

# Review and Assessment of the Effectiveness of Air Services in Western Australia

## Overview Report

For Department for Planning and Infrastructure

November 2002

---

**T** TOURISM FUTURES  
INTERNATIONAL

Centre for  
Asia Pacific Aviation 

---

---

---

# Contents

## Review and Assessment of the Effectiveness of Air Services in Western Australia

### Overview Report

	Page No.
1. <b>The Setting: The Challenges Facing Regional Aviation</b>	<b>1</b>
2. <b>Study Purpose: Informing Regional Aviation Policy</b>	<b>1</b>
3. <b>Overview: The Australian Regional Airline System in Transition</b>	<b>4</b>
4. <b>Regional Aviation Economics</b>	<b>5</b>
5. <b>The Sustainability of Regional Aviation - Experience Elsewhere</b>	<b>8</b>
6. <b>The Issues Behind An Aviation Policy Framework</b>	<b>11</b>
7. <b>Repositioning Air Services Policy</b>	<b>13</b>
8. <b>Determining Policy Needs</b>	<b>15</b>
9. <b>Policy Proposals</b>	<b>26</b>
10. <b>Specific Recommendations</b>	<b>31</b>

---

---

---

## **DISCLAIMER**

The information in this report is presented in good faith using the best information available to us at the time of preparation on the basis that neither Tourism Futures International nor the Centre for Asia Pacific Aviation, or their employees, agents or associates, are liable to any person or organisation for any damage or loss which may occur in relation to that person or organisation taking or not taking action (as the case may be) in respect of any statement, information or advice conveyed in this report.

# 1 The Setting: The Challenges Facing Regional Aviation

Aviation worldwide is experiencing volatility. This is obvious in depressed travel figures and distressed airlines. But, while the headlines focus on declining national tourism arrivals and the tribulations of the world's largest airlines, the consequences are equally significant for those small communities which have, over the past two decades, become highly dependent on their air links with larger centres. This dependency by communities on regional air services is mirrored by the dependency of the regional airlines on their larger interstate parents.

The loss of Ansett Airlines (Ansett) underlines the importance to airlines of pursuing profitability by focusing on routes where patronage and fare levels support good yields, and by avoiding loss-making routes.

Consequently, here, as elsewhere in the world, restructuring and uncertainty in aviation are hitting regional services hard, with operators failing and services disappearing altogether, severely compromised, or increasingly dependent on government subsidy.

The challenge to airlines is heightened as demand becomes increasingly differentiated. Different markets have different service requirements. For example, business and government travel requires regular departure and arrival schedules reflecting the rhythms of the business day and business week. Sectors like mining have distinctive periodic requirements reflecting their working conditions. Leisure travel is both seasonal in nature and more price sensitive. Personal business travel, necessary to maintain the viability of remote communities, may be less distinctive in its timing needs, but more sensitive to price.

## 2 Study Purpose: Informing Regional Aviation Policy

### 2.1 Purpose

Against this setting of volatility and uncertainty, the Aviation Ministerial Council (AMC) of the Government of Western Australia (WA) is reviewing intrastate air services policy. The AMC comprises:

- The Premier
- Minister for Planning and Infrastructure
- Minister for Tourism; State Development; Small Business
- Minister for Local Government and Regional Development; Housing & Works; and The Kimberley, Pilbara, and Gascoyne.

The Department for Planning and Infrastructure (DPI) commissioned this study of the economics of regional aviation to assist the deliberations of the AMC. It engaged a team of independent consultants, comprising Tourism Futures International and the Centre for Asia Pacific Aviation ("the Project Team"), to investigate the economics of current and potential future regional air services.

The specific aim of the study was:

*To recommend to the AMC which ports/intrastate routes can withstand competition and to provide an assessment of the impacts of airport charges within WA.*

The resulting recommendations about individual routes or aviation policy as a whole cannot be made without reference to underlying objectives. The broad objective contained in the terms of reference is 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.*

This study suggests that this can 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 as the preferred form of delivery is 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 Approach**

The investigation has been undertaken by a combination of consultation and technical analysis to provide a framework within which informed policy decisions can be made. Overseas and intrastate experience was also considered.

The study was conducted in two stages. The first focused on non-jet routes in the south of the State. It was programmed to assist the AMC to reach recommendations with respect to applications for new airlines to enter the traditional Skywest, non-jet network. WA maintains a system of State Aircraft Licensing, and via this, maintains access control to the operations of air service providers. While this has not been exercised since deregulation, the Government is prepared to consider its use in the interests of State economic and social development in the “post-Ansett environment”.

The second stage extended to jet routes and non-jet routes in the north of the State, and considered statewide aviation policy issues. In reaching conclusions on these and related matters, the consultants were to consider:

- ➔ Potential passenger numbers, tourism potential, airfreight, unmet demand and other relevant factors.
- ➔ The level of service reasonably supported by existing activity and the extent to which cross-subsidy within a network will be required to contribute to commercial viability.

- The relationship between airfares and passenger numbers.
- Airport charges relative to air service viability.

As part of this consideration, the leader of the consultant team, an officer of DPI, relevant Regional Development Commission officers and in some cases representatives of the WA Tourism Commission and Department for Local Government and Regional Development conducted meetings with regional stakeholders. Meetings were held in:

- Leonora (representatives of the Shire of Laverton also attended this meeting).
- Kalgoorlie.
- Esperance (a representative of the Shire of Ravensthorpe also attended this meeting).
- Albany (included representatives of the Shire of Denmark).
- Geraldton (included representatives from the City of Geraldton, and the shires of Greenough, Meekatharra and Mount Magnet).
- Kalbarri.
- Karratha (representatives of Paraburdoo/Tom Price attended via videoconference).
- Port Hedland (representatives of Newman and Hammersley Iron attended via videoconference).
- Derby.
- Broome.
- Kununurra (representatives attended from Wyndham and Halls Creek was connected via videoconference).
- Darwin (meetings with the Northern Territory Department of Transport and AirNorth).

Visits in Perth and/or telephone conversations were held with the following organisations:

- WA Local Government Association.
- WA Chamber of Minerals and Energy.
- Tourism Council of WA.
- WA Farmers Federation.
- Australian Airports Association.
- The Regional Aviation Association of Australia.
- Airlines visited included Skywest Airlines (Skywest), Skippers Aviation (Skippers), Great Western Aviation (GWA), Maroomba Airlines, National Jet Systems (NJS), Qantas Airways (Qantas), Virgin Blue, AirNorth and Northwest Regional Airlines (NWRA). Representatives of Golden Eagle Airlines, Wyndham Aviation, Alligator Airways and Slingair attended meetings in the regions. The General Manager of Ngaanyatjarra Air was contacted by telephone.

### **3 Overview: The Australian Regional Airline System in Transition**

Most states have deregulated all or a large part of their regional intra-state air services systems in recent years. The dramatic commercial changes hitting airlines since 2000 began well before the demise of Ansett. Today, Qantas is the dominant regional operator in Australia. The commencement of Regional Express (Rex) in regional New South Wales (NSW) and Alliance Airlines in Queensland will be watched with interest.

The Federal Government has shown little enthusiasm for ongoing involvement in intra-state regional operations beyond the financial support to Hazelton and Kendell after their collapse, the waiving of en route charges for most regional airlines (Skywest excepted) and provision of the Remote Air Service Subsidy (RASS) Scheme for the basic service to remote communities. The result of limited Federal Government involvement is a gap in the regulatory framework which, if filled, might provide greater certainty for states, consumers and airlines alike. In the meantime, each state government is obliged to review its own strategy, if only to accept that new regional airline services are unlikely to develop, unless a Qantas-dominated regime is accepted.

Reluctance to re-regulate is consistent with international sentiment, despite increased volatility and signs that the market is failing to meet customer expectations. Unless faced with imminent collapse of a major airline, most governments have been slow to respond to the new conditions in the aviation market.

Competition authorities are seeking to come to grips with the new situation. Their focus is on consumer protection. Linking this with the long-term viability of services generally falls outside their thinking. Yet, in an industry heavily influenced by global investment, marketing and operations, defining the level at which competition needs to be sustained and how to do so are major issues. Certainly, previously experienced levels of competition, with excess capacity leading to artificially low prices, can no longer be maintained, despite consumer expectations.

The consequences of reduced services or the withdrawal of services can be economically and socially extreme. They also prejudice tourism expectations on which many regional communities place great weight. As a result, while governments prefer to avoid difficult and unfashionable intervention, one consequence will be the need for tourism goals to be re-evaluated. Alternatively, aviation policy may have to change to provide support for tourism growth.

Even where a need is acknowledged, it is not easy to renew intervention. The more opaque forms of support typically applied in the past are no longer acceptable. Subsidy must today be transparent and is, therefore, more likely to be politically contested. Consequently, innovative approaches are being taken to government support for regional airlines, especially in North America.

*The route analyses suggest that an approach which leaves the provision of regional air transport to competitive investment in response to revealed or even potential demand is unlikely to achieve the objective of sustainable commercial services. Worse, such an approach could undermine the provision of services on some sectors that currently enjoy them. Another possible outcome is monopoly service provision on those routes that can justify services, where the operator concerned focuses on building the profitability of the operation rather than on responding to needs and expectations articulated by the community.*

## 4 Regional Aviation Economics<sup>1</sup>

### 4.1 Principles of Airline Operations

Several principles are important to evaluating the operation and economics of air services.

**First**, airlines are not highly profitable. They are cyclical and a few years of profit can be quickly wiped out by a major market slowdown. A large proportion of their costs are fixed. During periods of slow growth, or market decline, the aviation sector is particularly fragile. The ratio of net profit to revenue for Qantas has ranged between 3% and 6% over the past five years. This represents an average of 4.4 cents for every dollar of revenue.

**Second**, Regular Passenger Transport (RPT) airlines typically operate networks of routes. Not all routes are profitable on a fully costed basis. However, once profitable routes have been served, spare capacity can be allocated to marginal routes that at least cover the direct costs of operations. Such “cross-subsidy” is commercially sensible if it increases aircraft productivity, but it should not be confused with community service obligations. The operator achieves higher aircraft utilisation while passengers on marginal routes receive services that would not otherwise be available. An important implication is that if margins are cut on the profitable routes, due to competitive pressure for example, the operator’s ability to cross subsidise declines. Preserving strong routes, then, is one way to sustain operations on marginal routes.

