19 July 2002

Mr Brenton Holmes
Secretary
Foreign Affairs Defence and Trade Committee
Room S1.57
Department of the Senate
Parliament House
CANBERRA ACT 2600

Dear Mr Holmes,

Inquiry into Australia's Relationship with Papua New Guinea and Other Pacific Island Countries

Attached is Qantas' submission to the Inquiry, which outlines for the Committee's information the importance of a sustainable aviation sector for the region's future economic development.

Qantas has a close and continuing association with the region dating back some 60 years. Practical support by Australia, to sustain airlines, to assist in the provision of aviation infrastructure and to train industry experts will remain a vital regional need for the foreseeable future.

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

Yours sincerely,

John Kerr
General Manager
Government and Regulatory Affairs

Submission of Qantas Airways to the Senate Foreign Affairs Defence and Trade Committee Inquiry into Australia's Relationship with Papua New Guinea and Other Pacific Island Countries.

Introduction

Provision of safe, efficient and reliable air services is crucial to the economic development of Papua New Guinea and all South Pacific nations, and is an objective to which every government and airline in the region aspires. Possession of a national airline is generally seen as a vital factor in the difficult task of keeping in touch with each other and with the rest of the world.

Regrettably, in many parts of the region, weakness and instability, not inconsistent with the fragile economies and unstable regional political regimes all too often experienced in the South Pacific, plague the aviation industry. Problems exist not just with various regional airlines, but also in the provision and maintenance of infrastructure, training and safety oversight necessary to support the industry.

The need for support of South Pacific aviation is a regular subject of discussion at Pacific Island Forum meetings, as the need for a healthy industry is widely recognised.

There has been considerable discussion on the desirability of a regional approach, perhaps culminating in the formation of an airline or airlines representing not just one country, but several. Such ideas have not borne fruit, but there are now various examples of commercial cooperation between airlines short of formal equity sharing.

To provide a regulatory incentive to greater cooperation, Forum member nations have proposed an initiative to create a regional open skies multilateral approach to air service arrangements. However, many airlines in the region oppose a multilateral agreement, as they fear it may result in increased competitive pressures from stronger and larger neighbours.

The role of governments will remain important to sustain airlines for the foreseeable future, and provision of foreign aid to assist with the provision and maintenance of infrastructure and the training of personnel remains fundamental to keeping the region's airlines flying safely.

Qantas - Historical Background

Qantas' 60 year Papua New Guinea/South Pacific experience dates from 1942, when elements of our fleet were extensively used for air transport activities in cooperation with Australian forces in World War 2. Qantas was there to stay, and post-war established a presence and interest in the region that has remained strong since.

For nearly two decades following the War, Qantas was the major operator of both Australia-PNG air links and domestic services in PNG, before TAA took over these roles in the 1960s.

When PNG became independent in 1975, Qantas again became Australia's only operator of Australia-Port Moresby services, and provided assistance to the fledgling Air Nuigini.

Qantas' relationship with other parts of the South Pacific is almost as long. Regular flying boat services were commenced in 1946 from Sydney to Noumea with separate extensions to Suva and to Vila and Espiritu Santo in the then New Hebrides. A local Qantas service was also operated at this time from Lae to Honiara in the Solomon Islands.

Qantas' presence in Fiji was expanded in 1954, when Super Constellation services through Nadi, Canton Island (now part of Kiribati) to Honolulu and San Francisco commenced, following the Qantas takeover of British Commonwealth Pacific Airways. Qantas was responsible for construction of much of the infrastructure at Nadi airport, with some maintenance facilities and staff housing dating from the 1950s still in use today.

Qantas also had an early interest in local Fijian operations, buying out the then Fiji Airways in 1957, before ownership was spread in 1960 between Qantas, Air New Zealand (then T.E.A.L), British Airways (then BOAC) and the Government of newly independent Fiji. In 1972, Fiji Airways became Air Pacific, and, whilst other shareholders have come and gone, Qantas now holds a 46.05% equity in Air Pacific, with the Fiji Government holding the remainder.

The range of today's aircraft has removed the need for transit stops on long haul flights at ports in the South Pacific. This changed the whole Qantas approach to South Pacific operations which were initially point-to-point Qantas services but are now primarily conducted by regional carriers with Qantas as codeshare partner.

The Regional Aviation Picture

It is a characteristic of every newly independent nation to set up a "flag" airline as an immediate government priority. This has occurred as States have become independent of colonial administrations, and when larger entities have broken into constituent parts. Most recent examples have included the emergence of new airlines in the ex-Yugoslav republics, and in the independent nations which previously constituted the Soviet Union.

The South Pacific was, and is, no different. All of the countries/territories within the ambit of this Inquiry have either become independent of colonial administrations or continue to evolve more independent relationships with remaining colonial powers. Nearly all have local airlines, mostly wholly or majority government owned.

