SENATE SELECT COMMITTEE ON RED TAPE

EFFECT OF RESTRICTIONS AND PROHIBITIONS ON BUSINESS (RED TAPE) ON THE ECONOMY AND COMMUNITY – EFFECT OF RED TAPE ON CABOTAGE

SUBMISSION BY VIRGIN AUSTRALIA

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The Virgin Australia Group of Airlines (Virgin Australia) welcomes the opportunity to provide a submission to the Senate Select Committee on Red Tape's (the Committee) Inquiry into the effect of restrictions and prohibitions on business (red tape) on the economy and community, as this relates to cabotage.

As an integrated airline group operating services across the premium, low cost, regional, charter and cargo air transport markets, Virgin Australia provides an important source of competition in the Australian aviation sector. In the 2016 financial year, Virgin Australia carried 23.7 million passengers to 14 international and 44 domestic destinations on a fleet of 145 aircraft. This is estimated to have contributed $8.4 billion to the Australian economy (both direct and indirect contribution), as an Australian business operating approximately 3,900 regular passenger transport flights each week and through our facilitation of domestic and international tourism[1]. In addition, we provide employment for around 9,500 people, the majority of whom are based in Australia.

The Government's aviation policy seeks to foster a competitive and growing Australian industry, and recognises the employment and flow-on effects for the wider economy that it supports. Aviation policy settings and regulatory frameworks which are efficient, cost-effective and balanced will support the industry's ability to fulfil its role as a critical enabler of broader economic and social development.

Australian aviation policy has remained relatively stable for almost 20 years, reflecting the largely bipartisan approach adopted by successive governments. This has provided the industry with a measure of certainty to guide commercial planning and investment decisions, and it is widely acknowledged that these policy settings have generated benefits for consumers, tourism and trade. These policy settings encompass restrictions on the exercise of cabotage rights.

In Virgin Australia's view, current Australian Government policy in relation to consecutive cabotage remains effective and appropriate. Allowing foreign airlines to serve domestic routes in Australia would not enhance the efficiency or competitiveness of air services, nor benefit the economy or community. The potential benefits flowing from relaxation of current aviation policy settings concerning cabotage would be significantly outweighed by the associated costs, and therefore cannot be justified. Broadly, such costs include reduced direct investment in Australia's aviation sector, a decrease in air services and connectivity for regional areas and fewer local jobs. The detailed rationale for our views in relation to cabotage is outlined below.

Red tape in the Australian aviation industry

Given the Committee's focus on examining red tape faced by business, Virgin Australia would like to highlight that there is scope for the Government to reassess a number of areas of regulation faced by Australian airlines, with a view to lifting the productivity and efficiency of the aviation industry for the benefit of the economy and the community.

Aviation is a highly regulated industry, reflecting the need to ensure the operational integrity of air transport. Government-mandated regulation relevant to aviation in Australia is wide-ranging, encompassing safety, security, ground and air infrastructure, taxation, environmental matters, border facilitation and consumer protection. Over the past 15 years, the costs imposed on Australian airlines in connection with these areas of regulation have continually increased. Some of these costs are the direct result of unnecessary regulation, or red tape.

[1] Deloitte Access Economics, *The Economic Contribution of the Virgin Australia Group to Australia*, January 2017.

In furtherance of its red tape reduction programme, the Government has undertaken a number of initiatives to ease the aviation industry's regulatory burden, including the repeal of the carbon tax, conducting the Aviation Safety Regulation Review and reviewing regulations concerning aviation rescue and fire fighting services. These initiatives were strongly supported by Virgin Australia.

While there are many areas of regulation imposed on airlines that could be reduced, streamlined or enhanced, two key examples concerning secondary screening requirements for liquids, aerosols and gels and mutual recognition of air operator regulatory frameworks have been outlined below in some detail. Eliminating unnecessary regulation in these areas has the potential to deliver tangible benefits for the aviation industry, in terms of increased efficiencies and reduced costs. In stark contrast, any changes to the policy framework concerning cabotage restrictions would damage the Australian aviation industry and have negative implications for consumers, tourism and trade.