In the case of the Skywest network this study suggests cross subsidies flow from routes such as Perth-Geraldton and Perth-Albany to routes such as Perth-Monkey Mia and, at certain times of the year, Perth-Learmonth and Perth-Esperance. It is important to point out that were these cross subsidies not to occur then the subsidised services may not be provided thus reducing aircraft utilisation and increasing *overall* costs of provision.

**Third**, RPT airlines often have strong links with other operators through which they generate reciprocal passenger feed and increase aircraft loads. When there is competition on a route, the airline with the best networks of partner airlines and listings in domestic and international reservations systems will have an advantage. These inter-line relationships are also important for tourism marketing, because they facilitate the matching of arrivals from a wide array of origins with a variety of destinations.

<sup>1</sup> Section 4.2 of the Technical Report.

**Fourth**, there are important differences between RPT and charter services. Charter operators may provide RPT services when their aircraft are only partly committed to the guaranteed income associated with charter contracts. Such aircraft can often be used for RPT services with the need to cover little more than direct operating costs. As a result, the viability of RPT operators can be threatened by competition from services provided by charter operators who operate marginally costed RPT services. Conversely the charter operators could represent an opportunity to provide cheaper air services to communities.

**Fifth**, RPT airlines in general modify services to cater for different market segments. Business users, for example, favour flexibility, frequency and direct links between origin and destination and are prepared to pay a “premium” to receive these service attributes. Leisure travellers are more influenced by fare levels.

**Sixth**, aviation is subject to economies of scale, especially where RPT flights are concerned. The tendency towards larger, faster jet aircraft serving busy routes has reinforced that over the past thirty years. Large aircraft can carry more people per unit of fuel burned, per crew member, and relative even to the higher capital costs. The logistics of booking and meeting the needs of large numbers of people over a period of time are improved if there is a significant number of aircraft flying a large number of seats over a busy route.

For this reason, flights even on long distance international leisure routes and trunk domestic routes are inevitably lower in cost to the individual passenger than flights in small aircraft over relatively short regional routes where there are tens or perhaps hundreds of passengers a day, rather than hundreds of passengers a flight and thousands a day. Consequently, the costs per passenger kilometre are higher for regional services than they are for most domestic trunk and international services. This may mean that it is more expensive to fly within WA on smaller aircraft than to fly interstate or overseas to a destination such as Bali.

The advantages of economies of scale do not stop there. Despite the massive capital investment of capital city and international airports, they handle hundreds of aircraft and thousand of passengers a day, especially when they are hubs being fed by a number of smaller spokes, or handling transit traffic between other major cities. As a result, the costs per head of air traffic control, ground handling services, security and runway maintenance are invariably lower than on a small airport with a limited runway and facilities.

As more and more people travel on the main trunk and leisure routes, airlines are finding ways (through the so-called "low cost airline model") to further reduce costs, which are not available to services to remote regional locations. Similarly, hotels in major resort regions may marginally price their surplus capacity at certain times of the year, so lifting their occupancy rates while providing very cheap holiday packages in conjunction with low airfares.

This is further illustrated by comparing the costs for different aircraft on a single route such as Perth-Karratha. The average cost of operating a return Perth/Karratha with a B737-400 is estimated at \$44,000. This is compared to around \$18,000 for a Dash 8 – 100. The B737-400 aircraft operates with 139 seats compared to 36 for the Dash 8-100.

This represents a cost of \$317 per seat for the B737-400 aircraft and \$500 for the Dash 8-100. Assuming 65% of the seats are sold the cost per passenger becomes \$487 per passenger on the B737 aircraft and \$769 on the Dash 8. The cost per passenger is 58% higher on the smaller aircraft. On a busy route load factors on the larger aircraft can be higher on average providing an additional advantage over the operation of a smaller aircraft over a thin route.

## **4.2 The Challenge of Community Expectations**

An extensive programme of consultation was undertaken as part of this study (as per Terms of Reference 1.3.2). Community expectations have to be considered alongside the economics of supplying aviation services. Some people consulted, for example, want high frequency, business-oriented services and larger aircraft types. But for routes with limited demand, service choice is limited. Unfortunately, the smaller aircraft justified under these circumstances incur higher costs per seat/kilometre. As a result, a community faced with a perceived reduction in service through use of smaller aircraft may find that airfares actually rise rather than fall.

While views varied according to location and circumstance, certain recurring themes emerged from the consultation, highlighting the gap between expectations and reality. Participants generally favour the principles of deregulation and competition, but with the caveat that competition should not be allowed to threaten existing services or undermine the sustainability of aviation. Indeed, sustainability was seen as the most important objective in most communities. At the same time, service expectations favour: larger over smaller aircraft types, greater rather than lesser frequency, direct rather than indirect routes, and early morning departures and early evening returns on the same day. Current airfares are considered expensive, with too few discounted seats available, and there is a general concern that airlines do not appear to be marketing tourism.

The tourism sector is concerned about the prospect of a non-competitive aviation environment, with some members seeing competition as the source of the discount fares necessary to encourage price-sensitive leisure visitors. Unfortunately, if competition leads to smaller aircraft through market splitting, the availability of discount fares is likely to fall.

In any case, the view was widely expressed that small reductions in what are seen as expensive airfares would not produce significant changes in patronage; rather fare cuts of 50%+ would be required to increase leisure travel substantially.

## **4.3 Relating Community Expectations to Aviation Economics**

Ideally, the demands of discretionary, leisure or more price sensitive travellers can be met economically by capacity provided on services designed primarily to meet the less price sensitive demand of business travellers. Airlines use yield management systems to capitalise on these differences, allocating capacity across segments and fare classes, and trading-off the better economics of larger aircraft against the additional frequency of smaller aircraft. A mix of aircraft types is ideal for matching numbers with demand.

However where demand is limited, as in regional aviation, the efficiencies available from using aircraft of the same type outweigh the benefits of a mixed fleet and thereby reduce service options.

In addition, business travel is becoming increasingly price sensitive. Greater discretion is being exercised by corporations reducing travel budgets, combining trip functions, moving towards more use of telecommunications, and instructing employees to purchase low fares or shop around for the best deals.

While tourism destinations may support regular passenger services that can also be utilised by business and local resident travellers, the seasonality of tourism demand makes it difficult for airlines to operate full schedules year-round to resort destinations. This means that service levels and average fares will vary from time-to-time. Ideally, in the case of a place like Broome, minimising variability would provide some certainty and increase its attractiveness as a regional service centre and a second order hub (compared to Perth) within the north of the state.

*The issue overall, then, may be not what service configuration an airline might provide, but the trade-offs that business and the community is prepared to make to achieve a reasonable level of service, especially on low-density routes. In some instances, only indirect services, once-a-day service, or small aircraft may be sustainable. Where such services fail to meet even basic community needs, there may be a case for policy intervention.*

## **5 The Sustainability of Regional Aviation: Experience Elsewhere<sup>2</sup>**

### **5.1 United States**

A recent US study shows that over 75% of airports with 10,000 to 20,000 departures have only one main airline. Among routes with up to 50,000 departures, the proportion with just one airline increased over the year ending October 2001. Among all communities with populations of 100,000 or less, the median service is based on one airline only.

This limited level of service occurs despite the fact that routes are not regulated or licensed and despite far more favourable market and operating conditions than prevail in WA. The USA is characterised by large numbers of regional and mainline carriers, high aircraft availability, low fuel costs, lower landing fees, no en route charges, multiple airport options and many large population centres. Consequently, regional airlines are often large with substantial financial resources. Carriers operate over a number of route networks and have commercial alliances with mainline carriers, on which their survival is heavily dependant.

Individual states fund and upgrade airstrips using Federal resources sourced from an aviation fuel excise, resulting in minimal landing charges. Municipalities are prohibited from generating funds from airports to be spent off site.

---

<sup>2</sup> Section 7 of the Technical Report.

Yet, there is still a need for community support to some services. The Essential Air Services (EAS) and the Small Community Air Service Programme (SCASP) provide safety nets in the event of market failure on routes where proximity to alternative services is poor. Up to 40 communities can participate in the SCASP program, although no more than four from any one state.

The Federal Department of Transport and Regional Services (DOTARS) prioritises communities on the basis of higher than average fares, meeting some costs from local, non-airport revenue sources, establishment of a public-private partnership to facilitate service, and the potential for material benefits to a broad segment of the public.

## **5.2 Canada**

A diversified revenue stream is considered essential for successful regional airline operations, including a mix of charter, RPT, tourist charters, ad hoc charters and operations outside their usual geographic boundaries. Routes are not licensed and operators with a domestic license may operate anywhere within Canada, with no distinction between charter and RPT services. The logic is that the destination is the focus, rather than the air services. Fares are accountable to the Canadian Transportation Agency via benchmarking across routes. Where competition is limited, detailed monitoring and complaints resolution processes are required.

## **5.3 United Kingdom**

Recent concerns about air services to remote areas have resulted in reviews of access by the UK Department of Transport with the preference being to allow the market to operate. However, the government may meet public service obligations if a community can prove a need to ensure, for example, the provision of medical services.

## **5.4 Australia**

### **New South Wales**

The Air Transport Council licenses intra-state passenger transport and regulates the number of operators on specific routes. In 2001, the NSW Government removed access controls on routes with more than 50,000 annual passengers within a policy framework of 'managed competition'. Unfortunately, this coincided with the interstate fare wars, with Ansett, Virgin Blue, and Impulse competing against Qantas, the effect of which was to suck discretionary spending away from regional operations as people drove to Sydney to take advantage of low priced interstate services.

This and the new level of competition on intra-state routes exacerbated the plight of Hazelton, while Kendell suffered as management sought to introduce new regional jet aircraft to its fleet. Qantas partially filled the vacuum left by the demise of Kendell and Hazelton on the main regional routes. Virgin Blue recently entered the Sydney-Coffs Harbour market. The newly launched Rex has commenced operations based on the former Kendell and Hazelton services.

