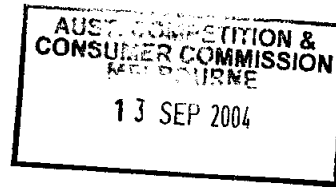


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## Department of Transport and Urban Planning

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9 September 2004

Ms Margaret Arblaster  
General Manager - Transport Prices Oversight  
Australian Competition and Consumer Commission  
BOX 520J  
MELBOURNE VIC 3001

FILE No:
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MARS/PRISM:

Dear Ms Arblaster

### AIRSERVICES AUSTRALIA DRAFT PRICE NOTIFICATION - AUGUST 2004

The purpose in writing to you is to reiterate the views of the South Australian Government, the Minister for Transport already expressed to Airservices Australia and the Federal Minister, Hon John Anderson MP, about the basis of Airservices Australia's existing and proposed charges. I do not intend to comment on the matters of detail involving Airservices Australia's proposed risk sharing arrangements, capital expenditure, asset base and rates of return.

The Hon Minister for Transport, Trish White MP, was invited by Airservices Australia to comment on its 31 May 2004 pricing proposal. That proposal involved:

- At Adelaide Airport the sum of Terminal Navigation Charges (TNCs) and Rescue and Fire Fighting Charges (RFFCs) rising from the current \$12.43/tonne to \$15.12/tonne (+21.6%) on approval and thereafter declining slightly to \$14.70/tonne by 2008/09; and
- At Parafield Airport TNCs (there is no RFF service) rising from the current subsidised level of \$7.42/tonne to \$100.40/tonne (+1253.1%) on approval and to \$109.55/tonne (+1376.4%) by 2008/09.

The Minister noted in her response to Airservices Australia and in a letter to the Federal Minister that this exacerbated Adelaide Airport's existing pricing disadvantage and was plainly absurd in the case of Parafield Airport. She also suggested that Mr Anderson should provide policy leadership on the issue because of the conflicting interests involved and should, if necessary, give Ministerial direction to Airservices Australia under Section 14 of the Airservices Act. She urged in view of the effects of the present pricing disparity across Australia, as well as Airservices Australia's proposal to widen it, that the various services it delivers should be charged on the basis of the cost of providing each service, but that each service should be priced uniformly at all locations.



Government  
of South Australia

The reason for her reaching this view is that existing location specific recovery of costs at airports (other than the subsidised airports) disadvantage every community in Australia that requires Airservices Australia airport services, except for Sydney, Melbourne and Brisbane. This is not only inequitable, it acts against other Commonwealth policy objectives such as the removal of access restraints to international airlines using secondary gateways and the promotion of regional development.

Airservices Australia's May proposal would have resulted in its charges at Adelaide Airport remaining three times those at Melbourne and more than double those at Sydney and Brisbane. This already acts as a significant disincentive to international airlines operating into Adelaide where, because of our market size, the decision to implement services is usually a marginal one. Airservices Australia's charging regime therefore reinforces an existing commercially driven tendency for international air services to be concentrated at east-coast gateways with all the resultant external costs related to congestion, noise and emissions that that involves.

The inequitable effects of the pricing differential are most marked for regional air services operating out of Adelaide to country destinations. They are disproportionately disadvantaged in that their operations are centered on Adelaide. They generally do not have the opportunity to offset the higher Adelaide charges with lower charges at the larger airports, as do the interstate operators. This adds another cost pressure to South Australian regional airfares, which are already high because of the nature of the aircraft operated, and it disadvantages the regional economy.

The differential hardly changes under the Price Notification now under consideration. The Price Notification suggests that prices should be cross-subsidised on a "basin" basis, but not nationally. This results in Adelaide Airport's charges rising slightly less initially, by 16.8% to \$14.52/tonne rather than to \$15.12/tonne as previously proposed, but by slightly more in 2008/09 to \$14.78/tonne rather than \$14.70/tonne.

However, the Price Notification reduces the absurdity of the previous Parafield Airport proposal and suggests a 71.0% increase over the five-year period to \$12.69/tonne rather than to \$109.55/tonne.

Clearly this represents a better outcome for South Australia and for the regional economies throughout Australia served by airports outside the Sydney, Melbourne and Brisbane basins. The reasons given to justify the "basin" cross subsidies are sensible: *"the existence of the secondary location has a significant positive impact on reducing the congestion at the major basin airport"*; without the secondary location the resulting *"increase in the number of light aircraft operating at major airports would impact on the operations of the major airport"*; and the *"significant levels of shared resources in the management of airports within a common 'basin'"*. To the extent that it delivers a better outcome for South Australia, I support the Price Notification.