The practical need for airlines within the region is of course driven by geography, as each of the small Island Nations covers a vast area of ocean, with population points generally relatively small and widely spaced. Papua New Guinea has similar problems with its spread of offshore islands, and also contends with a serious lack of mainland trunk roads.

The island States feel, with some justification, that they cannot afford not to have their own national, airline. Political and socio-economic imperatives dictate that independent governments should control their own means of communication, whatever the direct cost. National pride, some distrust of neighbours, both regional and beyond, and political influence and government are all involved. It is probably unrealistic to expect any Island State to accept a situation that does not guarantee air access in line with their own perceived requirements. There has certainly been no indication to date that any regional government would willingly accept loss of local control.

As clearly demonstrated in the past year, it is difficult enough for large airlines in fully developed economies to remain profitable. It can be much more so in less developed economies. Most regional airlines face remoteness from major markets, low per capita incomes, small populations, are often based in a country lacking natural resources and, importantly, lack capital. Lack of capital affects not only the ability to equip airlines, but to maintain aviation support infrastructure such as airports and navigational aids and to retain appropriately trained staff. Many of their airline related costs are in US dollars, and local currencies tend to be weak. Tourism is one of the few means of earning foreign exchange to pay for these costs.

The Australian Department of Foreign Affairs and Trade Country/Economy Fact Sheets provide a less than encouraging synopsis of most South Pacific regional economies. Apart from French Polynesia and New Caledonia, per capita GDP remains low and economic growth has been erratic and in some cases non existent over the past five years. Political instability is a further cause for concern in some cases as evidenced by the recent poor economic performance of Papua New Guinea, the Solomon Islands and Fiji. Difficulties faced by these countries were clearly reflected in the results achieved by their airlines.

There is relatively little business traffic within the region, with airlines mostly dependent on local traffic and tourism – market segments which traditionally return low fare yields. It is not surprising that most airlines of South Pacific nations struggle to remain viable.

A persistent problem for local airlines is to determine the type of aircraft required to fulfil their market needs, and to provide a reasonable return to the operator. The Secretary General of the Association of South Pacific Airlines, the region's representative airline body with16 full airline members from 14 nations (plus associate membership by Qantas and Air New Zealand) has said that his member airlines need an aircraft that doesn't exist. The optimum aircraft should have 50 to 70 seats, with the seat mile costs of a B747, and the range and comfort of a B767!

Regrettably, with no regional approach to achieve commonalities with neighbouring carriers, there have been many examples of aircraft added to regional fleets being subsequently identified as unsuitable.

Regional Characteristics

Inadequate airline networks and civil aviation facilities have exacerbated the difficulties naturally associated with small populations, wide geographical separation and marginal economies. The lack of financial resources available to the transportation sector, and the limited capability of the smaller island states to absorb or maintain technological development - in particular due to their lack of skilled indigenous manpower and technical training facilities - has made the aviation sector dependent upon donor funds and technical resources of the larger Pacific rim countries and beyond. There is no indication this is likely to change - Fiji and the French territories excepted.

Regional air travel remains expensive in local terms, with schedules infrequent, and often unreliable. This is due in part to thin passenger and cargo traffic volumes which restrict demand for air travel in any one State, with the exception of PNG, and in part to inadequate tourist infrastructure and trained personnel. North American and European tourists, and the burgeoning group markets from Japan, demand high standards, reliability and frequency if they are to circulate around the South Pacific region rather than spend their time and money at a convenient gateway point. These market characteristics demand a far higher degree of cooperation between the national airlines than has so far been apparent. Since virtually all have government shareholdings, any change of direction must involve political will to be properly effective.

Most of the small, regional airlines of the South Pacific have developed from “social-subsidy” domestic operations by the acquisition (generally by way of a lease) of a single jet aircraft. They are vulnerable to technical malfunctions, generally reliant upon expatriate pilots, engineers and senior management, are commercially dependent upon subleases and codeshare contracts and sometimes lack access to effective distribution systems. Such airlines cannot, by themselves, sustain the cost of operating modern aircraft plus technical support and training and computer reservation systems (CRS). Their revenue streams rarely do more than cover their direct operating costs on an ongoing basis. They are thus not commercially viable in anything but the short term, and lack depth of finance and organisation to sustain them through market downturns or technical crises. Except in a ‘lucky’ year they will need assistance in the form of a government subsidy, route or cost subsidy, capital funding or soft loans. The alternative is to allow another, stronger carrier to operate ‘their’ routes, on their behalf.

