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AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Attached is the submission from the Board of Airline Representatives of Australia (BARA) to the review of Australia's future tax system.

Please contact the undersigned on 02 9299 9919 on matters related to the contents of the submission.

Yours faithfully

Warren Bennett
Executive Director



BOARD OF AIRLINE REPRESENTATIVES OF AUSTRALIA
SUBMISSION TO
THE REVIEW OF AUSTRALIA'S TAX SYSTEM 2008

1. Introduction

The Board of Airline Representatives of Australia Inc (BARA) is the industry association representing the interests of international airlines operating to and from Australia. BARA currently has 37 international airline members.

BARA aims to establish a recognised means of communication between member airlines and statutory and other organisations whose interests and actions influence or affect member airlines and the aviation industry. Its purpose is to act on issues affecting the aviation industry in Australia and to provide a single concerted voice on policy and other matters when dealing with the Federal and State governments and other aviation industry stakeholders.

BARA's limited resources are directed towards representing international airlines in matters related to:

- (a) Ensuring that government controls and intervention regarding taxation, aviation operating efficiencies and financial parameters are efficient, equitable and consistent with global aviation activities and practices,
- (b) development of aviation infrastructure to service international airline operations,
- (c) access to and charges for aviation infrastructure for international airlines,
- (d) air traffic management operations and charges,
- (e) border control and passenger facilitation at international airports,
- (f) aviation security requirements, and
- (g) the impact of aviation on domestic and international environmental outcomes.

The following comments, therefore, relate to factors affecting (a) above with regard to international air services only. In this regard there are elements of the terms of reference for the Review of Australia's Tax System 2008 (the Review) that are of particular interest to airlines operating international air services to Australia. Those matters of interest are that:

- (a) raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and inter-generational) and minimise complexity for taxpayers and the community;
- (b) there should be enhancement of taxation arrangements on consumption (including excise taxes), property (including housing) and other forms of taxation collected primarily by the States; and

- (c) consideration should be given to the interrelationships between the tax system and the proposed emissions trading System (ETS)

2. Revenue Raising, Economic Efficiency and Equity

The Commonwealth Government raises revenue from airlines that operate international air services to Australia via direct taxation and via payments to Government monopoly service providers. Whilst the latter payments are notionally payments under Government cost recovery provisions applicable to those service providers, they can operate via inappropriate pricing signals to limit market based mechanisms that encourage productive efficiency.

2.1 Aviation payments for regional development initiatives

BARA is concerned that successive governments have sought to incorporate regional development initiatives within the pricing structures implemented by Government agencies for services provided to international airlines. Often this has resulted in charges imposed on international airline services being higher than they otherwise should be, so that charges for regional aviation services may be reduced below their full cost of delivery. Such pricing arrangements are equivalent to a tax on that particular segment of the aviation industry that operates international air services to the principal capital city airports.

BARA maintains that Government and industry policy in relation to air services to regional communities should be based upon the principle that those services meet the full cost of delivery. Location specific pricing (LSP) for all elements of regional air services, based on avoidable (incremental) cost, is consistent with maximising allocative efficiency, the principle of competitive neutrality, promoting productive efficiency and 'sustainability'. On the other hand, the notion of cross subsidisation of regional aviation services by charges on international or domestic trunk air services will damage competition, reduce allocative and productive efficiency and will quickly become unsustainable if there is a significant downturn in demand for those services from which the subsidy is extracted.

BARA is concerned, therefore, that in 2005 the Australian Competition and Consumer Commission (ACCC) abandoned its long established position on LSP for aviation rescue and fire fighting (ARFF) services provided by Airservices Australia. The ACCC apparently decided that allocative efficiency was best served by allocating at least part of the specific fixed costs of providing ARFF services at regional locations to major airports.

There are worrying implications of the ACCC's decision to accept network pricing for ARFF services for the efficient delivery and pricing of other aviation infrastructure developments.

By permitting Airservices Australia, the monopoly supplier of ARFF services, to establish a network pricing structure the ACCC set a precedent for the notion that any service provider with specific fixed costs at a regional airport or airports can seek to allocate that cost to the major airports. The obvious other example is terminal navigation (TN) services, also supplied by Airservices Australia. However, the notion

that the costs of security services at regional airports could be subsidised by charges at the major airports is another possible example.

There is already some cross-subsidisation of regional TN services via payments made by international and interstate domestic airlines for en-route navigation services. The ACCC's failure to address the broader implications of overcharging for ARFF services at major Australian airports opens the way for the argument that regional TN costs also should be allocated directly to major airports.