The sector remains volatile though, and the NSW Government has recently reviewed the regulations governing intra-state air services. The Government announced on 29 October 2002 that it would implement a package of measures to boost the intrastate airline industry:

- ➔ Rural and regional air routes with an annual capacity of less than 50,000 passengers will now be protected from competition. This move adds a further six centres to a list of 31 rural and regional centres that the government already protects.
- ➔ Licence fees will also be abolished for these routes, saving operators a combined total of around \$33,000 per year.
- ➔ The current three-year licence term for all regional operators in NSW will be increased to five years.

The NSW Government in May 2002 also waived stamp duty worth \$200,000 and offered staff relocation support to help Regional Express<sup>3</sup> (Rex) to purchase Hazelton and Kendell Airlines.

### Queensland

Aviation services were deregulated in 1987, with the exception of ten routes. The policy is to deregulate unless services cannot be operated profitably by commercial airlines. Queensland permits three levels of airline entry:

1. Deregulated routes, with no entry or pricing controls.
2. Entry-limited routes, where airlines bid for exclusive rights on certain routes.
3. Subsidised routes, where airlines are granted exclusive rights and a subsidy contribution based on a closed tender process. These are for essential services to retain business and community links. They are typically served by a "milk-run" using smaller aircraft which do not promote tourism growth.

Queensland has larger regional centres than WA, and more developed tourism. Despite this, the major Queensland based regional operator, Flight West, was already in serious financial difficulty before the collapse of Ansett. Today, Qantas is a near-monopoly operator on regional routes, although Virgin Blue operates in competition on Brisbane-Mackay, Brisbane-Cairns and Brisbane-Townsville routes.

### South Australia

There are no state restrictions on the establishment of airlines or on route entry. However, the SA Government has from time to time subsidised stations and townships for mail delivery. Since September 2001 it has reconsidered its position. In May 2002 Transport South Australia stated:

“If services are lost on any particular route we cannot assume, as we have in the past, that market forces will induce another operator to take up the route. Some routes in SA, although profitable, are probably only marginally so.

<sup>3</sup> Registered as Australiawide Airlines.

“If an airline operating a marginally profitable route withdraws for any reason, the resulting market disruption and start-up costs involved in acquiring aircraft to serve the route may be enough to deter other operators from implementing replacement services. This may leave some regional communities without air services for some time.”

*Air Transport (Route Licensing-Passenger Services)  
Bill 2002 Discussion Paper Transport South Australia (May 10 2002)*

While the SA Government does not intend to subsidise non-viable routes, it is prepared to license regional RPT services, and consider exclusive rights, where it is demonstrably in the public interest to do so.

## **6 The Issues Behind an Aviation Policy Framework**

The small size of communities and limited demand for air services in regional WA and persistent financial and structural volatility in aviation mean that the needs of individual communities cannot be addressed on an ad hoc basis. A consistent policy framework needs to be developed which recognises these realities. Four core policy decisions are needed to shape that framework and are discussed below.

### **6.1 What Service Levels?**

Service levels may be defined in terms of physical access to RPT services (e.g. communities over a given size should be within two hours drive of an RPT airport) and frequency. They may also be described with respect to the directness or otherwise of a route and, for many travellers, may reflect preferences for particular aircraft types (e.g. jet versus non-jet). Current services are better than “basic” on most routes, despite being lower than the level that some interests seek. Perhaps the easiest “bottom line” is to aim to at least retain current service levels, despite them falling below individuals’ or groups’ expectations in some instances.

### **6.2 What Relation to Other Policy Areas?**

Air transport is a derived demand, which exists only to serve the needs of other sectors. The question is how far the government might choose to subsidise a sector, such as tourism, through expenditure on aviation. If aviation policy is shaped by the objectives of other portfolios (e.g. tourism, minerals, health, community welfare), transparency is served by sharing costs accordingly. The aviation needs of various sectors can generally be defined in terms of accessibility: the configuration of services (where to and from?) and their frequency. In practice, there are trade-offs to be made.

Any inclination to increase air service subsidies to different communities and sectors needs to be reconciled also with macro-economic policy which may, for example, seek to minimise cross-sector subsidy or intervention in the interests of economic efficiency.

### 6.3 What Level of Intervention?

Currently, the State Government has some regulatory powers over entry of new RPT services – which it has avoided using in the recent past – and undertakes a degree of selective subsidy on routes that justify it for community service reasons. This recognises market failure where the expectations exceed the capacity of private enterprise to deliver “basic” services.

The failure of Ansett, the difficulties faced by Skywest in establishing a viable long-term RPT service, and the demonstrably marginal nature of some services illustrated in this report indicates that the capacity of the market to meet current service expectations has deteriorated. In the face of the Ansett failure and the overall deterioration in aviation economics, the State Government and community are faced with the prospect of deteriorating service standards, or moving to a more actively interventionist stance.

This may be achieved through extending the routes to which subsidies are applied, or by exercising more stringent entry requirements in an attempt to restore and sustain the commercial viability of existing or new private services.

### 6.4 Transitional Arrangements

While a policy framework is important for the consistency and transparency it brings to individual decisions, there is a risk that it becomes fixed and, in the face of a volatile sector and uncertain market, leads to inappropriate and unexpected outcomes. The key to maintaining flexibility without undue reduction in predictability lies in establishing a benchmark policy position and building from that an open review process, based on a combination of sector performance monitoring and consultation.

Ideally, a benchmark will identify the balance of intervention (policy input) against the balance of service levels attained (policy output), and objectives achieved (policy outcomes e.g. measures of tourism growth or community health). The current position involves minimal intervention with service levels regulated primarily by maintaining competitive conditions (as judged by the ACCC).

### 6.5 Policy Cross-Over

Any increase in intervention needs to recognise the different service expectations of four distinctive stakeholder groups:

- Community needs relate to the needs of individuals, households and non-commercial agencies, including government agencies. Individual and household needs relate to leisure travel, personal business and health needs;
- General business needs are less discretionary and relate to the commercial activities and the associated infrastructure which sustain communities;
- Demand for air travel from the mining sector helps underpin RPT services directly and indirectly – and may be capable of providing even greater support in some areas;
- Tourism currently generates little demand for intra-state air services, but there is an expectation that aviation services should be designed to support the sector.

The prospect of subsidising services to support tourism raises several questions, the answers of which are likely to be destination-specific:

1. Does the on-ground infrastructure exist to support the potential influx of multi-night leisure visitors in the relevant destinations?
2. Is the quality of facilities aligned with the expectations of leisure visitors who travel by air?
3. Is subsidising air transport the best means of supporting tourism development?
4. Is subsidising tourism the most appropriate means of supporting the community concerned?

*The need for sustainable air services suggests maximising services built on existing demand and developing significant flows between the main secondary airports and Perth, may be the most appropriate response to the argument for aviation to support tourism. Once a critical mass of services to a destination is achieved, the challenge is for the community to capitalise on it by developing local tourism opportunities.*

## 7 Repositioning Air Services Policy

Faced with deteriorating service conditions the government is contemplating increased intervention. By deferring decisions on the applications by charter operators, Skippers Aviation and Great Western Aviation, to provide RPT services (as a result of information generated by the first stage of this study), it has increased control of entry conditions to secure policy objectives. This policy shift can be located within a framework that compares levels of government intervention with service expectations and service levels achieved (**Figure 7.1**). The different policy positions within this framework are described below.

Note that the arrow in **Figure 7.1** shows a move from right to left, indicating higher levels of intervention, and points in an upwards direction, indicating a higher level of service. This higher service level results from the Project Team's assessment that for many turboprop routes, a 'hands off' and less interventionist approach that relies on competitive outcomes is likely to result in a *reduction* of current service levels or in the loss of service altogether.

1. *Non-Intervention* would involve approval of all route applications, subject only to safety requirements, and regulation only in the interests of maintaining freedom of entry by new operators. Mining contracts would operate outside the intra-state RPT aviation policy. Under today's conditions, this scenario could contribute further to instability, collapse of some smaller operators (and possible entry by other small operators), possible withdrawal by larger operator(s) and a profile of fragmented, uncertain, low level service.

2. *Active support* would be based on State Government measures to support existing services, without discouraging the entry of new operators. These might involve granting exclusive route rights (and possibly access to subsidies on designated routes) through competitive bidding processes, favoured purchasing agreements by government bodies, and entry conditions to limit predatory behaviour, for example.

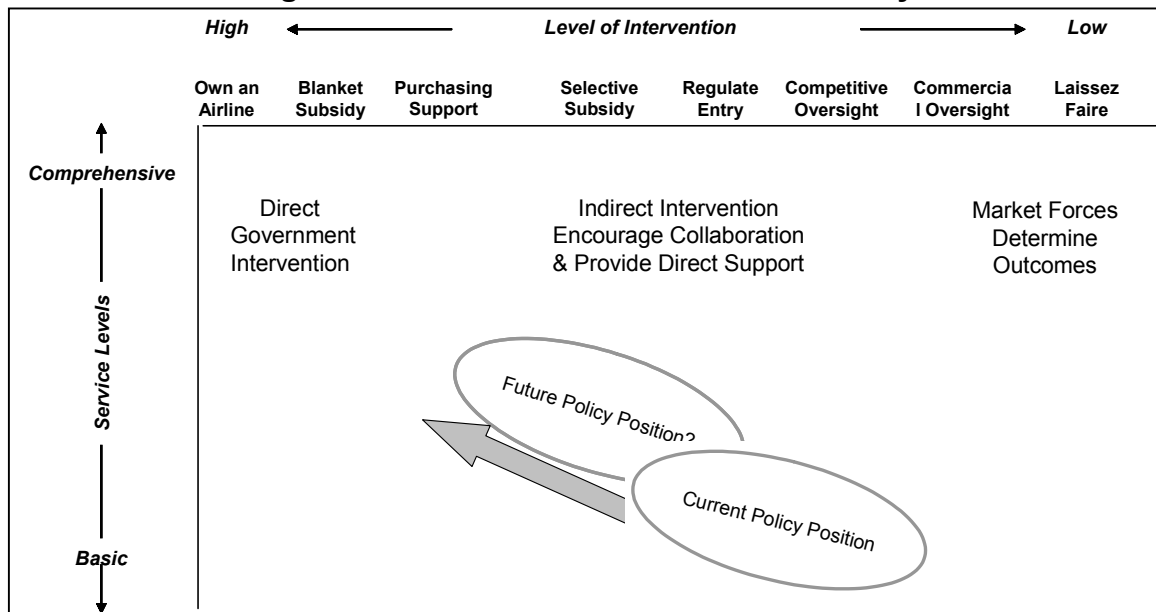
This position would promote the primacy of commercial considerations first and foremost, but might offer support to commercial operators where they are required to meet community ends. Today, such a position entails a high degree of transparency in the interests of both equity and in the pursuit of efficiencies which cannot be delivered by competitive forces.

