REVIEW OF INTRASTATE REGULATED AIR SERVICES IN WESTERN AUSTRALIA

to

Department for Planning and Infrastructure

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TOURISM FUTURES INTERNATIONAL

Centre for Asia Pacific Aviation

CONTENTS

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1. Overview & Executive Summary

1.1 Intrastate Air Services Policy

Following the collapse of Ansett in September 2001, the Government of Western Australia moved to review all intrastate air services to ensure that regional centres and communities in Western Australia (WA) would continue to have sustainable and viable air services.

The Department for Planning and Infrastructure (DPI) commissioned Tourism Futures International (TFI) and the Centre for Asia Pacific Aviation (CAPA), to undertake an independent analysis of intrastate air services in WA. TFI/CAPA produced its report in November 2002.

The Aviation Ministerial Council (AMC), chaired by the Premier, considered the report's findings and developed a new Air Services Policy for the State.

The central principle of the Air Services Policy is that the WA Government will regulate air services where necessary to protect vulnerable intrastate air routes. A series of initiatives would support this principle such as working with the resource industry to convert mining charter flights into public passenger services.

In a Statement released by the Minister for Planning and Infrastructure (13 March 2003) the Minister indicated that the State Government would:

- Offer Skywest Airlines a two-year exclusive licence to operate services from Perth to Carnarvon, Exmouth, Albany and Esperance, subject to providing ongoing services for Leinster and Leonora and acceptable service standards and fare structures.
- Open the Perth-Geraldton route to staged competition, as it has reached the threshold point of 55,000-60,000 passengers.
- Call tenders for an airline to provide a service between Perth, Kalbarri and Shark Bay through Geraldton.

Jet route services between Perth and Kalgoorlie, Port Hedland, Karratha and Broome would not be subject to any competition restraint.

The Minister indicated that the Government would monitor the impact and effectiveness of regulation and - at the completion of the two-year period - would either deregulate some or all of these routes, or proceed with an open and competitive tender to operate exclusive services.

A further outcome of the review was the decision to formally establish the role of an aviation “industry observer” to monitor the industry. As a result the Government (through the industry observer) has been monitoring fare increases, service levels, schedule and route developments, and the community response to changes in these areas.

1.2 Review of Air Services Performance

DPI has again contracted TFI/CAPA to undertake an update review of regulated air services in WA and to make recommendations with respect to whether:

- All regulated routes should continue to be regulated after May 2005?
- All regulated routes should be deregulated after May 2005?
- Some of the regulated routes should be deregulated after May 2005?
- All regulated routes should be deregulated but at a date later than May 2005?

1.3 Analysis Undertaken

TFI/CAPA has prepared an analysis of the current regulated routes in comparison to when the routes were regulated in June 2003. In undertaking this work, TFI/CAPA has taken into account:

- Passenger growth.
- Schedule growth and changes.
- Industry dynamics at a regional and national level.
- Changed social and economic conditions.

Consultation was undertaken with key stakeholders by direct contact or via a series of questions distributed to members of:

- Airline industry.
- Tourist industry.
- National Competition Council.
- Relevant State Government agencies.
- Regional communities including local government.

1.4 Conclusions

Industry Issues

- The regional industry generally has progressed towards a more stable and sustainable structure in the intervening period since the WA Government introduced its strategy for intrastate aviation early in 2003. However the sector across Australia is not highly profitable and remains subject to rapid and unpredictable movements in costs associated with changes in fuel prices, movements in the USA/Australian dollar and changes in airline and airport security measures that add to airline costs.
- For these reasons it is not likely that there will be a stable structure for second and third tier aviation in Australia. In other words TFI/CAPA expect to see ongoing changes in airlines participating in intrastate aviation across Australia. However the industry (and Skywest) is in a stronger position than when the original review was undertaken.
- The Skywest programme for commercial development, including a greater presence on jet routes with expansion underpinned by a stronger capital position, is a new ingredient that promises a long-term

presence but potentially short-term instability. It also suggests a possible change in the nature of its current alliance relationship with Qantas, the medium-term implications of which are not immediately obvious.

- In WA, other carriers such as Skippers Aviation, Airnorth, Great Western Airlines and Maroomba Airlines would appear to have potential to participate on WA scheduled services. Skippers has taken the place of Skywest on smaller routes such as Perth-Laverton and Perth-Monkey Mia, while Airnorth's new franchising structure should ensure it plays a central role in industry consolidation around Australia. Maroomba Airlines and Great Western Airlines currently provide RPT services to Mt Magnet and Halls Creek respectively

Market Issues

- Passenger traffic on the WA intrastate routes reviewed has not yet recovered to pre-Ansett collapse levels. Recovery has been slow in part because of the apparent transfer of passengers from air to road transport modes.
- It is unlikely that passenger numbers will grow dramatically in the medium term.

Therefore TFI/CAPA has assessed that:

- For most of the routes examined the level of passenger traffic remains too low for sustainable competition.
- An open market without economic regulation would encourage new entry on a number of routes. However this competition would not be sustained and a shake-out would occur leaving the strongest (most efficient or cashed up) participant.
- Smaller communities would find that airlines provide services with the "spare aircraft time" after meeting needs of passengers on competitive routes. Ultimately service levels may fall on these routes.

Policy Options

(1) Open the currently regulated routes to full competition.

This option is not favoured because of the weak nature of the smaller routes and their continuing inability to sustain viable services. Competition on these routes would see new operators achieving relatively low load factors or introducing marginally priced seat capacity (potentially involved also in charter operations). Either way, this would undermine the Regular Public Transport (RPT) services and is likely to see either airline failure or withdrawal of services in favour of more profitable routes.

Specifically the impact could be:

- Continued competition on Perth-Geraldton but a flow-on impact with potentially unstable connections between Carnarvon-Perth and Exmouth-Perth.
- Limited 'experimental' services could be expected to Monkey Mia and Kalbarri but these are unlikely to stimulate growth.

- Services could also be expected from Perth to Laverton, Leinster and Leonora but again schedules are likely to be ‘experimental’ implying instability.
- Services could be expected to continue at current levels for Albany-Perth unless destabilised by new entrants.
- Services between Esperance-Perth and Broome-Kununurra would continue, but with instability.
- Incentives by way of subsidy or sole operator status (licenses) would need to be provided for the provision of services for Broome-Halls Creek, and Perth to Meekatharra, Mount Magnet and Wiluna.

(2) Maintain the current regulations and accept the incumbent airline indefinitely (or until the next review).

This option obviously favours the incumbent operator and discourages alternative operators from developing their own services and growing fleets etc.

It is also possible that the limited returns available on the smaller routes may ultimately encourage Skywest to reduce services (or even withdraw) on smaller routes in favour of commercially more viable services.

(3) Maintain current regulations for a further two years and then open up to full competition.

This is a variant of option (2). At this stage, it is difficult to anticipate an overall improvement in market demand conditions or sufficient cost reductions to make the minor routes viable for the foreseeable future. The arguments advanced in (1) above, would remain.

A further two-year period of grace would no doubt be favoured by Skywest, which would have the opportunity to strengthen its network and perhaps be able to promote growth through stronger marketing.

(4) Move to a tender process.

The introduction of periodic tendering for say, a five year period, would impose some competitive discipline on the process. The period should be sufficiently long that the successful tenderer can develop appropriate services using the appropriate equipment, but not so long that they become complacent and adopt a cost-plus approach to airfares.

Counting against a tender process is the cost of conducting a tender and, perhaps more importantly, the costs of monitoring and if necessary enforcement to ensure that tender conditions are met. This may include a pricing element with provision for re-tendering if fares rise above an industry “benchmark + x%”; or an incentive element if fares fall below a “CPI - y%”. Further incentive may include market growth objectives.

Recommendations

1. Continue regulation on all currently regulated routes

Despite the prospects of better industry conditions, weak market conditions suggest that the government should continue to meet its community accessibility and service objectives through light-handed regulation of aviation services.

In concluding that there is a continuing role for regulation, it should be noted that the need is defined exclusively in terms of community service needs and not in terms of supporting marginal airline businesses.

Reference to the output of the consultative process appears to support this position. The overall view favours competition as the basis for reducing fares and increasing services, if this can be achieved. However, it does not favour deregulation where the impact would be to destabilise markets and reduce service levels.

On these grounds, the service level that policy should be aimed at can be defined as maintaining at least current levels of service and current fare levels. Any reduction in services or increase in fares could be interpreted by communities as a policy failure.

2. Based on the analysis undertaken by TFI/CAPA and the evaluation of the above options TFI/CAPA recommends that the WA Government move to a tendering approach for the regulated routes.

3. Implementation issues associated with the tender arrangements will need to be evaluated in detail. However TFI/CAPA recommends that groups of routes are tendered so that airlines, and communities, can achieve the economic and other benefits associated with network provision.

This raises the issue as to how routes or groups of routes would be defined for tendering. The tenderers could be encouraged to indicate the mix of routes or route groups they would need to service for economic viability.

TFI/CAPA believe that in the tendering process the WA Government could encourage potential operators to indicate how they would propose to grow the routes tendered for, and the prospects of offering lower fares on these routes. There may be specific incentives that could be offered for achieving these outcomes, or penalties for failure to do so.

The consultants have discussed this review and some of the potential outcomes with the National Competition Council (NCC). These discussions suggest that the NCC would look favourably upon a tendering option that encouraged tenderers to seek efficient outcomes and which provided incentives to lower fares and grow markets.

It needs to be recognised however that a tendering process would be complex. It would need to be based on a clear understanding of the levels of service that will be sought for each community. Reference to the output of the consultative process supports the position that the service level be defined as maintaining at least current levels of service and current fare levels.

Further, the tendering process may involve extensive negotiations with tenderers who indicate a need to serve groups of routes. Finally, it also requires monitoring to ensure that contracted service agreements are being met.

This raises the issue that if tendering is to be undertaken it must be adequately resourced. Discussions with the Queensland Department of Transport indicate that there was a substantial resource commitment required to successfully complete their tender process and to monitor performance of the successful tenderers.

2. CONTEXT

2.1 Review of TFI/CAPA Study November 2002

TFI/CAPA first reported on the issues confronting intrastate aviation in November 2002. The specific aim of the study was:

To recommend to the AMC which ports/intrastate routes could withstand competition and to provide an assessment of the impacts of airport charges within WA. The broad objective contained in the terms of reference for this study was to assist the State Government to redefine its aviation policy in a way that:

> *allows it to meet its obligations to the people of Western Australia in respect to the provision of air services within the State.*

The study suggested that this could be elaborated to:

> *ensuring that the actions taken by the State Government maximise the likelihood that sustainable commercial air services can be provided to regional WA and, where this cannot be achieved, to deliver the most cost effective way of maintaining communities' access to them.*

A focus on commercial operations is seen as the preferred form of delivery consistent with the prevailing policy position favouring the market as the arbiter of services wherever possible, a preference still expressed by the State and Federal governments in Australia and elsewhere.

Sustainability involves a commitment to long-term services implying minimum dependence on public subsidy, services defined realistically in relation to demand and an approach that recognises the role of network-based operations to sustain individual sectors.

2.2 November 2002 Study Conclusions

The study concluded that there is limited scope for competition on regional routes other than those serviced by jet aircraft. The study also found that the demand for air services by the mining sector is a key element in ensuring a range of aircraft is positioned in WA.

Based on economic analysis using the route model developed for this study TFI/CAPA established the following classification of routes:

(i) Routes that could withstand competition on an ongoing basis:

- Competition is possible on a number of the State's jet routes including Perth to Broome, Karratha and Kalgoorlie. However on some of these routes, for example Perth/Karratha, there is a single major mining contractor which limits a potential new entrant to 30% of the market or less.
- The introduction of additional capacity would substantially reduce airline returns, create instability and increase the medium-term

uncertainty of service even on the larger routes. The challenge in operating to Broome is the highly seasonal nature of the route. A high load factor and higher yields are required in the peak season to raise the average year-round financial performance of this route.

- Of the turboprop routes, only Geraldton/Perth might be able to support competition. This prospect will be enhanced by the government's decision to dredge Geraldton harbour and thereby facilitate shipment of the Mt Gibson iron ore deposit through the port increasing demand for air travel through Geraldton.

