and regional communities have the right to expect a level of regional service appropriate to their needs.

The regional aviation industry needs support, to provide these needs, not additional cost impediments that lead to the cessation of regional air services.

**The Adequacy of Commercial Air Services to Major Populated Islands and the Adequacy of Alternative Sea Services**

The RAAA has insufficient information on this topic to provide comment.

**Interconnectivity Between Regional Air Transport Systems, Major National Air Services (Including On-Carriage, Through Ticketing, Freight Handling, Timetabling And Airport Slotting)**

Prior to the Ansett collapse in September 2001, almost all regional operators had an affiliation with either Ansett or Qantas and all issues of on carriage, ticketing, freight, timetable and slots were regularly discussed between the regional operators and their last carrier and the system worked well to the benefit of all concerned,

Today, many regional operators do not have an affiliation with Qantas.

Qantas is the dominant force in the market place, and, so far has shown to be the only major trunk route operator willing to accommodate the needs of some regional operators.

A regional operator listed in the Qantas reservations system, may have a strong, competitive advantage over a competitor not in the Qantas reservations system, especially for on-carriage, when the passengers traveling to, or from one city to another, and then on to a regional carrier.

All the bookings can be made within the one reservations system – a major plus for the business traveler and the tourist.

The Ansett collapse, and that of its regional subsidiaries, has created a financial uncertainty in the market place for those carriers endeavouring to restructure and recommence flying. Customers may still be unwilling to book with these new operators until they have shown that they are capable of surviving, and that their money paid in advance, for a booking will be redeemable.

This unwillingness does not exist when booking with a Qantas affiliate.

**The Role Of Three Levels Of Government In Supporting And Assisting The Development Of Regional Services And Island Transport Systems**

The roles of the Federal and State Governments have already been discussed under a previous heading but the role of the Local Government is almost totally focused on airport ownership.

Privatisation of local airports without cost controls has already led to an increase in charges in excess of CPI increases.

Passenger Head Taxes and Landing Fees for some local airports are seen as wealth generators for their community, with charges appearing to exceed the funding necessary for the maintenance and upkeep of their airport.

Many Shires see the airport as an asset of the community and charge landing fees that allow household rates to be kept to a minimum, or to be used to fund a community project, with no thought as to the impact on the airline servicing their community, or the impact on their community if the airline ceases operations.

It is also fair to say, that some local Shires, with limited air services, struggle to maintain the upkeep of their airports and would be in need of assistance.

## The Role Of Major Air Transport Carriers In Providing Regional Services

As discussed earlier in this submission, Qantas is the dominant major carrier in the Australia today and the only carrier with regional aviation subsidiaries.

Qantas has acknowledged that much of their regional operation is so called "social flying" and is unprofitable.

Cross subsidisation of routes is not new, but is totally dependent on the largesse of the airline management.

A change of management or shareholding can have a dramatic impact on the commitment to "social flying".

It could be argued that the dominance of Qantas is not in the best interest of regional and remote Australia, Qantas is a very successful international carrier whose focus will always be on those areas of large passenger numbers, high revenue and large aircraft.

This commitment to "social flying" by Qantas may be totally dependant on the success of their international and trunk routes. A deterioration of profitability on the overseas or trunk routes, will surely see a rethink on the values of "social flying".

The independent regional operators, on the other hand, have a strong commitment to community service obligations, and the health and wellbeing of their regional communities, is paramount to the success of their airline.

Is regional aviation necessary?

Is regional aviation important to this nation?

This association believes that regional aviation is vital to Australia and is in critical need of assistance.

The industry continually finds itself reacting to Government decisions, and influences outside of its control, none of which are to the benefit of industry, but only increase costs.

It is a very Capital –intensive industry with a high employment requirement and has a strong need for direction and stability.

The only "Regional Aviation Policy" in place today is that of "market forces".

"Market forces" do not meet the needs of people in regional and rural Australia.

It should be remembered that regional airlines like Kendell, Hazelton, Skywest and Airnorth began from very humble beginnings, and took 20-25 years to grow to where they become household names to regional Australia.

That growth occurred, primarily in a stable protected environment.

The Federal Government has the opportunity to provide that environment.

I am willing to present before the standing committee if required to further discuss this submission.

Yours sincerely,

Bob Mason

Chief Executive Officer