

CONCORDIAVOX

To :

Aviation White Paper Branch, Domestic Aviation & Reform Division
Department of Infrastructure, Transport, Regional Development, Communications and the Arts
CANBERRA ACT 2601

Dear Sir/Madam,

Thank you for the opportunity to contribute to the development of the Australian Government's Aviation White Paper.

At Concordia Vox, we are committed to providing reliable ESG data that investors can use to make informed assessments of the long-term performance of companies. Our focus is on the 'S' part of ESG, social factors, which we measure through the use of artificial intelligence and automation to build independent datasets that capture the sustainability of business practices that impact consumers and employees.

A research priority of ours is the risk to shareholder value associated with business practices that boost short-run profits by compromising the quality of a company's products or services, sometimes in ways that are not completely visible to shareholders. In the aviation sector, these risks are particularly acute due to the information asymmetries that exist. Furthermore, given the sector's importance as a critical input for the broader economy, unsustainable practices can have ripple effects that ultimately diminish long-term returns for investors, even those with no direct exposure to airlines.

It is from this perspective that this submission has been prepared, with an emphasis on achieving more effective competition and consumer safeguards to the mutual benefit of consumers, employees and long-term investors. The submission considers this in two parts:

- Discussing key market failures that have emerged under deregulation
- Overview of policy interventions the White Paper could adopt in response to these concerns and to support other policy objectives

We look forward to contributing further information on these matters through the coming stages of the White Paper's development.

Yours faithfully

James Pawluk

Founder

Part A: Market failures

The White Paper should examine the extent to which deregulation can cause or exacerbate specific market failures and this submission identifies two for its consideration.

Risk of Cherry-Picking and Under-Servicing in the Aviation Industry

The aviation industry is a "network" business that can be susceptible to the cherry-picking of profitable routes by some carriers, leaving other parts of the network underserved. This not only negatively impacts the locations directly affected but also undermines the utility of the network as a whole, thereby diminishing the economic value it generates.

This issue has been studied extensively, with the current Chairperson of the Fair Trade Commission having written about it before her appointment by the Biden Administration. I would like to refer the Department to one of her more prominent articles, which describes the hollowing out of aviation services for large cities such as Cincinnati and St Louis since deregulation [1].

In Australia, we tend to accept deficient competition in some industries as an inevitable consequence of having a vast continent coupled with a small domestic market. However, even in the world's richest economy, growing cities with over two million residents cannot sustain essential air services under full deregulation. Therefore, we should be open-minded to the possibility that certain characteristics of the aviation sector may be inhibiting access to affordable and reliable air services in Australia.

Asymmetries in Knowledge and Bargaining Power between Passengers and Airlines

The aviation industry's complexity makes it vulnerable to asymmetries between consumers and firms. Although some level of asymmetry between passengers and airlines may be expected, it becomes concerning when firms make efforts to exacerbate or exploit them to their advantage, to the detriment of their customers.

Our research suggests that Australian consumers could have heightened exposure to potential downsides. For instance, airlines impose relatively onerous restrictions or fees on their customers making changes to their bookings compared to the flexibility they afford themselves, including the ability to cancel flights when they haven't sold enough seats. This negatively impacts not only those whose travel is disrupted but also results in higher prices on affected routes. When an airline is not committed to operating a service, it can keep prices higher, with the comfort that if they don't fill enough seats, they can consolidate that flight with flights on either side.

The data previewed in the addendum shows that Australian carriers were significantly overrepresented among flight cancellations for departing international flights from a popular overseas holiday destination. A traveller returning home to Australia on board an Australian airline, in the six weeks to 7 March 2023, was almost 22 times more likely to have their flight cancelled than a passenger travelling back to another country or back to Australia on a foreign carrier. This is inconsistent with claims that the flight cancellations Australians have been experiencing post-COVID are no different from what's happening around the world.

Another example, also previewed in the addendum, is the extent to which Australia's dominant airlines have taken steps to inhibit the flow of information regarding their service performance and pricing to consumers and other stakeholder groups. This is in contrast to most of their overseas counterparts who have not taken similar actions.

[1] <https://washingtonmonthly.com/2012/03/01/terminal-sickness/>

Part B: Policy interventions

This next section sets out potential policy responses that the White Paper could adopt to in order to address various market failures and assist with other policy objectives.

Fortunately, since deregulation, there have been several positive developments and innovations in the aviation sector that policymakers can leverage to improve outcomes, rather than resorting to reversing the clock. One of the key strengths of this sector is the skills and technologies that have been developed, making it one of the most advanced industries in Australia. This presents a tangible opportunity for policymakers to collaborate with forward-looking businesses and investors to achieve shared values and national goals, as called for by the Treasurer earlier this year.

A National Aviation Market Facilitator

To improve the functioning of aviation markets, the Australian Government should established a market facilitator with the ability to enter into bulk purchase agreements with domestic carriers and then sell those seats under its own terms, such as to international carriers or independent travel agents.

