QANTAS

15 October 2008

Dr Kathleen Dermody
Secretary
Senate Foreign Affairs Defence and Trade Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Dr Dermody

Inquiry into the main economic and security challenges facing Papua New Guinea and the Island States of the Southwest Pacific

In response to your letter of 3 July 2008 to Mr Geoff Dixon, Qantas is pleased to provide the attached submission to the above Inquiry.

Qantas has a close and continuing association with the region dating back well over 60 years. Our submission notes the importance of a sustainable aviation sector for the region's future economic development, and outlines our views on the need for this to be supported by adequate aviation security and infrastructure. We believe Australia should continue to provide practical assistance to the region in this regard.

Qantas would be pleased to provide further information, or appear at hearings, on this subject.

Yours sincerely

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Submission of Qantas Airways to the Senate Foreign Affairs Defence and Trade Standing Committee Inquiry into the main economic and security challenges facing Papua New Guinea and the Island States of the Southwest Pacific

Introduction

Safe, efficient and reliable air links within and beyond the region are vital to the continued economic development of Papua New Guinea and the Island States of the Southwest Pacific.

Such links are not easy to achieve, however, and it is not surprising that the aviation industry has encountered difficulties in a region noted for its small, fragile economies and unstable political regimes. These difficulties are reflected in the poor health of many airlines in the region, and the need for infrastructure, training, and safety and security oversight to support the industry.

Aviation is discussed regularly at Pacific Island Forum meetings, and the need for a healthy industry is widely recognised. This has included consideration of a regional approach, potentially culminating in the formation of an airline or airlines representing several countries. While such ideas have not borne fruit, there are now many examples of commercial cooperation between airlines, including formal equity sharing.

To provide the regulatory incentive for greater cooperation, Forum member nations have developed the Pacific Islands Air Services Agreement (PIASA)) - a regional "open skies" approach to air service arrangements. While this initiative is broadly supported the region's governments, many of the smaller carriers oppose the multilateral approach, fearing it may result in increased competitive pressure from stronger and larger neighbours.

Except for Papua New Guinea with its large mineral and oil/gas potential, the South Pacific nations have a narrow export base. Typically, they rely on root crops, exported to countries such as Australia and New Zealand, and fresh fish, particularly tuna, exported by air to the premium sashimi markets in Japan and USA.

However, for many South Pacific nations, the potential to increase receipts from tourism is seen as a better long-term prospect. As this market is highly competitive, they need to be effective in attracting families, weddings, meetings and conventions, and general leisure travellers – as opposed to the less demanding specialist off-the-beaten-track and backpacker segments. This requires investment in infrastructure such as electricity, water reticulation, sewerage and surface transport.

Government support will remain important to sustain many of the region's airlines for the foreseeable future. The provision of effective foreign aid, to assist in providing and maintaining infrastructure, security, and the training of personnel, remains fundamental to keeping them flying safely.

Qantas in the South Pacific Region

Qantas experience in PNG and the Southwest Pacific dates from 1942, when elements of our fleet were used extensively for air transport activities in cooperation with Australian forces in World War II. The airline established a post-war presence and interest in the region that remains strong to this day.

For nearly two decades following the War, Qantas was the major operator of Australia-PNG air links, and services within PNG, before TAA took over these roles in the 1960s. When PNG gained independence in 1975, Qantas again became Australia's only operator of Australia-Port Moresby services, and provided assistance to the fledgling Air Niugini.

Qantas' relationship with other parts of the South Pacific is almost as long. Regular flying boat services from Sydney to Noumea were commenced in 1946, 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 TEAL), British Airways (then BOAC) and the Government of newly independent Fiji.

In 1972, Fiji Airways became Air Pacific. While other shareholders have come and gone, Qantas now holds a 46.32% stake in Fiji's national carrier with the Fiji Government holding 51%. Small minority holdings by Air New Zealand (1.94%) and the governments of Kiribati (0.27%), Tonga (0.27%), Samoa (0.12%) and Nauru (0.08%) make up the remainder.

With the increased range of modern aircraft, the need for transit stops on long haul flights at ports in the South Pacific has been removed. This is reflected in changes to Qantas' services to the region. Having initially operated our own point-to-point services, we now rely primarily on services operated by regional carriers.