The South Australian Minister for Transport's concerns about the prices differential between Sydney, Melbourne and Brisbane Airports on the one hand and Adelaide Airport (and all other airports) on the other, nevertheless remain. Further, a 71% increase in charges at Parafield Airport over five years, while plainly more manageable than the previously proposed 1376% increase, also remains a concern. Parafield Airport's largest training provider, while opposing the increase, expects its business to be able to accommodate it.

The Minister stated in her letter to Mr Anderson, in support of her contention that Airservices Australia's charges should be nationally uniform, that *"Cross-subsidisation is always a difficult case to argue because of the distributive distortions that it usually entails. However, its benefits in this context are so large that I believe the argument is justified. Further, I understand the Commonwealth funds the current general aviation tower subsidy through jet fuel excise, so cross-subsidisation is already established as a principle."*

It should be noted that the arguments advanced by Airservices Australia in justification of "basin" cross-subsidisation could be applied also to national network charging. If Parafield Airport, through accommodating smaller aircraft, improves the efficiency of Adelaide Airport by reducing congestion and increasing landed tonnage as Airservices Australia asserts, then the same should apply to Adelaide Airport's relationship to Sydney and Melbourne airports. The fact that 61% of overseas air passengers of South Australian origin or destination and 65% by volume of the State's air freighted exports used interstate gateways in 2003/04, supports this. That traffic would be accommodated on international services at Adelaide Airport, if services existed in sufficient numbers. The fact that they do not of course is not solely related to the higher cost of using Adelaide Airport – the primary driver of international service decisions is the size and yield of our market. However, there is no doubt that the size of the price differential acts as a powerful disincentive to carriers implementing new services at Adelaide, or adding to existing ones.

It should also be noted that Adelaide Airport's cost differential is not solely related to Airservices Australia's charges. Airport operator costs are also disproportionately high – partly due to aeronautical infrastructure costs being spread over a relatively low volume of flights – and Adelaide Airport is subject to a Federal Noise Levy to fund acoustical insulation of residences and public buildings in proximity to flight paths. While Sydney Airport is subject to the same levy, Melbourne and Brisbane Airports are not. The existing effect of all these charges on the operating costs of international carriers (and regional carriers) is very significant. An international operator of a Boeing 777 aircraft would incur the following costs for each return flight to the various airports<sup>1</sup> on approval of the Price Notification:

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<sup>1</sup> Assuming no change to airport operator charges prior to the Price Notification being approved, an aircraft maximum takeoff weight of 251.744 tonnes, 323 seats and a passenger load factor of 85%. This does not take account of incentives offered to airlines by some airport operators, including Adelaide, for passenger and service growth.

Charges per International B777 Return Flight (GST inclusive)	Airports			
	ADL	BNE	MEL	SYD
<b>Airservices Australia Charges</b>				
ARFFC	\$790.48	\$427.96	\$319.71	\$201.40
TNC	\$2864.85	\$1,457.60	\$1,014.53	\$1,402.21
Noise Levy (No GST)	\$532.28	-	-	\$532.28
Subtotal	\$4,187.60	\$1,885.56	\$1,334.24	\$2,135.89
<b>Airport Operator Charges</b>				
Passenger Charges	\$6,501.34	\$5,825.95	\$6,408.00	\$10,696.47
Security Charges	\$3,020.05	\$2,374.86	\$1,015.84	-
Subtotal	\$9,521.39	\$8,200.81	\$7,423.83	\$10,696.47
<b>TOTAL AIRPORT CHARGES</b>	\$13,708.99	\$10,086.37	\$8,758.08	\$12,832.36
<b>GST Exclusive</b>	\$12,511.11	\$9,169.43	\$7,961.89	\$11,714.17

That is, at Adelaide Airport the international operator would pay, exclusive of GST, between 94% and 218% more in Airservices Australia charges, and 7% to 57% more in total charges than at the other airports. When Adelaide's new terminal cost recovery charge (PFC) is added in late 2005, Adelaide's total turnaround cost for this aircraft will rise to over \$17,000<sup>2</sup> and the differential to between 50% and 120%.

The Airservices Australia costs for regional operators at Adelaide Airport are equally disadvantageous, although Adelaide Airport Ltd's decision to freeze its charges for regional carriers when it raised prices following the lifting of the prices cap has resulted in a better net cost. For a regional Saab 340 operator<sup>3</sup>, the costs following approval of the Price Notification would be:

Charges per Regional Saab 340 Return Flight (GST inclusive)	Airports			
	ADL	BNE	MEL	SYD
<b>Airservices Australia Charges</b>				
ARFFC	\$41.31	\$22.36	\$16.71	\$10.52
TNC	\$149.70	\$76.17	\$53.01	\$73.27
Subtotal	\$191.01	\$98.53	\$69.72	\$83.80
<b>Airport Operator Charges</b>				
Passenger Charges	\$141.98	\$94.86	\$451.66	\$302.94
Landing Charges	\$73.27	\$127.60	-	\$110.00
Insurance Charge	\$1.97	-	-	-
Security Charges	-	\$166.46	\$50.49	\$37.33
Subtotal	\$217.23	\$388.93	\$502.15	\$450.27
<b>TOTAL AIRPORT CHARGES</b>	\$408.24	\$487.46	\$571.87	\$534.07
<b>GST Exclusive</b>	\$371.13	\$443.14	\$519.88	\$485.52

That is, at Adelaide Airport the regional operator would pay, exclusive of GST, between 94% and 174% more in Airservices Australia charges than at the other airports. This largely negates the cost saving offered by the airport operator.