In contrast to regulating airfares or route access, or direct government competition or subsidies, the goal here is to enable airlines to offload some of the risk associated with individual services. The capacity to on-sell would give the market facilitator exposure to any upside and the opportunity to influence the quality of contractual terms available to consumers.

By running it as a commercial venture with clear objectives, such as facilitating safe, affordable, and reliable aviation services for all Australians, it would be able to compete for talent with the sector itself and build an independent expertise that policymakers can rely on. Similar to the way the Australian Energy Market Operator (AEMO) does for the energy policy.

Adapting aspects of AEMO's industry representation could allow it to serve a number of secondary functions that would help improve the

functioning of Australia's aviation market:

- Act as a single purchaser on behalf of any level of government looking to develop new routes in their jurisdiction or improve the efficacy of existing forms of support.
- Serve as a transparent, cross-industry forum to assist government with the design of financial support packages in response to future crises. This could include the capacity to deploy its own support (rather than wait for government) provided market participants can agree on a method for recovering.
- Assume responsibility for setting sector-related government fees or charges to fulfil cost recovery targets with greater alignment to national policy priorities.
- Provide independent advice and coordination for transitioning Australia's aviation sector to net zero emissions.

Price signals to deter flight cancellations

Flight cancellations or long delays can cause significant inconvenience for travellers, which is why the European Union established rules in 2004 to compensate passengers in such events. This compensation can exceed the cost of the original airfare, particularly for short-haul flights. However, such rules did not decimate the low-cost carrier (LCC) business model, as the three largest LCCs have grown at four times the rate of the three largest traditional airline groups.

By implementing similar compensation rules in Australia, airlines would be deterred from cancelling flights purely for short-term profit. It would also ensure that cancellations are due to factors beyond the airline's control. The Australian scheme need not replicate all aspects of the EU scheme, and the Biden administration implemented its own measures in August 2022.

One important design aspect that Australia should retain is the option for passengers to submit claims through third parties. This is to ensure that airlines cannot create administrative barriers that undermine the scheme's effectiveness. Additionally, it may be worth considering tailoring penalty values and thresholds to individual sectors. For instance, the compensation required for cancellations on a busy route during peak hours could be different from those required on less-travelled routes.

To encourage experimentation and limit the risks of a one-size-fits-all scheme, the White Paper could encourage airports to introduce their own compensation schemes through contracts with airlines. Airports have a strong incentive to ensure passengers are satisfied as their financial compensation is calculated on a per-passenger basis. Additionally, systematic flight cancellations negatively impact airport utilization. Therefore, airports are well-positioned to administer compensation arrangements via a commercial approach rather than regulation.

Maximising the use of hubs that align to Australia's economic interests

As much as passengers might always prefer to fly direct, a large majority of the world will only every be accessible to Australia via transit hubs. A central question for the White Paper is whether to maintain a laissez-faire policy on which hubs should be most reliant upon. In answer this question it's worth noting that:

- Many countries have a national hub strategy to advance their own economic interests, meaning networks and routes are unlikely to ever be free from distortion (and Khan's article makes clear how big the distortionary effect of hubs can be);
- The differing commercial incentives for hub-and-spoke networks compared to point-to-point operations can explain some of the superior service performance of non-Australian carriers in the example in the addendum;

This doesn't mean Australia can or should follow Saudi Arabia's recent announcement to build six parallel runways for a brand new airline whose goal is to reach the size of Emirates in a quarter of the time.

Instead, market-based policies could craft a middle course between extreme state intervention and the current laissez-faire approach.

For instance, in early 2022 Qantas CEO Alan Joyce acknowledged the feasibility of a Darwin hub while pointing out it would take to years to build up demand. Its understandable why one airline wouldn't act on its own to develop such a network - it would be immediately undercut by established global hubs.

But where airlines stuck at 'the end of line' might traditionally be at a competitive disadvantage, government policy can flip Australia's geography into a strategic advantage. by pursuing of a multi-carrier hub that simultaneously preserves competitive-neutrality for international carriers alongside cabotage restrictions for domestic sectors.

The market facilitator proposed above can support this by purchasing capacity on domestic services between Darwin and Perth and the rest of Australia, which it can use to guarantee competitive access for international carriers that connect to either of those hubs.

Such an approach can boost the overall size of the domestic market, providing more scale to sustain meaningful competition. It can also allow more international carriers to connect to Australia - those who cannot service Sydney or Melbourne directly would now be able to connect to Australia as a network - which would boost competition on international services as well.

Other strategic factors that the White Paper should examine include:

- the capacity of various hubs to support regional connectivity;
- aligning with foreign policy and trade priorities such as the South East Asia Economic Strategy;
- expediting the shift towards lower-emissions technologies; and
- enhancing Australia's capability for repatriation.