Cabotage policy

Most governments around the world continue to maintain aviation policies that preclude foreign airlines from exercising cabotage rights, in recognition of the incompatibility of such rights with a strong local industry. In Australia, the likely practical impact of cabotage on the aviation industry has been recognised, and ruled out, in successive policy reviews on a bipartisan basis.

It is important to note that Australia's aviation regulatory regime is one of the most liberal globally, in that it provides foreign airlines with the ability to access commercial opportunities in the domestic market. This includes "investment cabotage", which enables foreign entities, including airlines, to hold 100% of the equity in an Australian domestic airline, subject to national interest tests. Both Virgin Blue and Tiger Airways were established under this policy, as airlines wholly owned by foreign interests. These operators brought increased competition and innovation to the domestic market, providing consumers with more services, greater choice and lower airfares. Equity investments in Virgin Australia by Etihad Airways, HNA Aviation and Singapore Airlines are also testament to the effectiveness of this policy.

The Government's aviation policy does not, however, permit foreign airlines to serve the domestic market by means of consecutive cabotage, ie the ability to pick up domestic passengers or freight at an Australian airport for carriage to another Australian airport. New Zealand is an exception to this, as Australia has had Single Aviation Market arrangements in place with New Zealand since 1996, which allow the exercise of these rights on a reciprocal basis. Globally, the grant of consecutive cabotage rights in air services agreements is almost non-existent.

The grant of consecutive cabotage rights, even on a limited basis for specific routes or regions, could be expected to have far-reaching consequences for the long-term sustainability of the Australian aviation industry. Operating alongside Australian airlines, these foreign airlines would earn marginal revenue while incurring marginal cost from an aircraft that would otherwise have remained idle in the intervening time period between international services. Domestic carriers would be severely impacted as a result, with foreign carriers potentially injecting a significant volume of additional capacity onto these routes at airfares which may be lower than the average cost faced by domestic airlines in operating such services. Over the longer term, this could be expected to result in network rationalisation by local operators, whereby aircraft are redeployed to higher-yielding routes at the expense of marginally-profitable or loss-making regional routes that deliver little overall network benefit. Allowing foreign airlines to operate domestic services on the basis of

consecutive cabotage rights would fail to give adequate recognition to the essential role that domestic airlines play in supporting Australia's tourism industry, particularly in regional areas.

It is also important to note that under most of Australia's air services arrangements, foreign airlines have the ability to access multiple points in Australia, either with their own aircraft or under code share arrangements with domestic carriers. Under the Government's "Regional Package", foreign carriers are offered unrestricted access to all points in Australia other than Brisbane, Sydney, Melbourne and Perth on a unilateral basis during air services negotiations. In addition, most of Australia's bilateral air services agreements extend own-stopover rights to foreign carriers, enabling them to carry their international passengers to multiple points in Australia with the same aircraft. Opportunities for foreign airlines to code share on Australian carriers' extensive domestic networks are also commonplace under Australia's air services arrangements.

Australia's investment cabotage policy allows foreign entities access to the domestic market, but entails a necessary commitment to the establishment of a long-term presence, generating employment and supporting economic development. Permitting consecutive cabotage would largely remove the incentive for foreign airlines to invest in the Australian aviation industry, as it would allow them to engage in the domestic market with a reduced commitment and to withdraw their participation more readily. The investment cabotage policy also promotes competitive discipline among domestic airlines, through the omnipresent threat of new market entrants.

It is widely acknowledged that the operation of international air services by Australian carriers is increasingly difficult, as a result of greater competition, labour rate differentials and Australia's geographic position as an end-of-the-line, rather than hub, market. Eroding the viability of Australian airlines' domestic platform, by permitting foreign airlines to exercise consecutive cabotage rights, will undermine the industry's ability to expand internationally, which is a stated objective of the Government's aviation policy, as the markets are inextricably linked.