(ii) Routes that would need to operate as a network to maintain a viable and ongoing level of service to regional communities:

- The fragility of service on even the commercially viable routes means that competition would undermine the capacity of existing operators to cross-subsidise marginal services and undermine the skeletal networks currently operated by, for example, Skywest.
- Markets such as Monkey Mia, Kalbarri, Laverton and Leonora can only feasibly be served (with F50s) in connection with other regional ports.

These routes will have an even better chance of success if linked to another port or service.

(iii) Routes that are likely to require an exclusive licence to be viable on an ongoing basis:

- Commercial operations by a single operator are feasible on Perth to Albany, Esperance, Carnarvon, Learmonth and Leinster and for Broome to Kununurra. Competition on these routes could result in a downgrade of service, medium-term instability and possible long term lowering of service levels.
- Routes such as Meekatharra and Mount Magnet can sustain limited commercial RPT operations.

(iv) Routes that may require government subsidisation:

- There is insufficient traffic to support Wiluna, Derby, Fitzroy Crossing and Halls Creek on a commercial basis. Services on these routes will require ongoing subsidy.
- Furthermore, there appears to be insufficient traffic to support services from Exmouth to Broome, via Karratha and Port Hedland or to initiate and support intra-regional Pilbara services.

In general terms TFI/CAPA found:

- Well in excess of 100,000 passengers would be required to support competition on jet routes.
- That routes with above 60,000 passengers could support competition amongst turboprop operators, although competition would have a potentially destabilising impact on the RPT network.
- Between 40,000 and 60,000 passengers, competition on a route is unlikely to be sustained.

- Between 10,000 and 40,000 passengers, airline services could operate commercially on a sole operator basis but not competitively.
- Below 10,000 passengers routes generally need to be part of a network to operate commercially or may require a subsidy.

2.3 Subsequent Investigations of Intrastate Aviation

Since the conclusion of the TFI/CAPA investigation there have been two major investigations of relevance to intrastate aviation:

1. *Regional Aviation and Island Transport Services: Making Ends Meet.* Inquiry into commercial regional aviation services in Australia and alternative transport links to major populated island by the House of Representatives Standing Committee on Transport & Regional Services (December 2003). Referred to in this report as the "Neville Inquiry" after the Inquiry Chairperson, the Honourable Paul Neville, MP.

2. *Regional Public Transport in Australia: Long Distance Services, Trends and Projections*. Working Paper 51 by the Bureau of Transport and Regional Economics (2003).

Neville Inquiry

The Neville Inquiry found[1]:

- The costs of operating regional air services are high and rising.
- The returns to regional operators are often low and declining, because their passenger numbers can be small and variable.
- Because of high costs and low returns, the levels of service are often poor in terms of the size of the operating aircraft, the frequency of services and the schedule of services. Costs per seat kilometre are significantly higher for smaller turboprop aircraft compared to larger jet aircraft.
- Poor interconnectivity between services exists because of a lack of interline agreements between regional and domestic service operators. The schedules some regional airlines fly do not arrive at appropriate times for passengers.
- The owners of some country airports are unable to sustain the cost of maintaining their airports, relying on rate payers to meet the shortfall.
- Aviation safety regulations and the way they are administered impose significant costs on small operators in particular. This is contributing to the decline in the number of regional operators and the level of air services in regional areas. However, to achieve aviation safety outcomes, a strong, effective and credible regulator is essential, and there is a need for the Civil Aviation Safety Authority (CASA) to strike the right balance between fostering a culture of safety in the industry and policing the regulations.
- A lack of coordination of government policies is creating potentially difficult business environment conditions. For example, all levels of

[1] Neville Inquiry page 3.

government imposed many taxes on regional aviation services with little regard for the cumulative effect. The Commonwealth's aviation policy, and its other transport and regional policies appeared to be largely independent of one another.

The committee also "found consensus" in the evidence that the regional aviation industry is adjusting (still) to the short and long term shocks that are continuing to affect the demand for regional air travel.

A further observation was that airline passengers want affordable airfares, comfortable aircraft, convenient flight times and connections to other services and security. Based on submissions it is suggested that the public's expectation of airfares has been shaped by the discount airfares offered by major domestic airlines between capital cities. The fact that people commonly see regional airline fares as high, influences their preparedness to drive instead of travelling by air. It was also found that people would choose to drive their car for three to five hours instead of flying.

In a section on the sustainability of air routes the Neville Inquiry reports:

- The viability of a route depends on costs and revenue. Regional airlines are faced with very high capital costs and high operating costs. This makes the cost per seat kilometre very high and reduces profit margins.
- The viability of regional air routes varies from sustainable to marginal to unsustainable, depending on the customer demand and type of aircraft the operator uses on the route. The smaller the aircraft and the shorter the sector length flown, the higher the unit cost per passenger or seat.

The New South Wales Government offered to the committee the research of Hazelton's administrator and bidders for the airline[2]. This research provided greater clarity on the issue of airline viability (at the time of Ansett's collapse in late 2001). The research found that:

- Routes with a volume of more than about 100,000 passengers per annum could support two airlines, each using a 36-seat aircraft full time providing three daily services per day to Sydney.
- Routes with a volume between about 65,000 and 100,000 passengers per annum could support one airline full time and another with a partly committed aircraft, each using a 36-seat aircraft providing three daily services per day to Sydney.
- A route volume of between 35,000 and 65,000 passengers per annum could support only one operator using a 36-seat aircraft full time.
- A route volume of between 6,000 and 35,000 passengers per annum could support one operator using a 19-seat aircraft on a full time or part time basis.
- Routes with volumes of less than 6,000 passengers per annum could only support nine to 12-seat aircraft.

[2] Neville Inquiry page 41.

BTRE Working Paper

Findings of interest to the present investigations include:

- Domestic air travel grew by 5.7% a year over the 15 years to 2000/01 and air travel to and from non-metropolitan areas grew by 1.4% a year over this period. In contrast, non-urban coach patronage has barely changed and non-urban rail travel has declined by about 3% a year. Travel by private car, the overwhelmingly dominant mode, increased by 1.8% a year[3].
- Regional travel is projected to grow by 1.3% a year to 2020, compared with 1.9% for total national (non-urban) travel. Air travel's share is projected to increase slightly. The coach share is projected to remain unchanged and the rail share is projected to decline[4].
- For distances of up to 400 kilometres, the private car has a non-urban mode share of around 90% of trips, with surface public transport modes making up most of the balance (although air has a small mode share for trips between 200 and 400 kilometres). For trips between 400 and 1200 kilometres, the private car share is around 50%, with the air travel mode share around 40%. The air travel share increases to more than 65% for trips of more than 1200 kilometres[5].
- There is strong growth in passenger travel to and from North Queensland (above 2.5% a year for Cairns), the Northern Territory (above 2.5% a year for many areas, with especially strong growth for Uluru and Kakadu regions) and the Kimberley region in WA (around 3.5% a year) [6].

These findings and those of the Neville Inquiry offer further support for the conclusions reached in the original TFI/CAPA investigations.

2.4 Aviation Regulation by State Governments in Australia

The Neville Inquiry (Appendix F, page 252) reviewed the regulatory policies of State governments around Australia with respect to regulation.

New South Wales

The New South Wales Government reviewed its aviation policy in 2001 and now regulates lower volume routes of up to 50,000 passengers per annum, to ensure their long-term sustainability. It does so by issuing an exclusive license to the operator for five years up to 2008. NSW does not use formal competitive tenders to select the exclusive operator.

[3] BTRE page v.
[4] BTRE page v.
[5] BTRE page 51.
[6] BTRE page xxxv.

Queensland

The Queensland Government reviewed its aviation policy following the events of 2001. Following its 2002 review of air services, Queensland believes that every community should be within 200km of an air service. Queensland now:

- Regulates air services requiring market entry restrictions to ensure the long-term sustainability of air services. It regulates certain routes by means of public tender and the issue of an exclusive licence for five years.
- Subsidises air services to regional areas to improve the affordability of air travel for transport-disadvantaged communities where there is a shortfall between the cost of operating the service to the prescribed standards, and the revenue collected as fares. It currently provides 7 million dollars per annum to subsidise essential air services to these communities.

South Australia

The South Australian Government has a long standing commitment to minimise government intervention in the state's aviation sector. However it has provision to regulate intrastate air routes under the Air Transport (Route Licensing – Passenger Services) Act 2002. Under this recent legislation, South Australia may offer licenses to operators by competitive tender or other means on declared routes for the provision of scheduled air services when that is in the public interest. This is intended to provide for community needs by encouraging investment by operators in very marginal routes suitable for single operators only.

Other States

The Tasmanian Government has not regulated aviation services within Tasmania since July 2000.

Victoria has a relatively low number of passenger air services and routes and the Victorian Government has not seen the need to intervene in any aspects of regional aviation to achieve strategic outcomes.

The Northern Territory has an open skies approach to intra-territory air services.

3. Review of Drivers of Aviation Growth in WA

3.1 WA and Regional Economic Factors

The WA Department of Treasury and Finance (WATF) published economic forecasts as part of its *2003-04 Mid-year Review* in December 2003. Forecast annual growth rates for the main aggregates are reproduced in **Table 3.1**. Economic growth slowed during 2002/03 but should recover in 2003/04. Growth prospects for the next few years remain strong although the Department points to a number of risk factors:

- Rise in the value of the Australian Dollar – the major risk is that the correlation evident between commodity price rises and the Australian dollar does not continue. This could put pressure on business investment.
- Interest Rates – risk that rates could be raised by more than expected.
- Business Investment – it is unclear whether current growth rates can be maintained over the 2004/05 fiscal year because many of the projects that have driven growth in recent times are scheduled for completion in 2003/04 and the first half of 2004/05.
- International Conditions – if US monetary policy is tightened in the face of increased price pressures as the economic recovery gathers pace, there is a risk that consumer spending could falter under the strain of rising debt levels.

Table 3.1: Economic Forecasts for WA

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	Actual		Mid-Yr Revision	Forward Estimate		
	%	%	%	%	%	%
Real Gross State Product Growth	5.90	3.90	4.50	4.25	4.00	4.00
State Final Demand Growth	5.20	7.10	4.75	2.00	3.75	3.75
Exports			1.00	7.75		
Employment Growth	1.10	2.50	2.00	1.75	2.50	2.50
Unemployment Rate	6.50	5.90	6.00	6.00	6.00	6.00
Wages Growth(a)	3.20	3.70	3.25	3.00	3.25	3.25
CPI Growth (b)	2.70	2.80	2.50	2.50	2.50	2.50

Source: WA Department of Treasury and Finance. Notes: (a) Wages growth now refers to growth in the Wage Cost Index, b) Does not include any impact from the tax reform package.

The WA Department of Local Government and Regional Development has published its Indicators of State Development which includes the Gross Regional Product (GRP) for WA regions as shown in **Table 3.2**.

It shows growth, above the regional average, for the Goldfields-Esperance, Mid West and Pilbara regions. This is based largely on the mining industry performance and suggests that the Australian dollar risk is of high significance to these regions.

Having reviewed this and other economic data TFI/CAPA does not believe that there is substantial change in the economic outlook for WA that would stimulate traffic in the regulated routes.

Table 3.2: Gross Regional Product (GRP), 2000/01

Region	GRP ($billion)	5 Year Average Growth[a]	GRP per capita ($)	% of GSP	Major Contributors
Gascoyne	0.50	5.2	48,448	0.7	Fishing, mining, agriculture, transport
Goldfields-Esperance	5.53	8.1	100,084	6.9	Mining, construction, property
Great Southern	1.56	4.1	29,271	2.1	Agriculture, forestry, fishing, manufacturing, finance and insurance
Kimberley	1.27	6.3	38,783	1.7	Mining, health and community services, transport
Mid West	2.95	6.8	58,509	3.8	Mining, agriculture, forestry and fishing, construction
Peel	2.27	6.5	29,612	3.0	Mining, manufacturing, construction
Pilbara	4.55	8.4	114,625	5.6	Mining, construction, transport
South West	4.56	6.0	35,085	6.0	Mining, manufacturing, construction
Wheatbelt	3.01	4.4	41,555	3.9	Agriculture, forestry and fishing, mining, transport
Regional WA	**26.20**	**6.6**	**50,301**	**33.7**	
Perth	47.92	6.0	34,593	66.3	Finance and insurance, property, manufacturing
State Total	**74.12**	**6.2**	**38,885**	**100.0**	

Source: Indicators of Regional Development in WA, Department of Local Government and Regional Development, pg. 8.
Note: (a) Calculated as average annual growth rate, not adjusted for CPI, over five years – 1995/96 to 2000/01.