There is now evidence that Airservices Australia may seek to take advantage of this opportunity. An Airservices Australia options paper regarding the structure and level of navigation charges following the expiry of the current pricing agreement at the end of 2009 indicates that Airservices Australia may be contemplating far greater reliance on network pricing for navigation services.

Targeted subsidies to airlines operating to regional locations funded through overcharging at major airports will damage competition and distort resource allocation within the Australian economy. This is because there are significant levels of inter-modal competition in the downstream markets served by airlines. This competition can include both land transport, including buses, rail and private cars and, sometimes, sea transport, such as ferries.

Inter-modal competition and regional passenger markets are well understood by the ACCC, though fundamentals were ignored in the return to network pricing for ARFF services. BARA has previously pointed out that the ACCC's submission to the Productivity Commission's (PC) 2002 inquiry into *Price Regulation of Airport Services* ACCC argued that:

"For tourists, particularly domestic tourists, the alternatives [to air travel] may be more palatable. While the available substitutes are imperfect, the differences in cost between air travel and other forms of transport may be large enough to compensate consumers for the associated disutility of using the inferior transport mode." (page 62)

and:

"In general, airports where tourists are a substantial proportion of passengers are more susceptible to competitive pressure from alternative modes of transport ..." (page 63)

and:

"... ferry services connecting Melbourne and northern Tasmania are an attractive alternative to flying (for many visitors). In this case demand side substitution possibilities are much greater than for other capital city airports." (page 64)

Network pricing structures for regional aviation services subsidise the provision of those services in the markets where there is the greatest competition from alternative forms of transport. As a result, the allocative efficiency gains at regional locations assumed by the ACCC (that is, an increase in the number of passengers on airlines serving regional locations) are largely nothing more than a distortion of competition and resource allocation away from competing forms of transport towards air transport.

The former Department of Transport and Regional Services (DOTARS) succinctly summarised the problems of targeted subsidies for regional airport passenger trips. In evidence to the Standing Committee on Transport and Regional Services DOTARS stated:

“... interventions to subsidise regional air services are a very blunt instrument and often do not achieve the results that are intended. Part of this is about squeezing out alternative forms of transport, such as bus operators. Often it ends up being a subsidy to an operator rather than the maintenance of a continued provision of services on regional routes.” (June 2003, page 18)

When one is prepared to look beyond just air transport passenger services the situation gets worse. Wider adverse economic consequences also emerge. International freight operators also cross subsidise regional passenger markets. Further, the intermediate input costs increase for Australian companies that rely on air passenger transport to conduct business.

Productive efficiency is also reduced under network pricing. Only LSP is consistent with promoting productive efficiency in the provision of regional aviation services.

Under network pricing the incentive to find ways to minimise the costs of regional aviation services and maximise opportunities will be greatly reduced. In particular, cost savings are not retained at the airport where they are derived. Instead, almost all of the gains are distributed away to other airports in setting the base level network charge.

Accepting network pricing also ignores competitive neutrality considerations. The Australian Government Competitive Neutrality Complaints Office (AGCNCO) was established to promote efficient competition between public and private businesses. It seeks to ensure that government businesses do not enjoy competitive advantages over private sector competitors simply by virtue of their public sector ownership. Importantly, the Government requires that:

- its businesses charge prices that fully reflect costs, and
- its businesses are not commercially disadvantaged (or advantaged) by requirements to deliver “non-commercial” services or to provide services at subsidised rates to particular groups of consumers.

The Airservices Australia approach involves charging below the price a private firm could charge at regional locations and above the price at Sydney, Melbourne and Brisbane airports. Airservices Australia can only do this because it is a government entity with a dominant market position.

Whilst there is no actual competitor to Airservices Australia in the provision of ARFF services or navigation services, there is a body of research by the PC, ACGNCO, Bureau of Transport and Regional Economics (BTRE) and ACCC that clearly indicates there is a broader competitive neutrality issue associated with subsidising ARFF services at regional locations that goes beyond the direct competition for ARFF services. The same principles apply in the case other aviation services.

Network pricing structures severely limit market-based mechanisms to encourage productive efficiency. With both inter-modal competition and charges for regional aviation services based on incremental cost by location, airlines, airports and other service providers have a continual market-based incentive to improve productive efficiency. Under the Airservices Australia approach, this incentive is largely removed. Instead, the merits of price controls are relied upon to encourage productive efficiency.