Overall, the benefits to consumers, the tourism industry and the broader economy of permitting foreign airlines to serve the Australian domestic market would be limited. This was confirmed in the conclusions of the Productivity Commission's 1998 Inquiry into International Air Services, where it stated that, "…it is unlikely that such services would lead to substantial efficiency gains in Australian resource allocation, as the Australian airline industry is relatively efficient and internationally competitive."[2] Current levels of competition in all segments of the domestic market are substantially greater, networks offered by airlines – including to the regions – are more expansive, and average fares are lower than in 1998 when the aforementioned review was undertaken. This suggests that granting consecutive cabotage rights is unwarranted and would be highly unlikely to yield any tangible benefits for consumers or the economy overall.

While it is the case that policy settings evolve, there does not appear to be a compelling reason for changing the current framework. While the Government is planning coastal shipping reform which includes changes to cabotage, it should be recognised that Australia's dwindling coastal shipping fleet stands in stark contrast to its growing and increasingly competitive aviation industry.

We also note that the Government's response to the 2015 Competition Policy Review did not support changes to cabotage policy. Instead, the Government stated it would focus on reducing costs for consumers and producers, as well as removing impediments to increased services.

[2] Productivity Commission 1998, *International Air Services*, Report No. 2, AusInfo, Canberra.

Liquids, aerosols and gels secondary screening requirements

Virgin Australia provides secondary screening for liquids, aerosols and gels (LAGs) at last ports of call for those of our inbound international flights as required under the *Aviation Transport Security Act 2004* and the *Aviation Transport Security Regulations 2005* (the Regulations). Such screening is not conducted for our flights from the United States and New Zealand, as exempt countries under the Regulations and in accordance with the relevant LAG Product Deeming Notice issued by the Secretary of the Department of Infrastructure and Regional Development.

While secondary screening for LAGs certainly remains a critical security measure in some countries, it is our view that this practice is not warranted in others where the risk of terrorism has been consistently assessed through open source intelligence as being low or insignificant and/or the screening equipment/technology in place is of a sufficiently high standard to adequately address potential security threats. Each of Fiji, Papua New Guinea, Solomon Islands, Samoa, Tonga and Vanuatu would fall into the former category, on the basis that there would be very little (if any) motivation or capability in these countries to carry out terrorism activities directed at passengers or Australian interests. Hong Kong is an example of the latter category, where the latest liquid bottle scanner technology incorporating explosive detection algorithms, is used for screening outbound passengers.

Virgin Australia operates services to/from each of the Pacific island nations listed above and will commence services to Hong Kong in July 2017. We are of the view that the considerable expense associated with secondary screening for LAGs at each relevant international airport represents an unnecessary regulatory burden on airlines operating to Australia from these countries, and cannot be justified on the basis of a risk assessment. Accordingly, we have a strong desire to see the obligation for secondary screening of LAGs in these countries eliminated as soon as possible through the making of an appropriate Product Deeming Notice, and have highlighted this as a priority in previous representations to the Office of Transport Security. This would be consistent with the Government's aviation policy, a key objective of which is to ensure that aviation security requirements are risk-based and intelligence-led, recognising that a 'one size fits all' approach does not necessarily produce optimal security outcomes.

Removal of the requirement for LAGs secondary screening would also improve the passenger experience at these airports, while providing airlines serving Australia with significant cost savings without any material reduction in security outcomes. For Australian airlines, an ability to realise these savings is particularly important given the additional costs expected to be imposed in the Australian aviation security landscape in connection with initiatives such as the strengthened airside security model, aviation security identification card programme review and airport front-of-house security review.

Mutual recognition of air operator regulatory frameworks

Mutual recognition schemes are an efficient mechanism for enhancing regulatory cooperation between jurisdictions, involving relatively low costs to negotiate, establish and maintain compared to other regulatory cooperation arrangements. This is due to the fact that jurisdictions do not need to negotiate changes to their own regulations and standards and instead simply agree to mutually recognise compliance with each other's laws. The value of mutual recognition schemes to government and industry will, however, depend on the extent to which each jurisdiction applies the schemes in practice. In this regard, the Productivity Commission noted its 2015 final report on Mutual Recognition Schemes that while such

arrangements with New Zealand are generally working well, the associated benefits risk being eroded due to a lack of adoption and implementation by regulators[3].