3.2 Population

The population projections included in the previous TFI/CAPA report were based on projections published in: *Western Australia Tomorrow - Population Projections of Statistical Divisions, Planning Regions and Local Government Areas of Western Australia*[7]. The base for these projections was the 1996 Estimated Resident Population (ERP) in turn based on 1996 Census results.

The Western Australian Planning Commission (WAPC) recently released a publication reviewing the accuracy of its projections[8] based on outputs from the 2001 Census.

In its review the WAPC found that for seven of the nine Planning Regions (excluding Perth Metro) the projection accuracy was 95% or more. The WAPC has not provided updated projections for these regions.

The Goldfields-Esperance's projection was found to be about 87% accurate. The WAPC suggests that the larger than expected discrepancy for Goldfields-Esperance "is partly due to the mining activity or inactivity in the region".

[7] Western Australia Planning Commission (WAPC), October 2000.

[8] *Are our Population Projections on Target? Comparison of ABS 2001 Estimated Resident Population and Western Australian Planning Commission Population Projections for 2001*, WAPC, March 2004.

The WAPC expects to publish new projections for all regions by mid-2004. However it has, as part of its review, published provisional projections for Goldfields-Esperance. Based on the provisional projections TFI/CAPA has revised the airport catchment projections for Goldfields-Esperance airports only. The original and revised projections are shown in **Table 3.3**.

The outcome represents an increase in the base and projected growth for Kalgoorlie and the reverse for other ports.

TFI/CAPA conclude from this analysis that population remains unlikely to grow at rates that would stimulate air travel on the routes reviewed in the present study.

Table 3.3: Population Projections by Airport Catchment

AIRPORT	No's of Persons				Average Annual % Change – 5 Year Intervals				Average %
	2001	2006	2011	2016	2001	2006	2011	2016	2001 to 2016
Albany (1)	41,350	44,750	46,300	49,550	1.5%	1.6%	0.7%	1.4%	1.2%
Broome	15,080	16,940	18,680	20,920	4.0%	2.4%	2.0%	2.3%	2.2%
Carnarvon (2)	6,500	6,700	7,000	7,500	-0.1%	0.6%	0.9%	1.4%	1.0%
Derby	3,280	3,440	3,680	3,920	4.7%	1.0%	1.4%	1.3%	1.2%
Esperance (3)	15,490	17,230	17,900	19,650	2.5%	2.2%	0.8%	1.9%	1.6%
- Revised[a]	14,570	15,720	16,460			1.5%	0.9%		
Exmouth	2,980	3,230	3,430	3,630	1.1%	1.6%	1.2%	1.1%	1.3%
Fitzroy Crossing	1,640	1,720	1,840	1,960	4.7%	1.0%	1.4%	1.3%	1.2%
Geraldton (4)	39,820	44,190	44,680	46,850	1.4%	2.1%	0.2%	1.0%	1.1%
Halls Creek	3,800	4,100	4,400	4,700	5.5%	1.5%	1.4%	1.3%	1.4%
Kalbarri	960	990	1,020	1,050	1.2%	0.6%	0.6%	0.6%	0.6%
Kalgoorlie (5)	39,910	43,385	45,485	48,600	1.7%	1.7%	0.9%	1.3%	1.3%
- Revised[a]	35,221	37,900	40,580			1.5%	1.4%		
Kununurra	7,600	8,000	8,500	8,900	3.2%	1.0%	1.2%	0.9%	1.1%
Laverton	1,650	1,695	N.A.	N.A.	3.5%	0.5%	N.A.	N.A.	N.A.
- Revised[a]	1,361	1,320	1,360			-0.6%	0.6%		
Leinster	1,650	1,815	2,035	2,200	1.6%	1.9%	2.3%	1.6%	1.9%
Leonora	750	825	925	1,000	1.6%	1.9%	2.3%	1.6%	1.9%
- Revised[a]	599	660	720			1.9%	1.8%		
Meekatharra (6)	2,350	2,480	2,400	2,500	0.9%	1.1%	-0.7%	0.8%	0.4%
Monkey Mia	1,000	1,100	N.A.	N.A.	3.2%	1.9%	N.A.	N.A.	N.A.
Mt Magnet	1,270	1,340	N.A.	N.A.	-0.9%	1.1%	N.A.	N.A.	N.A.
Wiluna	1,200	1,200	N.A.	N.A.	0.6%	0.0%	N.A.	N.A.	N.A.

Source: Based on DPI population projections. (a) Based on WAPC provisional projections March 2004. Notes (1) Excludes Jerramungup post 2006 forecasts not available. (2) Excludes Upper Gascoyne post 2006. (3) Excludes part Dundas post 2006. (4) Excludes Mullewa, Murchison and Yalgoo post 2006. (5) Excludes part Dundas and Menzies post 2006. (6) Excludes Cue post 2006. N.A. = Not available.

3.3 Tourism

The Western Australian Tourism Commission (WATC) provides market data for regions of WA. These were published in October 2003 and are accessible via the WATC website. The following summarises the tourism performance for regions of interest to the current review of regulated routes.

Australia's Golden Outback (includes Kalgoorlie, Leonora, Laverton, and Esperance)[9]

- 13% of visitors to the region were interstate visitors.
- 848,200 visitors stayed overnight in the region, of these 82% were intrastate, 13% were interstate and 5% were international visitors.
- Over 4 in 10 international visitors stayed in a caravan or camped whilst visiting Australia's Golden Outback.
- 7 in 10 visitors to the region travelled with at least one other person, just under one quarter travelled as an adult couple and a further third travelled as a family group or with friends/relatives.
- Around three-quarters of domestic visitors (76%) used a private or rented vehicle to access the region. Some 14% used air services.
- A substantial proportion of international visitors (75%) also used a private or rented vehicle to access the region. This compares with bus and coach (used by 16%) and air (8%).
- The average annual growth rate of domestic visitors is 6.3% (well above the State average of 2.8%) and for international is -4.5% (below the State average of -1.1%).

Australia's Coral Coast (includes Geraldton, Shark Bay, Carnarvon, and Exmouth)

- 700,500 visitors stayed overnight in the region, of these 80% were intrastate visitors, 10%, were interstate visitors and 10% were international visitors.
- On average, domestic visitors stay 5.9 nights in the region.
- UK visitors account for 34% of international visitors to the region.
- The majority of domestic visitors (85%) used a private or rented vehicle to access the region.
- International visitors also commonly accessed the region using a private or rented vehicle (68%). This compares with bus and coach (used by 30%) and air (just 4%).
- The average annual growth rate of domestic visitors is 1.5% (below the State average of 2.8%) and for international is -3.9% (below the State average of -1.1%).

Australia's South West (includes Albany but also a number of other tourist attractions such as Margaret River)

- 1,909,500 domestic visitors and 116,900 international visitors stayed overnight in the region.
- 29% of overnight visitors visit the Shire of Busselton and 20% visit the Shire of Augusta-Margaret River.
- 38% of domestic visitors stayed with friends/relatives during their visit to the region.
- The majority of domestic visitors (85%) used a private or rented vehicle to access the region, just 1% used air transport.

[9] All figures for both the Golden Outback and the Coral Coast are based on a two year average over 2001 and 2002.

- Private or rented vehicles were used by 84% of international visitors to the region with 14% using bus or coach and just 2% using air transport.
- The average annual growth rate of domestic visitors is -0.7% (below the State average of 2.8%) and for international is 4.6% (well above the State average of -1.1%).

These figures suggest that tourism growth has slowed since TFI/CAPA last reviewed performance. This is in keeping with the decline of 2.2% in visitor arrivals to Australia during the 2003 calendar year (ABS source).

An ongoing feature of the regional tourism performance is the very limited use by tourists of air transport to access the regions reviewed above.

3.4 Mining

Demand for air travel from the mining sector helps underpin RPT services directly and indirectly. Mining ventures often result in significant contracts for air charters. Whilst some centres may benefit directly from this, the State benefits as a whole because the mining ventures support the positioning of a number of aircraft of various sizes, including turboprop and jet aircraft, within WA. When not flying the charters, these aircraft are then available for RPT service provision.

Prospects for mining in WA appear quite strong despite the risks associated with an increase in the Australian dollar. Major developments which contribute to a growth in the sector include[10]:

- The signing of a $25 billion LNG contract between the North West Shelf Joint Venture and the Chinese Government, China's inaugural LNG contract.
- The proposed development of the Gorgon gas field. This project centres on the development of an LNG facility on Barrow Island, which will supply LNG for distribution to markets abroad.
- BHP Billiton has invested $1 billion to fast-track the Marra Mamba iron ore deposit (Mining Area C) to meet strong Asian demand.
- North West Shelf LNG train 4 – the fourth train and associated trunkline development have been proceeding, with a total expected investment of $2.4 billion.
- The $1.4 billion Hope Downs project, proposed by Hope Downs Management Services Pty Ltd which is a joint venture owned by Hancock Prospecting and South Africa's Kumba Resources. The joint venture aims to develop a 400 Mt ore reserve 75 km northwest of Newman, will include a new $300-million railway, and could be in production by 2005/06.

[10] Largely sourced from Western Australian Mineral and Petroleum Statistics Digest 2002-03 Department of Industry and Resources.

3.5 Summary

TFI/CAPA considers that there is little material change in the wider environment now compared to the period in which the previous detailed review was conducted. Whilst we expect to see an improvement in tourism growth nationally and for WA as a whole, there is little evidence to suggest that this will flow strongly, via aviation, to the regions considered here.

4. AVIATION INDUSTRY OVERVIEW

4.1 National Overview

The Australian regional market continues to be volatile and characterised by relatively flat growth, low margins and financial pressures varying from moderate to intense, particularly for smaller operators. Since the publication of the TFI/CAPA report in November 2002, growth on intrastate sectors has been subdued by the collateral effects of the Iraq War and SARS on international tourism flows, especially during the first half of 2003.

Structural changes to the air travel market and rising costs for security and regulatory compliance, have served to intensify pressures for consolidation among regional operators and moves by some carriers to introduce larger, more efficient jet services on certain routes in an attempt to improve returns. These developments are discussed in more detail later in this section.

The operational performance of Qantas, the dominant regional airline, reflects the uncertain environment. Passenger volumes for its QantasLink subsidiary fell by 3.1% in the year to 30 June 2003, and by a further 13.1% in the following six months to 31 December. QantasLink capacity in terms of Available Seat Kilometres (ASKs) declined by 3% in 2002/03 and 14.8% in the first half of 2003/04.

While the passenger decline has been exaggerated by restructuring and rationalisation of the airline's regional network and fleet, it also indicates the still fragile state of the overall market. QantasLink has withdrawn direct services from non-profitable or marginal intrastate routes, installed jet services to a number of destinations and entered into commercial relationships with smaller carriers such as Skywest and Airnorth to strengthen its presence on intrastate sectors.

Many of the recent initiatives undertaken by operators are a response to market-based changes, including:

- Greater price sensitivity across the customer base. This trend is more noticeable on international and trunk routes, but it has also filtered through to the regional market. Indeed, the Regional Airlines Association of Australia (RAAA) recently raised the increased pressures from consumers to reduce fares as one of the major challenges the industry faces. Government and corporate purchasing policies targeting reduced air travel expenditure extend to regional sectors. Cutting fares to unsustainable levels can have a disproportionate impact on operators of small aircraft typically with limited cash flow.
- The emergence of value-based carriers.
- Virgin Blue's incursions into the regional market and the impending entry of Jetstar have served to heighten consumer expectations as to the availability of cheaper fares. In some cases, regional passengers are driving to larger centres where these fares can be accessed.
- Growing cost pressures.