With regard to the broader issue of the development of Australia's regional aviation network, BARA maintains that government is the only appropriate source of incentives and subsidies via the general taxation system. BARA further maintains that any incentives and subsidies provided by government must be transparent and direct and must not be derived from other aviation stakeholders.

2.2 Cross-subsidisation of air traffic management infrastructure

The government is presently considering its approach to the introduction to satellite technologies for navigation and surveillance. A joint discussion paper – prepared by the Department of Transport and Regional Services, Airservices Australia and the Civil Aviation Safety Authority in July 2007 – canvassed options for the introduction of that technology and the means of funding its introduction. BARA generally supports the deployment of ADS-B and GNSS technologies for Australian aviation. It is acknowledged that the proposed technology will deliver safety and operational benefits to the aviation industry.

The introduction of the technology also will avoid the need for further investment by Airservices Australia in the future in existing radar technology. BARA, therefore, supports the timely deployment of ADS-B and GNSS technology.

However, the joint discussion paper included options for cross-subsidisation of the costs associated with introducing the new technology by international airlines for the benefit of other aviation stakeholders. Those stakeholders included the military and GA operators.

As cross-subsidies are an effective tax on one party for the benefit of another, BARA strongly opposes the notion that there should be any cross subsidy by airlines of the costs of some redundant navigation and surveillance facilities to be retained beyond 2012/2014 to support military operations. The full cost of any redundant facilities retained for military purposes should be met by the Department of Defence.

BARA is also concerned that the government may consider “cross-industry” funding to assist the transition of light aircraft to the use of ADS-B and GNSS technologies. BARA holds the strong view that the Government and Airservices Australia must provide a guarantee that Airservices Australia's charges to international airlines will not increase as a result of the deployment of the technologies to general aviation.

It seems that the government will require fitment of ADS-B to all aircraft above 5700 MTOW. BARA does not object to the proposed mandate. However, given the likelihood that some civil and military aircraft will not be compliant by the mandated date, it is imperative that operational priority be afforded to civil aircraft equipped

with ADS-B over aircraft not equipped and operational priority be afforded to civil aircraft in civil airspace over military aircraft not equipped.

The broader question of the pricing structure to be adopted for air traffic management services is also matter of some concern to BARA. It was noted in section 2.1 that the adoption of a network pricing arrangement for ARFF services was contrary to encouraging productive and allocative efficiency. BARA maintains that network pricing arrangements also should be avoided in the case of air traffic management services. The same arguments against network charges that were put forward in the case of ARFF charges are equally applicable for TN and en-route navigation services.

2.3 Airline Levy for Bureau of Meteorology Services

Inappropriate pricing signals are also an effective tax on one party relative to another. The Bureau of Meteorology pricing structure for aviation weather services is a good example.

The charging mechanism for Bureau of Meteorology services to aviation users is via the Airservices Australia en-route navigation formula, which comprises a weight and distance component. The charge to users is determined by the weight of the aircraft, as well as the chargeable distance for each sector of flight. This results in operators of larger aircraft paying a higher fee for Bureau of Meteorology services than other users. BARA does not accept that this is the most appropriate methodology for apportioning Bureau of Meteorology charges.

Bureau of Meteorology costs need to be more transparent to demonstrate how respective cost allocations are made between aviation operators, maritime users and public weather services. Further, in line with the “user pays” principle, aviation services should be funded, as appropriate, by members of that user group. For example, regional Tower Area Forecasts should be paid for by users of that service.

3. Taxation Arrangements on Consumption, Property and Other Forms of Taxation Collected Primarily by the States

The aviation industry is the subject of a Commonwealth Government tax and State government taxes that are taxes on tourism consumption. They are:

- (a) the Passenger Movement Charge imposed by the Commonwealth Government, and
- (b) State Government stamp duties imposed on airlines global insurance policies.

3.1 Passenger movement charge

The PMC commenced life as the Departure Tax, which was introduced in 1978. The rationale for its introduction was that it would pay for the full cost recovery of customs, immigration and quarantine (CIQ) processing at international airports and the cost of the issue of short term visitors’ visas. However, the Departure Tax was a general revenue item not linked to costs associated with CIQ services.

The Departure Tax was collected by a government agency – Australia Post – acting on behalf of the Commonwealth Government. BARA understands that a primary motive for the introduction of the PMC was that it would cost the Government less to administer because of the responsibility on airlines for collection.