Qantas is a code share partner of Air Niugini, Air Pacific, Air Vanuatu and New Caledonia's Air Calin. Noumea is the only South West Pacific port now served directly by Qantas.

A new element of regional competition has emerged in recent years with the introduction of services by Virgin Blue's regional offshoots, New Zealand based Pacific Blue - which operates between Australia/New Zealand and Fiji, Vanuatu, Tonga, the Cook Islands, and Polynesian Blue - which is a joint venture between Virgin and the Samoan government.

Aviation in PNG and the South West Pacific

The need for airlines within the region is driven by geography, as each of the small island nations covers a vast area of ocean, with population points that are 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 small island states of the Southwest Pacific have long felt a need to have their own airlines. Along with national prestige and regional rivalries, political and socio-economic imperatives have tended to dictate that independent governments should control their own means of communication, whatever the direct cost.

Inadequate airline networks and 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 that 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, European and Japanese tourists demand high standards, reliability and frequency if they are to move beyond convenient gateway points. 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 effective.

In these circumstances, it is not surprising that aviation within the region is in relatively poor shape. Some of the smaller island nations have been unable to sustain an airline or have seen services cut back. For instance, Air Kiribati and Polynesian Airlines now operate only domestic services and RoyaL Tongan Airlines has disappeared. There is now greater reliance on limited point-to-point services operated by airlines such as Air New Zealand and the Virgin Group (ie Pacific Blue and Polynesian Blue), and Air Pacific, which covers the majority of intra-Pacific and major metropolitan markets via Fiji.

Intra-island air transport is generally low frequency, expensive and unreliable. Over the years, numerous studies - often aid- funded by the EU, Australia and New Zealand - have reported that the intra-Pacific market is poorly served and that the region's airlines ought to do better.

Unfortunately, while the countries concerned tend to acknowledge the problems, they can do little to overcome them. Non-airline aviation infrastructure is in poor condition and, in some instances, continues to deteriorate.

Runways are often unfenced, navigation aids intermittent, and there are insufficient trained personnel for the provision of air traffic control and weather information. There is limited aircraft handling equipment, and qualified staff. Terminal facilities do not meet current safety and security requirements. Often there is a lack of communication aids which means that airlines departure control systems, reservations systems and other fundamental computer links operate intermittently.

The majority of runways have poor surface markings. Many do not have night landing facilities or possess lighting that is up to international standards. Aircraft are therefore forced to operate only during daylight hours, greatly restricting connectivity and viability of airline schedules.

The larger oil companies have withdrawn from some smaller markets, such as Kiribati and Tuvalu, as the volumes required are too small to sustain operations and the costs of shipping imported fuel are very high.

As a consequence, refuelling is typically taken over by national governments. However, as the sources and quality of fuel are unclear, airlines are in many cases reluctant to refuel. This is impacting airline operations. As an example, we are advised that Air Pacific, which serves Funafuti in Tuvalu with an ATR42 aircraft fitted with 42 seats, sells only 22 seats as the aircraft must carry round trip fuel from Nadi. This has made the service non viable from a commercial perspective. As a consequence, Air Pacific has informed the Government of Tuvalu that, unless fuel can be certified and is suitable for use at Funafuti, services will have to be withdrawn. This would effectively isolate Tuvalu.

Understandably, given the weakness of aviation and related infrastructure in many parts of the region, investors are unwilling to commit funds for construction of hotels and other tourist plant.

Apart from French Polynesia and New Caledonia, per capita GDP remains low and economic growth remains erratic. This situation, and the capacity to attract investors, has not been helped by political instability and security fears, as evidenced in recent times by events in Papua New Guinea, the Solomon Islands, Tonga and Fiji.

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

A Pan-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.

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.

However, the pan-regional approach was never realised. Air Pacific evolved from the intended regional airline into Fiji's international airline, serving that country's trade and tourism interests, while 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 needed to make it a reality.

Security Issues

The security challenges confronting aviation in PNG and many of the Southwest Pacific islands states are evident in the difficulties they have in implementation and adherence to international regulatory standards and practices. In particular, compliance with ICAO standards is a key structural constraint for many island states.