- The downward pressure on fares and yields has accelerated moves by operators to reduce operational costs. Regional carriers also face significant additional compliance expenses through the regulatory reform programme of CASA and the Federal Government's Enhanced Aviation Security Package, which includes the provision of hardened cockpit doors on non-jet aircraft. The industry is concerned that the security measures will be only partially funded by government.

4.2 Commercial Airline Developments

The regional airline industry achieved a greater degree of stability during 2003 as independent operators continued to rebuild following the collapse of Ansett and the disaggregation of its intrastate subsidiaries. As noted, Qantas also undertook the initial stages of a regional reconstruction strategy. Among the major developments during the last 12 months:

- Virgin Blue increased its involvement in regional markets with the addition of services in NSW to Newcastle, Ballina and Coffs Harbour. This has seen the introduction of larger B737-700 and B737-800 jets to destinations previously served by turboprops.
- Qantas announced value-based subsidiary Jetstar will operate from May 2004 with B717s formerly flown by QantasLink to a number of regional markets, including Newcastle, Proserpine and Maroochydore.
- Horizon Airlines went into voluntary administration, and was subsequently acquired with its NSW routes by Queensland's Macair.
- Airnorth's owner Capiteq Ltd purchased Adelaide-based Emu Airways and Airlines of SA and established Australia's first franchise grouping of independent airlines under the RegionalLink brand. The RegionalLink initiative is a unique approach to problems often experienced by smaller operators, as it will provide shared reservations, yield management and other infrastructure services and bulk purchase aircraft orders for its member airlines.
- Skywest undertook a capital and operational restructure, and introduced limited jet operations with two leased F100s.
- Skippers Aviation expanded its scheduled services in WA.

The selective expansion of value-based operators to traditional regional markets will apply further pricing and competitive pressures to smaller airlines both directly and indirectly, particularly on the eastern seaboard. Similarly, increasing use of higher capacity jets on non-trunk routes (eg. Qantas and Skywest) is likely to constrain returns for turboprop-based carriers and may lead to overcapacity.

Given these and other pressures, it is possible over time that the regional industry will consolidate into three or four major groupings of airlines to realise economies of scale and sustain the viability of smaller operators. Indeed, such a scenario is already taking shape with Qantas extending its national network of commercial partnerships and the emergence of the RegionalLink franchise.

The recent developments with the major regional carriers servicing the Australian market are provided in detail in the following section.

4.3 Qantas Airways

Qantas' regional services have maintained high earnings growth as a result of; the transfer of marginally or non-profitable routes to partner airlines, and the sale of its inefficient Beech 1900D fleet. While traffic levels have declined consistent with reduced capacity, the profit before interest and tax of QantasLink increased by 34.8% in 2002/03, and by 40.2% in the six months to 31 December 2003.

The redeployment of Qantas link's 14 B717s to Jetstar in May 2004 will further deplete capacity available to the regional subsidiary. This will be partially offset by the delivery of 7 50-seat Dash 8s during the first half of 2004, to be operated in NSW, the ACT, Queensland, Victoria and Tasmania. These aircraft will expand the seat supply on routes between Sydney and Canberra, Coffs Harbour, Port Macquarie and Albury. Qantas expects delivery of the first Jetstar A320s from November 2004.

Jetstar will focus initially on primary east coast airports and secondary airports such as Avalon, near Melbourne, and Newcastle in NSW. Jetstar is likely to expand into other countries across Australia from November 2004; however no firm dates are set for introduction of the services into WA.

The Perth-Broome services of Skywest and Qantas may benefit from the passenger growth generated by Jetstar to WA. Conversely, the Perth-Broome sector could be adversely affected by a diversion of east coast traffic that travels on direct services to Broome rather than via Perth.

In WA, Qantas has strengthened its competitive position by:

- Scaling up capacity by 1,700 weekly seats in total through the use of larger gauge BAe146 and B737 aircraft on existing services between Perth and Kalgoorlie, Karratha, Broome, Port Hedland, Paraburdoo and Newman (February and March 2004).
- Announcing plans to introduce a once weekly tourism-based service between Perth and Kununurra for the seasonal peak period between May and September 2004.
- Launching non-stop services linking Perth with Canberra and Cairns (February 2004).
- Adding 800 seats per week to services between Broome and Alice Springs, Sydney and Melbourne (March 2004).

4.4 Alliance Airlines

Alliance Airlines has maintained a modest growth of its F100 jet services on the north Queensland routes flown by the carrier, adding two services a week to Brisbane-Townsville in August 2003. The airline also provided a F100 to Skywest under a "wet lease" arrangement until late 2003 for use on the WA airline's contract service with Rio Tinto for the Argyle Diamond Mine.

4.5 Airnorth

The RegionalLink Airlines group established by Airnorth's owner Capiteq has the potential to resolve endemic cost problems experienced by smaller regional carriers, and by doing so, enhance the viability of that sector of the industry.

Launched by Capiteq on 1 March 2004, RegionalLink is a national franchise arrangement whereby member airlines operate under a single brand and share core functions such as reservations, purchasing, yield management, airport services and information technology. In effect, this should enable these airlines to achieve the economies of scale normally limited to much larger operators.

Airnorth and two other Capiteq subsidiaries, Airlines of South Australia (formerly part of the Ansett Group) and Emu Airways, will form the nucleus of the grouping. Capiteq acquired Emu Airways, operator of high frequency services between Adelaide and Kangaroo Island, in March 2004.

RegionalLink will not operate aircraft in its own right but coordinate group branding and services, and place bulk purchase orders for participating carriers for items such as fuel, insurance and spare parts. Individual carriers will continue to trade under their own names in their home markets.

According to Capiteq, RegionalLink will bring "stability, sustainability and profitability to the regional air transport sector". The grouping also offers Qantas a stronger indirect representation at the small end of the industry, given that Airnorth and Airlines of South Australia are both commercial partners.

Airnorth's only WA service, linking Darwin with Kununurra and Broome, faces direct competition from Skywest from April 2004. Skywest's Perth-Broome-Darwin service commenced on 5 April, with Skywest flying into the Northern Territory two times a week, expanding to three weekly services in May 2004. Skywest's service will be the first jet operation on the route since Ansett's withdrawal in 2000. It will compete head-to-head with Airnorth's 30-seat Embraer Brasilia, which flies 11 times a week to Kununurra from Darwin with on-flights to Broome 9 times a week.

4.6 Macair and Horizon Airlines

Macair, a partner of Qantas, extended its regional operations from Queensland to NSW after assuming control of Horizon Airlines in November 2004. Horizon went into voluntary administration in October 2003, three months after the airline secured the sole licence for the Sydney-Grafton route.

With the Horizon acquisition, Macair obtained licences to operate services between Sydney and Grafton (23,000 passengers in the year ended 30 June 2003), Taree (7,800 passengers), Newcastle-Williamtown (40,000 passengers), Kempsey and Cooma (5,700 passengers) with its Saab 340 aircraft. Macair subsequently handed over the Newcastle route to another independent operator Aeropelican and withdrew from the Kempsey route.

4.7 Regional Express Airlines

Regional Express (Rex) has undergone further significant management and commercial changes in its attempt to gain traction in the highly-competitive markets of eastern Australia. The airline has gained limited linkages with the trunk market under its commercial partnership with Virgin Blue, which provides for bookings on either carrier through Rex and through baggage check-in on connecting flights.

However, Virgin Blue is also imposing competitive pressures on Rex, as reflected by its decision to take up B737NG flights between Sydney and Ballina from August 2004. Virgin's introduction of daily flights with 180-seat jets onto a route presently operated by Rex with Saab 340 turboprops and QantasLink with Dash 8s, raises the prospect of excess supply unless substantial traffic growth occurs.

Rex has pre-empted Virgin's arrival by lowering its fares on flights between Sydney and Ballina and neighbouring Lismore, and expanding services by an additional 884 seats per week. The airline has been able to cut its one-way fares to Ballina, Lismore and other destinations such as Coober Pedy, Merimbula, Narrandera and Parkes, and grow its traffic levels, by securing partnerships with the respective airport operators. The nature of these partnerships is not clear, although most involve marketing and discounting of airport charges.

The initiatives adopted with specific airports has, in effect, provided for an incremental expansion of services, particularly in NSW. Other attempts to increase its share of employee travel business with the Federal and ACT Governments proved less successful. Rex ceased flights between Melbourne and Canberra in July 2003 after gaining only 1% of government bookings on Canberra-based services. The airline also stopped flying the add-on leg of its Sydney-Canberra service to the rural centre of Traralgon in Victoria.

As part of its strategy to build its share of the government travel market, Rex introduced a frequent flyer programme involving one free flight for every nine flights taken with the airline and airport lounges in Sydney and Canberra.

The airline also underwent senior management changes, including the recent appointment of Geoff Breust, formerly general manager of Kendell Airlines, as the Chief Executive.

5. WESTERN AUSTRALIAN AIRLINES

5.1 Skywest

Skywest embarked on a major reconstruction during 2003 which has largely stabilised the airline's finances, returned it to modest profitability and provided a platform for scheduled and charter service growth. However, the situation is still fluid with the airline, and much will depend on the success or otherwise of the airline's move into jet services and the ongoing relationship with Qantas.

After reporting a loss of $975,000 for six months to the end of December 2002, Skywest undertook a recovery strategy in March 2003 which entailed:

- Arranging finance to purchase its 5 F50 turboprop aircraft for $9.4 million (including a $6.5 million loan from Commonwealth Bank).
- Raising $4.2 million through an issue of convertible shares, to be applied to reduce debt levels.
- Withdrawing services on loss-making routes between Perth and Karratha and Perth-Laverton in May and July 2003.
- Reducing services between Perth and Esperance by two flights a week (since reinstated).
- Reducing staff numbers by 15%, and improved wage and productivity arrangements.
- Introducing scheduled jet services using F100s.
- Increasing fares by 3% in November 2002 and a further 7% from April 2003.

The restructuring process was aided by the WA Government's provision to Skywest of exclusive operating rights for two years for services between Perth and Carnarvon, Exmouth, Albany and Esperance. Under the changes, Skywest also lost its rights to service the tourism route between Perth and Monkey Mia (Shark Bay) to Skippers Aviation, through an open tender process. Skywest also faces competition from Skippers through the staged deregulation of the Perth-Geraldton route.

Traffic generally has not fully recovered to levels experienced before Ansett's collapse in 2001. Skywest states in the prospectus for its convertible share issue last year that passenger numbers on its core routes are at 86% of the level before Ansett's administration. Limited growth is anticipated during 2003/04 on the Geraldton and Albany routes, on the basis of forecasts provided in the prospectus. However, Skywest emphasises in the document that it has taken a conservative view of passenger demand for 2003/04. The forecast for Perth-Geraldton of 1.8% growth for 2003/04 allows for the prospect of additional competition on the route.

Skywest achieved a net profit of $546,000 for the year to 30 June 2003. With further benefits from its revamp, greater cost containment, and a firmer Australian dollar, the airline performed more strongly in the first half of the current fiscal year with a net profit of $1.8 million for the six months to 31 December 2003. This was slightly ahead of the $1.7 million forecast in the company's prospectus for its convertible shares.

According to the prospectus, Skywest is forecast to return an after-tax profit of $2.4 million for the 2003/04 year on revenue of $46.7 million. While passenger volumes will remain relatively flat at 185,000, the revenue improvement is expected to reflect better yield as average fares rise to a forecast $200 due to approved fare rate increases.

Skywest's growth strategy is based on the following key areas of development:

- Increased penetration of the charter market. Skywest's three-year contract with Rio Tinto to provide air services to the Argyle Diamond Mine has substantially strengthened its position in the WA charter market, lifting its share of that market from 3% to 11%.
- Expansion of jet services. Skywest began intrastate scheduled jet services with the introduction of a three times per week service using a 97-seat F100 on Perth-Broome in October 2003. It has since maintained loads above break even level. This service will increase to six flights a week, with three of those flights carrying on to Darwin, from April-May 2004. The airline also plans to introduce a six times weekly service with a second F100 linking Perth with Karratha and Port Hedland in May.
- Higher utilisation of the F50 fleet. The airline has improved utilisation of its turboprop fleet by introducing a twice weekly Kalgoorlie-Esperance service, and expanding frequencies on Perth-Kalgoorlie and Perth-Esperance.
- Commercial links with Qantas. The affiliation secured with Qantas in February 2003 provides for Qantas Frequent Flyers to earn and redeem points on Skywest flights. Passengers can also book and check their luggage through to final destinations when connecting between services of the two airlines. These linkages give Skywest greater mass in certain markets, improved connections with international and interstate flights and the ability to coordinate schedules.

