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Shire of **EAST
Pilbara**
AUSTRALIA'S LARGEST SHIRE

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27 July 2017

Dr David Worth
Principal Research Officer
Economics and Industry Standing Committee
Western Australian Legislative Assembly
Parliament House
Perth WA 6000

Dear Dr Worth,

RE: Inquiry into regional airfares in Western Australia

I refer to your letter dated 26 June 2017 regarding the Economics and Industry Standing Committee Inquiry (the Inquiry) into "Regional airfares in Western Australia".

Communities such as ours are amongst those most affected by the level of airfares. For this reason we believe it is critical for your Inquiry to hold public consultation sessions in our Shire.

We therefore invite you to the Shire of East Pilbara (the Shire) to lead these community engagement forums. This will ensure that you will have access to first-hand accounts of the influence of airfares on the daily lives of those living in Regional areas.

Background and context to our submission

The Shire operates three airfields within the Shire borders. Of these, Newman Airport is alone in receiving regular public transport (RPT) services.

In the main, these are provided by the various airline brand names within the Qantas and Virgin Australia groups. From time to time other providers offer these services as well. Our only RPT link is to Perth Domestic Airport.

Concerns about the cost of accessing regional airline services resonate with regional airports. At Newman Airport we must make investments and carry significant fixed costs in order to continue to facilitate the air connections upon which our community depend.

Whereas airlines can actively manage their capital assets, adjusting the quantity and size of airframes servicing particular routes, an airport operator cannot. In that sense, public assets can easily become public liabilities.



Airports as contributors to high RPT airfares

As a small regional airport with very limited access to the market in order to fund operating expenditure, the Shire recognises the importance of cost control.

As a result, the Shire has instituted a number of measures over the past years to assist its airline partners in managing their costs and to continue serving our community.

Some of these measures include:

- During 2009/2010 the Shire froze all aviation fees and charges to airlines serving Newman Airport for a period of five years. This was done to create a stable pricing and costing base from which airlines could conduct medium term route planning.
- The Shire extended a massive discretionary discount on the landing fee to airlines at the time. Although this has been reduced in recent times after no evidence over the years could be found that this was allowed to flow through to our community, a significant discount is still in place (25% for FYE 2017).
- During the above time frame the landing fees for RPT operations was set at a fixed rate which, if compared to the standard per weight landing fees for non-scheduled flights, equated to only 32% of the normal rate for a typical aircraft in the 70 tonne MTOW category. This was an effective reduction of 68% in primary airport user fees.
- In addition to this, Council approved a further 50% reduction in fees as a new route incentive, valid for the first three months of the operation of a new route. This offer is still valid for any airline to utilise at a reduction of 25%.

From the above, you will note that our Shire has historically made a substantial contribution to controlling costs of providing RPT services to and from Newman Airport. Unfortunately, at historic (and current) high airfare price levels the airport fees and charges makes up an almost insignificant portion of airfares.

The Shire and its executive have on numerous occasions raised the issue of high airfares with RPT providers. This has had little measureable effect on the ticket price of the majority of seats available.

There is no airline strategy to provide the community with access to reasonably priced airfares. As such, the Shire calls upon airlines servicing our community for the implementation of a "Locals Card". The aim of this will be to provide legitimate permanent residents of the Shire of East Pilbara with cheaper flights.

We believe that there is much to be gained by your committee assisting our community to understand the pressure points in ticket price make-up. We welcome a comprehensive review informed by a detailed understanding of the total price make-up of a ticket from airlines on sectors such as the Newman - Perth - Newman route.

As an example, the following costs are currently (until 31 July 2017) levied by the Shire at Newman Airport to airlines providing RPT services:

Table 1

Fee detail	Incl. GST
Landing fee for aircraft MTOW larger than 10,000kgs	\$22.77 / 1,000kg
Discount to RPT operators off the full per tonnage rate landing fee	25% (\$17.08)
Passenger charge per passenger arriving and departing	\$24.20
Security fee (departing passengers only)	\$13.57

A common airline argument encountered is that average loadings (how many seats are booked both ways on a flight) are low and therefore overheads must be carried by fewer passengers.

Shire data shows that average load factors on the Newman – Perth – Newman route are about 50%. Shire fees directly to passengers will add \$37.77 to each outgoing traveller's airfare (which includes \$13.57 to recoup security costs), and \$24.20 for landing passengers.