3. *Encourage Collaboration.* The most obvious area in which government might act as facilitator is at the interface of mining industry charters and RPT services, where it could also exert leverage through any of the other interests available to it, including entry-licensing provisions and purchasing contracts for government travel. Collaboration may also be encouraged to achieve integration (interlining) among local, regional and perhaps state-wide (jet route) operators.

Active support and encouragement of collaboration imply a central positioning, with actions and initiatives in response to community pressure to move towards the top of the policy service matrix (comprehensive services) against pressure from aircraft economics to move towards the bottom (basic services).

4. *Direct intervention* in today’s environment is a policy position of the last resort. The most extreme form is public sector ownership of an airline. Less extreme and potentially more acceptable may be the expansion of subsidies, provided specific goals can be identified and appropriate transparency procedures are put in place.

**Figure 7.1: A Framework for Aviation Policy**



Source: TFI/CAPA.

*The present study suggests that the WA Government may need to move its policy programme slightly and more explicitly towards the higher intervention (left-hand) end of the spectrum if it is to avoid a significant lowering of service standards. More active purchasing support, a transparent selective subsidy programme, and more explicit expectations written into licensing conditions would contribute to such an adjustment.*

*Beyond that, the State Government might encourage more active collaboration between airlines operating at different levels and in different regions.*

*It may also seek to effect increased collaboration across the RPT and mining sector. The essence of any such agreements will be the pursuit of minimum service levels for the community, the promise of some security of service, and transparency. The latter would be particularly important if cooperation across the network is not to be perceived as anti-competitive.*

## **8 Determining Policy Needs**

### **8.1 Operating Conditions<sup>4</sup>**

Three features stand out when reviewing the structure of air services in WA.

#### *1. Long average route lengths.*

All except one of the WA routes under consideration in this study are substantially above 300 kilometres. By way of contrast, in a study of Regional Aviation Competitiveness across Australia, the Bureau of Transport Economics (BTE)<sup>5</sup> found that in 1997 “over half of the 481 regional flight stages offered were less than 300 km, more than a third were less than 200 km, and 14 per cent were less than 100 km. The average length of a flight stage was 405 km. This figure does not reflect the majority of stages, being held artificially high by a small number of very long legs. The median route length, which lessens the impact of the skewed data, was 295 km”.

#### *2. The decline in routes served exclusively by domestic jet airlines<sup>6</sup> over the past decade.*

In 2000/01 domestic airlines provided jet services to nine airports in WA (including Perth), compared with 12 airports ten years earlier. The jet services accounted for 77% of passengers in 2000/01 down from 84% in 1990/91. It is unusual now to find jet services to airports in Australia with fewer than 200,000 passenger movements annually.

#### *3. The number of intrastate routes with limited passenger numbers.*

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

Based on airport data from DOTARS for 2000/01 there were 686,451 passengers carried by jet airline services<sup>7</sup> on intrastate routes within WA.

<sup>4</sup> Section 2 of the Technical Report

<sup>5</sup> Bureau of Transport Economics, *Regional Aviation Competitiveness* Working Paper 41 2000.

<sup>6</sup> DOTARS distinguishes between airlines with larger capacity (largely jet) aircraft, domestic airlines with lower capacity aircraft and regional airlines.

<sup>7</sup> Aggregate of passengers carried in both directions on a route.

Kalgoorlie/Perth, Karratha/Perth and Broome/Perth accounted for 24%, 23% and 21% of the passengers respectively. Port Hedland for 11% and between them these four routes accounted for 80% of all passengers carried by jet services on intrastate routes.

Again based on DOTARS data for 2000/01 the number of passengers carried on turboprop or piston aircraft amounted to 279,751 passengers. The top nine routes all include Perth and accounted for 64% of all passengers. The major routes were Perth to/from Geraldton (62,043 passengers 22% of the total), Albany (43,546 passengers or 16%), Leinster (35,667 passengers, 13%) and Esperance (34,797 passengers, 12%).

The next four routes - Carnarvon, Mount Keith, Kalgoorlie and Learmonth – each accounted for 15,000 to 18,000 passengers in the year 2000/01. Thereafter the size of the routes drops dramatically.

Furthermore, a substantial fall in passenger numbers followed the collapse of Ansett. For example, comparing the first four months of 2001 and 2002:

- Albany -28%
- Carnarvon -24%
- Esperance - 22%
- Geraldton -24%
- Learmonth – 20%
- Broome -24%

## 8.2 Market Conditions<sup>8</sup>

Three features stand out when considering the nature of demand.

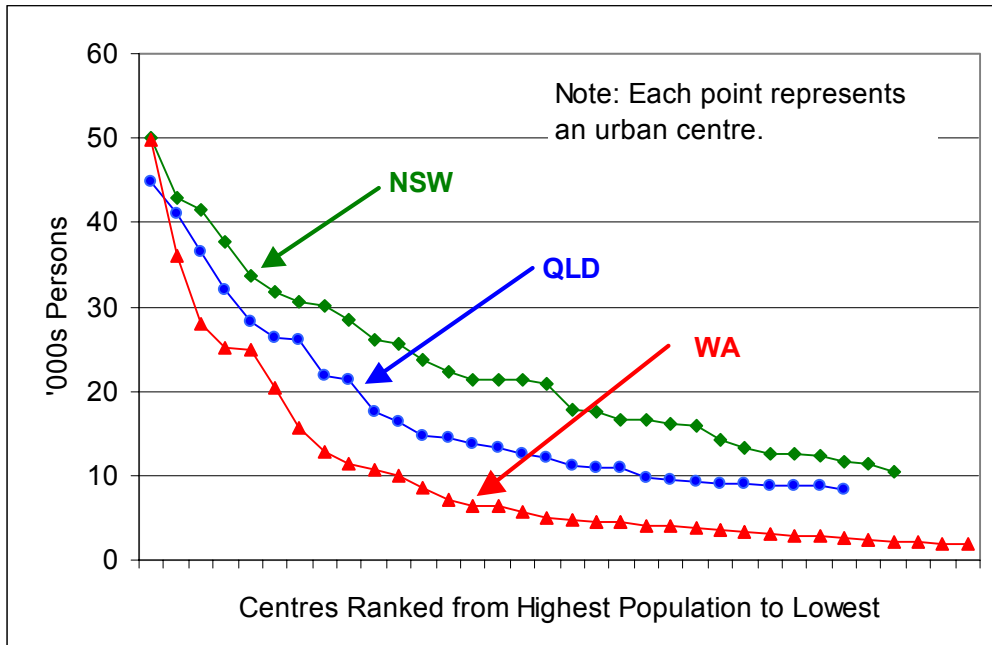
### 1. *The absence of large regional centres and the focus on Perth.*

There are no large cities outside Perth that could operate as significant airline traffic hubs. In this respect, Western Australia contrasts with the other states (**Figure 8.1**). The limited size of urban centres creates major problems for airline operations in WA. The largest centre is Albany with a population catchment<sup>9</sup> of around 41,000 residents but it is remote from most other centres. Geraldton and Kalgoorlie have the next largest catchments with around 40,000 residents. The Karratha, Esperance, Broome and Port Hedland catchments contain resident populations of 14,000 to 16,000 people. Population growth will contribute around 1% to 2% per annum to these catchments over the next five years, with Broome the fastest growing at around 2.2% per year.

<sup>8</sup> Section 3 of the Technical Report.

<sup>9</sup> The Project Team has constructed resident catchments for each airport based on the estimated proportion of residents in each surrounding LGA likely to travel by air via that airport.

**Figure 8.1: Distribution of Urban Centres With Less Than 50,000 Residents:**



**NSW, Queensland and WA, 1996**

Source: TFI Based on ABS Census Data on Urban Centres, 1996.

*2. The significance of mining as the foundation for air services development in WA.*

While the mining sector is, on the face of it, diverse and dispersed, in practice the value of output and number of employees is concentrated among a relatively small number of commodities. It is also relatively concentrated geographically (although local distances between facilities are large, nevertheless). Petroleum products are concentrated in the northwest in the Pilbara region and further south in the Mid West region. Iron ore production is also concentrated in the Pilbara. The recently announced natural gas contract with China will increase the construction of production facilities, annual production and air travel, to and from Karratha.

Argyle is the major centre for diamond production and Argyle Diamond Mines Pty Ltd generates significant charter travel from Argyle to Perth.

Gold production is more dispersed, conducted by 30 operating entities over some 50 sites. These are generally located in the Mid West and Goldfield Esperance regions around the towns of Kalgoorlie, Leonora, Coolgardie, Meekatharra and Mount Magnet.

*3. The large seasonal variations in the major tourism routes within WA.*

The four tourist destinations of Broome, Kununurra, Exmouth and Monkey Mia are particularly seasonal.

According to the latest available International Visitor Survey (1999) 13% of all visitors to Australia visit WA.

Information on places visited within WA indicates that around 8% and 11% of all visitors to WA visit Broome/Kimberley and Monkey Mia respectively (the two most popular WA destinations outside Perth), or 2% of all visitors to Australia visit these attractions.

Based on data provided by the WA Tourism Commission (WATC) Perth is the major source market for domestic tourism and accounts for over half the visitors to the regions. Holiday/leisure is the major reason for travel to all the *WATC-defined* regions although business travel is relatively high to Perth, the Goldfields, the Mid West, the Pilbara and the Kimberley. Private vehicle was the main transport mode, accounting for over 90% of visitors to the South West, Peel and Heartlands regions and over 70% of visitors in the Great Southern region, the South East, the Mid West and the Gascoyne region. One-third of domestic visitors to Perth, over one-third to Kimberley and 27% to the Pilbara, travel by air.

The tourism industry requires access to discounted seats and has not been able to secure them to the extent they would like in WA. Tourism interests are concerned that the airlines are focused primarily on meeting the needs of business travellers. Their view is that fares are too high, or access to discount fares too limited, to attract tourists. As a result, it is felt that there is unmet demand for tourist travel.