The *Civil Aviation Legislation (Mutual Recognition with New Zealand) Act 2006* amended the *Civil Aviation Act 1988* to implement Australia's part of the joint commitment made in 1996 between the Australian and New Zealand governments for the mutual recognition of air operator certification. The legislation enables the mutual recognition of Air Operator Certificates (AOC) for the operation of aircraft of more than 30 seats or 15,000kg, as issued by the Civil Aviation Safety Authority (CASA) in Australia and the Civil Aviation Authority of New Zealand (CAANZ). Airlines can apply for an AOC with Australia and New Zealand Aviation (ANZA) Mutual Recognition Privileges from either regulator, to support the operation of services to, from and within either country on the basis of their home certification.

In practice, these mutual recognition arrangements have not provided the efficiencies intended, principally because the enabling legislation has not been translated into the operational parts of either CASA or CAANZ rules. The failure to formally adopt such arrangements has left airlines facing rules that undoubtedly constitute red tape, reducing the efficiency and competitiveness of airlines in both Australia and New Zealand.

It has been Virgin Australia's experience that regulators have either taken a restrictive view or disregarded the mutual recognition arrangements in relation to some operational approvals. This was particularly evident when we undertook a restructure of our operations to consolidate the Virgin Australia New Zealand (VANZ) AOC administered by CAANZ into the Virgin Australia International Airlines (VAIA) AOC administered by CASA. The transition of the VANZ operations (including all aircraft and crew) to VAIA and its Australian AOC, was undertaken in order to deliver a range of group-wide efficiencies.

The lack of regard for and understanding of the mutual recognition arrangements essentially required Virgin Australia to secure a separate, additional approval from CASA for every operational approval issued to VANZ by CAANZ. On several occasions, CASA stated that the existence of a CAANZ approval was of no effect whatsoever, with Virgin Australia obliged to demonstrate that we met CASA's standard alone. A number of specific examples are as follows:

- CAANZ interpreted ANZA privileges as applying to trans-Tasman operations only, with the result that legal advice was sought to confirm that operations into and out of New Zealand to/from third countries were permitted under the privileges;

- CAANZ's approval of Virgin Australia's Fatigue Risk Management System was not accepted by CASA, which required us to meet a new, more restrictive CASA standard; and

- CASA Part 145 Maintenance Repair Organisation legislation should permit CASA's acceptance of international standards, however, in practice it requires all international maintenance organisations to undergo CASA Part 145 approvals, including those in New Zealand.

This approach made the process of AOC integration a costly and time-consuming exercise, despite the existence of the mutual recognition legislative framework between the Australian and New Zealand governments. To ensure the aviation industries of Australia and New Zealand have the ability to capitalise on the efficiencies the mutual recognition arrangements were intended to deliver, Virgin Australia would like to see the Australian Government

[3] Productivity Commission 2015, *Mutual Recognition Schemes*, Research Report, Canberra.

address this regulatory impediment by pressing CASA and CAANZ to amend their rule sets as required without delay.

Virgin Australia also urges the Australian Government to encourage CASA to establish mutual recognition arrangements with aviation safety regulators in other countries where a high degree of confidence is held in the outcomes achieved under the laws of the other jurisdiction, such as the US. This could be facilitated through the utilisation of International Civil Aviation Organization (ICAO) Standard and Recommended Practices. Using the example of CASA Part 145 Maintenance Repair Organisation legislation as noted above, Virgin Australia is only permitted to have maintenance performed on its aircraft by an organisation in the US if it holds a separate approval from CASA, even in the case where such an organisation has already been approved by the US safety regulator (Federal Aviation Administration) to undertake such activities. In addition to the time involved, the significant costs borne by the foreign maintenance repair organisation as part of securing the required approval from CASA are ultimately passed on to Virgin Australia, for no practical benefit. This has a negative impact on our economic efficiency and productivity as a business.