The relationship with Qantas may be tested by Skywest's introduction of aggressively-priced jet services on routes competing with Qantas in the north-west of the state to Broome, Karratha, Port Hedland and to Darwin. While Skywest insists that the F100 operations will complement and strengthen Qantas' involvement in WA, its move into the intrastate jet market and continuing expansion, could be viewed by Qantas as predatory.

Skywest enhanced its competitiveness with the introduction of an online low fare option with its "skydeals" web fares in July 2003. These fares are available to passengers booking at least three days in advance and paying at the time of booking. Skywest, for example, is offering $99 one-way fares under the "skydeals" programme to Albany and Geraldton, $149 to Esperance and Kalgoorlie, and $199 to Carnarvon and Esperance.

The March quarter is historically a quieter trading period for Skywest, with a number of aircraft out of service during January and February for heavy maintenance and a reduced schedule on RPT routes.

Following the improvement in its operating performance and future prospects, the airline indicated that it plans to list its shares on the Australian Stock Exchange during the first half of 2004. This development has the capacity to further strengthen its capital base and provide a broader range of funding options.

5.2 Skippers Aviation

Skippers Aviation has significantly expanded its scheduled network with the withdrawal of Skywest from the Perth-Laverton route and changes instituted by the WA Government during 2003.

The airline secured the exclusive rights for two years to operate Perth-Laverton with a thrice weekly Metro 23 aircraft after the government called for expressions of interest to operate the service. Fare increases on the route are limited to Consumer Price Index (CPI) rises under the terms attached to the rights.

Skippers Aviation also won the rights to operate a Perth-Kalbarri-Monkey Mia (Shark Bay) service, with limited services to Geraldton, for two years. Skippers began flying a Metro 23 three days a week between Perth and Kalbarri, and five days per week to Shark Bay, in January 2004. The airline has taken up rights to operate five return services per week between Perth and Geraldton in competition to Skywest.

Skippers Aviation continues its three days per week services between Perth-Meekatharra-Wiluna.

5.3 Great Western Airlines

Great Western has scaled down its involvement in WA scheduled intrastate services following the withdrawal of its twice weekly Perth-Kalbarri service as a result of Skippers Aviation's success in the State Government route tendering process.

The airline has switched its focus to South Australia, launching double daily services between Adelaide and Kangaroo Island in October 2003, and 16 services a week between Adelaide and Port Lincoln in December 2003. Great Western continues to offer two flights a week (Monday and Friday) between Perth-Newman and Newman-Halls Creek.

5.4 Maroomba Airlines

Maroomba Airlines operates RPT flights four times per week Perth to Mt Magnet using the 18-seat Jetstream 31 aircraft.

5.5 Golden Eagle Airlines

Golden Eagle Airlines has held an RPT Air Operators Certificate since 1995. Currently it provides a return service on behalf of Skippers Aviation between the towns of Derby and Broome six times a week Monday to Saturday.

Golden Eagle operates a variety of aircraft ranging from the single engine Cessna 206 to the larger twin engine 10-seat Piper Chieftain and its fleet are located over three bases throughout the Kimberley and Pilbara.

5.6 Northwest Regional Airlines

Northwest Regional was granted a license to operate in early 1999. It provides airline schedules from Broome to Karratha and Port Hedland (its southern services) and to Fitzroy Crossing and Halls Creek (its east-west services). The services operate three times per week from Karratha through Port Hedland to Broome and six times per week from Broome through Fitzroy Crossing to Halls Creek.

5.7 Conclusions

The regional industry generally has moved further down the track towards a more stable and sustainable structure in the intervening period since the WA Government introduced its strategy for intrastate aviation early in 2003. However the sector across Australia is not highly profitable and remains subject to rapid and unpredictable movements in costs associated with changes in fuel prices, movements in the USA/Australian dollar and changes in airline and airport security measures that add to airline costs.

Skywest has undertaken initiatives both with its operations and capital base which should make it more competitive as a whole, and provide greater financial strength and resources to underpin its regulated routes. However, it should be stressed that Skywest is only part-way through the process of rehabilitation, despite progress made with the refinancing of its F50 leases, entry onto jet routes, and confidence in growth prospects and the maintenance of profitability.

Other carriers such as Skippers Aviation, Airnorth, Great Western Airlines and Maroomba Airlines would appear to have potential to participate on WA scheduled services. Skippers has taken the place of Skywest on smaller routes such as Perth-Laverton and Perth-Monkey Mia, while Airnorth's new franchising structure should ensure it plays a central role in industry consolidation around Australia. Maroomba Airlines and Great Western Airlines currently provide RPT services to Mt Magnet and Halls Creek respectively.

Consolidation, at both the small and larger ends of the regional industry, is probably inevitable as many of the airlines lack the resources to meet rising costs and provide the infrastructure necessary for growth and sustainable profits. Clearly, the industry is migrating, albeit at a relatively slow pace, to a more compact structure following the splintering effect of Ansett's collapse in 2001 and the re-emergence of various independent operators in competition with Qantas.

Skywest appears to be positioning to take part in that consolidation which is also likely to involve Regional Express, the Airnorth group and perhaps Queensland's Alliance Airlines or Macair. Realistically though, further restructuring will need to occur over the next two years to ensure strong foundations exist for any future amalgamation and it seems certain that this process also will result in more airline casualties.

The establishment of greater competition on jet routes in WA, and Skywest's ability to achieve acceptable passenger loads during this expansion phase, suggests that the denser intrastate jet routes, particularly associated with mining developments, are capable of higher growth. But there remains a fragility in the regional non-jet routes which makes the industry vulnerable to further external crises.

6. AIRLINE ROUTE PERFORMANCE IN WA

6.1 Route Status

The route-specific impact on flight frequencies and capacity of the changes in the WA intrastate air market, as discussed in the previous section, are shown in **Table 6.1**. Clearly, the level of services, particularly on the main jet routes, has grown strongly since the end of 2002.

Table 6.1: Changes to WA Intrastate Air Services, 2003- 2004

Route	Service Change	Net Impact					
		Change in nos. of flights	Total flights per week	Weekly Seats before changes	Change in nos. of seats	% Capacity Change on Route	Weekly seats after changes
		Jet Routes					
Perth-Broome	Entry of Skywest F100 service	+6 (May 2004)	29	2,250	+582	+26%	2,832
Broome-Darwin	Launch direct F100 service by Skywest	+3 (May 2004)	12	272	+291	+107%	563
Perth-Karratha[a]	Launch Skywest F100 service	+6 (May 2004)	26	1,740	+174	+10%	1,914
Perth-Port Hedland[a]	Skywest begins F100 service	+6 (May 2004)	20	1,236	+408	+33%	1,644
		Turboprop Routes					
Perth-Geraldton	Entry of Skippers Aviation with Embraer service	+5 (+1 through service)	31	1,196	+150	+13%	1,346
Perth-Laverton	Skippers Aviation Metro 23 service replaces Skywest's F50 service	No change	3	60	-3	-5%	57
Perth-Esperance	Skywest introduced Kalgoorlie-Esperance service	+2	12	460	+92	+20%	552
Perth-Shark Bay*	Skippers Aviation Metro 23 & Embraer services replace Skywest F50 services	+1	5	110	-11	-10%	100
Perth-Kalbarri*	Skippers Aviation replaces Great Western services	+1	3	18	-1	-5%	17
Total		***+30***	***141***	***7,342***	***+1,683***	***+23%***	***9,025***

Source: Skywest, Qantas, OAG Pocket Flight Guide. (a) On routes with multiple destinations (eg. Perth-Karratha-Port Hedland), 30% of the available capacity has been allocated to the interim destination and 70% to the final destination.

The growth depicted underestimates the true overall situation as the table does not take into account proposed capacity increases announced by Qantas to six WA destinations. As noted, Qantas added a further 1,700 weekly seats to the intrastate market in February and March 2004 through the introduction of larger gauge aircraft. However, the airline has not identified on a route-by-route basis where this additional capacity has been deployed.

6.2 Overall Route Performance in WA

In the 2002 review of WA routes TFI/CAPA concluded:

- Well in excess of 100,000 passengers would be required to support competition on jet routes.
- Routes with above 60,000 passengers could support competition amongst turboprop operators, although competition would have a potentially destabilising impact on the RPT network.
- Between 40,000 and 60,000 passengers, competition on a route is unlikely to be sustained.
- Between 10,000 and 40,000 passengers, airline services could operate commercially on a sole operator basis but not competitively.
- Below 10,000 passengers routes generally need to be part of a network to operate commercially or may require a subsidy.

Table 6.2 provides data for the turboprop routes in WA for the calendar years 2000 through to 2003. The data source is DOTARS. Overall traffic remains nearly 10% below the level achieved in 2000.

Table 6.2: Passengers on Turboprop Routes in WA, Year ended 31 December

Routes	2000	2001	2002	2003	2003 on 2000	2002 on 2001
Total	**252,484**	**219,554**	**217,376**	**228,123**	**-9.6%**	**3.9%**

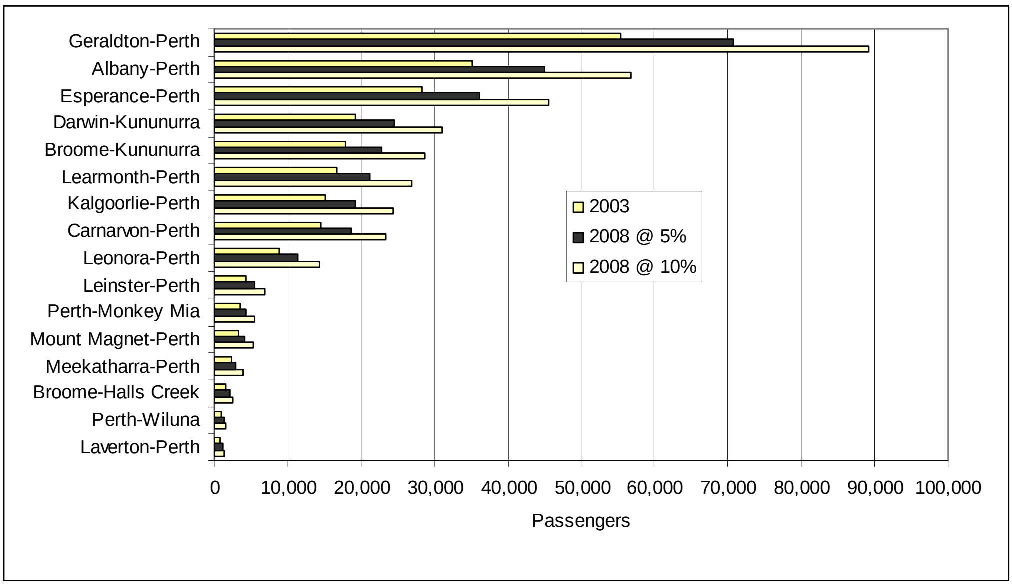
Source: TFI based on DOTARS.

Figure 6.1 takes the 2003 level as the base and then shows the impact of an average growth of 5% per annum and 10% per annum for the five years to 2008. These growth rates are well above the averages achieved for these routes but are used to show the longer term position of the routes even with substantial growth.

By 2008, with 5% annual growth, only Geraldton secures above 60,000 passengers. Albany-Perth achieves 45,000 passengers with 5% annual growth but only approaches the level required to support competition if 10% annual growth is achieved. Other routes do not achieve the level necessary to support competition, even at 10% growth per annum.

This analysis suggests that even with substantial (unrealistic growth) only one additional route moves into the theoretical range that can support competition.

Figure 6.1: Passengers Levels on Turboprop Routes in WA 2008 Assuming 5% and 10% Growth per annum,



Source: DOTARS for 2003, TFI

6.3 Airfare Comparisons

TFI/CAPA has collated a range of fares for a number of Skywest and Airnorth routes in WA and for a number of routes in other States. The comparisons on a cents per kilometre basis are reported in **Table 6.3**.