However, without a substantial change in the tourist profile and facilities of the region, it is difficult to see how the sector might generate substantially more demand for aviation. Even the high profile Broome depends, for example, on the domestic market for much of its business, and, within the domestic market, 58% of visitors come from Perth. While aviation capacity may be perceived as a limiting factor, the capacity of destinations to attract full fare paying visitors or to induce passengers to switch from ground to air transport may be the more fundamental issue. The alternative is to ensure that tourism can benefit from capacity provided to meet business and community demand generally and thereby to incrementally build another source of demand for aviation services. A further option is the development of 'back-of-the-clock' charter operations for tourism. This concept is developed further in the Conclusion.

### 8.3 Route and Service Analysis<sup>10</sup>

A model has been developed to analyse regional route economics under different passenger demand, aircraft type, and operational (frequency and load factor) assumptions. It is to be used for benchmarking, monitoring, and for supporting policy decisions (as required by the Terms of Reference for Stages 1 and 2). It has been used in this study to determine the sustainability of regional aviation based on simulating route economics. The performance parameters analysed are aircraft type, service frequency, net revenue and break-even load factors.

The key variables are passenger numbers, aircraft type, costs and capacity, passenger seat factors and average fares. The passenger seat factors and average fares vary according to the routes. On routes with a high level of business passengers airlines will favour higher frequencies to achieve the higher average airline fares on offer.

<sup>10</sup> Section 5 of the Technical Report.

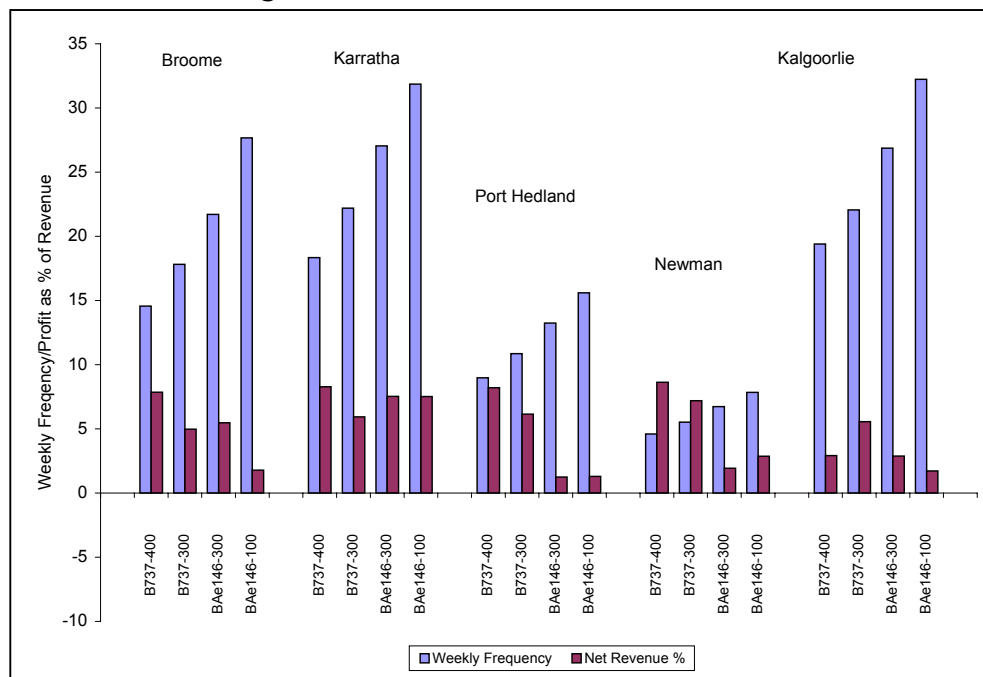
For leisure routes larger aircraft types with lower frequencies compensate to some extent for the lower average airline fares. The problem of lower yields is often complicated on leisure routes by a high level of seasonality. This has the impact of lowering year-round average passenger seat factors.

On **jet routes** the results indicate that as size of aircraft diminishes and frequencies increase, so profitability diminishes (see **Figure 8.2**). Operators and communities are faced with trade-offs on the major radial routes from Perth. On a route-by-route basis profitability is generally highest for the largest aircraft considered (the B737-400), but this is at the cost of frequency to any one destination. However, the fact that larger aircraft can be deployed across a number of routes to take advantage of relatively low utilisation on any one of them enhances the sustainability of the jet routes. However, switching to a smaller aircraft like the BAe146 to increase frequency increases the commercial risk substantially.

On most routes, the frequencies simulated were different to those currently in place. With passenger numbers having declined since 2000/01, this suggests load factors are lower than assumed in the simulation.

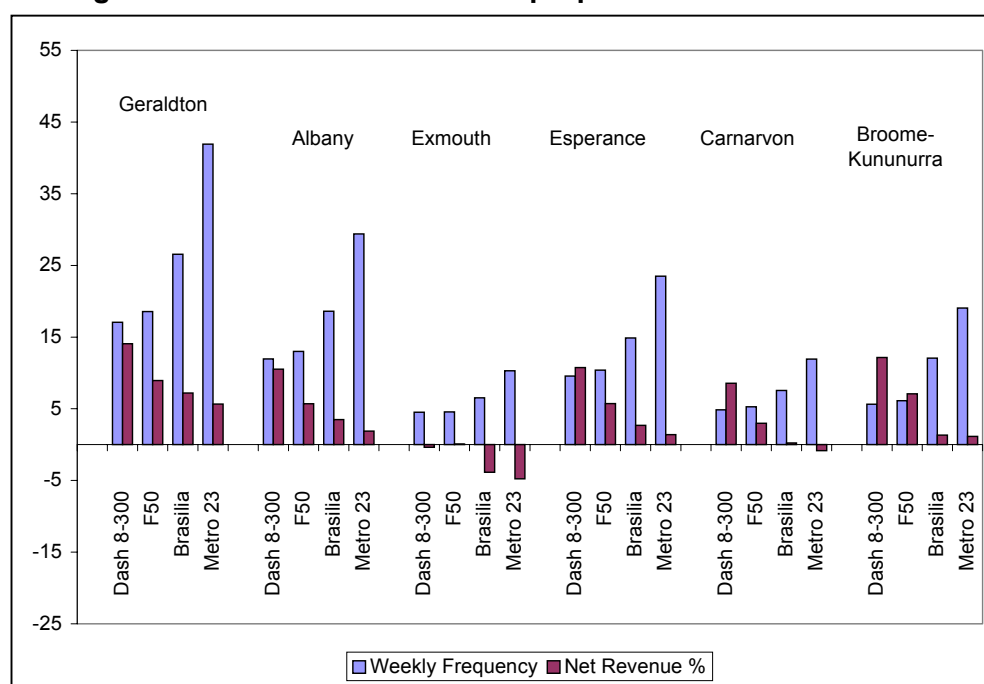
While the mix of aircraft on the jet routes at present are apparently sustainable, their viability is, not surprisingly, sensitive to any reductions in load factors or yields. The implication is that competition would pose a significant threat to current service levels. Conversely, the likelihood of effective competition against the current incumbent operators is low.

**Figure 8.2: Performance of Jet Routes**



Source: TFI/CAPA.

**Figure 8.3: Performance of Turboprop Routes – Perth Routes**



Source: TFI/CAPA.

**Turboprop routes** have been modelled, again assuming different load factors and average achieved fares by type of route. The same general principle emerged as for jet routes – larger aircraft flying fewer frequencies are demonstrably more economic and therefore more commercially sustainable. But returns are substantially lower compared with jet routes, confirming concerns about long-term route viability without a substantial change in revenues.

Many turboprop routes are marginal, at best. Under present market conditions, all would experience significant disruption with the introduction of competition. The level of market stimulation necessary to sustain increased frequencies is unlikely to be attainable and the negative impact on fare yields is likely to offset any revenue gains that might be associated with greater passenger numbers.

#### 8.4 Airport Charges<sup>11</sup>

While airport charges are significant, and tend towards the high side of regional charges within Australia generally, the Project Team has not examined the basis of the cost variation. Variability can be explained in part, for example, by a moderate relationship between airport charges and aircraft size. Because regional airports have relatively few aircraft movements and do not handle large numbers of passengers, increasing aircraft size makes disproportionately greater demands on resources without yielding the advantage of economies of scale available to primary airports.

<sup>11</sup> Section 6 of the Technical Report.

The “diseconomies” of handling larger aircraft in regional airports is compounded by the consequent spikiness or peaked nature of demand for airport services. This is a problem for the larger regional airports in WA.

One way of looking at the impact of airport charges on route economics is to compare charges per passenger against the average fare. This has been done using the traffic and load factors used in the base case model<sup>12</sup>, above, which indicates on jet routes, for example, the highest airport charges on a per passenger basis are recorded on the Port Hedland-Perth route at a total of \$67 or 10% of the standard fare. This share obviously increases in significance if discounting reduces the average fare.

The question is the extent to which a reduction in airport charges could stimulate traffic? For example, halving airport charges on what appears to be the most expensive jet route, Karratha-Perth, would reduce the assumed average fare by 4%. In practice, a halving of charges is unlikely to be obtainable and savings achieved are more likely to lie between 10% and 20%, yielding between 0.8% and 1.6% saving across the average fare. The impact, if this reduction is passed on to the public in full, is unlikely to be significant in terms of its capacity to stimulate additional traffic.

There is a question whether the discount or standard fare should be taken as the benchmark for evaluating the significance of airport charges. Is airport administration prepared to reduce its revenue to support an airline in its bid to increase traffic volume to a particular destination by discounting?

*Addressing the charges associated with regional airport operations, should be seen as an important part of any wider programme to encourage and sustain growth in tourism, but not as a panacea for current difficulties with air services across WA.*

## 8.5 Charter Operations

Fifty charter routes are currently recorded. Of them, only 25 (predominantly jet services) provide more than 40 seats capacity to a destination per week. In addition, a small number of operators account for the majority of services: Skippers account for 50% and Qantas another 17% of charter capacity. Charters accounted for 220,600 passenger movements in 2001 (247,000 in 2002), equivalent to 22% of the estimated 990,700 regional RPT passengers.

