



Airlines PNG

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Mr Thomas Abe
Commissioner & CEO
Independent Consumer & Competition Commission
1st floor, Garden City
Angau Drive **BOROKO**
National Capital District
Papua New Guinea

Dear Sir

REVIEW OF AIR TRANSPORT SECTOR IN PNG

We refer to:

Your letter dated 21 February 2006, seeking information from various stakeholders

- ⇒ The meeting at your offices on 9 March 2006 between Airlines of Papua New Guinea (APNG) representatives and officers from the Commission
- ⇒ Issues Paper released 20 March 2006
- ⇒ Subsequent discussions at our offices on 30 March 2006 with Commission representatives – including Mr Mark Vassarotti of PricewaterhouseCoopers

The ICCC Issues Paper identifies several areas of concentration and seeks comments thereon. We have encapsulated those areas under the following 12 major topic headings:

- 1. Legislative Environment**
- 2. The Department of Transport and the Civil Aviation Authority – its functions and service delivery performance.**
- 3. Airports: -**
 - a. The state of infrastructure;**
 - b. Effectiveness or inefficiencies caused by current ownership arrangements**
 - c. Possible rationalisation**
 - d. Availability and allocation of terminal space**
- 4. Safety and security aspects of the industry.**
- 5. The structure of air services pricing.**
- 6. Adequacy of industry training facilities in PNG and recognition of foreign qualifications**

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7. **“Default service provider” CRS arrangements causing an unfair competitive position**
8. **Adequacy of existing level of air services to satisfy market needs**
9. **Barriers to new entry**
10. **The exercise of market dominance and the effect of minimising competition**
11. **Levels and impacts of cross-subsidisation across route networks and business segments.**
12. **Air transport industry’s future changes, including new entrants (corollary – exit of current participants!)**

APNG is conscious of the stated aim of the review, viz. **“...increasing competition and reducing air transport costs”** and have framed this response accordingly. We have already – at the consultative stage prior to preparation of the Paper and subsequently - verbally expressed our thoughts in some detail to your representatives in respect of the many issues raised.

In this submission, we propose to limit our response to the Issues Paper to those matters we believe are the major issues that we would wish to bring to your attention again by way of emphasis. Our comments will in effect provide suggestions as to how to address those issues that at present discourage competition and result in higher than optimum air transport costs for consumers.

A. MARKET DOMINANCE OF AIR NIUGINI (PX) AS A BARRIER TO COMPETITION – SUGGESTED REMEDIES

i. Distribution systems and tourism promotion activities

It is recommended that a not-for-profit body (‘NFP’) be charged with the sole responsibility to encourage and facilitate travel and tourism to/within PNG. The Board of that body (which should be limited to say 8 members) should comprise representatives from the national carrier and at least one other airline – with the balance coming from other private sector stakeholders. In order to maximise that body’s effectiveness and spread the benefits of its activities:

- The Travel Offices would generate income by charging industry standard commissions and fees. Any surplus after deducting operating costs would then be used to fund tourism promotion activities;
- The NFP should develop its own web site/internet booking site for use by all PNG airlines, accommodation and tourism operators. (This would help overcome the high cost to smaller operators of setting up their own individual e-commerce platforms. A further benefit of that would be instead of airlines and travel agents paying high US\$ costs offshore for GDS and CRS systems, lower costs could be achieved, much of which would be retained onshore PNG.)
- The web engine could also be used to broaden the distribution network to include not only travel agents but possibly banks, government offices, post offices – even supermarkets, etc.

- The NPF could also act as a centralised Clearing House for smaller PNG operators, hotels, etc (as IATA is for larger airline operators)

ii. **Capacity sharing (including Code share)**

- APNG notes that the IASC approval of the current Air Niugini/Qantas code share arrangements expires in mid 2007. APNG's position in respect of any proposed renewal will be assessed and presented early in 2007. Our position will be determined by several factors – including the competitive 'behaviour' of the code share partners, service standards, price controls and any possible requirement for price controls.
- PX enjoys an effective monopoly/market dominance position on international routes to/from PNG. APNG recommends that consideration be given to a system whereby all or some of the available seat capacity on PX's current Boeing 767 services be opened up to tender by other PNG airlines and tourism operators. PX would be able to establish a minimum price per seat – based on either its fully absorbed costs plus acceptable margin or its per seat charge to its code share partner. Operators will tender for number of seats at various prices on specific dates. Tender process could be overseen by ICCC or the Department of Finance in order to ensure transparency.

