QANTAS

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Mr Andrew McGowan
Committee Secretary
Standing Committee on Economics,
Finance and Public Administration
Department of the House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Mr McGowan

Inquiry into Australia's Service Industries

Further to our telephone conversation earlier today, I am pleased to attach a submission by Qantas to the above inquiry.

We would be pleased to provide further information and to attend any public hearing that might be held by the Standing Committee on this subject.

Yours sincerely

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SUBMISSION TO

THE STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

INQUIRY INTO

AUSTRALIA'S SERVICE INDUSTRIES

AUGUST 2006

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Introduction

Aviation and tourism are important elements of Australia’s diverse and ever growing services sector.

The aviation industry is valuable in its own right, and for its contribution to Australian tourism and other transport dependent industries.

Given Australia's size, population distribution and relative isolation from source markets, aviation links assume particular importance for tourism. Each makes a significant contribution to Australia’s exports in an increasingly competitive international environment.

Qantas plays an important role. Its integrated network connects international flights with domestic and regional services via the main gateway points and assists in distributing inbound tourists throughout Australia. In conjunction with key tourism bodies, Qantas also undertakes significant activity in promoting Australia overseas.

While the price, quality and availability of air links have an important bearing on the competitiveness of Australia as a destination, non-aviation aspects of Australia’s tourism offering, including product quality, marketing, infrastructure and facilitation issues are also significant.

Macroeconomic factors such as exchange rate movements also have a significant bearing on Qantas and Australia’s success as a tourism exporter.

Although Qantas is Australia’s major international airline and over half of its traffic consists of inbound visitors, it carried only approximately 30 percent of all international arrivals in 2005. The majority was carried by Qantas’ 41 competitors in Australia’s international market, many of which are government owned or subsidised and/or enjoy favourable home based hub advantages.

Qantas’ ability to contribute to further growth in inbound tourism will be heavily influenced by its international competitiveness relative to these airlines. While this challenge rests largely with Qantas, it is important that policy settings for Australia’s aviation industry recognise the uneven playing field and the distortions associated with the bilateral framework governing aviation.

Economic Contribution of Inbound Tourism

Travel and transportation accounted for $27.7 billion - or 74 percent - of Australia’s record $37.2 billion services exports in 2005. Of this, inbound tourism accounted for some $18.5 billion. This is forecast to increase to $19.1 billion in 2006.

The Tourism Forecasting Committee (TFC) predicts that the real economic value of inbound tourism (TIEV) will grow strongly over the medium term - at an average annual rate of 7.1 percent to reach $35.6 billion by 2015.

Qantas' Contribution to the Economy

In 2005, the Qantas Group's gross value added as a proportion of Gross Domestic Product (GDP) was 0.7 percent, or approximately $871 million, up from 0.6 percent a decade earlier.

Qantas Group expenditure on locally provided goods and services exceeded $2.3 billion, while wage and salary payments to Qantas' approximately 35,000 Australian-based staff amounted to almost $2.9 billion.

In undertaking its aviation-based activities, Qantas relies upon - and generates demand for - a wide range of goods and services. These services include financial, information and communications technology, advertising, printing and publishing, catering, cleaning, engineering and maintenance, ground handling, ground transport, airport services, design and construction, accommodation, air navigation, air safety inspection, rescue and firefighting, meteorological, insurance, security, health, and news/music/entertainment.

Some of these services are mandated by regulation, while others relate to Qantas' competitive product and market offering; some are provided in-house and others by external suppliers; and some are provided by major specialists, others by small businesses.

A key point to note is that a strong, flexible and diverse services sector is vital not only for Australia, but also to Qantas' ability to compete internationally.

Passenger Services

Australia's service exports include airfares paid by foreign visitors and spending by foreign visitors when they arrive in Australia.

Airfares paid by foreign visitors to Australia form a part of Australian export earnings. These include airfares paid on international legs to Australia on an Australian airline (for example, a resident from the US flies from Los Angeles to Sydney on a Qantas aircraft) and those paid on domestic legs (for example, a US resident flies from Sydney to the Gold Coast on a Jetstar flight).

A quarterly time series of Australian passenger service credits between September 1994 and March 2006 is presented in Graph 1 of Appendix 1. Australian passenger service credits generated $7.6 billion of export revenue over the four quarters ending March 2006, and trend upward at a Compound Annual Growth Rate (CAGR) of 3.8 percent per annum.

The passenger service credit entries in Graph 1 include both air travel data as well as shipping data. The air travel data includes passenger revenue (which not only includes airfares but also excess baggage charges, and anything purchased on the aircraft) and other payments made to Australian residents for such services as landing charges, baggage handling, storage and warehousing.

The airlines that have contributed to the passenger revenue component of Graph 1 include Qantas, Australian Airlines, Jetstar and Virgin Blue. The Qantas Group share of Australian carriage of foreign visitors is presented in Graph 2.

The Qantas Group share of Australian carriage of foreign visitor traffic is around 95 percent.

The Qantas Group's contribution to Australian passenger service credits was in the order of $2.6 billion for the 12 months ended May 2006, including foreign point of sale international passenger revenue for Qantas International, Australian Airlines and Jetstar International. This represented just over 33 percent of total Australian passenger service credits.

In the same period, the sum of domestic and regional Qantas Group airfares paid by foreign visitors was estimated at around $400 million for the 12 months ended March 2006. This contributed to the $19.8 billion in service credits over the same period.

Qantas carried approximately 1.9 million visitors to Australia in 2005. According to the Australian Bureau of Statistics (ABS), the average visitor spends approximately $3,500 (excluding airfares). This means that in total, the Qantas Group contributed around $3 billion to Australia's export earnings and will have contributed indirectly by carrying visitors who spend around $6.7 billion in Australia.

Growth in International Markets

Qantas is the world's eleventh largest airline in terms of revenue passenger kilometres (RPKs), with a fleet consisting of 213 aircraft.

In 2004/05, the Qantas Group offered more than 700 international flights each way each week to 80 destinations (including code share services) and carried almost two million visitors to Australia.

The Group currently serves 13 of Australia's top 20 inbound tourism markets with its own aircraft and 18 markets if code share services are included, as summarised in Table 1 at Appendix 2 (refer Appendix 3 for full list of points served).

<u>Qantas</u>

Qantas Airlines is continuing to grow in Australia's key tourism export markets.

- UK: Services between London and Australia via Hong Kong increased from four per week to daily in April 2006. Qantas now operates 28 services per week to the UK;

- North America: Qantas offers 43 services per week between the US and Australia, 33 of which are non-stop. Qantas introduced three weekly non-stop services between San Francisco and Sydney in March 2006. Extensions to Vancouver are added between June and August, and December and January. Services between Brisbane and Los Angeles increased from four to five per week in January of this year, and New York services increased by two services per week from the following month to a total of five weekly;

- South Africa: Services between Sydney and Johannesburg increased from four to five per week from December 2005;

- China: Qantas introduced three weekly services to Shanghai in December 2004 and increased frequency to four per week in November 2005. Qantas commenced services to Beijing in January 2006 with three flights a week from Sydney and plans to increase both Shanghai and Beijing services to daily by 2008; and

- India: Qantas is the only airline to offer same aircraft services between Australia and India following the introduction of three weekly flights between Mumbai and Sydney in September 2004.