Even if average load factors are considered, landing fees are unlikely (on average) to add more than \$12.23 per passenger. Considering that airfares are often upwards of \$600 one way, and at times in excess of \$1,000 per ticket, airport and security fees are almost negligible to total ticket prices.

Such is the level of ticket pricing in the Pilbara that even using assumptions that maximise the airport fee contribution to the total ticket price, Shire fees remains almost immaterial to the total price. For a graphic depiction of the limited contribution Airport fees make towards airfares, please refer to Attachment 2.

The cost of securing aircraft, airline passengers, screening those passengers and their baggage as well as to ensure no unlawful interference with aircraft operations is also borne by airports. The national model is that airports on-charge this expense to airlines who recoup the cost from passengers on a user pays basis.

At Newman Airport, this adds only between one and two percent to the total ticket price. This does however represent about 35% of our passenger charge as per Attachment 3. This relatively large contribution to total airport costs indicate the pressure we have put on managing those costs we can control very closely (such as landing and passenger fees).

The Shire acknowledges that airlines incur costs other than airport fees.

However, these costs are fairly uniform across Australia and include fuel, aircraft purchase/ leasing and flight crew costs, maintenance etc. Considering the above, a significant difference in ticket prices remains unexplained as per Attachment 4.

This attachment also shows the airport direct passenger charge relative to a range of airfares commonly charged on our sector. As per the graph, the level of airfares on our sector is in complete contrast to airfares charged on comparative routes on the east coast. It is clear that airfares are delinked from airport fees and charges.

Resource sector, Commonwealth and airline contributors

Often RPT flights carry workers flying as per a bulk book or an allocated tender by a resource company. The basic cost of providing that flight is covered by the contract/ charter component. Making available RPT seats on these flights is a prudent commercial decision increasing yield.

If the cost of these airfares however is justified, it could imply that either tendered prices for bulk seating are done at such a cut price that the community is relied upon to make the flights economical, or that airlines charge higher rates on the assumption that any additional seats can only be taken by those in the community with no travel choice.

In addition, private travellers have to buy their way into aircraft seats, competing with resource companies that earn a tax benefit on the flight booking. The full FIFO exemption provided by the Fringe Benefits Tax Assessment Act skews the market further.

Resource companies rely on the FBT exemption based on the assumption that FIFO workers work at Perth Airport and at times are travelling to Regional Australia as part of their work. This could be seen as a loophole as FIFO workers only travel through that airport on their way to work.

The tax laws above crafted by Government are in conflict with the stated Government objectives of regional development and counterproductive to the investment by all levels of Government, including the Royalties for Regions Program.

Community cost, airline profit

The confluence of the above could highlight a possible factor contributing to the high airline ticket prices in especially mining communities. Because FIFO airfares are in effect subsidised by Government as a result of the above, airlines may have just created an artificial charge level by adding the Government subsidy into the airfare thereby “collecting” the tax incentive for their shareholders.

For the Pilbara community airfares are often a grudge purchase. The level of fees may reflect the airlines knowledge of the lack of community bargaining power. The alternative would mean spending two days on the road (with accompanied risk of accident, cost and loss of productivity) to and from Perth.

We are particularly disappointed by the apparent failure of airlines to hand the generous fee reductions and discounts referred to in Table 1 to passengers. This does however show the delinking of the cost drivers of the service and the fee that knowingly can be commanded.

A cursory look at the annual report and investor briefings of the average RPT provider shows that the overall profitability of a popular airline company per passenger mile is below that of (on the face of it) a number of the Western Australian regional routes.

Should this be correct, it could mean that regional routes are in effect subsidising the capacity wars and price competition that is delivering reasonable airfares to metropolitan communities. If true, leveraging disadvantage and market power in this manner would be inexcusable.

Action options

Historically WA State Government has from time to time applied the “community fare” model. One such instant was the State Government funded flights between Kununurra and Halls Creek.

At present the issue at stake is not the availability of new routes, but the cost of existing sectors. There may be an application for such an approach to bring additional competition to the current duopoly market.