While ‘subsidy’ is an unpopular concept in the developed and deregulated world, it is often the only means of survival in the developing and regulated world. Most of the regional airlines in the South Pacific require some form of support to continue operating what are – in airline terms – essentially uneconomic routes, either for social or tourist development reasons. Subsidies – even in terms of cross-subsidisation from international to domestic routes – are an incentive to guarantee the continuity of the airline and the socio-economic survival of the island state. It is no secret that the two French Territories’ airlines received significant subsidies from Paris for their purchase of state of the art aircraft.

A Regional Approach

To outside observers, and to the management of many South Pacific air carriers, it is clear a major structural weakness in aviation is the fragmented approach that has resulted in the establishment of many small, inherently unviable airlines that are often a serious drain on governments.

The logic of a pan-regional approach has been recognised and promoted for many years. Fiji Airways changed its name to Air Pacific back in 1972, with the intention of becoming a “hub and spoke” type airline, on behalf of as many neighbouring states as were interested in a partnership that would preclude the requirement for each to possess an individual flag carrier.

The hub and spoke concept was well ahead of its time, and later became the basis of operations for many US domestic airlines. It would have provided the means for a single fleet, equipped with appropriate aircraft to cover the entire region. Long-haul international services would have been concentrated at Nadi, with regional feeder operations providing links to/from and between the various potential partners.

The pan-regional approach was, however, never realised. Air Pacific evolved from the intended regional airline into Fiji’s international airline, serving that country’s trade and tourism interests, whilst the other island territories developed and protected short-haul feeder-cum-domestic airlines with direct and indirect subsidies and bilateral hedges against international competition.

National rivalries, fuelled by fears that Air Pacific would operate to Fiji’s benefit and their own detriment, and by some confidence that their own national carriers could be successful has meant the pan-regional airline concept never received the political backing it would have needed to become a reality.

Qantas’ Regional Relationships

Qantas has well developed aviation relationships with the airlines of PNG and the Pacific Island states.

Over time Qantas has found that to commit its own aircraft to South Pacific routes is difficult, and a more sustainable alternative is to enter into “codeshare” agreements to take seats for sale under the Qantas flight designator on aircraft operated by regional airlines.

This is a good outcome for both partners, as Qantas benefits from the ability to participate in a partnership with a lower cost operator and the local partner gains access to Qantas’ powerful sales distribution network in Australia and beyond.

Papua New Guinea

Qantas currently operates four B767 services weekly Sydney-Brisbane-Port Moresby vv, whilst Air Nuigini operates twice weekly A310 services on the same route plus a once weekly Brisbane-Port Moresby return service. Between Cairns and Port Moresby, Air Nuigini operates 12 services weekly, 11 with F28 jets and one with an A310, on which Qantas purchases a block of codeshare seats.

Air Nuigini also operates scheduled international services between Port Moresby and Singapore, Manila and Tokyo.

The market overall between PNG and Australia is relatively flat, with little change in the number of airline services over a long period. Law and order fears and a shortage of tourism infrastructure mean the flow of tourists remains relatively small and confined to smaller niche markets, such as those seeking adventure/eco experiences (eg Kokoda Track, Sepic River, reef diving etc).

The health of Air Nuigini is fundamental to the Papua New Guinea economy. In a country with many outlying islands and few roads connecting Port Moresby with other mainland points and with a wide diversity of spoken languages, Air Nuigini is a vital element of national infrastructure, both as a window to the world and in the provision of domestic services.

The F28 jets used domestically are now ageing, and are a type no longer manufactured. Eventually, replacement aircraft will be required, together with new support systems, the funding of which will require considerable capital. Australia recently granted special permission for AirNuigini F28 aircraft, no longer compliant with Australian noise regulations, to continue operating to Cairns

Qantas and Air Nuigini have recently entered into a commercial arrangement under which Air Nuigini is to replace its A310 aircraft with a B767-300, compatible in configuration with Qantas aircraft of this type, and will take over <u>all</u> flight operations between Australia and PNG. Qantas will participate on all services as Air Nuigini’s codeshare partner, but will no longer operate services with its own equipment.

Air Nuigini will therefore have access to a more modern aircraft, with a considerably higher utilisation rate that will provide improved costs and efficiencies. Qantas will provide technical and other support to Air Nuigini for this operation.

More fundamentally, with its Australian services the backbone of its international operations, the return to profitability for Air Nuigini which this arrangement is designed to facilitate, is essential to the airline's continued presence as an international operator. This structure is currently under consideration by Australia's regulatory authorities.

Fiji

For many years preceding the political coup of 2000, Air Pacific was a conspicuous success story amongst airlines of the South Pacific. It achieved consistent profits for more than a decade - before the coup induced drop in tourist numbers which caused a F$38m operating loss in the year to March 2001.

Despite a setback following 11 September 2001, especially in the flow of US origin passengers, there has been a strong return to growth in tourism accompanied by an increase in general business confidence. A most encouraging turnaround in Air Pacific's fortunes has been achieved, with a profit before tax of F$9.7m recently announced for the year to March 2002. This is particularly pleasing to Qantas, which holds a 46.05% equity share in Air Pacific.