The TFC is forecasting annual average growth in tourist arrivals from China of 15.7 percent between 2006 and 2015, which will make it Australia's second largest international market by 2014. Similarly, India is forecast to grow at an average annual rate of 15.6 percent over the same period, albeit off a lower base.

While it is anticipated that emerging markets such as China and India will take time to become profitable, Qantas is committed to building and maintaining a presence to ensure that Australia becomes a key export beneficiary of these burgeoning economies with growing middle class populations seeking to travel.

Qantas also has the flexibility to mount seasonal services from various international destinations to Australia, as required by peak demand periods and special events. For example, between December 2005 and February 2006, Qantas operated services between Seoul and Brisbane.

Qantas also operates charter flights to meet specific market opportunities.

Jetstar

In December 2005, Qantas' wholly owned value-based subsidiary, Jetstar, commenced international operations with services to New Zealand, including the inauguration of Coolangatta-Christchurch services.

Jetstar plans to commence long haul flights to six further international destinations in the Asia Pacific from Sydney, Melbourne and Brisbane from November 2006, operating a fleet of six Airbus 330-200s offering two classes of service. Jetstar's launch network will comprise Thailand (Phuket and Bangkok), Indonesia (Bali), Vietnam (Ho Chi Minh City), the US (Honolulu) and Japan (Osaka).

From August 2008, Jetstar will transition from its interim Airbus 330-200 fleet to a fleet of 12 new Boeing 787 aircraft.

Although Jetstar's initial tranche of flying is largely concentrated on outbound traffic due to its brand strength in Australia, its second phase of flying will have a greater focus on inbound tourism markets.

Jetstar's expansion will stimulate the growth of inbound tourism from markets that Qantas has been unable to serve on a commercially viable basis - even with its recently absorbed lower cost subsidiary, Australian Airlines - as well as developing new markets.

Code Sharing

Qantas is also involved in a number of alliance and code share arrangements which allow it to provide a wider, more efficient range of services.

Since 1995, Qantas and British Airways (BA) have been parties to a Joint Services Agreement (JSA), giving customers the benefits of global fare products, reciprocal frequent flyer programs and lounge access, joint lounges and global freight cooperation.

The JSA is authorised by the Australian Competition and Consumer Commission (ACCC) allowing Qantas and BA to coordinate schedules and pricing on services between Australia, Asia and Europe, including an extensive code share relationship. Qantas and BA code share on each other's services between Australia, Singapore, Bangkok, Hong Kong and the UK and Frankfurt. Qantas code shares on BA services from London to UK domestic and European ports and BA code shares on Qantas Australian domestic, trans-Tasman and Auckland-Los Angeles services.

Qantas and American Airlines (AA), the largest US carrier, work together through code sharing agreements, reciprocal frequent flyer programs and reciprocal lounge access arrangements. The relationship began in 1989 with what was, at the time, the world's first commercial code share agreement.

Qantas code shares on AA services to 16 points in the US and four points in Canada. AA code shares on Qantas services from Auckland, Brisbane, Melbourne and Sydney to Los Angeles and New York and from Sydney to San Francisco and Honolulu. The airline also code shares on Qantas operated Australian and New Zealand domestic services.

In some cases, using Qantas' own aircraft to serve a particular market may not be commercially viable. This may be due to factors such as insufficient volume or yield, constraints on aircraft availability and/or the competitive environment, including regulatory restrictions.

In such circumstances, code sharing with other airlines may provide an alternative which still enables Qantas to have a presence in that market. For example, Qantas operated direct services to Paris for a number of years, however, under the air services agreement between Australia and France it was limited to three B747 services per week. Due to the lack of frequency, these services were not competitive and consequently made heavy losses. In October 2004, Qantas withdrew from the market in favour of a code share on daily Air France services, and this has proven to be highly effective with a much greater recognition of Australia in the French market.

Code sharing can also provide carriers with valuable access to their partners' home marketing network, for example, Qantas' code share relationship with Japan Airlines (JAL) enables it to tap into JAL's extensive distribution channels and relationships with travel wholesalers in Japan, which significantly enhances Qantas' ability to attract inbound tourists.

More recently, Qantas and Jet Airways announced a code share arrangement that will considerably expand Qantas' network within India. From 6 September 2006, Qantas will place its code on Jet Airways' services between Delhi and Singapore, and Mumbai and Singapore. The code share means that Qantas will offer a greater than daily frequency from Mumbai to Sydney when combined with our existing three weekly services. Perth will also gain a daily codeshare connection to Mumbai, while Delhi services will provide connections from Sydney, Melbourne, Brisbane, Perth, Cairns, Darwin and Adelaide via Singapore.

Tourism Marketing

As an Australian based carrier, Qantas has a relatively small and mature domestic market from which to generate international outbound traffic. Today, over half of Qantas' passenger traffic is inbound tourists. Given the comparative growth rates expected for air travel in the medium to longer term, this proportion is expected to increase. According to the TFC, inbound arrivals to Australia are forecast to grow by 5.5 percent over the period 2006 to 2015, compared with an average annual growth of only 2.8 percent for outbound departures.

Qantas therefore has a strategic interest in increasing tourism and this is reflected in its network growth strategy, as well as its investment in marketing Australian tourism.

Australia faces fierce competition from foreign destinations vying to attract tourists. To counter such competition, Qantas works cooperatively with key Australian tourism organisations, including Tourism Australia (TA), the State Tourism Organisations (STOs), the Australian Tourism Export Council (ATEC) and TTF Australia.

As part of its relationships with TA and STOs, Qantas provides substantial financial support for joint promotional activities in overseas markets, and is the single largest private sector financial contributor in terms of marketing Australia overseas. Given the high cost of promotions in target markets, joint activities represent an effective use of funds.

Qantas Holidays is Australia's leading wholesaler of domestic and international holiday packages, providing flights and accommodation in conjunction with Qantas Group airlines and other airlines.

Qantas Holidays has over 220 offices worldwide which promote Australia as a destination. All these offices market and sell Qantas and Qantas Holidays products to Australia, and produce brochures with a focus on selling Australia as a destination.

Qantas also has a 75 percent stake in Holiday Tours, with offices in Singapore, Thailand, Hong Kong and Bali, and a commercial arrangement with Qantas Vacations in America, who purchase Qantas Holidays land products.

Marketing Activities

Global Brand: Qantas has an integrated global marketing strategy based on a consistent brand positioning across all markets. Qantas' brand seeks to represent the personality of Australia and Australians, and this "Spirit of Australia" is communicated in all global marketing activities.

Outside Australia, Qantas' marketing falls into two key complementary streams - Qantas' own brand product and "Destination Australia" advertising.

Brand Australia: Qantas works closely with its largest and most important marketing partner, TA, in all key overseas markets to attract international visitors. Qantas is in the second year of a three-year global destination marketing partnership with TA. The partnership sees more than $60 million invested in cooperative advertising that promotes Australia as a destination.