The four largest leased federal airports are subject to regulation and oversight in relation to prices of aeronautical services and facilities, car parking, ground transport and quality of service. Annual monitoring is conducted by the Australian Competition and Consumer Commission (ACCC) in accordance with the Airports Act 1996 as well as the Competition and Consumer Act 2010.

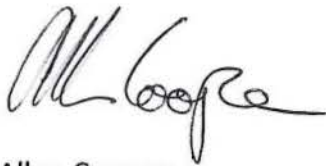
This was done as a check and balance in recognition of those that noted that potentially monopolistic behavior (however remote) must be guarded against.

Arguing for independent economic oversight is an area where your committee can add much value. Recognizing that the free market is not delivering on community expectations and could in fact have failed, possibly being assisted by a regulatory system that is contrary to Government Policy, demands a similar periodic review and public report.

Very importantly, the 2009 change to subsection 47(7) of the Fringe Benefits Tax Assessment Act is subsidising airfares for (effectively) multinational organisations. The WA State Government can use its considerable advocacy capability to secure an equitable outcome for the community.

If you have any queries please do not hesitate to contact me.

Yours faithfully



Allen Cooper
Chief Executive Officer

ATTACHMENT 1

Response to the Terms of Reference for the Economics and Industry Standing Committee inquiry into and report on matters relating to airfare prices on regular public transport (RPT) air routes in regional Western Australia.

Inquiry terms of reference	Comment
a). Factors contributing to the current high cost of regional airfares;	<ul style="list-style-type: none"> i) Lack of airline competition allows the market to settle around the higher end of fees. With high barriers to entry, few alternative options and limited market participants, airfares are not the subject of vigorous price and service competition; ii) Distances and lack of alternative travel options for regional communities means little modal competition; iii) Little risk of negative publicity by airlines as no reliable data are available as to cost drivers; iv) No compulsory price oversight or focussed economic oversight mechanism; v) Resource companies bulk book/ tender and receive tax benefits for seats booked. Community members has to compete with corporate FIFO seats but do not receive tax breaks; vi) The full FIFO exemption provided by the Fringe Benefits Tax Assessment Act skew the market further; vii) Little effective capacity within regional communities to mount a productive and coherent regulatory or legal challenge to fees; and viii) Because of high reliance on air travel the perceived risk of termination or downgrade of services in response to downward pressure on fees is a strongly perceived political risk.

<p>b). Impacts that high-cost regional airfares have on regional centres- from a business, tourism and social perspective;</p>	<ul style="list-style-type: none"> i) A barrier to entry for metropolitan businesses that would have brought greater price and quality of service competition to regional areas; ii) A barrier to entry to small business as they cannot compete with large businesses that have access to FBT tax exemptions; iii) A barrier to families moving to regional areas. The cost of keeping in touch is deemed very high meaning that young families and retirees shun regional areas. This leaves only active working families with little commitment or roots in the area. Families often relocate when children has to attend secondary school as the cost of flights preclude boarding options for many. Regional areas become transient with little community engagement; iv) A barrier to FIFO personnel moving to the areas they work. The full exemption in the Fringe Benefits Tax Assessment Act for FIFO's incentivise workers not to relocate to the areas they work. In addition to the mental health, personal and family impact of families living separately (as highlighted by the WA Legislative Assembly commissioned inquiry into the impact of FIFO work arrangements in the resources industry by the Education and Health Standing Committee), this ensures that regional economies do not get the benefit of population relocation. The cost of this incentive is carried in some part by those that did relocate in the form of: <ul style="list-style-type: none"> - Artificially high airfares; - Less vibrant communities; - Diminished public and private investment; and - Lack of infrastructure such as education, health and recreational facilities.
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	<p>v) Tourism suffers greatly. As an example, international flights from Perth are often cheaper than flights to the Pilbara. If you multiply the cost across the number of family members and consider the full day each way lost in travelling by vehicle to the Pilbara it is understandable why metropolitan, interstate, and intrastate residents would rather holiday elsewhere (internationally even) than visiting the Pilbara or other regional areas;</p> <p>vi) Local Government officials, small business operators, teachers and other public officials are less likely to be able to afford or get authorisation to attend education opportunities, networking or consultative meetings, trade-shows and be exposed to especially those opportunities that isolated communities need in order to stay up to date and to overcome the tyranny of distance;</p> <p>vii) With a lower than expected population growth because of the factors above, a number of secondary effects are experienced such as:</p> <ul style="list-style-type: none"> - A smaller rate base meaning service delivery is curtailed; - Capital investment by private sector and local government are lower than it would have been if the population growth was strong; and - Development of tourism, retail and support functions are stunted resulting in lower than expected growth, tourism attraction and community spend.
c). Impact of State Government regulatory processes on the cost and efficiency of regional air services;	<p>Resource companies must be discouraged to construct Airports in close proximity to public airports. This practice is economically inefficient as multiple airports are constructed, each marginal in its existence. Communities do not get the benefit of the infrastructure investment, however are relied upon in emergencies.</p> <p>Government is often convinced by claims of billions of Dollars of investment into regional areas. In reality most of that investment is not publicly accessible or in support of the community. When the resource is depleted, little benefit remains behind.</p>