The presence of substantial charter traffic is important because it sustains the presence of more operators and aircraft than justified by RPT services and is a relatively stable element of the state’s aviation sector.

Consideration of a convergence in policy and operational terms between charters and RPT services is called for not just for the opportunities it offers to the sustainability of commercial aviation, but also because of the cost of air transport to mining, regional WA’s most important economic activity. Among other things, the significance of mining to regional WA is likely to be reflected in the demands it makes for RPT services as well as charters, thereby helping to sustain commercial aviation generally.

<sup>12</sup> The model is described in the Technical Report.

RPT services provided to Karratha, Port Hedland, Newman and Paraburdoo are heavily reliant on mining contracts.

The current state of the RPT sector may mean that distinguishing between RPT and charter services in state aviation policy is no longer appropriate. However it may not be appropriate to implement rule changes with respect to airworthiness and maintenance as proposed by the Civil Aviation Safety Authority<sup>13</sup> (CASA). These changes to regulations (in particular Parts 121A and 121B) effectively remove the distinction between charter and RPT operations to create a new classification, Air Transport. The added costs of these proposals in terms of compliance requirements and higher maintenance standards, particularly for piston-engine aircraft operators, may lead to the loss of air services to remote parts of WA and elsewhere in Australia. This raises questions about the practicality of fully aligning aircraft safety regulations across different levels of service. This is a matter that the State Government should further evaluate but is beyond the scope of this study.<sup>14</sup>

## 8.6 Government Travel

According to the WA Department of Industry and Technology (DIT) WA government domestic air travel expenditure during 2001 was nearly \$25million. The sum of Full Published fares for the travel undertaken during this time was about \$33m resulting in contract savings of about 25%. These savings combine discounts from cheaper fare classes, returns of commissions and overrides from airlines and Government airline rebates. Currently savings of around \$6.2 million are made by the government for rebates on a number of intrastate routes due to discounts made available by airlines.

Again based on value, around 60% of the intrastate spend is for travel on routes on which there is just one operator. With respect to fare usage, 16% of the tickets purchased on the competitive routes are purchased at full economy rates whilst for the non-competitive routes this amounts to 40% of all tickets purchased.

The government passenger contribution by route peaks at around 18% to 19% each for Broome to/from Kununurra, Karratha and Fitzroy Crossing. The next level is 5% to 10% each for Perth to/from Geraldton, Port Hedland, Broome, Carnarvon, Paraburdoo and Karratha and for Broome - Port Hedland and Broome – Derby. The overall contribution of government passengers to Broome traffic is around 9%.

The largest savings currently are achieved on the Qantas network and therefore largely in the northern parts of WA. It is suggested that the current contracts and savings could be used to achieve:

- ➔ Encourage the airline operator to add additional discount seats if the government pays full fare.

<sup>13</sup> The package is published as three Notices of Proposed Rule Making (NPRMs) for review and comment by the aviation community.

<sup>14</sup> We understand that the WA State Government has provided a report to the Civil Aviation Safety Authority regarding the prospects for Parts 121A and B. The State Government has also provided a Submission to the House of Representatives Standing Committee on Transport and Regional Services' Inquiry into Commercial Regional Aviation Services in Australia and Transport Links to Major Populated Islands.

It is noted that the WA Government currently achieves an overall discount of around \$6.2 million on its intrastate travel. Based on average fares the Project Team estimates that is equivalent to around 12,000 tourist fares in WA. A business case would need to be prepared to ensure there is significant value returned to the community and the state through this approach.

- ➔ Encourage the airline to extend a route provide a 'through fare', or add a service.
- ➔ Encourage the airline to maintain a service, or reduce required subsidy for an existing service, based on a commitment to volumes of government travel at full economy fares.

For the turboprop routes, largely operated in the Gascoyne and southern regions, it is considered necessary to mandate that government employees travel by air where feasible or appropriate. This will assist to build traffic on a number of routes which have limited traffic volumes at present.

## 8.7 Conclusions

There is limited scope for competition on regional routes other than those serviced by jet aircraft. Even there, current operations are likely to be under some financial stress and any foreseeable pick-up in demand is unlikely to be sufficient to encourage or sustain competition.

This conclusion is consistent with the international experience. Even a significant recovery in traffic, back to levels achieved prior to the Ansett collapse (which cannot be anticipated with any confidence in the next two years) would not guarantee viable, let alone contestable, service on many of the routes.

Economic analysis based on the route model developed for this study leads to the following classification of routes as required by the Terms of Reference. It is important to note that the larger routes in WA tend to be serviced by jet aircraft and do not appear to be as fragile as many of the smaller routes operated by turboprop and piston-engine aircraft.

(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 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.

These results demonstrate the difficulty of meeting community expectations for air services by relying on a policy model that relies heavily on a competitive and largely unregulated market place. This conclusion underlies the policy propositions contained in the following section.

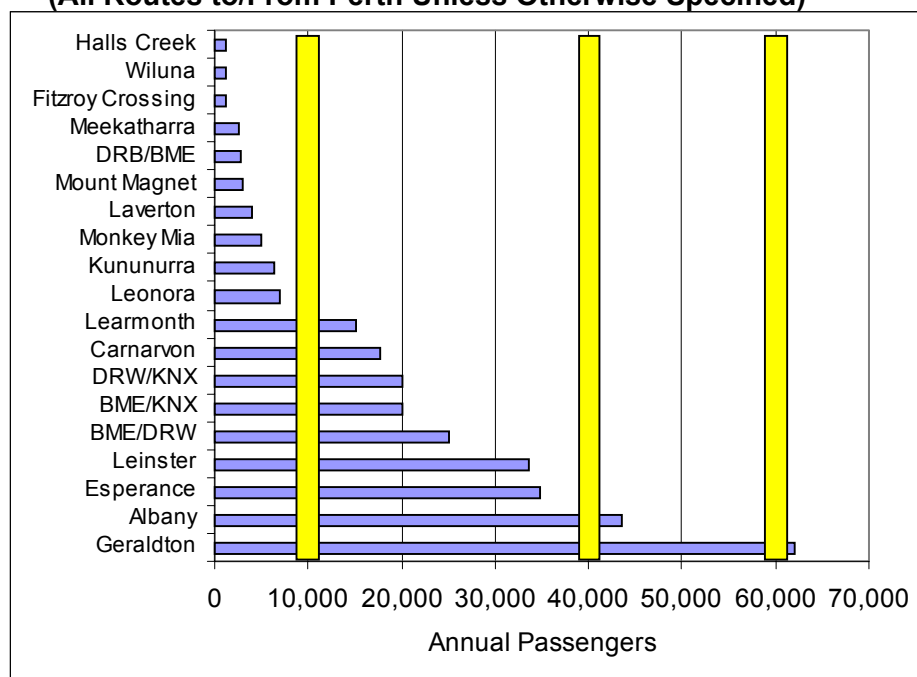
The WA Government would need to consider all these factors in granting these licenses. It is a conclusion that can be generalised to help guide the level and intent of any increase in government intervention that might follow in terms of broad route "thresholds". In general terms, routes with above 60,000 passengers<sup>15</sup> could support competition amongst turboprop operators, although competition would have a potentially destabilising impact on the RPT network.

<sup>15</sup> These are the aggregate of all passengers carried on a route in both directions.

At between 40,000 and 60,000 passengers, competition on a route is unlikely to be sustained, while between 10,000 and 40,000 passengers, airline services could operate commercially but not competitively. Below 10,000 passengers routes generally need to be part of a network to operate commercially or may require a subsidy.

Well in excess of 100,000 passengers would be required to support competition on jet routes (Figures 8.7 and 8.8).

**Figure 8.7: Passenger Numbers on Non Jet Routes, 2000/01**  
(All Routes to/From Perth Unless Otherwise Specified)



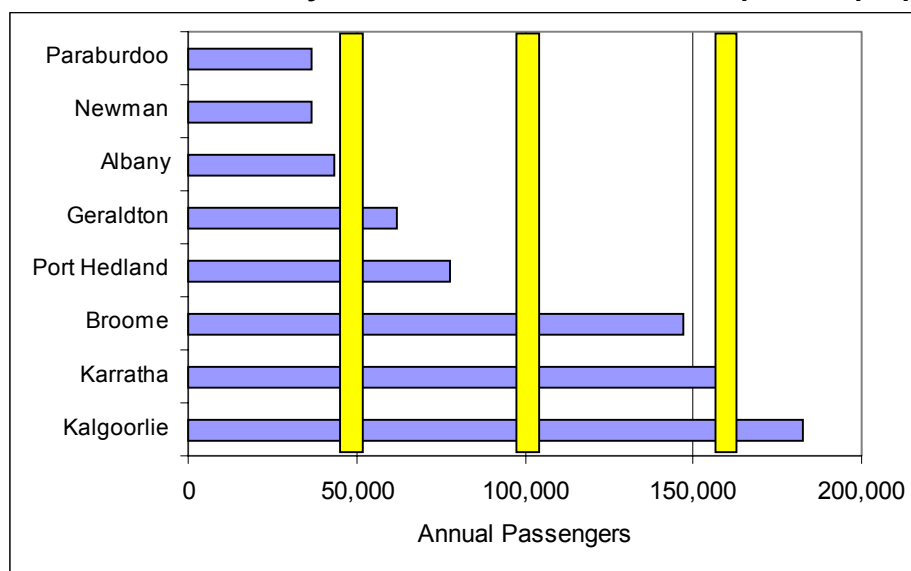
Note: BME is Broome, DRB is Derby, KNX is Kununurra.  
Source: TFI/CAPA.

The situation for jet routes in WA is difficult to summarise in the same way. **Figure 8.8** shows the major jet routes in WA with Perth/Albany and Perth/Geraldton added for comparison purposes. At 50,000 passengers on a route annually, an airline could operate 12 return services per week using a BAe146 aircraft (64 seats, assumes 65% passenger seat factor). At 100,000 passengers annually the airline could operate 12 services per week using a B737-300 aircraft (128 seats). At 160,000 passengers an airline could operate aircraft with seating of 165 to 220 seats (say B737-800 or B767 aircraft) with 12 to 14 services per week. Twice daily services, certainly during the working week, were considered highly desirable by communities.