At the time of its introduction the Departure Tax was set at \$10 per passenger. It was increased to \$20 per passenger on 1 June 1991. The Departure Tax was replaced by the PMC on 1 January 1995 and increased to \$27. The Government offered no explanations of the reasons underlying these rate increases.

The PMC was further increased to \$30 per passenger in 1998. This increase was purportedly implemented to raise money for greater tourism advertising to offset the effects of the Asian economic downturn. A further increase in 2001 raised the PMC to \$38. The latest increase, announced in the 2008-09 Budget, raises the PMC to \$47 per passenger.

3.1.1 PMC administrative problems

The PMC is a charge levied on airline passengers departing Australia. It is collected by airlines on behalf of the Commonwealth Government under individual agreements between the airlines and the Australian Customs Service (ACS). The ACS is the government agency responsible for administering the PMC. The money collected by airlines is remitted to the Government.

Although the rationale for the PMC is cost recovery, it is a tax and the revenue collected is paid into consolidated revenue. The ACS, Department of Immigration and Citizenship (DIAC) and Australian Quarantine and Inspection Service (AQIS) costs for border control services are met through normal Budget appropriations.

Airlines are dissatisfied with the current administrative arrangements relating to the collection of the PMC. This dissatisfaction arises for two reasons.

First, the PMC is a hybrid revenue arrangement. Whilst it was originally implemented to cover the costs of CIQ services at airports, it is now – according to the Australian National Audit Office (ANAO) Audit Report No 12 – applied partly as a general revenue raising source and is no longer solely linked to a cost recovery of CIQ services. The PMC, as a hybrid revenue arrangement, is characterised by a disturbing lack of transparency. There is no accountability by Government for that part of the PMC which is allocated for the provision of CIQ services and that part which is a general revenue raising tool. BARA believes that, as a matter of principle, hybrid revenue arrangements such as the PMC should be discontinued and all Government collections made either a transparent cost recovery mechanism or a transparent taxation mechanism.

Second, the collection arrangements in place for the PMC result in a direct net cost on airlines, despite an allowance for airlines to claim a small administrative fee. Collection of the PMC places a considerable administrative burden on airlines. That administrative burden results in significant direct costs that airlines are required to bear. Airlines bear further direct costs because not all tickets issued overseas include the taxes as part of the overall fare received by airlines. Despite this leakage, airlines are still required to forward the tax to the Government.

The current administrative arrangements and agreements between airlines and the ACS came into effect on 1 July 2001. The original agreements with airlines provided for a 5% tolerance between assessed collections and actual remittances to the ACS. The 5% tolerance was reduced to 3% in 1998. However, the new agreements removed the reference to the 3% tolerance in accordance with a recommendation contained in Audit Report No 12. Hence, from 1 July 2001, there has been no recognition of the direct cost to airlines associated with the leakage from the PMC collections, principally due to travel agents failing to include the charge on some tickets. BARA maintains that, where a third party is required to collect a charge from consumers to meet Government costs, there should be adequate arrangements in place to allow the third party to deduct as near as possible to the full costs of collection and remittance of the charge.

3.1.2 PMC policy shift to disguise over-collection

Whilst the PMC is a charge under the Commonwealth Government's taxing powers, the Treasurer's 1994 Budget Speech and the second reading speech for the PMC legislation stated that the PMC was introduced to recover or "fully offset" the costs of CIQ processing of incoming and outgoing international passengers and to recover the costs of issuing short-term visitor visas.

The Auditor General's Audit Report No 1 (1996-97) stated that "despite its character as a tax, some descriptions of the PMC to the public suggested the impost was a charge intended (simply) to recover CIQ and short term visa issuing costs." (page 7, para 2.6)." In that Report the ANAO recommended that ACS, the (then) Department of Immigration and Multicultural Affairs (DIMA) and AQIS collectively monitor the costs of their activities the subject of the PMC to provide assurance that these costs were fully offset, consistent with the PMC policy objective. (Recommendation No 1, p xv) The ANAO noted at the time that the public rationale and policy objective of the PMC was clearly that of cost recovery.

The ANAO conducted a follow-up audit of the administration of the PMC in 2000 (Report No 12). In that Report the ANAO stated that the PMC "is now applied partly as a general revenue raising source and is no longer solely linked to a cost recovery of Customs, Immigration and Quarantine service." (p13) On the basis of the Auditor General's Report No 12 it appears that a policy shift took place with regard to the PMC.