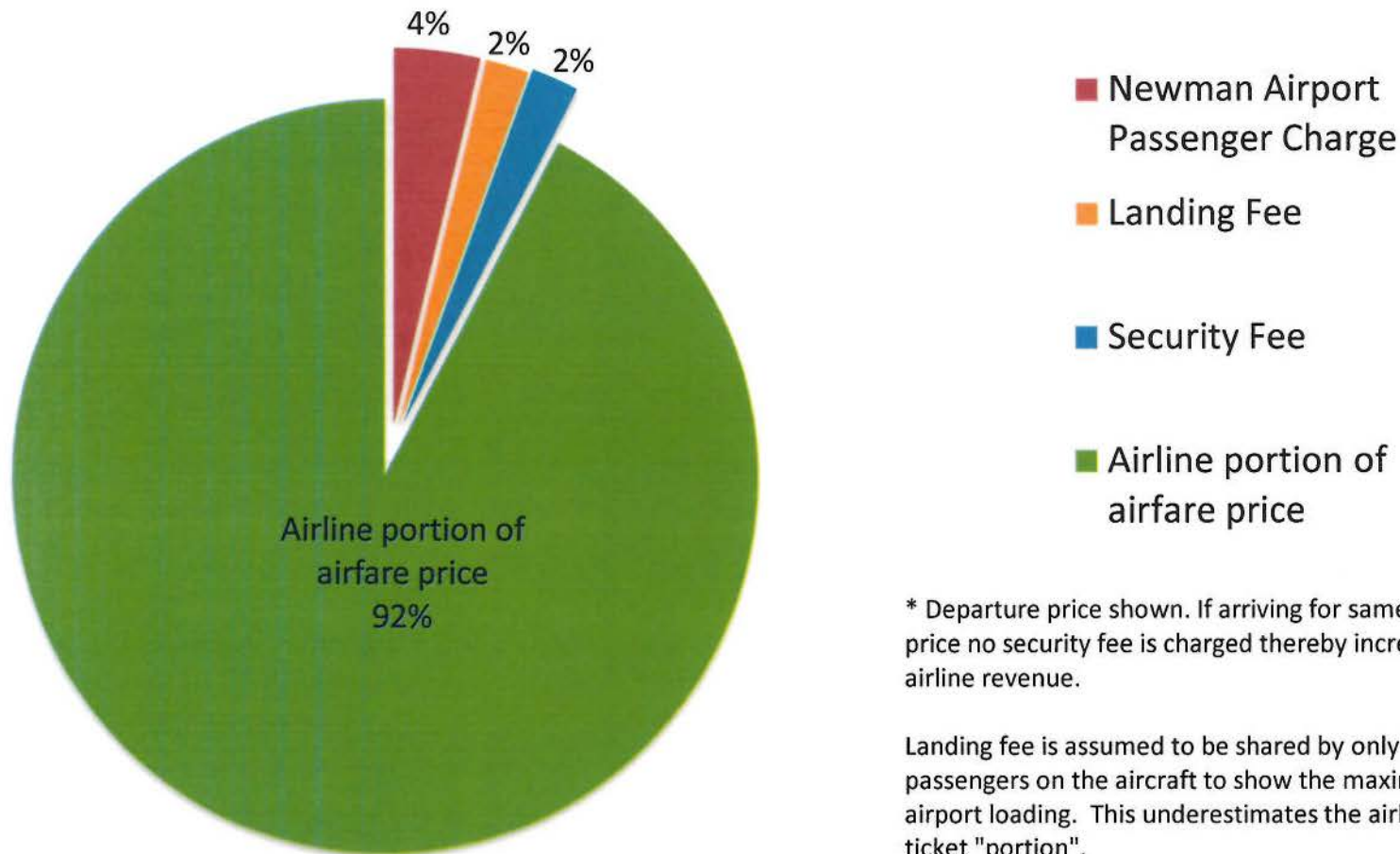
<p>d). Actions that the State and local government authorities can take to limit increases to airfares without undermining the commercial viability of RPT services;</p>	<p>Although intervening directly in the setting of prices could have unintended consequences, the State Government and the Economics and Industry Standing Committee can assist by:</p> <ul style="list-style-type: none"> i) Putting in place measures that will allow for price information to be comparable. Currently price quotes on airline websites are difficult to track and have no accompanying quantity numbers. This raises suspicions that discount fares are offered in very small quantities only for marketing purposes; ii) State Government can create and foster market competition. The perception is that in the current duopoly the free market is not leading to transparent and fair pricing. By considering regulated routes and government tenders for scheduled services, artificial competition can be created to allow market forces to come into play; iii) State Government can advocate for arrangements similar to the Ichthys LNG venture in Broome where Shell undertook to purchase tickets from both Qantas and Virgin as well as not to purchase discounted tickets so that these are reserved for the community; iv) Putting in place an independent economic regulation oversight enquiry similar to the monitoring that is conducted by the Australian Competition and Consumer Commission (ACCC) in accordance with the Airports Act 1996 and the Competition and Consumer Act on leased capital city airports. Reports are made public; and iv) Lobby for a change from the current full FIFO exemption provided by the Fringe Benefits Tax Assessment Act to a partial exemption.
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<p>e). Actions that airlines can take to limit increases to airfares without undermining the commercial viability of RPT services; and</p>	<p>i) Airlines are entitled to a commercial return. However, it becomes a matter of public concern if the perception exists that vulnerable communities are leveraged to maximise shareholder value and dividend payments. Airlines could rebuild trust by working together with Local, State and Federal Government to create an understanding within the community of the reasonableness of pricing by:</p> <ul style="list-style-type: none"> a) Having reasonable pricing; b) Pricing that is comparative with that offered in other markets; c) Pricing that is justified; d) Earning returns on routes that are publicly defensible; and e) Being willing to work with Parliamentary Enquiries to provide data that publicly shows pricing reasonableness. <p>Should a regular economic regulation review show that this is not the case, market pressures will step in to put fees to reasonable levels.