PNG has a robust suite of aviation legislation, and a regulatory framework consistent with its obligations under the Chicago Convention. However, due primarily to economic constraints, it has been unable to implement the requirements of this framework consistently. With regard to aviation security, this inconsistency has played a part in limiting the nature and scale of Qantas' operations into PNG. Due to the security risks, the crew of Qantas' current weekly cargo service are not allowed to overnight.

The cost of aviation security is an issue confronting most governments and airport operators internationally. Given the prevailing economic conditions and political challenges, it is an even greater challenge for the Southwest Pacific region. These states generally lack the financial resources and technical expertise required to purchase and implement modern aviation systems and security strategies, and to develop and maintain appropriate airport infrastructures. The relatively low skill base of available labour is a further limitation to the delivery of modern systems and maintenance of international standards.

The importance of preventative maintenance of equipment, and supply and upkeep of spare parts, are often overlooked or not followed by island states. Because of this, elements of aviation infrastructure – sometimes donated – fail to provide ongoing value. For any aid-based infrastructure provided by foreign donors, a commitment to ongoing maintenance should be considered as an integral part of the package.

In light of the foregoing, Qantas strongly encourages the Australian Government to support regional governments in terms of capacity building - including through the provision of necessary security equipment, training, and supervision - to address the challenges they face in developing effective, modern aviation security systems, and in implementing their international obligations.

Qantas' Regional Relationships

Qantas has well developed aviation relationships with the airlines of PNG, Fiji Vanuatu, New Caledonia and Tahiti.

Over time, Qantas has found it difficult to commit its own passenger aircraft to South Pacific routes. A more sustainable alternative has been to enter into 'code share' agreements with regional airlines, on whose services Qantas markets seats under its own flight designator.

This has benefited Qantas and its respective local partners, the latter gaining access to Qantas' powerful sales distribution network in Australia and beyond.

Papua New Guinea

Air Niugini currently operates eight weekly Port Moresby-Brisbane services, with twice weekly Sydney services using leased B767-300, B757 or Embraer 190 aircraft and 14 services weekly between Port Moresby and Cairns using F100 or Embraer 145 aircraft. Qantas operates a once weekly all-cargo B737 charter service between Cairns and Port Moresby, for the carriage of general cargo inbound, and fresh fish outbound.

Airlines PNG, an independent PNG based airline, currently operates a daily turboprop Dash-8 service between Port Moresby and Cairns and three per week B737-200 jet services between Port Moresby and Brisbane. Under arrangements announced in early September, Airlines PNG will place its code on the four weekly services that Virgin Blue's international subsidiary, Pacific Blue, is planning to operate between Brisbane and Port Moresby as from November this year.

While considerable business and family based traffic moves between Australia and PNG, 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).

The health of airlines 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 Niugini's domestic services and limited international operations form a vital piece of national infrastructure.

Qantas maintains a code share relationship with Air Nuigini, under which Qantas purchases, and markets under the QF code, seats on all of Air Niugini's services between Sydney, Brisbane, Cairns and Port Moresby. With Australian services forming the backbone of Air Niugini's international footprint, the profitability of this arrangement underpins its continued viability as an international operator.

<u>Fiji</u>

For many years preceding the coup of 2000, Air Pacific was a notable success amongst airlines of the South Pacific, achieving consistent profits for more than a decade. The coup-induced drop in tourist numbers contributed to the airline's F$38m operating loss in the year to March 2001.

Despite a further setback following 11 September 2001, especially in the flow of US origin passengers, there was a steady return to growth in tourism accompanied by an increase in general business confidence.

While the situation was again reversed in the immediate aftermath of the 2006 coup - with Air Pacific barely breaking even in the year to 31 March 2007 – it has again bounced back strongly. An after tax profit of F$25 million was registered for the year to 31 March 2008.

As the largest company in Fiji, Air Pacific is one of the largest employers in the country, and as Fiji's national carrier and international airline, is an employer of choice for many Fiji citizens. Air Pacific directly employs approximately 800 people, the majority of whom are based in Fiji and are Fijian nationals.

As a shareholder, Qantas has assisted Air Pacific in growing the aviation skill base in Fiji. In 1984, at the request of the Government of Fiji and with Air Pacific technically bankrupt, Qantas entered into a Support Agreement with Air Pacific. One of the key elements of the agreement was for Qantas to provide Air Pacific with the required aviation skills to effectively run the airline.