The profitability and potential for competition on these services depends on a number of factors. Routes such as Perth/Karratha that have a major mining customer contributing up to 70% of the passengers provide the contracted airline a guaranteed market share. Under these circumstances a second operator is likely to find it difficult to build sufficient mass to generate a sustainable profit.

By contrast on a route such as Perth to Kalgoorlie, a route without a single dominant customer, airlines can compete vigorously with the potential for profit.

**Figure 8.8: Passenger Numbers on Jet Routes, 2000/01**  
(Routes to/from Perth, Albany and Geraldton added for comparison purposes)



Source: TFI/CAPA.

## 9 Policy Proposals

In addition to reviewing and benchmarking airline routes, and using this to derive recommendations with respect to licensing decisions facing the Government, this study was required to inform the development of a consistent Intrastate Air Services Policy.

The ideal in today's policy environment, if, as demonstrated, the market cannot deliver the desired level of service, policy measures should focus on the Government's role as catalyst. This means using encouragement, coordination, and incentives to bring about desired aviation service and regional development outcomes – an intermediate rather than an extreme position in the policy framework outlined in **Figure 7.1**. Despite the demonstrable shortcomings of the competitive market for delivering expected regional aviation services, too much direct intervention can discourage innovative approaches and reduce incentives for operators to pursue efficiency and service gains.

A strategy can be proposed, however, that reflects the realities of the “new” regional aviation environment. Six planks are proposed for this strategy, within which individual policy initiatives can be developed. The first plank is simply acknowledgement of the limitations of a competitive market as the basis for providing regional aviation services.

## 1. Recognising the limits of the competitive model

The study has demonstrated through analysis and experience elsewhere that the market alone is unable to deliver sustainable services that meet the needs or the expectations of some communities, and this is unlikely to change in the foreseeable future.

It has demonstrated thresholds above which commercial operations may be sustainable, although in WA it is by no means clear whether even the most favoured routes can sustain competition without adverse community or economic consequences. The contribution of the mining sector even to many RPT routes is significant.

On some routes there may be sufficient traffic to encourage new entrants. However, the subsequent stimulation of traffic through additional capacity and fare discounts is unlikely to offset the reduction in load factors and yields. The most likely outcome is the exit of one or more operators, or even - in the worst case - both. There may be a temporary gain from improved services and a period of discounted fares for the duration of competitive supply, but this has to be set against the longer-term impact of disruption in the travel market and the uncertainty this introduces for resident households and businesses.

On the other hand, the *prospect* of competition, combined with surveillance by the ACCC, may be sufficient to justify minimum regulation on the jet routes in WA by providing some pricing discipline and service incentive to the “monopoly” operator.

On other routes, though, there is difficulty sustaining even one operator without direct or indirect support from the public sector. At one level, that support may come from restricting entry to protect the incumbent. At another, it may entail support through favoured (government) purchasing policy or through subsidy. At yet another level, public sector support may mean coordinating different players, perhaps through incentives and regulation, in an attempt to derive system wide efficiencies.

*Acknowledgement of these characteristics of aviation in WA provides a basis for developing a coherent policy position. There is no “quick fix”, nor a particular ideological position that can be adopted to provide a consistent response to aviation needs, nor any set of rules to bring about sustainability. Rather the need is for a multi-faceted, flexible and coordinated policy process to oversee the sector during a period of continuing volatility.*

## 2. Establish an Oversight Committee for Policy Revision Purposes

The study has demonstrated the non-viable or, at best, marginal nature of many services. There is already State Government assistance available on some routes, and Federal Government grants available through RASS in some cases. Given the demonstrable long-term non-viability of a number of regional services, there is, however, a need to review arrangements for public sector support of aviation and related services to remote communities, and to identify where collaborative or supportive actions initiated by the government may enhance the prospect of commercially sustainable operations.

It is considered that the existing Strategic Aviation Committee (SAC), which is chaired by DPI and reports to the AMC, is the appropriate vehicle for this review. SAC fulfils at least three requirements in the area of policy review: (1) it ensures that the range of expertise and disciplines required are brought to bear; (2) it provides a formal channel for communication and coordination across agencies and different levels of government; and (3) it can access a broad network of stakeholders outside government.

Following the AMC policy review and subsequent policy revision, it may be appropriate to maintain SAC on an ongoing basis to oversee the elements of the resulting policy. A move away from a totally deregulated market implies a commitment of public resources which needs to reflect and align as far as possible the costs and the beneficiaries. An inter-agency committee such as SAC can do this and ensure equity, transparency and efficiency of any funding required.

### 3. Addressing Community Needs

It is recommended that the inter-agency committee should review community needs for aviation so that:

- Community needs can be aligned with the capacity of the aviation sector.
- The fiscal implications are clearly established.
- Funding is aligned with the purpose of any assistance.
- Federal and state assistance is coordinated.
- Mechanisms for community input and commitment are established.
- Transparency is assured.
- A contestable service model is developed to ensure efficiency in service delivery (and avoid the service provider capturing all the benefits).
- Alternative or complementary policies to direct subsidy (such as favoured and pooled air travel purchasing agreements) are considered.
- Government's own policies (for example, for travel) are consistent with enhancing the sustainability of aviation services to regional points.

Consistency and transparency are important objectives in developing a community service funding programme, for the purposes of stability in the programme and predictability of outcomes.

Among other things, a number of cross-portfolio initiatives may have to be considered. For example, within the Kimberley region there were widespread concerns that as air services have been reduced within the region access to mail and daily newspapers have emerged as problems. Newspapers are received one to two days after publication. Even subsidy will not necessarily resolve this problem given that it arises in part from the lack of timely connections from Perth into the region. One approach that might be considered is the development of a licensed publisher in the Region to utilise the World Wide Web for access to, and then the printing of, the latest news. This approach is one example of the need to look for currently viable solutions rather than pursuing unrealistic expectations from the past.

Such novel communications strategies based on internet services may be explored wherever there are gaps in communications services because of the limited level of aviation services. The inter-agency committee could respond to such opportunities or initiatives by identifying the level and location within government or the community where some responsibility for providing an alternative service might be located. In doing so, it will help develop more realistic expectations among remote communities.

#### **4. Encouraging secondary hubs and thickening trunk routes**

The sustainability of regional aviation in WA and the provision of a reasonable level of service (in terms of frequency, aircraft type and price) depend on the profitability of the principal routes and, in turn, on creating higher passenger volumes. The development of key regional centres as the focus of air services growth is an important part of this process.

One candidate is Broome in the Kimberley. It was pointed out in **Section 8.2**, Point 1 that in WA there is an absence of large regional centres and a heavy air network focus on Perth. This results in many long routes with few passengers creating difficulty for commercial air service provision. A focus on Broome as a key centre for air services may mean encouraging access to Perth via Broome for both charters and RPT services operating in the Kimberley region. As part of such a strategy, parallel initiatives would ideally be pursued to encourage the development of a commercial and community service base in Broome. This would explicitly reinforce the relationship between the provision of aviation infrastructure and regional development in remote communities. As east coast services to Broome grow - via Darwin, Alice Springs and direct from Melbourne and/or Sydney – the distribution throughout the Kimberley is possible through the intra-regional services.

Similar arguments could be applied to Karratha and Geraldton, which could be promoted as minor hubs serving regional needs and, based on that role, building capacity and service standards to Perth.

In the case of the Pilbara, one of the key issues to emerge during consultation was the need for intra-regional air services to connect Paraburdoo and Newman to Karratha and Port Hedland. The analysis undertaken for this study indicates little prospect for such a service to be provided commercially because, among other things, there are unlikely to be sufficient community users at the fares required to pay a commercial return to the airline operator. Members of the community suggested that the WA Government should be prepared to subsidise such services.

The Project Team understands that there are a number of air charters within the Pilbara that are contracted by mining interests and by Health Services. The inter-agency committee should be well-placed to examine these charters in detail to assess their potential to meet community needs and defray costs to the existing charter users.

## 5. Addressing tourism expectations

Tourism has expected or sought support from aviation both to increase throughput and profitability in current businesses and to reduce the uncertainty associated with investment. The study establishes that it is unlikely in the current environment that airlines will support tourism to the extent of providing capacity at the discounted fare levels required by the tourism industry. However the Project Team considers that there is a prospect to achieve a closer match between airline and accommodation capacity than exists at present.

The airline system as constituted is unlikely to contribute to the ‘quantum’ increase in visitors that is sought by the tourism industry. With the smaller aircraft types often used on regional WA routes, the best that can be hoped for from the current system is incremental tourism growth.

As an alternative approach, the Project Team proposes consideration of tourism charters operated at off-peak (“back of clock”) times. These could cater for the capacity needs of specific tourism destinations by encouraging airlines to offer charter programmes that meet the needs of tourism operators, providing linkages with international and inter-state flights at Perth, for example, at the appropriate times. Attention would, however, need to be given to the potential risk of diverting traffic from existing services and thereby further undermining their sustainability.

Clearly, the criteria for implementing special services of this nature would have to include the creation of additional demand through a balanced business development or marketing plan on the part of the community interests promoting it.

Such an initiative could be treated as developmental for proving and building demand, and as such could attract some finite public funding to facilitate it. Ideally, a community, through its tourism operators, would prepare a proposal for funding (within pre-determined guidelines), covering a programme of charters over, say, a three to six-month period. The proposal should cover markets and marketing; the nature and availability of ground infrastructure; plans for medium-term sector development; and sector (and community) commitment of resources to the programme.

For the Gascoyne region, and particularly for Exmouth, the Project Team recommends immediate investigation of the possibility of accessing seats on the Australian Government-supported air services to Christmas and Cocos Islands. The services are provided by National Jet Systems and could provide up to forty seats per week to Exmouth. They would need to be packaged by the tourism industry in such a way that they would not be accessible to users of current RPT air services.

## 6. Developing a programme of public support

The preceding five planks of the proposed strategy are based on:

(1) recognition of the need for a coordinated and coherent response to the intrinsic difficulty of providing sustainable aviation services to regional centres over long distances;

(2) development of a policy framework and process (within the context of an inter-agency committee convened by the Department of Planning and Infrastructure) which will identify and address the different elements of a policy (community support, aviation network development, and tourism promotion) in an appropriate governmental and community context; and

(3) a commitment to stakeholder consultation and community commitment prior to introducing new initiatives in support of the resulting programme.