</p> <p>ii) Airlines could consider changing the current approach to airport engagement whereby significant downward pressure is brought to bare upon a very small portion of the cost drivers in an adversarial manner. Working together will likely yield better results and understanding from the community.</p> <p>iii) Airlines could use reductions in fees provided by communities to lower airfares rather than be perceived to be rolling those concessions into the bottom line to fund shareholder pay-outs.</p> <p>iv) Airlines could cooperate with Local Government to implement a "Locals Card". The aim of this will be to provide legitimate permanent residents of the Shire of East Pilbara with cheaper flights.</p> <p>v) Airlines could implement a responsible community approach when negotiating airfare tenders with resource companies. This should at minimum include the ring fencing of cheaper fares for community members.</p>
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<p>f). Recent actions taken by other Australian governments to limit regional RPT airfare increases.</p>	<p>i) Western Australia could consider rolling out a version of the Queensland Government Regulated Air Services program. This is similar to the Coastal Network Contract that the WA Government operates and can be used to great effect to create:</p> <ul style="list-style-type: none"> a) Competition on routes where established providers can easily leverage market power for a short time to create barriers for entry by way of a short term capacity push or ticket fire sales that new entrants cannot match; b) Routes within our State between regional airports. Currently most regional passengers utilise air routes within Western Australia that cycle through Perth Airport. Although a world class facility, it does add two additional sector legs (extra time and airfares must be purchased) per return trip. A Regulated Air Services program can link communities directly and put downward pressure on airfares between those areas and Perth; and c) A market entry for a low cost provider, or the opportunity for a local provider to upscale in order to foster future competition.
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ATTACHMENT 2