As part of the Support Agreement, Qantas trained Fiji nationals to operate B747 aircraft and other aspects of the airline. Under this training, the current Chief Pilot of Air Pacific was the first Fiji national licensed to fly a B747 aircraft. Today, this successful training program continues and has, over the years, been completed by a large number of senior executives and personnel at Air Pacific.

The Support Agreement initially involved the secondment of three senior executives to the roles of CEO, CFO and Engineering and Maintenance Technical Controller, however, the focus remains on providing employment opportunities to Fiji citizens. A very small number of employees are not Fijian citizens.

Air Pacific invests heavily in the development of skills and expertise for its people, spending F$7.1 million on external training costs in 2007/08. Air Pacific also supports internal training programs, such as the Management Development Program which is aimed at enhancing the skills of senior and middle management.

Understandably, Qantas' 46% shareholding encourages Qantas to maintain strong commercial links with Air Pacific. Qantas does not operate between Australia and Fiji, but maintains a code share presence on all 20 services operated by Air Pacific between Nadi and Sydney, Melbourne and Brisbane, and on all services operated by them between Nadi and Auckland, Nadi and Honolulu and Nadi and Los Angeles.

Air Pacific has extensively expanded South Pacific services and now links Kiribati, Funafuti, Tonga and Apia via Nadi with New Zealand and Australia.

In May 2008 the Fiji Interim Government announced that a Cabinet Task Force had been established to review the national airline's performance. This would include a review of the shareholder's agreement between Air Pacific and Qantas Airways.

Vanuatu

Air Vanuatu operates a B737-800 aircraft, and is heavily dependent on its nine weekly services between Port Vila and Brisbane, Sydney and Melbourne, on which Qantas purchases code share 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.

Pacific Blue now operates services between Australia and Vanuatu, and this has helped to expand the aviation market.

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 international airline, is well placed to benefit from this.

Noumea is the only South Pacific destination to be served directly by Qantas, and a mutual code share arrangement between Air Calin and Qantas is maintained on all Noumea-Australia services of both airlines.

French Polynesia

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

Other South Pacific Airlines

Polynesian Blue, a joint venture between the Virgin Group and the Samoan Government, operates services between Sydney and Apia and Auckland and Apia.

Solomon Airlines maintains an Australian presence by leasing Air Vanuatu's aircraft to operate services between Honiara and Brisbane.

Tonga no longer has an international carrier since the demise of Royal Tongan Airlines, but Pacific Blue now operates services between Tonga and Sydney and Tonga and Auckland. Tonga is also served by Air New Zealand.

Air Nauru, now known as "Our Airline", operates its single B737-300 aircraft once weekly between Nauru and Brisbane via Honiara. Qantas undertakes Air Nauru's maintenance.

The airlines of Kiribati and Cook Islands do not possess jet aircraft, and have no Australian market presence. However, Pacific Blue operates between Auckland and Rarotonga, with connections available from Australia.

Future Requirements

Smaller regional airlines find it very difficult 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 other than the most basic of technical facilities.
Even a regional engineering and maintenance base is problematic, given the variety of aircraft types and marques, and the differing licensing and regulatory authorities which, despite the Pacific Forum's initiative, appear unlikely to achieve harmonisation in the short term.

The only regional technical and training facilities, besides those in Australia and New Zealand, 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, although the EU is now a major contributor. As both countries also continue to be the largest sources of tourists visiting the region, providing added reason to promote safe travel, we believe priority should be given to the aviation sector under Australia's aid programs.

In this respect, help towards both development and maintenance of airport infrastructure, together with upgrading of aviation and security facilities and services in the islands, would be of benefit.

AusAID is sometimes constrained from putting in and maintaining infrastructure in partnership with local populations. This perception is most likely due to difficulties in spreading limited funding across the many areas of need.

Wider provision of 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 conscious that retention problems arise when trained local personnel are attracted to wider opportunities available in Australia, New Zealand and beyond.

Workshops and seminars on aviation related matters, such as disaster management, harmonisation of technical and safety regulations and safety and security, would considerably assist, if only to create awareness of their importance to the region.