The strategy emphasises reviewing existing arrangements, rethinking future arrangements, and working jointly with the relevant agencies and the community to do so.

The implication is a more active approach with some commitment of public funds, directly or indirectly and ongoing government oversight and coordination, at the same time as community initiatives are seen as both triggers and pre-conditions for such support.

Based on this platform, the sixth plank of the strategy is to develop a coherent but flexible programme of public support for developing regional aviation in the interests and through the initiative of the communities to be served. This might entail identifying the public resources required or affected by aviation policy in WA and seeking to coordinate their application within a coherent policy framework. The focus should be on outcomes (in terms of accessibility and viability of communities and economies) as much as on outputs (in terms of aviation service parameters). This should lead to innovative and transparent funding arrangements that draw across levels of government and across portfolios within different levels.

## 10 Specific Recommendations

The WA intrastate aviation market is characterised by many long routes with limited passenger numbers. The study has demonstrated through analysis and experience elsewhere that in these circumstances the market alone is unable to deliver sustainable services that meet the needs or the expectations of some communities, and this is unlikely to change in the foreseeable future. Analyses reported in **Section 8** of this report and **Section 5** of the Technical Report have demonstrated thresholds above which commercial operations may be sustainable, although in WA it is by no means clear whether even the most favoured routes can sustain competition without adverse community or economic consequences. Major RPT routes such as Perth-Karratha rely heavily on the contribution of the major mining sector clients.

On some routes there may be sufficient traffic to encourage new entrants. However, the subsequent stimulation of traffic through additional capacity and fare discounts is unlikely to offset the reduction in load factors and yields. The most likely outcome is the exit of one or more operators, or even - in the worst case - both.

There may be a temporary gain from improved services and a period of discounted fares for the duration of competitive supply, but this has to be set against the longer-term impact of disruption in the travel market and the uncertainty this introduces for resident households and businesses.

The following recommendations are proposed in recognition of the shift in policy position required by the evidence that competitive provision alone will not deliver services of the desired standard to regional communities and the tourism industry.

1. *It is strongly recommended that* the WA Government adopt a more active aviation economic licensing regime to promote RPT. In doing so it is important in WA to consider the implications for charter activity in the State, particularly for the mining industry, given the possible impact new Civil Aviation Rules 121A and B (if they are implemented), and the consequent narrowing gap between RPT and charters bringing the latter into the licensing regime.

In adopting a more active licensing regime, the Government should address the impact of entry by new operators on individual routes and on the system as a whole, including the viability of existing operators, as well as impacts on a route-specific and/or network basis.

Where the restricted entry offers a commercial advantage to an operator, this should be accompanied by clear conditions on the licence, including reporting requirements.

2. *It is recommended that* consideration be given to the integration of mining charters and RPT services to enhance regional air services. Mining companies already contribute significantly to aviation in WA through their contractual commitments to aviation capacity implied in the mining charters (which support the positioning of aircraft capacity in WA) and, in a number of cases, through the direct support of RPT services.

It has been identified that service improvements can be realised in WA through better communication, negotiation and cooperation between government, communities and the resource sector. The objective is to enhance both the sustainability of regional aviation and to support the longer-term interests of mining (by, for example, containing or reducing the transport costs of mining operations through services rationalisation). The intent is increase the opportunity for communities to utilise existing and proposed charters serving point-to-point needs between areas not likely to achieve commercial or subsidised RPT air services.

3. *It is recommended as support to recommendations (1) and (2) that* DPI establish a strong aviation monitoring function as part of the role of the Industry Observer (as established by the State Government following the first stage of this review). The Project Team recognises that this recommendation will require additional resources for successful implementation. The overall goal would be much the same as the purpose of this study, ensuring a sustainable regional aviation sector in the state so that the WA Government can act as effectively as possible to meet the needs of the community.

Three specific areas of responsibility are envisaged:

- (1) as part of an active licensing regime;
- (2) in order to advise an inter-agency committee; and
- (3) to track policy outcomes.

Specific areas of monitoring would include:

- Airline industry developments, covering major world developments in areas such as airline alliances and issues that might impact upon the viability of airlines currently operating to and within WA.
- Passenger levels, frequencies and fares on routes in WA. Economy and discount fares can be monitored on all routes and average fares on routes with a single licensed operator.

The monitoring activity needs to be coordinated with DOTARS to avoid unnecessary duplication of activity by airlines and government agencies.

- Landing charges and head taxes at airports.
- WA mining and government charter activity.
- State Government travel by mode and State-funded travel for health, education, and other community and public services.

4. *It is recommended that* the WA Government use its travel budget to support aviation policy. Currently savings of around \$6.2 million are made by the government for rebates on a number of routes due to discounts made available by airlines. The largest savings currently are achieved on the Qantas network and therefore largely in the northern parts of WA. It is suggested that the current contracts and savings could be used to:

- Encourage the airline operator to add additional discount seats if the government pays full fare. A business case would need to be prepared to ensure there is significant value returned to the community and the state through this approach.
- Encourage the airline to extend a route provide a 'through fare', or add a service.
- Encourage the airline to maintain a service, or reduce required subsidy for an existing service, based on a commitment to volumes of government travel at full economy fares.

For the turboprop routes, largely operated in the Gascoyne and southern regions, it is considered necessary to mandate that government employees travel by air where feasible or appropriate. This will assist to build traffic on a number of routes which have limited traffic volumes at present.

5. *It is recommended that* a 'regional air services programme' be implemented to
  - (a) support the development of an essential community services aviation programme;

- (b) assist regions to source cheaper tourist seats on a scheduled-charter/RPT basis; and
- (c) pursue any other related initiatives that the Minister might deem appropriate from time to time.

This programme should be transparent, it should be based on a comprehensive policy framework and a set of decision rules should be established for its implementation. It is envisaged that the programme will be administered in the following manner:

- Communities will be required to bid for programme funds.
  - The basis for the bidding will be the development of a business plan outlining the approach to market development, developments in local infrastructure of relevance to the proposal, numbers of tourists sought and the attractions and activities they will pursue, and the profit/loss outcome in the initial programme of activity.
  - Joint public-private initiatives or collaborative initiatives across sector interests or among communities will be favoured as a basis for leveraging other contributions that may assist in achieving efficiencies and moving towards sustainable solutions.
6. *It is recommended that* local government, as the major owner of airports in regional WA, be encouraged to review the role of their airports as part of the regional development of air services and tourism communities. A review of management and pricing policies for regional airports should recognise:
- The potential for efficiency gains from benchmarking and pursuing best operating practices.
  - The need to avoid the diversion of funds to non-aviation purposes.
  - Consideration of the benefits that could flow from favourable pricing initiatives in conjunction with other stakeholder cooperation to encourage discretionary, leisure and tourist travel.
  - The need to identify opportunities for supporting the local leisure sector, thereby helping tourist interests to attract more visitors.

This means recognising that airports do not create tourism demand, but exist to facilitate demand generated by regional tourism attractions and investment. It also means acknowledging that airports benefit from growth in tourism through increased traffic and revenue, but that airport inefficiencies could prejudice that growth.

7. *It is recommended that* the Strategic Aviation Committee (SAC) be seen as the peak body to oversee revision of aviation policy for the state, recognising in its membership the community and economic benefits of sustainable regional aviation, the need to work across levels of government and portfolios to secure those benefits, and the potential role of community participation in resolving regional and local aviation problems.

There may be a need from time to time to establish Regional Aviation Task Forces to identify and progress innovative and appropriate methods for securing or sustaining aviation services within the regions. These task forces would comprise local key interest groups and would report back to, and be co-ordinated by, SAC.

8. *It is recommended that* the Federal and WA Governments engage immediately, at both the Executive Government and ‘officials’ levels to work closely in the development and coordination of policy for international, interstate and intrastate aviation. It is desirable to have a federal aviation strategy which addresses the issue of regional aviation, delivering some certainty of regulatory outlook for states, consumers and airlines alike. A formal mechanism may be required to ensure that the states are consulted in relation to impacts of potential changes in regulations and policies. The Federal Government needs to recognise the National Aviation Working Group (NAWG) as a key ‘officer’ forum for the exchange of information and data. Specific issues raised in this review of intrastate air services that could be incorporated in joint activity include:
- ➔ Definition of basic service levels for regional aviation nationally in the same way that it has for telecommunications. This would facilitate that assessment of areas of need not currently addressed and to undertake the capital, operational and financial planning necessary to address deficiencies.
 

Included in such an initiative should be a collaboration on advancing the RASS programme, partly through clarification of the respective roles and responsibilities of the State and Federal governments in its implementation. The approach adopted by the federal government in its land transport planning – ‘AusLink’ to encourage better advice, better planning, better decisions and better infrastructure - should be applied to air transport.
  - ➔ Regional impact assessment of national regulatory and policy changes. An example is the disproportionate impact on WA of the changes to Parts 121A and B of its CASA’s air services regulations. The impact assessment would estimate the cost of these changes to remote regions in WA and the need for compensation and/or ensure the development of long-term strategies should these changes be implemented.
  - ➔ En-route costs comprise 3% to 4% of the costs on regional routes in WA. While they comprise a relatively small portion of ticket costs, the slim airline margins on regional routes make it desirable to review them. The aim would be to determine whether incentives can be developed to reduce en-route charges on promotional and tourist-oriented air services, in particular. The move by Airservices Australia to location-specific charging means that costs on regional routes increased substantially relative to trunk routes between capital cities. The challenges in sustaining regional aviation mean that it is timely to reconsider the merits of cost spreading in such a way as to reduce this disadvantage and restore an element of cross-subsidy across the network.

The whole intrastate aviation system across Australia is fragile. Many regional airlines have failed and services have been terminated to a large number of centres. Sustaining levels of air service acceptable to the community, business and tourism interests in WA is a major challenge. There are few major urban centres in the state and large distances between the many smaller centres and Perth.

The mining industry contributes significant passenger volume to many of the major routes including Perth to/from Kalgoorlie, Karratha, Port Hedland and Newman/Paraburdoo. The key challenge is to maintain existing services whilst pursuing the means to increase volumes on key tourism routes. The consultants consider that only through more active intervention by the WA Government can the objectives of sustainability and growth be achieved. The specific recommendations above target these objectives.