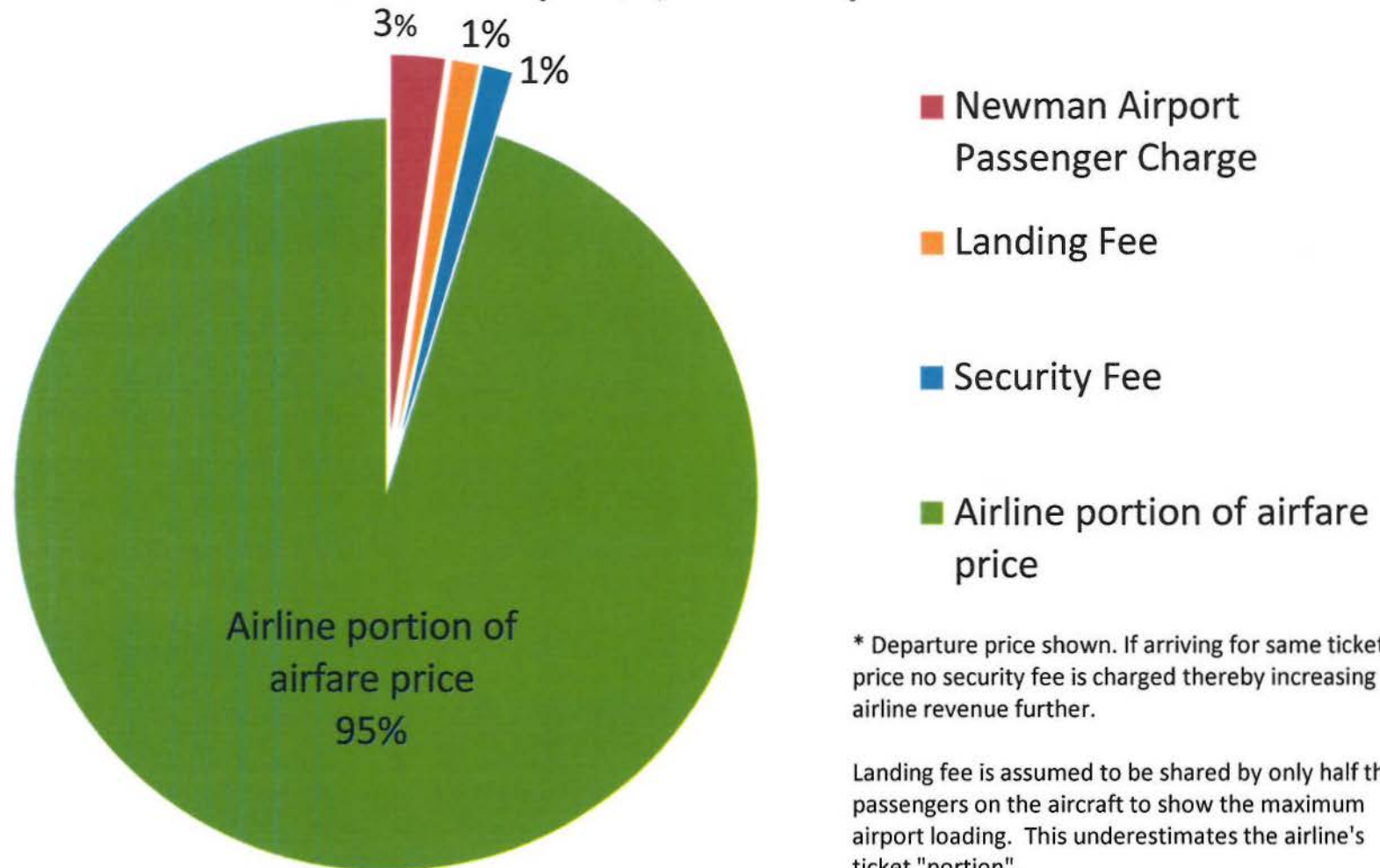
Ticket make-up at \$600 ticket price*



* Departure price shown. If arriving for same ticket price no security fee is charged thereby increasing airline revenue.

Landing fee is assumed to be shared by only half the passengers on the aircraft to show the maximum airport loading. This underestimates the airline ticket "portion".