The apparent policy shift that now has the PMC identified as a tax was surreptitious. BARA questions whether the policy shift was an attempt to disguise the fact that the PMC over collects from airline passengers the costs of the CIQ services it was introduced to cover.

3.1.3 Evidence of over-collection of PMC

BARA submits the fact that the ANAO acknowledges that the PMC is a general revenue raising tool confirms that it collects more than is required to meet the cost of CIQ services.

The ANAO Audit Report No 1 concluded that the PMC over collected \$19 million from airline passengers in 1996-97 (p xii). Further work undertaken by BARA also suggests that the PMC over collects the costs of CIQ services (see Attachment 1).

In 2002-03 the PMC raised \$290.6 million for the Government and there is publicly available information to suggest that the PMC generates significant surplus funds. The data that point to an over-recovery of CIQ control costs by the PMC are a Government report titled *Passenger Movement Charge; Quantum, April 1997* and information supplied to the House of Representatives on 27 November 2000 by the Attorney General.

3.1.4 PMC issues to be addressed

It was noted above that the ANAO Audit Report No 1 concluded that the PMC over collected \$19 million from airline passengers in 1996-97. However, for 1996-97, because international airlines collected less than the aggregate estimated by ACS as correct for that year, based on total passenger departures on international flights and to the limit of the agreed tolerance, the airlines were required to make up the "shortfall". BARA maintains that this process requires reassessment.

It is unreasonable to expect that the PMC will at all times be correctly reflected on passenger tickets. Airlines providing actual carriage are often not the ticket issuing agent. A significant proportion of airline tickets are issued by travel agents not under the control of the carrying airline. Many tickets covering travel sectors from Australia will have been issued in foreign countries by airlines other than the carrying airline. Increases in code share practices, the further development of alliances and technological advances (e-tickets, etc) mean that the incidence of one airline issuing tickets for travel on other airlines will increase. Further, the operational requirement for speedy passenger throughput at check-in is not conducive to close scrutiny of each ticket to determine that all taxes are correctly noted.

The Government recognised the above matters when the arrangement was made originally with airlines to act as PMC collectors. As noted above, 5% tolerance on total collection estimates was granted. However, the tolerance arrangement has now been eliminated. BARA maintains that the original 5% tolerance arrangement should be reinstated.

BARA further maintains that the PMC should conform to the equity and transparency principles applicable to all government charges. Hence, as a minimum, the government should revert to original intent of the PMC to recover the costs of government CIQ services. Further, the government should provide the aviation and tourism industries with timely annual statements of PMC collections and costs of services for which funds were collected.

If the PMC is to remain in place it should conform to the following principles applicable for government charges:

- efficiency - consumers should pay charges based on efficient delivery of services;

- user pays/equity - consumers should pay for costs of those services actually consumed;
- public accountability/transparency - the efficiency of charges levied by government monopoly service providers must be transparent; and
- quality of service - charges imposed by government agencies should not reward them for providing poor service.

There is sufficient evidence to suggest that the PMC fails the second and third of the above principles. BARA submits, therefore, that the PMC represents a hidden tax on tourism.

BARA maintains that the PMC is an inefficient funding mechanism that should be abolished. The PMC suffers from the following disadvantages:

- (i) it is characterised by complete lack of transparency,
- (ii) there is no accountability by Government for that part of the PMC which is allocated for the provision of CIQ services and that part which is a general revenue raising tool,
- (iii) it imposes an unwarranted direct cost on airlines,
- (iv) there is a body of evidence to suggest that the PMC collects more than is required to meet the cost of CIQ services, and
- (v) it fails equity and transparency principles applicable to all government charges.

3.2 Stamp duty on airlines' global insurance policies

In the same way that the PMC represents a hidden tax on tourism imposed via the international aviation sector, so State government stamp duties on airlines' global insurance policies are a tax on international tourism. Various States impose stamp duty on the premiums paid by BARA's members for policies of insurance covering aircraft which fly into and out of Australia. BARA submits that it is appropriate for the Commonwealth to act to put an end to the States' unjustified impost on international airlines.

International airlines arrange airline insurance through the specialist London aviation insurance market, either directly or by re-insurance. The placing of the risk is unconnected with the Australian States and the only basis for seeking to impose duty is the temporary presence of aircraft within a State. BARA maintains it is arguable that the imposition of duty in these circumstances is in violation of Australia's obligations under the Chicago Convention.

Western Australia was the first State to seek to impose duty, at 10% of the total airline insurance premium, on airlines flying to Western Australia. Subsequently, the amount was revised to 10% of a proportion of the total premium for worldwide cover, calculated by the number of landings and take-offs in Western Australia.