The establishment of "Australia Week" in the US is an example of Qantas' commitment to marketing Australia. This Qantas initiative is undertaken in conjunction with TA, the Department of Foreign Affairs and Trade (DFAT), Austrade and various Australian export corporations, and the week long event celebrates all things Australian.

Qantas is the major partner of TA's "Visiting Journalists Program". Qantas provides travel for a large number of international media groups from around the world who write articles and produce programs on "Destination Australia". The exposure generated by this program is estimated to generate approximately $350 million in publicity for Australia each year.

Additionally, Qantas is the major sponsor of TA's two major trade events - "Dreamtime" and the "Australian Tourism Exchange". Qantas provides travel for the majority of international tour wholesalers and media from around the world to Australia for these events. While in Australia, they conduct business with Australian travel product suppliers to facilitate the compilation of tour programs to Australia.

Qantas also collaborates globally with TA on the “Aussie Enthusiasts Program”. This is an innovative destination awareness program that operates in markets where TA does not have an active presence. In these regions, Qantas staff work with local agents to increase their knowledge of Australia.

Qantas is a sponsor of high profile Australian national sporting teams and events such as the Wallabies and Socceroos, the Hong Kong Rugby 7’s and the Commonwealth Games held in Melbourne in March 2006. Qantas is also working with the tourism industry to capitalise on the Australia-Japan “Year of Exchange” in 2006.

Qantas Strategy

Qantas’ ability to deliver an ongoing contribution to Australia’s economy and maintain and grow its role as a major service exporter will be heavily influenced by the success of its current strategic plan. The Group’s international strategy is focused on defending market share, maintaining profitability and growing the business to achieve a sustainable future.

Key pillars of the strategy are:

Investment and Innovation - The ability to grow and be competitive is closely tied to Qantas’ fleet and product strategy. Highlights include:

- $12 billion investment in fleet and product over the past five years, including the delivery of 55 aircraft and installation of the latest inflight entertainment system and the Australian designed Skybed business class seat;

- an order for 12 Airbus A380 aircraft, the first being delivered in 2007; and

- 65 Boeing 787 aircraft on order for Qantas’ mainline and Jetstar operations for delivery from 2008, with rights for an additional 50 aircraft.

Cost Efficiencies - In the three years to 2005/06, cost efficiencies of $1.5 billion have been achieved. In light of record oil prices and ongoing competitive pressures, that target has been increased to $1.5 billion over the next two years.

Segmentation of the Flying Businesses - The Group has segmented its flying businesses into two main brands - Qantas Airlines and Jetstar. Qantas Airlines offers customers a premium product on routes where demand is sufficient, while Jetstar operates on routes that are predominantly leisure destinations offering a value-based service for the more price sensitive consumer. This strategy maximises growth opportunities for the Group and enables it to attract tourists which may fall into either category of traffic.

Portfolio Diversification - Qantas is pursuing growth opportunities in international and domestic freight to diversify the earnings base of its business and reduce risk.

In 2005/06, the Qantas Group contributed $320 million in service credits through freight operations when uplifting exports in Australia and transporting them overseas, or when transporting goods between two overseas ports.

Freight is carried to all Qantas destinations in the underfloor hold space of aircraft. Qantas also offers access to the global route network of 135 countries and territories covered by the **one**world alliance.

Since 2004, Qantas has been operating a dedicated freighter network using Boeing 747-400 freighter aircraft wet leased from Atlas Air. The freighter network serves New York, Chicago, Toledo, Los Angeles, Honolulu, Anchorage, Mumbai, Singapore, Bangkok, Hong Kong, Dubai and Shanghai.

In the domestic market, Australian air Express (AaE) - a joint venture between Qantas and Australia Post - provides domestic freight and mail services and seamless transfer between international and domestic networks.

Expansion into Asia - Qantas owns 44.5 percent of Orange Star, which owns and operates the value-based airlines Jetstar Asia and Valuair, based in Singapore. Planned closer cooperation between Jetstar and these airlines will assist the development of inbound tourism to Australia.

Competitiveness of Australia's Tourism Exports

In 2004, Australia's share of global international visitor arrivals was 0.7 percent. There is a wide range of factors that affect the competitiveness of Australia as a tourism destination, and therefore its prospects of increasing this share.

However, in developing targeted strategies in this regard, the focus should not be exclusively on volume at the expense of yields. It is worth noting that the rankings by TIEV of Australia's top 20 markets (refer Table 2 of Appendix 2) do not align with the passenger volume rankings set out in Table 1. It is important that a balance between high yielding and high volume markets is struck.

The volume versus yield question is an important one for both airlines and the tourism industry as a whole. Yield management strategies and tools are imperative in ensuring that profits are realised and maintained through peaks and troughs in demand.

Tourism Marketing Funding

In 2006, the major entity charged with Australia's tourism marketing effort, TA, was awarded a budget of $140 million by the Government, of which approximately 80 percent will be spent on marketing initiatives.

This funding is relatively low when compared with other competitor destinations in the region. According to financial statements of the Singapore Tourism Board, Singapore spent approximately S$127 million (A$1.1 million) on promotion and development in 2004/05. Hong Kong's Tourism Board spent around HK$354 million (A$62.4 million) for the year ended March 2005. New Zealand spent approximately NZ$70 million (A$60.5 million) promoting tourism in 2005.

While these figures are comparable to Australia's promotional spend, Australia spends much less than its regional neighbours in relative terms when the size of each country's GDP is considered. Australia's GDP is over five times greater than Singapore's, more than three times larger than Hong Kong's and almost six times larger than New Zealand's.

The current level of funding for TA will expire at the end of 2006/07. Qantas considers it important that this level is retained as a minimum, but ideally it should be increased.

Product and Infrastructure

It is important that Australia's tourism product offers quality and value and meets customer expectations, as poor quality product can easily damage a good reputation. High quality product will increase the likelihood of return visits and will also lead to more positive recommendations to other travellers.

Underpinning Australia's tourism offering should be a solid grouping of products and services that cater for and deliver on the expectations of the various market segments.

The move to quality control through recognised accreditation is supported by Qantas as a means of encouraging the provision of a higher standard of product. This will provide a better travel experience for tourists, and lead to consequential revenue benefits.

To adequately manage the growing number of tourists to Australia, infrastructure such as airports, ground transport networks, hotels and utility services must also expand to support this growth. Coordination and strategy at a national level, particularly in light of deregulation and privatisation of many industries in the supply chain, is required in order to ensure that efforts are appropriately directed and consistent in the development of Australia's infrastructure.

Australia' tourism infrastructure benefited from a significant period of investment in the late 1980s and early 1990s and again prior to the 2000 Olympic Games held in Sydney.

However, this has diminished in recent years and the level of foreign investment – which fuelled the investment boom of 15-20 years ago – has also fallen considerably as investors have found superior returns in overseas markets. In addition, returns on private sector tourism investment within Australia have generally been lower than average returns on investment across other industries.

The National Tourism Investment Strategy (NTIS) report commissioned by the Government in 2005 notes that the ability of the tourism accommodation sector to meet future investment requirements will be dependent on the successful implementation of a range of strategies to overcome market impediments and reduce the level of risk relative to returns.