Ticket make-up at \$1,000 ticket price*

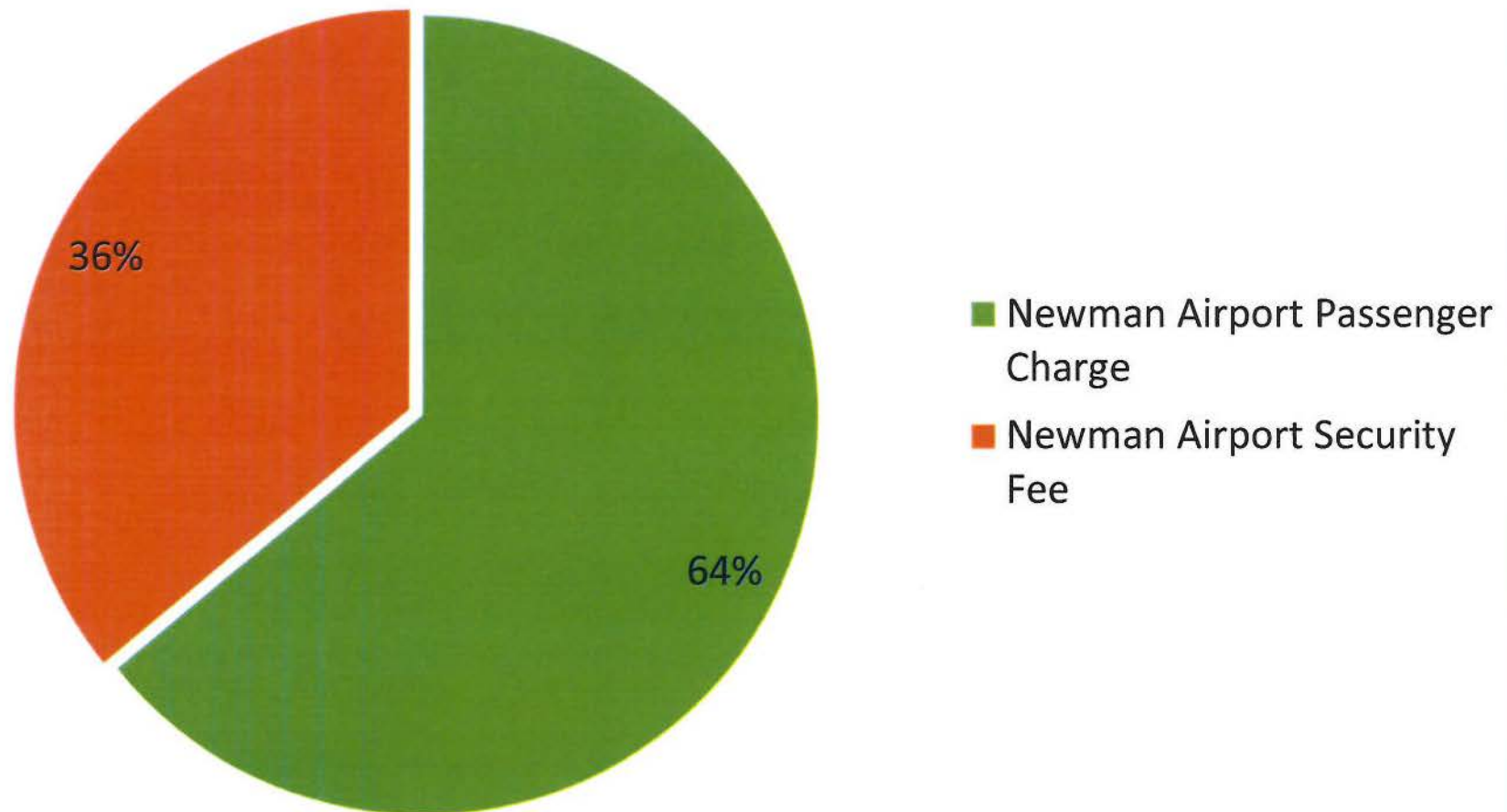


* Departure price shown. If arriving for same ticket price no security fee is charged thereby increasing airline revenue further.

Landing fee is assumed to be shared by only half the passengers on the aircraft to show the maximum airport loading. This underestimates the airline's ticket "portion".

ATTACHMENT 3

Breakdown of fees charged to passengers at Newman Airport



ATTACHMENT 4