Airfares are difficult to compare given that we do not know the number of seats airlines have allocated to each fare type.

The Lower and Upper fare levels shown in **Table 6.3** were obtained by accessing fares on the respective airline website for discount (Lower) and fully flexible (Upper) fares for travel one-week out from booking and for six weeks out from booking.

Skywest fares appear to be amongst the lower fares shown in the table. However because of the relatively long route lengths operated by Skywest, the fares are high in absolute terms and this is the source of many of the complaints from those consulted for this review.

Table 6.3: Sample Fares on Australian Regional Routes

	Distance (Kms)	Airline	Aircraft Type	Seats	Fares		Cents/km	
					Lower	Upper	Lower	Upper
Exmouth-Perth	**1094**	**Skywest**	**F50**	**46**	**599**	**811**	**0.27**	**0.37**
Broken Hill-Sydney	932	Rex	Saab 340	34	398	870	0.21	0.47
Blackall-Brisbane	838	QantasLink	Dash 8	36/50	397	752	0.24	0.45
Carnarvon-Perth	**816**	**Skywest**	**F50**	**46**	**247**	**665**	**0.15**	**0.41**
Coober Pedy-Adelaide	748	Rex	Saab 340	34	338	664	0.23	0.44
Broome-Kununurra	**731**	**Airnorth**	**Brasilia**	**30**	**541**	**726**	**0.37**	**0.50**
Monkey Mia-Perth	**713**	**Skippers**	**Metro / Brasilia**	**19/30**	**350**	**659**	**0.25**	**0.46**
Esperance-Perth	**582**	**Skywest**	**F50**	**46**	**296**	**493**	**0.25**	**0.42**
Moree-Sydney	509	QantasLink	Dash 8	36/50	376	625	0.37	0.61
Griffith-Sydney	472	Rex	Saab 340	34	260	505	0.28	0.53
Darwin-Kununurra	**441**	**Airnorth**	**Brasilia**	**30**	**356**	**517**	**0.40**	**0.59**
Broken Hill-Adelaide	426	Rex	Saab 340	34	274	488	0.32	0.57
Albany-Perth	**375**	**Skywest**	**F50**	**46**	**201**	**393**	**0.27**	**0.52**
Geraldton-Perth	**370**	**Skywest**	**F50**	**46**	**197**	**389**	**0.27**	**0.53**
Port Macquarie-Sydney	320	QantasLink	Dash 8	36/50	294	496	0.46	0.78
Bundaberg-Brisbane	287	QantasLink	Dash 8	36/50	252	480	0.44	0.84
Port Lincoln-Adelaide	246	Rex	Saab 340	34	168	381	0.34	0.77
Maryborough-Brisbane	212	Sunshine Express	Shorts 360	36	197	434	0.46	1.02

Source: Airline websites.

7. CONSULTATION

7.1 Consultation Questions

Stakeholders and stakeholder representatives were asked a series of questions with respect to their views on air services. Because Skywest is the major airline operating intra WA services, the survey focused on its operations and network. The results are summarised in this section.

1. *Are the air services provided by Skywest meeting the travelling needs of the community (social), business and/or tourism? If 'No' for any of these segments, please indicate why.*

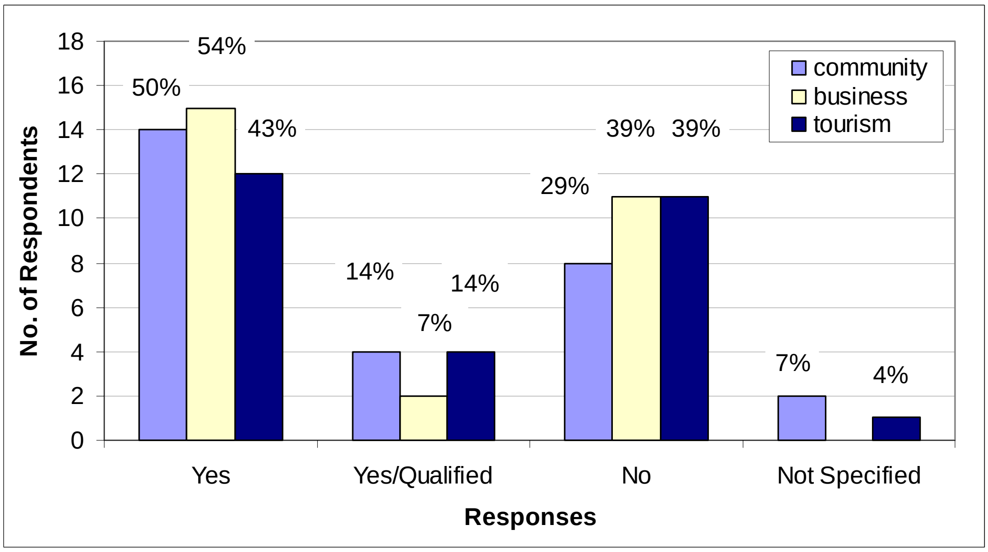
Over one-half of the respondents believe that Skywest is meeting the needs of the community. A number qualified their response by suggesting that although needs were being met, services were provided by Skywest at a high cost to passengers. A further 29% consider that Skywest is not meeting the needs of the community.

Over half of the respondents judged Skywest to be meeting the needs of business travellers although a large proportion, 39%, disagreed with this.

Over half of the respondents, 57%, agreed that Skywest was meeting the travelling needs of the tourism sector although 14% qualified this view with suggestions that fares were too high overall and that there was only limited access to discounted seats. Overall 39% disagreed that Skywest was meeting the needs of the tourism sector.

These responses suggest that whilst there may be recognition of the service provided by Skywest the perception is that it comes at a high price.

Figure 7.1: Results of Survey Question 1



Source: TFI.

2. *How would you rank the following in terms of importance to your area of interest (community, business or tourism?*

Airfares
Access to discount fares
A regular schedule
Sustainable air services
Direct Air services
Competition
Frequency
Being part of a network of airline routes
Other (specify)

Results are summarised in **Tables 7.1** and **7.2**. **Table 7.1** reports the proportion of respondents indicating each service element by rank. For example 46% placed a regular schedule as the top issue. **Table 7.2** provides a cumulative total for each element – for example 61% of respondents ranked airfares as first, second or third in importance.

Regular schedules, airfares and frequency are most often ranked 1, 2 or 3 by respondents. Competition is amongst the lowest ranked elements. However many see competition as the only means to achieve airfare reductions.

Figure 7.1: Results of Survey Question 1

Service Element:	Most Important---------------------Rank-----------------------------Least Important									
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**Nil**	**Sum**
	Share of Respondents									
Airfares	43%	7%	11%	18%	7%	4%	0%	0%	11%	100%
Access to Discount fares	7%	25%	14%	11%	14%	7%	7%	0%	14%	100%
Regular Schedule	46%	7%	21%	18%	0%	0%	4%	0%	4%	100%
Frequency	29%	25%	18%	11%	7%	4%	0%	0%	7%	100%
Direct Air Service	11%	7%	11%	7%	7%	25%	18%	7%	7%	100%
Sustainable Air Service	25%	7%	4%	11%	14%	14%	7%	4%	14%	100%
Network	4%	11%	11%	0%	11%	11%	25%	11%	18%	100%
Competition	4%	7%	11%	4%	7%	7%	0%	39%	21%	100%

Source: TFI.

Figure 7.2: Results of Survey Question 1 Cumulative Shares

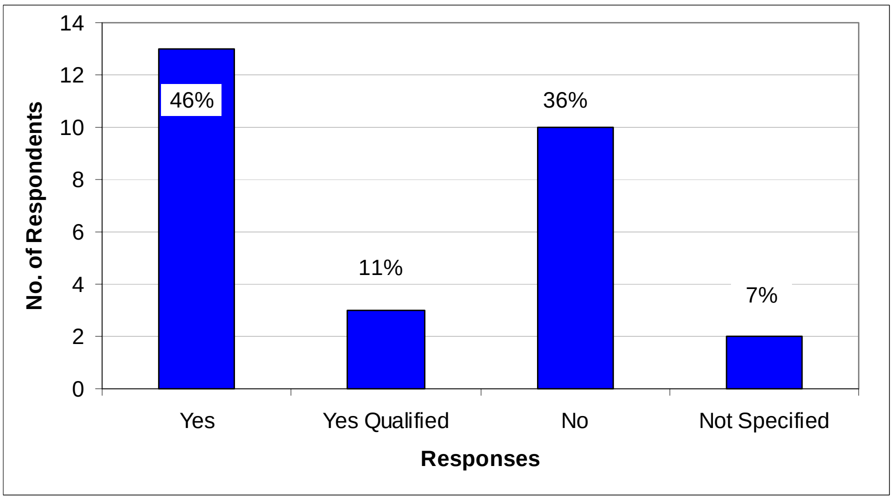
Service Element:	Most Important---------------------Rank-----------------------------Least Important								
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**Nil**
	Cumulative Share of Respondents								
Airfares	43%	50%	61%	79%	86%	89%	89%	89%	100%
Access to Discount fares	7%	32%	46%	57%	71%	79%	86%	86%	100%
Regular Schedule	46%	54%	75%	93%	93%	93%	96%	96%	100%
Frequency	29%	54%	71%	82%	89%	93%	93%	93%	100%
Direct Air Service	11%	18%	29%	36%	43%	68%	86%	93%	100%
Sustainable Air Service	25%	32%	36%	46%	61%	75%	82%	86%	100%
Network	4%	14%	25%	25%	36%	46%	71%	82%	100%
Competition	4%	11%	21%	25%	32%	39%	39%	79%	100%

Source: TFI.

3. *On the basis of your answer to (2) would you support the introduction of competition, either partial or full? If YES please indicate the main areas of benefit you envisage will flow from the competition.*

Some 46% of respondents indicated 'Yes' to this question. A further 11% also supported the introduction of competition with reservations. Around one-third responded 'No'.

Figure 7.2: Results of Survey Question 3

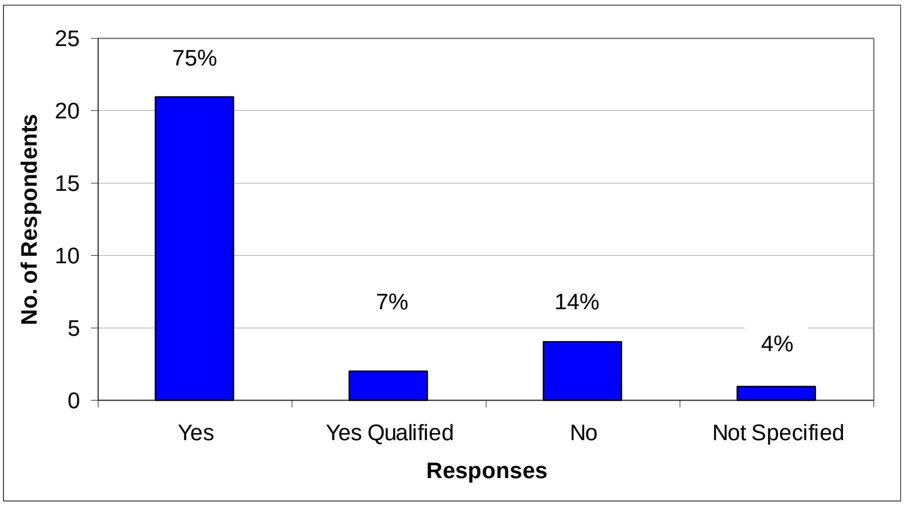


Source: TFI.

4. *Do you feel that Skywest has assisted in promoting, developing and growing air services to your region? If you answered No, why?*

There are a very high number of respondents suggesting that Skywest is assisting in these areas. However 7% qualified their responses with suggestions as to the service improvements required. Respondents expressed the view that services and other contributions have decreased in recent years.

Figure 7.3: Results of Survey Question 4



Source: TFI.