The NTIS report identifies a number of impediments to investment including planning regulations and taxation issues such as asset depreciation schedules, investment incentives and capital gains tax, and suggests areas where the Government might consider streamlining processes and requirements to facilitate increased private sector investment on tourism development in Australia.

It is worth noting that the trend in investment by tourism operators stands in contrast to that of the Australian aviation industry where significant and increasing capital investment is being undertaken.

Passenger Processing

Australia’s major international gateways have been experiencing significant delays in the processing of passengers through border control points for both inbound and outbound travel.

It is anticipated that these delays will only worsen with the natural growth in anticipated passenger numbers and the introduction of larger aircraft such as the Airbus A380.

Although the 95 percent target for inbound passenger processing within 30 minutes of arrival at the primary line is predominantly being met, there are significant delays at the secondary (quarantine) screening points.

Outbound travellers experience similar delays at primary processing points when exiting the country. It must be remembered that inbound visitors are also outbound travellers on their homeward journeys, and an unsatisfactory experience at the end of their journey could leave unfavourable lasting impressions of their overall visit to Australia.

Delays in outbound passenger processing by border agencies also reduce time available for duty free shopping and/or to claim a GST refund on purchases.

Airports and airlines have provided significant investment towards ensuring that the necessary infrastructure is in place to support the facilitation process, for example, Qantas is a major participant in the Government’s SmartGate initiative at several airports. However, this commitment needs to be matched by the Australian Government to meet the standards that have been mandated and to ensure that Australia's international aviation and tourism reputation is not diminished.

The key short-term challenge in improving border processing for inbound visitors involves the introduction of new business practices in quarantine policing to reduce queuing.

The Government has recognised the need to address these issues and has established a Passenger Facilitation Taskforce. Which is consulting with industry.

Looking further ahead, the benefits for tourism of an Australia/New Zealand common border are considerable. The 'single border' concept would make trans-Tasman travel almost as simple as a domestic journey, and would streamline and reduce the cost of processing passengers arriving from New Zealand, allowing resources to be directed elsewhere.

Visas

Australia's universal visa requirements have the potential to impact tourism as the cost and complexity of qualifying for and obtaining visas relative to competitor destinations may act as a disincentive for travel to Australia from some source markets.

The advent of the Electronic Travel Authority (ETA) was a positive step in improving access to Australia from important markets. The Department of Immigration and Multicultural Affairs (DIMA) has recently introduced the e-visa, which is now fully operational in China and is being trialed in India. Qantas would like to see e-visa made available to more countries, particularly potential growth markets.

Taxes and Charges

The high level of taxes and government-mandated charges borne by the Australian tourism industry, and particularly the aviation sector, affects the competitiveness of its exports.

A Passenger Movement Charge (PMC) is imposed by the Government on all international passengers departing Australia and is collected by airlines – currently at a rate of $38. However, the charge is not hypothecated to the border agencies and as such, does not represent a "cost for service" charge. In a similar vein to visas, charges of this magnitude could act as a deterrent to tourists weighing up where to travel.

Since September 11 2001, a large number of additional aviation security measures have been imposed by governments, aimed at strengthening national borders.

In Australia, the division of responsibilities between government and industry for implementation of aviation security measures is not reflected in responsibility for meeting the associated costs. The present arrangements see the aviation industry funding the majority of the protective security infrastructure at Australian airports, which are acknowledged as a part of Australia's critical national infrastructure.

Airport operators recover their security costs from airlines in full. Airlines in turn recover some of their security costs from passengers through charges levied on air tickets, which has an associated negative effect on demand for air travel and consequently the tourism industry. Internationally however, many governments meet some or all of these charges, in recognition of the national security benefits that enhanced aviation security provides.

Exchange Rate Movements

Relative movements in exchange rates have a significant impact on the international tourism industry, in the same way they affect the competitiveness of Australia's other goods and services exports.

The Australian dollar has strengthened considerably against a number of major currencies in recent times. As a result, growth in the number of foreign visitors to Australia in some markets has slowed, while the number of Australian residents travelling has risen sharply.

For example, while the weakness of the Japanese economy over the past decade has had a uniformly dampening effect on Japanese outbound tourism, relative exchange rate movements have heavily influenced Japanese leisure travel patterns in recent years.

The Australian dollar has increased by approximately 45 percent against the Japanese yen over the period September 2001 to December 2005. Qantas' estimate of the elasticity of demand with respect to the exchange rate is in the order of -0.3 to -0.4 percent, meaning a 10 percent rise in the exchange rate would constrain arrivals by around three or four percent. An increase of 45 percent could therefore potentially curb arrivals in the order of 13.5 to 18 percent, all other factors being equal, particularly where close substitute destinations are available.

Concurrently, the Australian dollar has appreciated against the US dollar. The net effect is that the cost in Japanese yen of purchasing tourism services in Australia relative to the US, has diverged sharply in favour of the US (refer Appendix 4, Graphs 1 and 2). This effect is evident in many inbound markets, however, Qantas' experience is that the Japanese and US markets are particularly sensitive to exchange rate changes.

Similarly, the strength of the Australian dollar against the US dollar has generally dampened inbound tourism from the US, while outbound traffic to the US has risen dramatically (refer Appendix 4, Graphs 3 and 4).

Qantas believes that sufficient acknowledgment is not given to exchange rate effects on arrivals trends by tourism industry and related stakeholders.

Aviation Policy

Australia's reliance on international air links to deliver inbound tourists means that the aviation and inbound tourism industries are more closely bound than in some other countries.

This geographic dependence has led to calls for "open skies" by some Australian tourism interests and stakeholders in related industries. Notwithstanding the absence of a clear or accepted definition of the term, some advocates of "open skies" view an offer of unfettered access to Australia's aviation markets as the only means of delivering tourism growth.

Such calls overlook the complexities of the bilateral system governing aviation access rights and fail to recognise that, for the great majority of markets, capacity has already been negotiated well ahead of demand. They also ignore the many factors, including high levels of government ownership and support, which prevent airlines from competing on a level playing field.

Stepping back from the emotive debate, it is clear that Australia needs a wide-ranging and competitive network of air services, capable of attracting increased tourist numbers in all market segments, and that aviation policies that enable airlines to compete and grow on a sustainable basis are also required.

Further liberalisation of Australia's air services must therefore occur in a balanced way, recognising the economic and strategic importance of Australian based airlines, and enabling aviation and tourism to grow.

Geographic Position

Australia's geographic position relative to its principal tourism markets and major airline competitors poses significant challenges for Qantas.

Many foreign carriers operating to Australia have the benefit of a more central location and access to traffic flows between major regions. This affords these "hub" carriers certain advantages over airlines such as Qantas who are located in "end-of-line" markets.

Under the bilateral framework that governs aviation access, hub carriers are able to combine point-to-point rights to carry passengers to and from markets on either side of their home market. These "rights" (although they are generally *de facto* rather than formally granted) are referred to as sixth freedoms. For example, Hong Kong's airlines can operate in the UK/Australia market on a sixth freedom basis without Hong Kong being a party to UK/Australia bilateral agreements, by connecting services under the Hong Kong/Australia agreement with flights under the Hong Kong/UK agreement.