We recognise that this would be a somewhat unorthodox approach. In effect, each of the operators "sharing" the capacity provided by PX would be 'wholesalers' on behalf of PX. At the same time however, they would be in competition with each other and against PX and its codeshare partner in the sale of available seats. Such competition will avoid artificially inflated seat prices on what would otherwise be an effective monopoly route. The 'flip-side' being the efficient use of the available aircraft capacity will assist to reduce costs.

B. AIRPORTS, GROUND HANDLING, CIVIL AVIATION CHARGES

- i. APNG recommends the tendering out of ground handling at all major airports so that there is a single service provider in each location. The Tenders Board could be made up of representatives from the major airlines as well as CAA, etc. This would promote efficiencies, reduce duplication and costs and also facilitate opening up terminal space for new airline Operators.
- ii. Navigation aids must be upgraded and properly maintained. The present situation causes inefficiencies and extra costs due to reduced payloads owing to extra fuel being carried.
- iii. Aerodromes themselves must be better maintained. Where necessary, they should be upgraded to accommodate larger aircraft. The present state of some aerodromes makes them marginal for safe operations – with some completely unusable in their current condition.
- iv. Recently introduced (and contested in some cases) CAA fees and charges and new Airport Taxes impose cost pressures on airline operators much of which must be passed on to the travelling public. The twin effects of such imposts are that airline profitability is impacted directly and by reduced demand as air travel becomes out of reach to more and more PNG citizens as well as deterring the budget-conscious tourist. CAA's announced profit of PGK17 million would indicate that there is little justification for increases in charges of the magnitude we have seen over the past couple of years. In fact, it should be noted that there is a legislated review process that CAA has failed to observe

Operators had expressed their concern that CAA had failed to control its costs and maintain that the operators should not have to underwrite CAA inefficiencies and lack of cost control. In the face of that opposition CAA failed to enter into further dialogue with the operators and unilaterally imposed the increases.

C. RAISING LOCAL TECHNICAL COMPETENCE & ENCOURAGING LOCAL INDUSTRY & INVESTMENT

- i. Some PNG airline operators send their aircraft offshore for maintenance when the capacity to perform that maintenance exists in PNG. APNG recommends that some form of surcharge be introduced in respect of all P2 registered aircraft that are sent overseas for maintenance. The surcharge could be used to fund an industry aviation training centre, based in PNG. Administration of such a scheme would require all foreign facilities (approved by PNG CAA) to report details of all work done on P2 aircraft on say a quarterly basis for auditing purposes.
- ii. We would recommend that employers in the aviation sector be encouraged to provide national employees with education and training in the aviation technical disciplines associated with the flying and maintenance of aeroplanes. That encouragement would most likely be in the form of taxation incentives (e.g. 150% tax deduction for related expenses).
- iii. APNG recommends that likewise any self-education expenses incurred by PNG resident taxpayers for aviation specific training or study should be eligible for similar taxation relief so as to encourage young aviation industry employees (targeting pilots & engineers) to:
 - a. undertake appropriate training/studies; and
 - b. remain onshore PNG.
- iv. We would recommend that consideration be given to introducing taxation incentives to encourage PNG financial institutions and industry participants to invest in the purchase of aircraft and aviation maintenance facilities. This could be by way of accelerated depreciation and/or double depreciation allowances. Such incentives should provide local PNG airlines and maintenance providers with access to funds and/or lease facilities currently out of their reach and encourage the onshore retention of ownership and leasing arrangements.
- v. Further incentive to establish productive, foreign exchange earning capacity in PNG could include tax-free status for given periods for aviation maintenance providers that export their services to foreign aircraft operators.
- vi. An overriding observation we make is that the rates of personal income taxation in PNG remain high compared to that of other jurisdictions (notably Australia and New Zealand) that are competing for the scarce personnel technically skilled in aviation related disciplines required here. This will also be true of other professional/technical disciplines. Until that 'imbalance' is corrected, PNG will continue to find it difficult to attract and retain skilled personnel and/or PNG-based enterprises will be forced to pay higher professional salaries to compensate – thereby weakening their cost competitiveness.

D. COMMUNITY SERVICE OBLIGATIONS, MARGINAL ROUTES AND CROSS SUBSIDISATION

- i. Many rural air services are quite clearly economically non-viable and will remain so indefinitely. Some previously operated routes have been discontinued because of that non-viability, others because aerodromes are unsafe. Some are presently being continued because operators have been prepared to marginally cost those operations – effectively cross-subsidising them by their other, more profitable routes flown.

However, with other operators “cherry-picking” by operating ONLY on the profitable sectors, the ability to continue cross-subsidisation is weakened to breaking-point.