5. *In your view, which of the following is more important:*

(A) One stronger carrier providing regular services as part of a network with cross-subsidisation, or

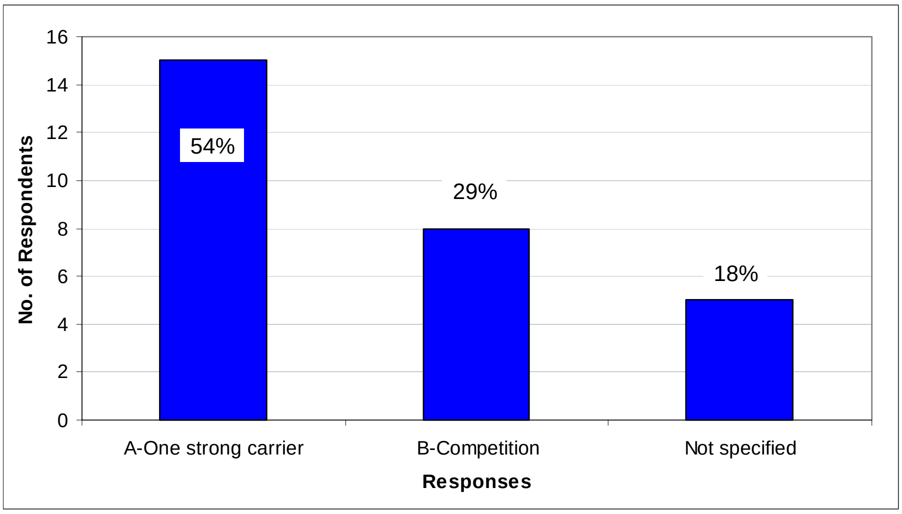
(B) Competition between carriers operating viably on stand alone individual routes (eg. not part of a single-airline network). If you answered (b), please indicate for what reasons?

Over half the respondents support proposition 'A'. However many are equivocal. The response from Albany Chamber of Commerce and Industry is typical of the type of response here. It suggests:

"A, as long as pricing is competitive".

In other words, and consistent with responses to other questions, there is a desire for the stability that comes with a strong single airline but fares are seen as being too high. For around 29% of respondents competition is seen as important if the benefits of lower fares and improved services are to be achieved.

Figure 7.4: Results of Survey Question 5



Source: TFI.

7.2 Summary

Overall views expressed by some of the respondents are as follows:

Views from Esperance

Esperance Seaside indicated that the 'New' Skywest has improved its discount fare structure, but that it is still recognised as one of the most expensive fares in Australia. More would travel if fares were more affordable.

Views from the Shire of Esperance and Esperance Chamber of Commerce generally echoed these views.

Views from Geraldton and the Mid West

The Mid West Chamber of Commerce and Industry suggested that:

- Competition would result in lower air costs, making travel more affordable which would result in fewer empty seats and in making services more viable for the airlines.
- Lower airport charges and lower flight charges would "surely" increase air traffic.
- Managed competition is needed so that services are sustainable. An alternative could be based on a partnership rather than introducing a new carrier.
- Concerns include the ticket cost, timetable to Perth, lack of services from Geraldton to the north or east and lack of connecting flights via Perth to these destinations.

The City of Geraldton supports the "managed introduction of competition", on the basis of not undermining the sustainability of Skywest or others, and introduced incrementally to ensure quality frequency of service. Main benefits are reduced airfares, better access to discount rates, a broader range of flight times, availability and linkage to more alternative airline routes.

According to the City, it appears that the recent introduction of another carrier to Geraldton and associated routes has proved viable and successful. With further promotion and economic development, the level of competition could be increased, but may not be for some years. The Community requires a good quality, reliable direct service at an affordable cost.

However Geraldton Airport suggests that restrictions on service days (for Skippers) should be lifted and that restricted times between services should remain in place to prevent parallel servicing.

Further, according to Geraldton Airport, networks are important to achieve economies of scale for airlines, but cross-subsidisation is not a reasonable impost on passengers unless costs are minimised by spreading them over a large network. This happened with the old Ansett WA network, where airfare between Geraldton and Karratha via Perth was the same as the Geraldton-Karratha price, encouraging decentralisation and businesses to locate in regional centres without penalty.

Views from the Gascoyne Region

The Gascoyne Development Commission suggests that competition is necessary and desirable. However it would be "detrimental if introduced before the volume of tourism travellers is increased to support competition. Based on current travel numbers, competition may not result in better service or cheaper fares".

Views from Exmouth

The Shire of Exmouth suggests that Skywest provides excellent service, but that there is no point having good service if the public cannot afford it. Exmouth is still seeing only 18,000 passengers per annum using the airport but it could be expected that with an increase in exploration and permanent oil rig in Woodside, this number will increase. The recent release of three "super lots" at Exmouth Boat Harbour for commercial, resort and residential use will generate additional air traffic and lead to more visits.

Exmouth Visitor Centre suggests that if another airline is permitted to operate to Exmouth, the Government should consider the following issues:

- There should be a minimum standard of aircraft and seat capacity set for all operators. Often airlines do not provide a larger aircraft when the flight is full, instead opting for waitlist options to the passengers.
- Availability for airlines to offer frequent flyer points and redemption
- Ensure that daily services are not reduced.
- Flight reservations should be available in Global Distribution Systems. When Northwest Regional operated flights over Exmouth-Broome, the schedules were not in the GDS for two years, so travel agents incorrectly advised their clients that there was no direct service available and Exmouth-Perth-Broome flights were booked.
- Availability to uplift excess baggage, freight and animals.

The Gascoyne Development Commission suggests that some in Exmouth have unrealistic expectations as they believe Skywest to be too expensive and does not carry a high enough passenger volume into town.

Views from Carnarvon

The Carnarvon Visitor Centre suggests that the high cost of air travel forces passengers to use alternative transport modes. Competition would result in reduced fares and increased services.

The Shire of Carnarvon suggests that further opportunities are required to meet the strong community demand for packages to attend sporting events, weddings etc. Tourism needs are not met.

Views from Kalgoorlie-Boulder

The Kalgoorlie-Boulder Chamber of Commerce suggests that schedules and costs are priority matters. 60% of eighteen in the City and Regional Development Sub-Committee agree that airfares are too expensive and 80% are disappointed with access to discount fares.

Competition is seen as driving down costs and stimulating more affordable airfares.

The Kalgoorlie-Boulder Tourist Centre believes that Skywest is not meeting business and tourism needs. More flights are required, morning and night.

Their view is that competition would result in better prices and frequency of flights. Airfares need to be reduced and there should be “great” package deals to attract visitors to the region.

Views from the Tourism Council of WA (TCWA)

The TCWA supports competition provided it can be sustainable. The TCWA does not want a new carrier to enter the market, provide temporary competition, disrupt the market and lead to withdrawal.

The licensing of a second carrier on current Skywest routes should be based on sustainability. In making this judgement issues to consider include:

- Has the current demand for the service increased?
- Is it sustainable?
- How would competition affect demand?

8. Options and Evaluation

8.1 The Policy Dilemma

Interstate air services in Australia are not regulated. Increasing competition for these routes has generally seen a greater variety and quality of services, and a reduction in prices. The establishment of low cost airlines, Virgin Blue and now Jetstar, has resulted in fares well below levels seen previously in this country.

Such outcomes have created:

- Frustration amongst consumers of regional services in WA where high airfares now seem even more unreasonable.
- An expectation that competition will inevitably lead to cheaper airfares.

This general outcome for interstate services has not, however, prevailed for the low density regional services, which globally still struggle to justify commercial delivery. This is because costs to operators on such routes are intrinsically high and revenue is limited.

When TFI/CAPA reviewed the WA situation in 2002, three features characterised the structure of air services in WA: the long average route lengths, the decline in routes served exclusively by domestic jet airlines over the previous decade, and the number of intrastate routes with limited passenger numbers.

The passenger volumes on the route network within WA were found to follow a similar pattern to the population distribution. There are few large routes and a relatively large number of routes with limited passenger volumes.

Two years on and it appears that:

(1) The airlines serving the region are in better shape today than they were at the time of the first review, and that, external conditions allowing, modest continuing improvement may be expected.

(2) There are prospects for alternative arrangements under franchise and alliance relationships that could reinforce a trend to appropriate sizing of aircraft to routes.

(3) Individual regional routes, however, are not performing substantially better than they were at the time of the 2002 review; market recovery generally is limited, despite a buoyant regional and national economy.

The question is whether the conditions affecting the sector justify continuing to regulate the smaller turboprop routes. If low growth or decline is anticipated together with continuing industry volatility, then regulation may be justified to maintain a degree of continuity and certainty for remote communities. If however, traffic recovery strengthens, then there may be grounds for reducing or removing commercial regulation.

In making such a decision there is a need to consider the likelihood of the alternative outcomes and the regret that might follow from acting contrary to what actually happens (**Table 8.1**).

Hence, if it is decided to deregulate and recent gains in sector stability are combined with strong demand growth, Outcome 4 is the most likely result. This should maximise consumer satisfaction and, in theory at least, lead to a stronger aviation sector.

If, however, volatility persists, then deregulation is likely to contribute to further instability and uncertainty and there is the risk of loss of services (Outcome 3).

The decision to deregulate, then, would reflect a high expectation of improving market (industry demand) conditions, and a willingness to accept the service consequences if this expectation proves unfounded.

Paradoxically, even under more buoyant economic conditions, some communities may be expected to suffer as uneven minerals-based development concentrates new regional investment and population in a small number of settlements; and as airline operators are attracted to the greater revenue and profit prospects of a small number of key routes.

Table 8.1: Trade Off Matrix

		Aviation Environment Outcome	
		Volatile/Stagnant	**Stable/Growing**
Policy Decision	**Regulate**	***Outcome 1:*** Provide supplier certainty, maintain minimum service levels, meet basic community needs	**Outcome 2:** Provide supplier certainty; service to community below competitive services
	Deregulate	**Outcome 3:** Unpredictable, unsustainable competition, potential loss of service, community uncertainty	**Outcome 4:** Sustainable competition; enhanced service levels, maximum potential community satisfaction

Source: TFI/CAPA.

8.2 The Policy Options

There are a number of options open to the WA Government. A summary of the options is provided in **Figure 8.1** and they are discussed below.

(1) Open the currently regulated routes to full competition.

This option is not favoured because of the weak nature of the smaller routes and of their continuing inability to sustain viable services. For most of the smaller routes, competition is unlikely to deliver substantially higher growth in a sustained manner. As a result, competition on these routes would see new operators achieving relatively low load factors or introducing marginally priced aircraft (potentially when they are available after charter operations). Either way, this would undermine RPT services and is likely to see either airline failure or withdrawal of services in favour of more profitable routes.

Specifically the impact could be:

- Continued competition on Perth-Geraldton but a flow-on impact with potentially unstable connections between Carnarvon-Perth and Exmouth-Perth.
- Limited 'experimental' services could be expected to Monkey Mia and Kalbarri but these are unlikely to stimulate growth.
- Services could also be expected from Perth to Laverton, Leinster and Leonora but again schedules are likely to be 'experimental' implying instability.
- Services could be expected to continue at current levels for Albany-Perth unless destabilised by new entrants.
- Services between Esperance-Perth and Broome-Kununurra would continue, but with instability.
- Incentives by way of subsidy or sole operator status (licenses) would need to be provided for the provision of services for Broome-Halls Creek, and Perth to Meekatharra, Mount Magnet and Wiluna.

(2) Maintain the current regulations and accept the incumbent airline indefinitely (or until the next review).

This option obviously favours the incumbent operator and discourages alternative operators from developing their own services and growing fleets etc.

It is also possible that the limited returns available on the smaller routes may ultimately encourage Skywest to reduce services (or even withdraw) on smaller routes in favour of commercially more viable services.

(3) Maintain current regulations for a further two years and then open up to full competition.

This is a variant on option (2). At this stage, it is difficult to anticipate an overall improvement in market demand conditions or sufficient cost reductions to make the minor routes viable for the foreseeable future. The arguments advanced in (1) above, would remain.