The ability of hub airlines to build up networks on this basis is an often understated and unrecognised feature of the bilateral air services regime, making it different from other bilateral trade agreements.

This disadvantages end-of-line carriers such as Qantas unless they are provided with equivalent offsetting opportunities in the form of fifth freedom rights in a way which replicates their use by sixth freedom carriers. Using the above example, this would mean the ability of Australian carriers to operate beyond Hong Kong to the UK, and these rights must be formally secured from both the UK and Hong Kong. While the UK has granted Australia open access via Hong Kong, Hong Kong restricts services beyond to the UK by Australian carriers to seven frequencies per week and places limits on the uplift of traffic at Honk Kong.

Although Australia has been reasonably successful over the years in obtaining fifth freedom rights, their value means that these are becoming increasingly more difficult to obtain.

Aviation Market Access

Progressive liberalisation of international air services agreements has been a feature of the global regulatory environment in recent years. Australia has been at the forefront of these developments and has pursued a policy of negotiating capacity well ahead of demand. While this has ensured that growth has not been constrained in Australia's major tourism markets, it has supported the expansion of carriers who are not necessarily operating capacity according to commercial considerations. In some cases it has also seen Australia’s leverage for securing fifth freedom rights diminished.

The overall effect of this has been a substantial decrease in Qantas’ share of visitor arrivals to Australia over the past decade. At privatisation, in 1995, Qantas’ share of this market was 40 percent, in 1999 it had fallen to around 35 percent, and has now dropped to approximately 30 percent.

Qantas believes that international aviation policy settings must strike a balance between tourism interests and the commercial sustainability of services by airlines which have a long-term commitment to Australia. This will ensure that Australia continues to be adequately served and enjoy growth in visitation, while making certain that the carriers of Australia remain competitive in international, domestic and regional markets.

To be active in developing and maintaining inbound traffic flows, Australian carriers need access to hub points, a fact that was acknowledged in the Federal Government’s recent aviation policy review. During an address to the Bureau of Transport and Regional Economics (BTRE) Transport Colloquium in June 2006, the Minister for Transport and Regional Services, the Hon Warren Truss MP, stated that;

> “Hub carriers wanting access to the Australian market need to be aware that in exchange for access, we will continue to seek the rights

> for Australian carriers to fly beyond a hub point, in the same way hub carriers can already do so. This will help to balance the undeniable commercial and network advantages hub carriers have over our airlines".

In securing this access, the sequencing of liberalisation is paramount. To be competitive in end-of-line markets such as the UK and Europe, liberalisation with these countries needs to occur before access at hubs is opened up.

Unfettered aviation access through unilateral liberalisation of Australia's air services agreements will not result in a long-term boost in tourism to Australia. If such a policy were adopted, it is unlikely that non-Australian airlines will provide the broad range of support and long-term commitment that Qantas has to the markets, regions and communities of Australia. In addition, Australia would risk losing further valuable future negotiating leverage through such an approach to liberalisation, which did not give due regard to pacing and sequencing.

The Government's aviation policy review acknowledged that "open skies" is an aspirational goal to be sought on a case-by-case basis, where it is in the national interest. The review also recognised the contribution an Australian-based airline industry makes to the economy.

Structural Disadvantages

The structural advantages of many carriers with which Qantas competes have a significant impact on its competitiveness in international markets. While some of these differences apply to all businesses - for example, the corporate tax rate in Singapore is 20 percent and in Dubai no tax is payable, while in Australia it is 30 percent - some are aviation specific.

Appropriate government policies that enable Australian carriers to invest and grow, in an environment that is not a level playing field, have an important bearing on Australia's ability to attract foreign tourists.

Government Ownership - Airlines that have a substantial proportion of government ownership have a sovereign risk profile, and are therefore able to sustain a higher level of gearing than would otherwise be acceptable to lenders. This effectively makes the cost of debt cheaper for the airlines.

Governments that hold a stake in their national carriers can more readily align the objectives of airlines, airports and tourism interests. As an extension of this, government owned and supported airlines may also be under less pressure to make commercial decisions with respect to capacity and pricing, as a broader national agenda may be in place. The Chief Executive Officer of Qatar Airways, Akbar Al Baker, was quoted in June 2006, as saying:

> "You should put the airline business in the context of a bigger picture. Even if your company may not be able to make profits, the country can immensely benefit from it.''

As a privately owned firm, Qantas does not enjoy any of these benefits.

Limitations on Foreign Ownership - The 49 percent cap on total foreign ownership imposed by the Qantas Sale Act raises Qantas' cost of capital by artificially restricting demand and lowering the share price. As the pool of global equity capital is far greater that that locally, overseas demand exceeds that in Australia. An inflated cost of capital makes it more difficult for Qantas to remain appropriately geared and protect its credit rating, and to undertake the major capital expenditure program it has under way.

Airport pricing - After the privatisation of Australia's major airports, the Government decided that a "light handed" oversight of airport pricing practices would be sufficient to maintain fair charging regimes. However, high and increasing profitability continues to be a feature of airport operations, driven by monopoly-style revaluations of assets and a reluctance to submit transparent cost data to customers for analysis.

As the largest single operator through Sydney, Qantas is the most exposed of all carriers to the impact of that airport's high and rising fees, combined with increasing constraints on its terminal and runway capacity during periods of peak commercial demand. This disadvantages Qantas relative to carriers who operate from airports with lower charging regimes in place.

The availability and cost of access to airport infrastructure are critical not only to Qantas' ability to serve the needs of global passenger markets in a competitive international environment, but also for Australia as a destination.

Prohibitively high charges will discourage international carriers from serving Australia if network scheduling choices are marginal and superior returns can be achieved elsewhere.

Aircraft Depreciation - Qantas' aircraft are depreciated over a 10-year period for taxation purposes, while carriers from Singapore and Hong Kong, for example, are able to depreciate their aircraft over a three-year and five-year period respectively. Singaporean carriers can also take advantage of investment allowances of 20 to 50 percent of the cost of productive equipment.