- ii. We believe a timely opportunity exists for the country to take advantage of the current surge in resource projects to assist it to maintain what are essential air services to remote locations. APNG recommends that Government should:
- a. Nominate services to which ports that are considered essential services and the required frequency and standards; **AND**
 - b. Similar to what is applied in some jurisdictions (e.g. Queensland, Australia), provide ‘sole operator protection’ on certain ports – selected based on minima for either population or numbers of passenger movements annually (e.g. 10,000 p.a.). These selected routes would be tendered based on say 3-year contracts. All regular passenger movements (including regular charters) would be the sole right of the approved operator. **AND**
 - c. Such a process should then bundle in ‘marginal’ or loss-making routes so that the selected operator MUST provide services on the marginal loss making routes as well as the more lucrative ones – thus ‘forcing’ a cross-subsidisation - would prevent certain carriers selecting only the lucrative routes on which to bid. In other words, the sole operator status
 - d. A further disincentive to operators “cherry-picking” could be the application of a surcharge on use of any foreign registered aircraft in domestic PNG flights (based on MTOW; prepaid and approval per flight). Also – in order to ensure that local operators are not at any competitive disadvantage - all foreign registered aircraft must be made to strictly comply with PNG CAA regulations.

In the absence of any such ‘bundling process’ the Government will be forced to provide subsidies to operators that will cover operating costs and provides a contribution to their overheads plus a reasonable margin that compensates for the inherent physical and commercial risks associated with flying in ‘hostile’ terrain and conditions. If nothing is done, more remote services will be discontinued.

E. OTHER ISSUES

There are many other factors that impact upon the aviation industry’s ability to cost effectively deliver services to the public. Some specific to the PNG environment include:

i. **Aviation and general insurance**

The regulated situation that forces the use of local underwriters in turn forces up premium costs, which flow on to air fares. APNG recommends the insurance market be de-regulated and opened up to international competition. If it is deemed advisable, the competitiveness of local underwriters could be protected by the imposition of a ‘foreign underwriting margin’ – although we consider that to be an undesirable measure.

ii. **Fuel**

Quite obviously, the international crude oil prices are beyond the control of most countries. However, restricted availability and/or unreliable supply of aviation fuel in some PNG locations remain operational and cost impediments to the local aviation industry. Problems with AVGAS supply to piston aircraft operators in particular will increasingly impact adversely on those operators’ ability to service remote ports. Government might look to some system of freight subsidy or penalty/reward system for aviation fuel suppliers that will guarantee reliable and affordable supplies of aviation fuel.

ii. **Law & Order & Security**

In common with many PNG industries, the aviation sector suffers from increasing costs to maintain security in the face of continuing law and order difficulties in PNG. Not only are increased costs incurred but demand for travel to PNG by inbound tourists remains constrained because of adverse travel advisories and tourists choosing safer Pacific Islands destinations for their holiday travel as a result. Airlines revenues suffer as a consequence.

Domestic travel too is affected by personal security concerns of travellers. In PNG, people will not travel at night. This means that airlines are unable to schedule domestic flights at night – thereby restricting their ability to maintain the utilisation of aircraft at levels that make airlines in safer jurisdictions more cost effective.

In unison with all PNG citizens and businesses, we can only but urge Government to address the law and order matter as one of the highest priority.

F. CONSEQUENCES IF SITUATION NOT ADDRESSED

APNG considers that, unless measured and appropriate action such as that suggested herein is not adopted, aviation inefficiencies and undesirable social consequences are likely to occur. Examples being:

- There will likely be a reduction in number of smaller airlines operating AVGAS-using piston engine aircraft. Businesses such as Airlink and North Coast Aviation will become increasingly marginal and may cease operations – leaving some remote populations without critical air services.
- APNG itself will be forced to consider reductions in its Twin Otter services in order to concentrate on fewer but less marginal Dash 8 services and its charter operations.
- There will be increasing losses of experienced pilots and engineers – raising flight safety concerns in the difficult PNG conditions.

- Because of reduced and discontinued loss-making routes, several more aerodromes will fall into disrepair – further compounding the existing problems and cutting many remote communities from their only viable means of contact with other population centres and access to medical and education services.
- If the industry ‘shrinkage’ continues – with fewer operators and services – CAA’s revenue base will be eroded to the point where it will be unable to fund investments in and maintenance to infrastructure
- PNG will continue to lose out on earning considerable foreign exchange from higher visitor numbers. Also the considerable downstream benefits of tourism that trickle down to village communities will not attain the levels possible.

G. CONCLUSION

APNG is pleased to have been given the opportunity to contribute to the ICC Review and would be happy to respond further to any matter on which the Commission may wish to obtain clarification or expansion.

Yours faithfully

Simon Wild
CHIEF EXECUTIVE OFFICER