Understandably, this shareholding encourages Qantas to maintain strong commercial links with Air Pacific. No Qantas aircraft operate between Australia and Fiji, but Qantas maintains a codeshare presence on all Air Pacific services operated between Nadi and Sydney, Melbourne and Brisbane, between Sydney and Suva, Nadi and Auckland, Nadi and Honolulu and Nadi and Los Angeles.

Samoa

Polynesian, which operates two new generation B737-800 aircraft, has a broad commercial relationship with Qantas. Qantas codeshares on Polynesian services between Australia and Auckland, Apia, and Tahiti.

Vanuatu

Air Vanuatu operates a B737-300 aircraft, and is heavily dependent on its 8 services weekly between Vila and Brisbane and Sydney, on which Qantas purchases codeshare seats. Vanuatu is seen as a safe destination compared to its Melanesian neighbours to the north, but, like many South Pacific neighbours, suffers from a shortage of capital to increase and improve tourism infrastructure.

New Caledonia

New Caledonia's rich natural resources and continued links to France mark it out as an economic exception to most of its neighbours. Air Calin, the local airline, is well placed to benefit from this.

Noumea will be the only South Pacific destination to be served directly by Qantas when the new Air Nuigini codeshare commences, and a mutual codeshare arrangement between Air Calin and Qantas is maintained on all Noumea- Australia services of both airlines.

French Polynesia

Air Tahiti Nui is equipped with 2 long range A340 aircraft, and operates a network which includes Japan, the USA, France and New Zealand. Qantas codeshares on Air Tahiti services between Papeete and Auckland and Los Angeles, whilst Air Tahiti Nui codeshares on selected Qantas services between Auckland and Sydney.

Other South Pacific Airlines

Solomon Airlines' previous arrangement with Qantas, under which a Qantas B737 was leased for services to/from Honiara with Qantas codeshare participation has been discontinued. Solomon Airlines maintains an Australian presence by leasing Air Vanuatu's aircraft to operate services to Brisbane.

Royal Tongan Airlines no longer has a jet, but maintains a link to Australia via a codeshare on Polynesian Airlines.

Air Nauru operates its B737 aircraft to Melbourne and Brisbane, and leases the aircraft to Norfolk Jet Express to conduct Australia- Norfolk Is services. Qantas codeshares on these services to Norfolk Island and undertakes Air Nauru's maintenance.

The airlines of Kiribati and Cook Islands do not possess jet aircraft, and have no Australian market presence.

Future Requirements

It makes little sense for smaller regional airlines to attempt to develop their own technical bases and training infrastructure. The cost in capital and skilled manpower is beyond their resources, and the stability of their fleet and aircraft types too uncertain to justify any but the most basic of technical facilities. Even a regional engineering and maintenance base is problematical, given the variety of aircraft types and marques, and the differing licensing and regulatory authorities which, despite the Pacific Forum's initiative, are unlikely to achieve harmonisation in the short term.

The only regional technical and training facilities which make economic sense are those of Air Pacific, which operates a maintenance complex at Nadi Airport. They must, in any case, satisfy the criteria of geographical convenience and technical resources to justify regional support and external funding.

A major problem in the island region is the lack of clearly stated policies for aviation and tourism. Even countries which possess written policies lack continuity, as they often change them to suit changed local agendas.

Australia and New Zealand have traditionally been the largest donors to the region, in terms of national and regional assistance. Australia and New Zealand also continue to be the largest supplier of tourists to the region. In terms of neighbourly responsibility, and to promote safe travel for Australians within the region, we believe Australian aid, directed at the aviation sector should be given priority. In this respect, help towards airport infrastructure, development and maintenance, including upgrading of aviation and security facilities and services in the islands would be of benefit.

Assistance in terms of providing technical training through scholarships for local aircraft engineers and pilot training would help in preparing local people for future employment in areas currently taken up by expatriate personnel. In saying this, we are also conscious of the subsequent all too common “brain drain” problem – that attracts such trained personnel to the wider opportunities available to them in Australia, New Zealand and beyond.

Conducting regional workshops and seminars on aviation related matters, such as disaster management, harmonisation of technical and safety regulations and safety and security, would go a long way to help the region, even if only to create awareness of their importance to the region.

Qantas is aware that Australia’s overseas aid budget is carefully targeted to ensure that recipient nation’s pressing needs in areas such as health, water supply, basic education, economic management, agriculture and fisheries etc are advanced. It is our view that a healthy aviation sector is also vital to the future of each country, in terms of both internal and external communications and social linkages, and should be given appropriate aid focus.

Qantas Airways Limited
19 July 2002