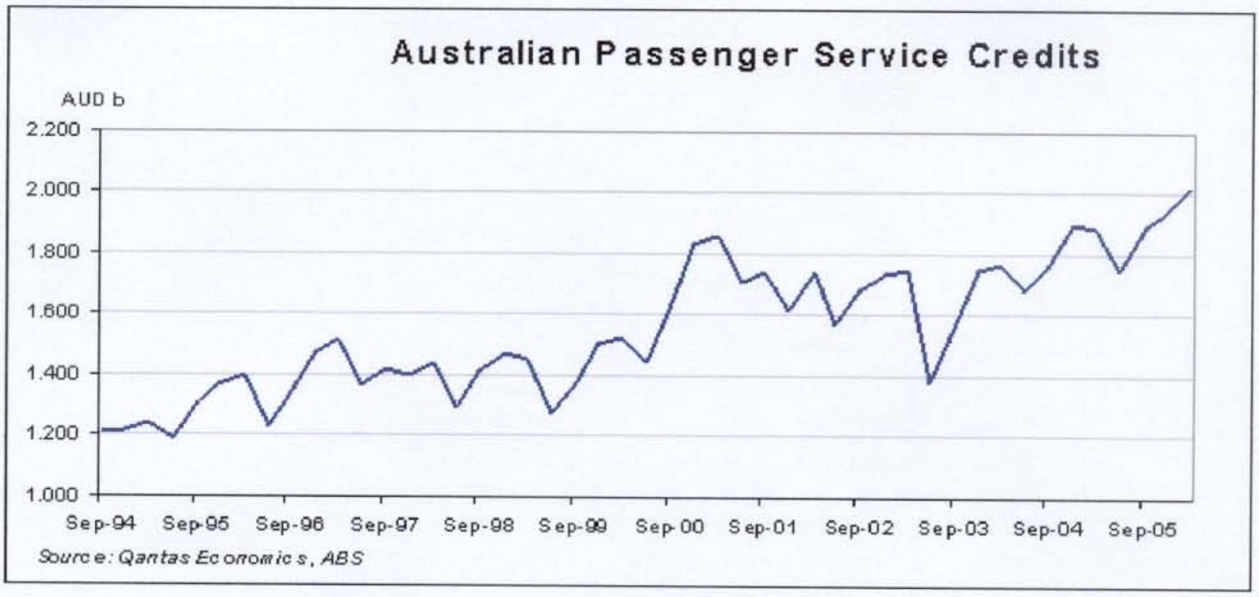
These differentials represent a significant disadvantage to Qantas, making its fleet and product investment programs more costly than those of its major competitors.

Recent Budget developments marginally assisted Australian carriers through an increase in the diminishing value rate for determining depreciation deductions from 150 to 200 percent for depreciating assets acquired on or after 10 May 2006, regardless of the asset's effective life. While this is a step in the right direction, aircraft specific depreciation provisions in Australia remain far from internationally competitive.

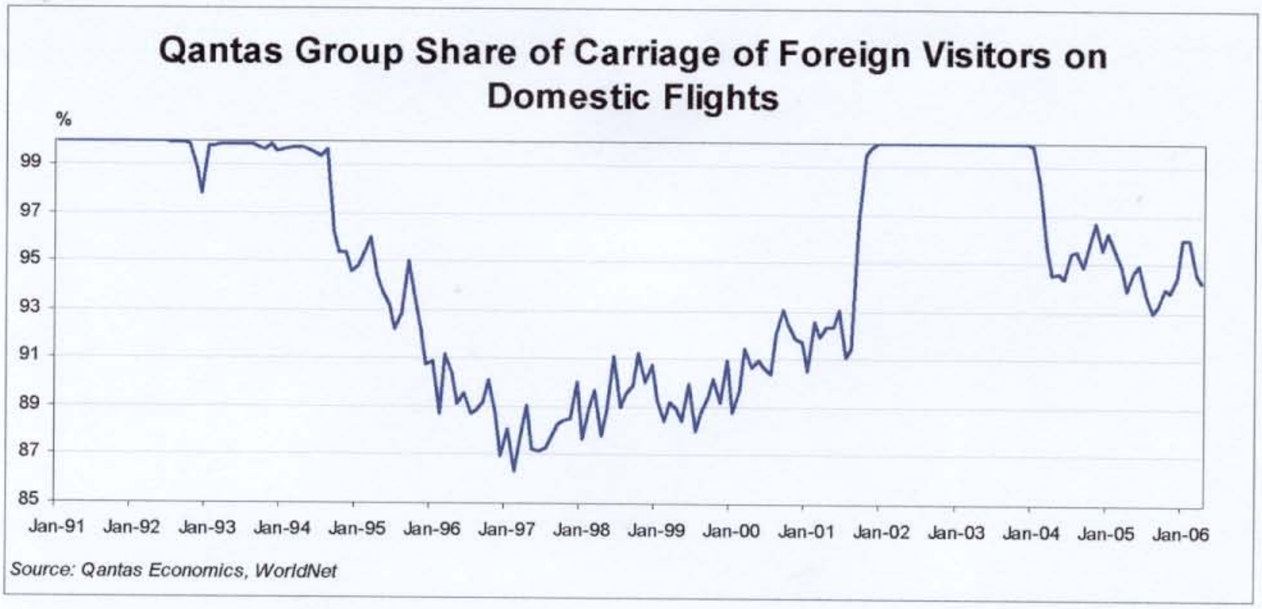
Appendices

Appendix 1

Graph 1:



Graph 2:



Appendix 2

Table 1:

Australia's Top 20 Inbound Markets (12 Months to May 2006)		
Market	**Passengers**	**Qantas Services**
New Zealand	1,125,626	✔
United Kingdom	778,099	✔
Japan	685,552	✔
USA	464,463	✔
China	338,603	✔
Singapore	279,417	✔
Korea	257,904	S/C
Hong Kong	181,959	✔
Malaysia	171,925	-
Germany	154,906	✔
Canada	112,443	✔
Taiwan	109,448	C
India	101,656	✔
Indonesia	94,044	✔
Thailand	85,227	✔
France	68,882	C
Ireland	65,821	-
South Africa	63,721	✔
Italy	53,061	C
Netherlands	52,136	C
Total	**5,916,936**	-

Source: ABS
✔ - Operated by Qantas
C - Operated by code share partner
S - Seasonally operated by Qantas

Table 2:

Australia's Top 20 Inbound Markets (TIEV - 2005)	
Market	**TIEV ($billions)**
United Kingdom	3.1
Japan	2.1
USA	1.8
New Zealand	1.6
China	1.5
Korea	0.9
Germany	0.7
Singapore	0.7
Malaysia	0.6
Hong Kong	0.5
Canada	0.4
Indonesia	0.4
Ireland	0.4
Middle East*	0.3
Netherlands	0.3
Switzerland	0.3
Taiwan	0.3
Thailand	0.3
France	0.2
South Africa	0.2

Source: TFC
* includes - Bahrain, Gaza Strip, Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, UAE, Yemen, Algeria, Libya, Morocco, Egypt, Tunisia, Sudan and 'other' North African countries

Appendix 3

ROUTE NETWORK

SERVICES OPERATED BY QANTAS GROUP AIRLINES AND CODE SHARE PARTNER AIRLINES

Countries served **39** (including Australia)
Total Destinations **143** (including code shares)

Asia and the Pacific (19)

Australia	China	Fiji*	Hong Kong	India
Indonesia	Japan	New Caledonia	New Zealand	Norfolk Island*
Papua New Guinea*	Philippines	Singapore	South Korea*	Taiwan*
Thailand	Tahiti*	Vanuatu*	Vietnam*	

Europe (13)

Austria*	Denmark*	Finland*	France*	Germany
Greece*	Italy*	Netherlands*	Norway*	Poland*
Sweden*	Switzerland*	United Kingdom		

Middle East (3)

Bahrain*	Lebanon*	United Arab Emirates*

The Americas (3)

Canada	Chile*	United States

Africa (1)

South Africa

Australia (63)