Other States have also sought to collect stamp duty on a proportion of each airline's total premium for worldwide operations, calculated by reference to the number of landings in the relevant State to the total worldwide landings. This method of calculating the claimed liability for duty highlights that the duty has ceased to be a

duty on an instrument, but is instead a tax on aircraft landings and take-offs in each State.

The methodology adopted by the States further demonstrates that the States' actions are contrary to two Articles of the Chicago Convention - Article 15, which prohibits fees, dues or other charges for the right of transit or entry or exit, and Article 24, which requires aircraft to be admitted free of duty.

This action by the States adds significantly to the cost of providing air services to and from Australia. It may also prompt retaliatory or imitative taxes in other countries.

This is precisely the type of duty that the Chicago Convention and the various bi-lateral agreements under which foreign airlines' operations are conducted into Australia were designed to prevent. The duty is effectively imposed on the arrival and departure of aircraft in the various States.

The fact that Western Australia initially sought to collect 10% of the total airline insurance premium paid by each foreign carrier flying to Western Australia demonstrates the serious consequences of the tax. Six Australian States and two Territories between themselves could almost double the insurance costs for some airlines, amounting to tens of millions of dollars a year.

In its report on *International Taxation* of 28 February 2002 *The Board of Taxation* recommended measures to remove impediments to Australia's attractiveness as a location for internationally-focused companies to operate regional and global business. The Board expressed the view that taxation was among the "most important factors" behind foreign company decisions that a government could directly influence. Further, the *Warburton-Hendy International Benchmarking Study* confirmed the necessity to reduce taxation levels and, in particular, transaction taxes such as stamp duties imposed by State and Territory governments in Australia.

In light of recent attempts to improve the competitiveness of Australia as a centre for regional headquarters for foreign groups by abolishing taxes and by introducing a more attractive taxation system, the imposition of additional duties at a State level appears counter-productive and appears to be in line with the latest approach of some States to refuse to abolish double-taxation. As efficient and cost effective transportation is crucial to the economic performance of an open economy such as Australia, the additional costs imposed by this tax will have financial consequences for trade and commerce by Australian enterprises and exporters.

The stamp duty imposed on airlines' global insurance policies represents a hidden tax on international tourism. It fails the transparency test. Further, no other jurisdiction imposes a duty on the value of airlines' global insurance policies. It is a tax unique to the Australian jurisdiction.

As the Commonwealth has effective jurisdiction over aircraft engaged in international and interstate carriage and has ratified and given effect to the Chicago Convention, BARA maintains that the appropriate course is for the Commonwealth to enforce the exemptions created by the Chicago Convention, possibly by a regulation under the Air Navigation Regulations.

4. The Tax System and the ETS

BARA is concerned that the taxation review and the review of the Australian Government's policy response to climate change are being pursued separately. In the case of the aviation industry, at least, the two are linked.

BARA understands that the objective of the proposed ETS canvassed in the Government's Green Paper on climate change is to improve the environmental performance of industry via pricing signals designed to speed the process of reductions in greenhouse gas emissions, its impact on the aviation industry should be reviewed in this context. BARA questions the extent to which the changed pricing signals inherent in the proposed ETS will speed up the implementation of more environmentally benign investment decisions and operational procedures. BARA maintains that existing pricing signals and financial imperatives as they apply to aviation are especially effective in driving environmental improvement by the industry.

The additional costs imposed on Australian aviation by the ETS will not induce relatively greater efforts for environmental improvement. They will simply impose a deadweight cost on the industry – an effective tax – and reduce its capacity to undertake further environmentally efficient investment into the future. The proposed ETS risks encouraging a perverse outcome in the case of the aviation industry.

BARA's contention is supported by the following:

- (a) The aviation industry has a good environmental history dating back 40 years. The UN attributes only 2% of carbon emissions to aviation – motor vehicles are responsible for 18%, electricity and heating 35%, cattle production 9%. Airlines are a small part of the climate change problem.
- (b) Airlines have been working on fuel efficiency and emissions reduction since long before Kyoto. There has been a 70% improvement in fuel efficiency in the last four decades. The fuel efficiency of modern aircraft is 3.5 litres per 100 passenger kilometers. The A380 and the B787 will further improve on that performance, taking the figure below 3. Qantas is investing in both the A380 and B787 as part of its fleet renewal and upgrade. Virgin Blue is investing in the B787 as part of its fleet expansion program.
- (c) It is expected that the billions of dollars planned for investment in new aircraft will drive a 25% improvement in global fuel efficiency by 2020.
- (d) As with most industries, technology is at the forefront of tackling emissions. Aircraft and engine manufacturers and airlines are cooperating in planning beyond the A380 and the B787 to the next generation of even more fuel efficient aircraft. Oil companies and airlines are cooperating in the development of alternatives for aviation jet fuel. The Virgin group of companies is presently actively participating in one such program.
- (e) IATA, the airlines' international organisation, has a target of 10% conversion to alternative fuels by 2020.