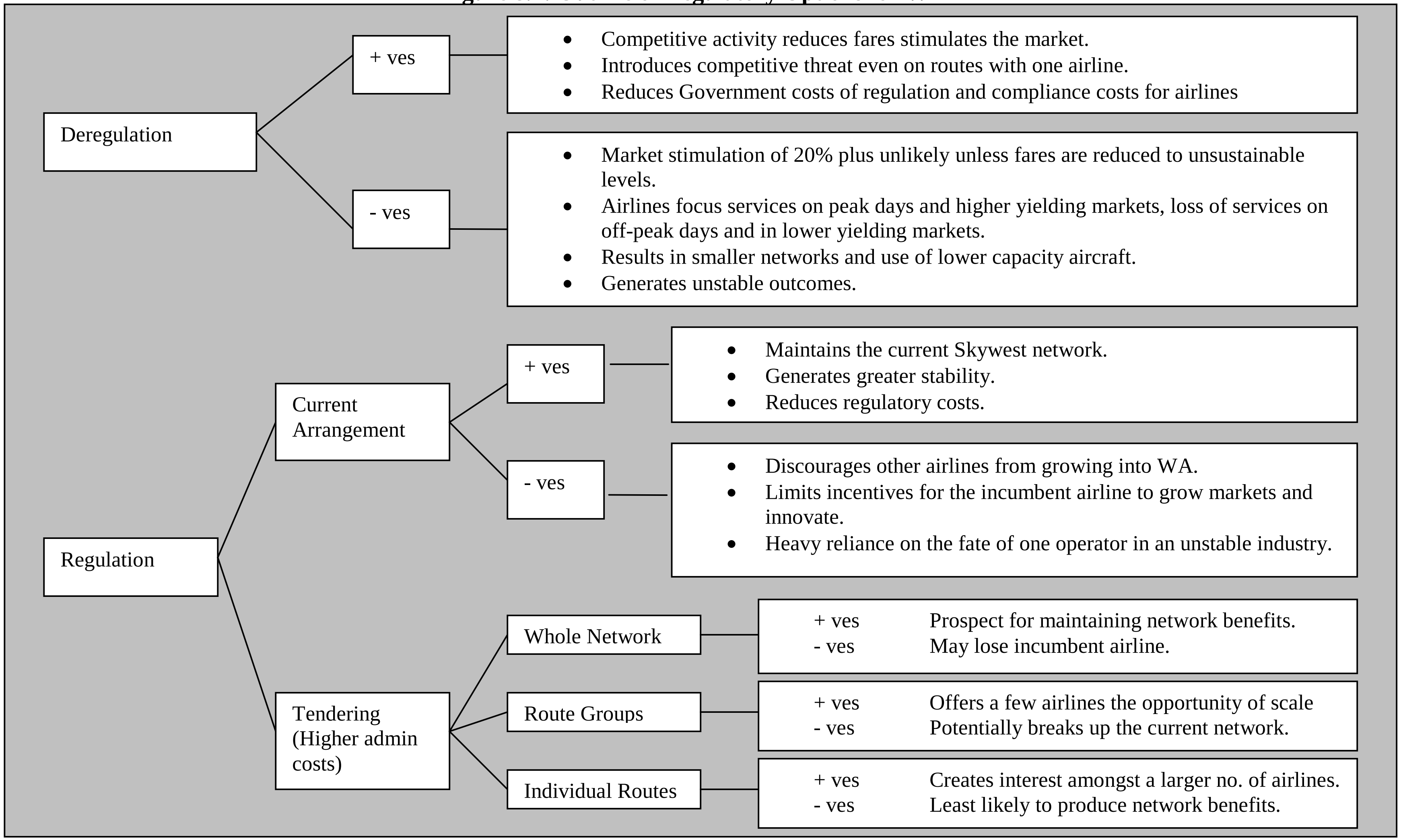
A further two-year period of grace would no doubt be favoured by Skywest, which would have the opportunity to strengthen its network and perhaps be able to promote growth through stronger marketing.

(4) Move to a tender process.

The introduction of periodic tendering for say, a five-year period, would impose some competitive discipline on the process. The period should be sufficiently long that the successful tenderer can develop appropriate services using the appropriate equipment, but not so long that they become complacent and adopt a cost-plus approach to airfares.

Counting against a tender process is the cost of conducting a tender and, perhaps more importantly, the cost of monitoring and if necessary, enforcement to ensure that tender conditions are met. This may include a pricing element or formula to cover increases in operations costs beyond the control of the operator and provision for re-tendering if fares rise above an industry "benchmark + x%"; or an incentive element if fares fall below an industry “CPI-y%”. Further incentive may include market growth objectives.

Figure 8.1: Outline of Regulatory Options for WA



Source: TFI/CAPA.

8.3 Routes or Networks

If the decision is made to proceed with tendering, the question that will need to be resolved is whether to tender *routes* or *groups of routes (networks).* This raises the question as to the types of networks we see operating in WA.

- Network Based on Aircraft Utilisation

  Skywest has developed a turboprop network with Perth as the hub. Services have been provided from Perth to Esperance and Albany in the South, to Geraldton and the Gascoyne region north of Perth and to Kalgoorlie, Leonora and Laverton in the Goldfields. This network has been based on Skywest operating five 46-seat F50 aircraft. Because of the large route lengths and the size of the aircraft, Skywest has joined some of the destinations on the same routes. This is particularly the case in the Gascoyne Region.

  Although in public discussions the issue of connections within regions is often raised (eg. Carnarvon to Exmouth) there is in fact little demand for air travel between such centres at the fare levels necessary for airline profits.

  Thus most of the traffic is between Perth and the destinations connected by Skywest. The benefit of this network therefore is largely that the aircraft can be allocated to the most profitable routes and then to the less profitable, or loss making, routes on a marginal cost basis to increase overall utilisation. All destinations on the route network benefit from this capacity allocation.

- Network Based on Connecting Thin Routes

  This is a specific case similar to that just described. In these cases routes such as Perth to Wiluna and Meekatharra are connected on the same service because one or both ports cannot justify a service in its own right.

- Network Based on Passenger Transfers

  This type of network is one in which passengers utilise the services of one airline to connect them to another for their final destination. Whilst there is little evidence of Skywest passengers transferring between flights across Skywest's own network, passengers do transfer between Skywest and the networks of other airlines such as Qantas. The ability to interconnect, to build and redeem frequent flyer points are all examples of this type of network. The use of code sharing and the ability to have interconnected networks displayed in computer reservations systems are all important element necessary for customer convenience and tourism development.

The network such as that operated by Skywest is of high value to the communities served in WA and allows Skywest to use a larger aircraft type than would be available if the network were broken up.

9. CONCLUSIONS

9.1 Principles

In commissioning this review DPI specifically required advice on the following:

- Should all regulated routes continue to be regulated after May 2005?
- Should all regulated routes be deregulated after May 2005?
- Should some of the regulated routes be deregulated after May 2005?
- Should all regulated routes be deregulated but at a date later than May 2005?

In approaching this task TFI/CAPA utilised a set of principles established to assist in trading off.

- Sustainability – the community generally appears to weight highly the consistency and apparent "certainty" associated with the provision of air services in a sustainable manner.
- The encouragement of competition and open markets where this is consistent with sustainable development.
- Where competition is not possible; the development of commercial outcomes to encourage efficiency, improved (or at least not reduced) service, and lower fares.

TFI/CAPA's main conclusions are as follows:

Industry Issues

- The regional industry generally has progressed towards a more stable and sustainable structure in the intervening period since the WA Government introduced its strategy for intrastate aviation early in 2003. However the sector across Australia is not highly profitable and remains subject to rapid and unpredictable movements in costs associated with changes in fuel prices, movements in the USA/Australian dollar and changes in airline and airport security measures that add to airline costs.
- For these reasons it is not likely that there will be a stable structure for second and third tier aviation in Australia. In other words TFI/CAPA expect to see ongoing changes in airlines participating in intrastate aviation across Australia. However the industry (and Skywest) is in a stronger position than when the original review was undertaken.
- The Skywest programme for commercial development, including a greater presence on jet routes with expansion underpinned by a stronger capital position, is a new ingredient that promises a long-term presence but potentially short-term instability. This is because its operating and commercial model will be increasingly driven by shareholder expectations and will focus on net profit generation. It also suggests a possible change in the nature of its current alliance relationship with Qantas, the medium-term implications of which are not immediately obvious.

- In WA, other carriers such as Skippers Aviation, Airnorth, Great Western Airlines and Maroomba Airlines would appear to have potential to participate on WA scheduled services. Skippers has taken the place of Skywest on smaller routes such as Perth-Laverton and Perth-Monkey Mia, while Airnorth's new franchising structure should ensure it plays a central role in industry consolidation around Australia. Maroomba Airlines and Great Western Airlines currently provide RPT services to Mt Magnet and Halls Creek respectively

Market Issues

- Passenger traffic on WA intrastate routes reviewed has not yet recovered to pre-Ansett collapse levels. Recovery has been slow in part because of the apparent transfer of passengers from air to road transport modes.
- It is unlikely that passenger numbers will grow dramatically in the medium term.

Therefore TFI/CAPA has assessed that:

- For most of the routes examined, the level of passenger traffic remains too low for sustainable competition.
- An open market without economic regulation would encourage new entry on a number of routes. However this competition would not be sustained and a shake-out would occur leaving the strongest (most efficient or cashed up) participant.
- Smaller communities would find that airlines provide services with the "spare aircraft time" after meeting needs of passengers on competitive routes. Ultimately service levels may fall on these routes.

Specifically addressing the Terms of Reference issues:

Should all regulated routes continue to be regulated after May 2005?

Yes – if Geraldton is excluded it may result in the need for subsidies for other routes. This does not exclude the possibility of limited competition on this route however.

Should all regulated routes be deregulated after May 2005?

No – for reasons suggested above.

Should some of the regulated routes be deregulated after May 2005?

No – for reasons suggested above.

Should all regulated routes be deregulated but at a date later than May 2005?

This issue depends on whether it is believed that route passenger levels will strengthen sufficiently to enable open competition. There is little at this stage to suggest that this will be the case. However there is little to stop the WA Government from tendering for say, three to five years, and then opening the market to competition or re-tendering.

A second reason for delaying the onset of tendering relates to the workload associated with establishing the tender process, giving time to potential tenders to prepare their documents, and allowing for transitional arrangements as incumbent operators give way to successful tenderers without service disruption.

9.2 Recommendations

1. Continue regulation on all currently regulated routes

Despite the prospects of better industry conditions, weak market conditions suggest that the government should continue to meet its community accessibility and service objectives through light-handed regulation of aviation services.

In concluding that there is a continuing role for regulation, it should be noted that the need is defined exclusively in terms of community service needs and not in terms of supporting marginal airline businesses.

Reference to the output of the consultative process appears to support this position. The overall view favours competition as the basis for reducing fares and increasing services, if this can be achieved. However, it does not favour deregulation where the impact would be to destabilise markets and reduce service levels.

On these grounds, the service level that policy should be aimed at, can be defined as maintaining at least current levels of service and current fare levels. Any reduction in services or increase in fares could be interpreted as a policy failure.

2. ***Based on the analysis undertaken by TFI/CAPA and the evaluation of the above options TFI/CAPA recommend that the WA Government move to a tendering approach for the regulated routes.***

3. ***Implementation issues associated with the tender arrangements will need to be evaluated in detail. However TFI/CAPA recommends that groups of routes are tendered so that airlines, and communities, can achieve the economic and other benefits associated with network provision.***

This raises the issue as to how routes or groups of routes would be defined for tendering. The tenderers could be encouraged to indicate the mix of routes or route groups they would need to service for economic viability.

TFI/CAPA believe that in the tendering process, the WA Government could encourage potential operators to indicate how they would propose to grow the routes tendered for, and the prospects of offering lower fares on these routes. There may be specific incentives that could be offered for achieving these outcomes or penalties for failure to do so.

The consultants have discussed this review and some of the potential outcomes with the National Competition Council (NCC). These discussions suggest that the NCC would look favourably upon a tendering option that encouraged tenderers to seek efficient outcomes and which provided incentives to lower fares and grow markets.

It needs to be recognised however that a tendering process would be complex. It would need to be based on a clear understanding of the levels of service that will be sought for each community. Reference to the output of the consultative process supports the position that the service level be defined as maintaining at least current levels of service and current fare levels.

Further, the tendering process may involve extensive negotiations with tenderers who indicate a need to serve groups of routes. Finally, it also requires monitoring to ensure that contracted service agreements are being met.

This raises the issue that if tendering is to be undertaken, it must be adequately resourced. Discussions with the Queensland Department of Transport indicate that there was a substantial resource commitment required to successfully complete their tender process.