Adelaide	Albury	Alice Springs	Armidale	Avalon^
Ayers Rock-Uluṟu	Ballina-Byron Bay^	Barcaldine	Blackall	Blackwater
Brisbane	Broome	Bundaberg	Burnie	Cairns
Canberra	Charleville	Coffs Harbour	Darwin	Devonport
Dubbo	Emerald	Gladstone	Gold Coast	Gove
Hamilton Island	Hervey Bay^	Hobart	Horn Island	Kalgoorlie
Karratha	Kingscote	Kununurra~	Launceston	Leinster>
Longreach	Lord Howe Island	Mackay	Melbourne	Mildura
Moree	Mt Hotham~	Mt Isa	Mt Keith>	Narrabri
Newcastle	Newman	Paraburdoo	Perth	Port Hedland
Port Lincoln	Port Macquarie	Proserpine^	Rockhampton	Roma
Sydney	Sunshine Coast^	Tamworth	Thangool>	Townsville
Wagga Wagga	Weipa	Wollongong		

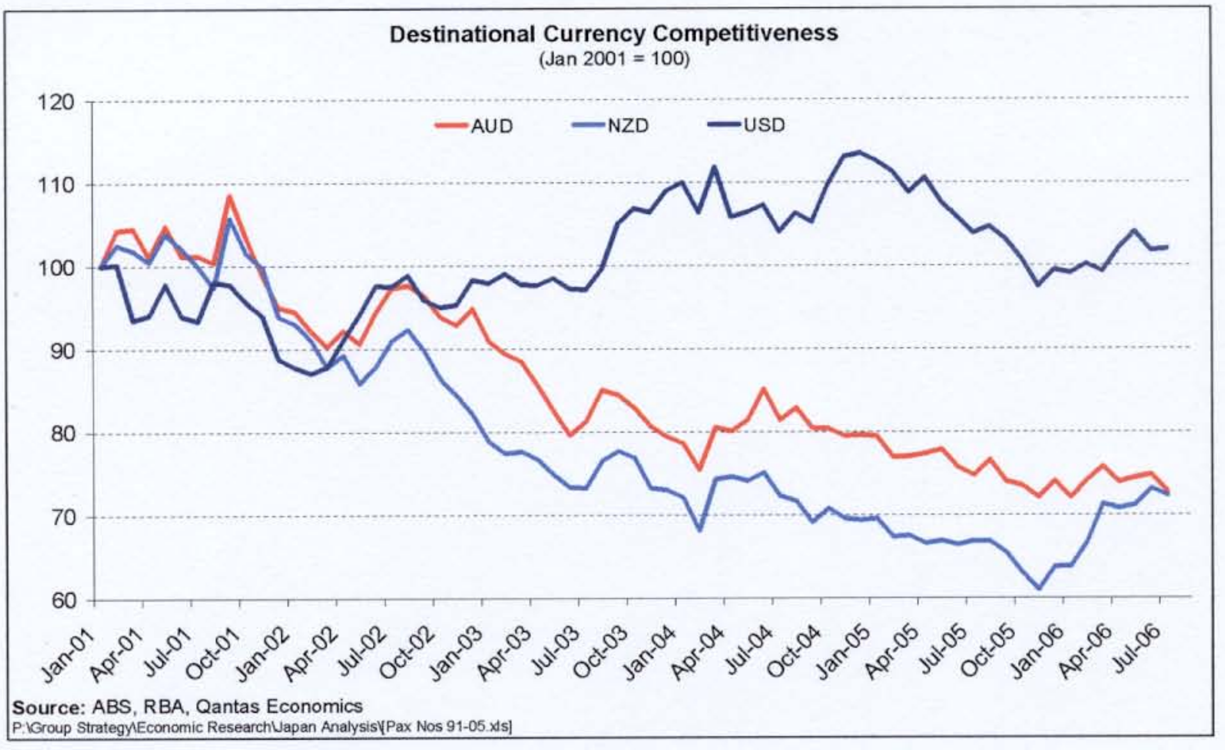
International (80)

Aberdeen*	Amsterdam*	Athens*	Auckland	Bahrain*
Bangkok	Beijing	Beirut*	Berlin*	Birmingham*
Boston*	Calgary*	Chicago*	Christchurch	Copenhagen*
Dallas/Fort Worth*	Denpasar	Denver*	Dubai*	Dusseldorf*
Edinburgh*	Frankfurt	Geneva*	Glasgow*	Halifax*
Hamburg*	Helsinki*	Ho Chi Minh City*	Hong Kong	Honolulu
Jakarta	Johannesburg	Las Vegas*	London	Los Angeles
Lyon*	Manchester*	Manila	Miami*	Montreal*
Mumbai	Munich*	Nadi*	Nagoya	New York
Newcastle-on-Tyne*	Nice*	Norfolk Island*	Noumea	Osaka
Oslo*	Ottawa*	Papeete*	Paris*	Phoenix*
Port Moresby*	Port Vila*	Portland*	Queenstown	Rome*
Rotorua	San Diego*	San Francisco	Santiago*	Sapporo ~
Seattle*	Seoul*	Shanghai	Singapore	St Louis*
Stockholm*	Suva*	Taipei*	Tokyo	Toronto*
Vancouver (from June)	Vienna*	Warsaw*	Washington DC*	Wellington

*** Services operated as code share flights**
^ Jetstar only
> Charter
~ Seasonal

Appendix 4

Graph 1:



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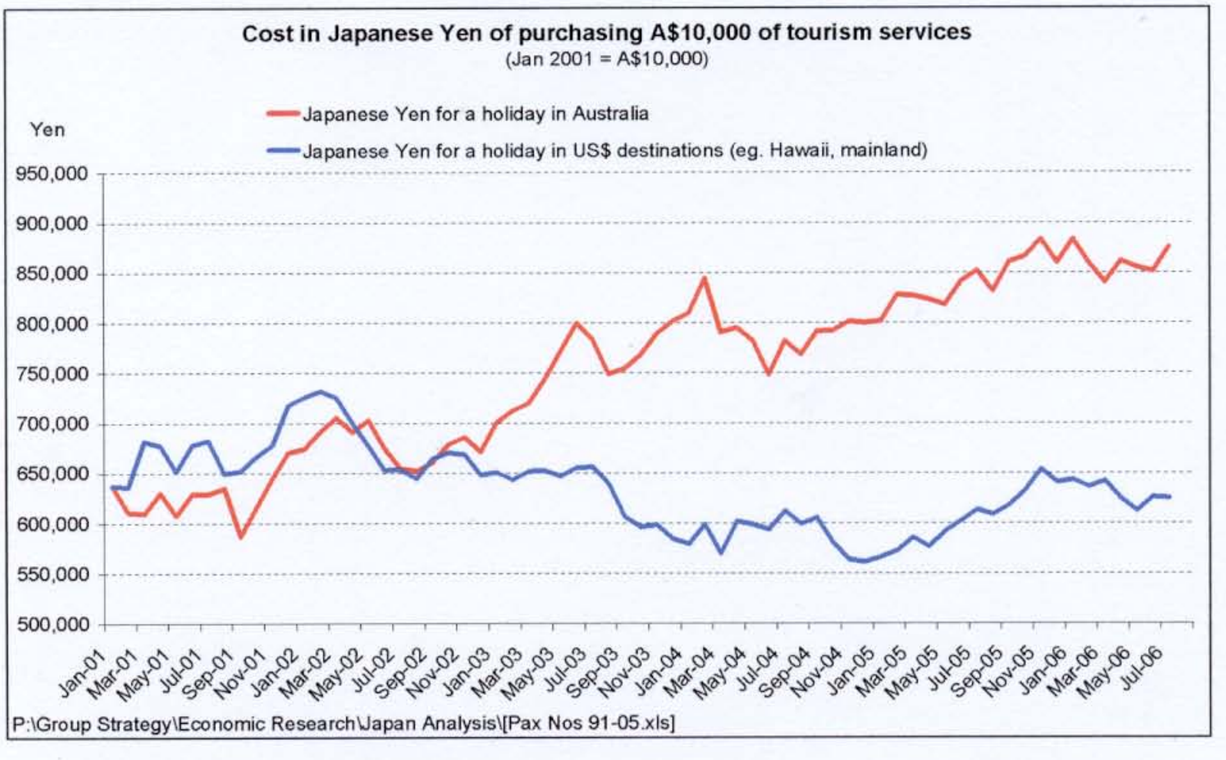
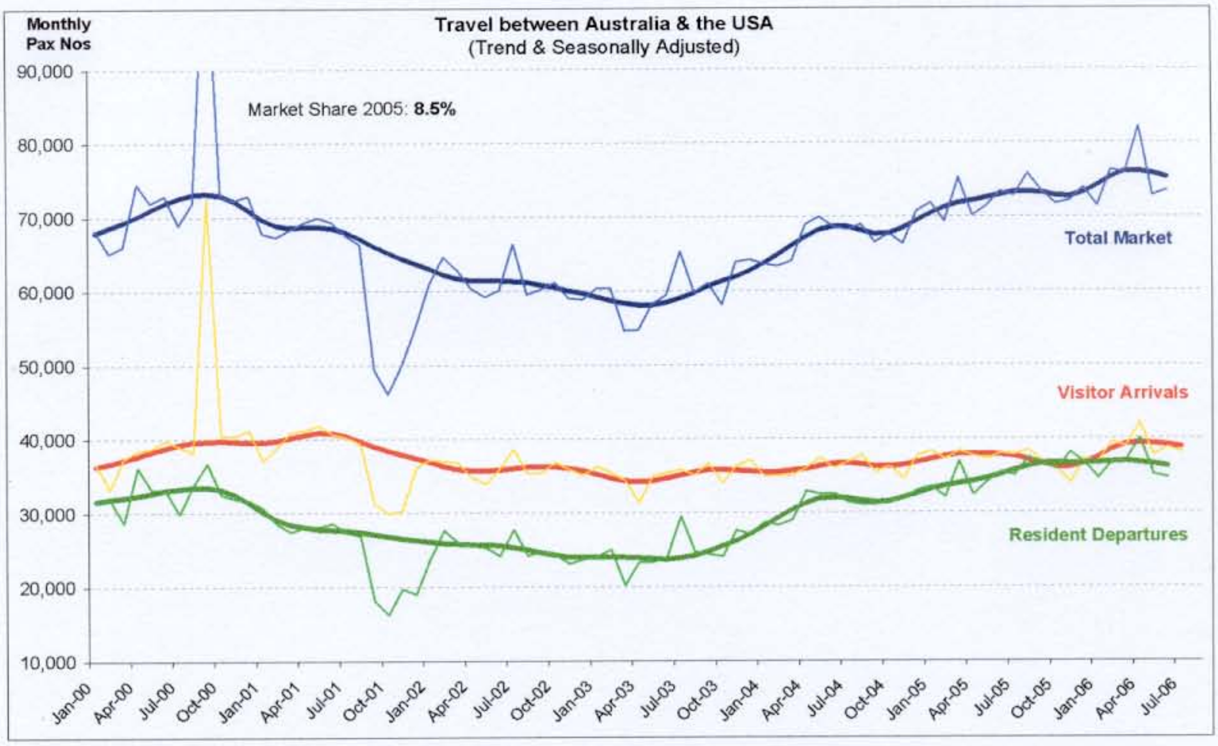
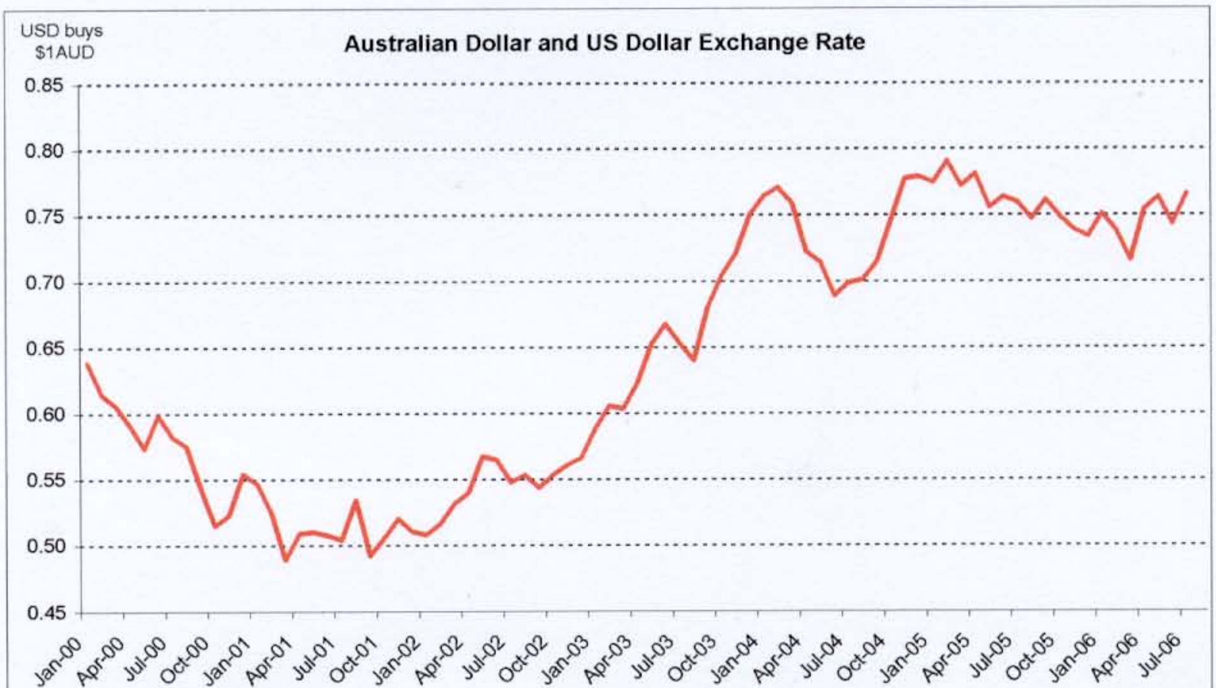


Graph 3:



Graph 4:



Source: RBA, Qantas Economics
S:\Group Strategy\Economic Research\Economic Analysis\Australia\Top 15 Analysis\[Exchange Effects Mar06.xls]