- (f) Airlines in cooperation with air traffic management organisations are undertaking detailed reviews of flight operations. Every minute that a flight is shortened saves about 60 litres of fuel and 160 kg of carbon emissions. The UN has identified 12% inefficiency in global air traffic management. That is an annual wasted fuel bill of about \$13.5 billion and 73 million tonnes of un-needed carbon emissions.
- (g) Australia boasts a world leader in air traffic management. Airservices Australia is at the leading edge of introducing environmentally friendly user preferred routes. These air traffic management systems have the daily flexibility to take advantage of the best flying conditions.

Australian aviation policy responses to climate change need to acknowledge the position of aviation in the broader climate change issue and the longer term behaviour of the aviation industry in meeting its environmental responsibilities.

4.1 Aviation as a trade exposed industry

The Green Paper dismisses the claims of the Australian aviation industry to be a 'trade exposed' industry. BARA maintains that such dismissal is economically irresponsible and will result in the effective tax on the Australian aviation being higher than is justified.

The Australian aviation industry, for the most part, displays the characteristics of a strongly affected industry. Domestic aviation for tourism purposes competes directly with international aviation for tourism purposes. This is clearly demonstrated by the rapid increase in recent years in the number of outbound passengers from Australia to overseas tourist destinations.

Further, the assessment in the Green Paper that "Aircraft value is not related to the particular routes flown or other geographical characteristics of the asset owner" fails to grasp fundamental factors affecting airline profitability. While "aircraft value" per se might not relate to particular routes flown, the profitability of airlines can be influenced considerably by the variability of supply and demand characteristics of particular routes.

For airlines operating to and from Australia their Australian routes are part of the airline's route network. Such a network typically comprises a core route or routes surrounded by marginal routes. Core routes are characterised by relatively high traffic density with a significant proportion of passengers in the business and premium leisure categories. Marginal routes are characterised by generally lower or more seasonal or more variable traffic density, with a significant proportion of passengers in the leisure category. There are relatively few core routes in the market for international air services to and from Australia. The principal ones would be east coast Australia to London via various transit ports, Sydney to Los Angeles and Trans Tasman routes. It is evident that routes can affect profitability.

Australian based international airlines operate from a small international market at the end of the transport network. They do not operate from hubs at the centre of the transport network. This represents a competitive disadvantage relative to foreign

carriers. Yet Australian based airlines are in direct competition with foreign carriers. The end result of the ETS in imposing a deadweight cost and an effective tax on the Australian based aviation industry will be a transfer of profitability overseas.

4.2 Institutional constraints on aviation

The aviation industry is one of the most highly regulated industries in the world. The ability of the aviation industry to streamline, rationalise and otherwise improve the efficiencies of its operations – and hence its environmental performance – is constrained by institutional rigidities.

These institutional rigidities include:

- (a) the operation of international air services agreements;
- (b) the inefficiencies in the delivery of air navigation services world-wide, and
- (c) the implementation of competition policy.

The case of (c) above is particularly concerning. The objectives of competition policy in Australia may be contrary to the objectives of climate change policy.

A potential strategy for improving the operational efficiencies of airlines may be the rationalisation of the number of airlines world-wide through merger and takeover. Other industries have achieved economic efficiencies via this strategy. Yet this broader economic issue as it affects aviation is not considered in the Green Paper.

BARA is concerned that particular economic imperatives of the aviation industry are ignored by the Green Paper. For example, the ACCC recently rejected on competition grounds the proposal by Qantas to take over Air New Zealand. At the time of the proposal there were arguments for and against it and BARA does not express here the view that the proposal should have been allowed to proceed. Nevertheless, there may have been climate change benefits that may have ensued from the proposal. To the best of BARA's knowledge these considerations were not addressed by the ACCC.

BARA is concerned that sub-optimal climate change outcomes may be imposed on the aviation industry via conflicting institutional rigidities that are in place in the case of aviation. It is BARA's view that the treatment of the aviation industry in the Green Paper is narrowly based and short-sighted. The end result of the ETS for the aviation industry is likely to be an increase in costs for no discernible benefit from a change from current environmental strategies and a net overseas transfer of wealth from the Australian industry.

4.3 A level playing field for Australian aviation

The Australian aviation industry should be granted the same benefits under the proposed ETS as other trade exposed export industries. As proposed, the ETS imposes a new effective tax on Australian aviation via increased costs that are not recoverable. In order to establish a level playing field for the Australian aviation industry under the ETS, the scheme should:

- (a) acknowledge that existing pricing signals and financial imperatives as they apply to aviation are especially effective in driving environmental improvement by the industry;
- (b) recognize that the ETS will simply impose a deadweight cost on the industry and reduce its capacity to undertake further environmentally efficient investment into the future; and
- (c) categorise the aviation industry as a trade exposed industry and extend to the aviation industry the benefits afforded under the scheme to other trade exposed industries.



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30 November 1999

Mr Damon Hunt
 Adviser
 Office of the Minister for Justice and Customs
 Parliament House
 Canberra ACT 2600

Dear Mr Hunt

I refer to your letter dated 23 August 1999 and the attached report on the quantum of the PMC. The Board of Airline Representatives of Australia (BARA) has reviewed the report.

The report provides a very cursory analysis of the costs of the border control agencies in providing what is described as "the short term visa function and the airports function". The data contained in the report is too highly aggregated to provide any comfort to airlines that PMC revenue does not exceed the agencies' costs by a significant amount.

In fact, based on the information provided in the report and on current statistics on international passenger departures, the report apparently demonstrates that the PMC continues to generate a substantial surplus of revenue over costs.

You would be aware that the number of international airline passengers departing Australia during the year ended 31 December 1998 was about 7.1 million. Adopting the conservative assumption that the same number of international airline passengers departed Australia in the fiscal year 1998-99, the amount of PMC revenue generated in 1998-99 would be at least \$202 million. This estimate also assumes a roughly equal distribution of departing passengers between the first and second halves of the fiscal year.

The report identifies the full costs in 1995-96 of the short term visa function and the airports function performed by the border control agencies as \$165.8 million. The report then specifies an average annual rate of growth in costs of 5% as a reasonable estimate of likely future cost increases. Adopting that assumption, it would be reasonable to expect the agencies' full costs to have increased to about \$192 million in 1998-99. This full cost is at least \$10 million less than PMC revenue.

However, the excess revenue generated annually by the PMC could be even greater than \$10 million. This is because the report is unclear about what costs it actually purports to measure. For example, in describing the "approaches applied in agencies to gathering costs" for the Australian Customs Service (ACS), the report refers to "a costing exercise such as is required for passenger processing". It is possible that the ACS costs may include all passenger processing costs, ie the costs of the airports function and the marine ports function. Similarly, the report refers to the Department of Immigration and Multicultural Affairs (DIMA) "short term visitor visa function". It is possible that the DIMA costs may include all short term visa function costs, including the costs of issuing visas to international

passengers arriving in Australia by ship.

Further, the report states that "AQIS costs relating to departing sea passengers are not included in the cost figures provided". BARA welcomes this aspect of the costing exercise, but costs relating to departing sea passengers are irrelevant in any event. It would be AQIS costs relating to arriving sea passengers that would particularly have to be identified and excluded from the border control costs used in the report. The report does not identify those costs as having been excluded.

Of course, the Government's revenue sources to meet the costs of the short term visa function have been expanded since 1995-96 by the introduction of the visa application charge, initially set at \$50 per visa application and currently set at \$60 per visa application.

BARA's view that the PMC generates revenue significantly greater than the correctly measured costs of the border control agencies remains unchanged. Consequently, airlines continue to assert that the surplus revenue generated by the Government's short term visa function and airports function should be directed towards offsetting airline and, hence, passenger costs. For example, the surplus revenue could be applied to paying for Government mandated security requirements at international airports, such as checked baggage screening and passenger screening. Alternatively, the surplus revenue could be applied to the payment of rent and outgoings by the Government border agencies to airport operators so as to permit a commensurate reduction in airline rents and outgoings.

Yours sincerely

Warren Bennett
Executive Director

cc Mr Dario Castello, Assistant Secretary, Border Control, Department of Immigration and Multicultural Affairs
Mr Les Jones, National Director, Border Management, Australian Customs Service