<sup>2</sup> Exclusive of GST, assuming the PFC for international passengers is set at \$10 per passenger arrival and departure. The actual amount has yet to be determined.

<sup>3</sup> Assuming no change to airport operator charges prior to the Price Notification being approved, and aircraft maximum takeoff weight of 13.155 tonnes, 36 seats and a passenger load factor of 85%.

Airservices Australia's August 2004 Draft Price Notification recognised the need to redress its pricing disparity between major airports and their secondary towered airports through its proposal to cross-subsidise on a "basin" basis. If it did not, as its Price Notification identifies, major market distortions would result from the very high prices at the secondary airports necessary under full location specific cost recovery. The Price Notification does not, however, redress the disparity between the major airports as the table above demonstrates.

Information supplied by Airservices Australia during consultation on its pricing proposals suggests that a return to nationally uniform pricing would result in network charges of \$6.45/tonne for TNCs and \$2.40/tonne for RFFCs. If these were to be implemented, they would result in a fall in total Airservices Australia charges at all airports other than Sydney, Melbourne and Brisbane. In Adelaide's case, the fall would be \$5.67/tonne to the proposed 2004/05 total charge, offset by increases of \$2.48/tonne at Sydney, \$3.55/tonne at Melbourne and \$1.36/tonne at Brisbane. Parafield (and the other secondary towered airports throughout Australia) would drop \$2.22/tonne for TNCs only.

The result of this, prior to the implementation of Adelaide's new terminal passenger facilities charge (assuming airport operator charges did not change) would be that Adelaide's total charges, exclusive of GST, for the international Boeing 777 operator<sup>4</sup> would be 9% less than Sydney's and the differential for Brisbane and Melbourne would be reduced to 18% and 28% respectively:

Network Charges per Intn'l B777 Return Flight (GST inclusive)	Airports			
	ADL	BNE	MEL	SYD
<b>Airservices Australia Charges</b>				
ARFFC @ \$2.40/tonne	\$604.19	\$604.19	\$604.19	\$604.19
TNC @ \$6.45/tonne	\$1,623.75	\$1,623.75	\$1,623.75	\$1,623.75
Noise Levy	\$532.28	-	-	\$532.28
Subtotal	\$2,760.22	\$2,227.94	\$2,227.94	\$2,760.22
<b>Airport Operator Charges</b>				
Passenger Charges	\$6,501.34	\$5,825.95	\$6,408.00	\$10,696.47
Security Charges	\$3,020.05	\$2,374.86	\$1,015.84	-
Subtotal	\$9,521.39	\$8,200.81	\$7,423.83	\$10,696.47
<b>TOTAL AIRPORT CHARGES</b>	\$12,281.61	\$10,428.75	\$9,651.77	\$13,456.69
<b>GST Exclusive</b>	\$11,213.49	\$9,480.68	\$8,774.34	\$12,281.74

The effect of the same Airservices Australia network charges on a regional Saab 340 operator would then be as follows:

<sup>4</sup> Using the same assumptions relating to airport operator charges, aircraft weight and passengers as in the first table.

Network Charges per Regional Saab 340 Return Flight (GST incl)	Airports			
	ADL	BNE	MEL	SYD
<b>Airservices Australia Charges</b>				
ARFFC @2.40/tonne	\$31.57	\$31.57	\$31.57	\$31.57
TNC @ \$6.45/tonne	\$84.85	\$84.85	\$84.85	\$84.85
Subtotal	\$116.42	\$116.42	\$116.42	\$116.42
<b>Airport Operator Charges</b>				
Passenger Charges	\$141.98	\$94.86	\$451.66	\$302.94
Landing Charges	\$73.27	\$127.60	-	\$110.00
Insurance Charge	\$1.97	-	-	-
Security Charges	-	\$166.46	\$50.49	\$7.96
Subtotal	\$217.23	\$388.93	\$502.15	\$420.90
<b>TOTAL AIRPORT CHARGES</b>	\$333.65	\$505.35	\$618.57	\$537.32
<b>GST Exclusive</b>	\$303.32	\$459.41	\$562.34	\$488.47

This demonstrates that Airservices Australia network charging would significantly redress the disadvantageous prices differential that Adelaide Airport presently suffers and would continue to suffer under the Price Notification. The whole rationale for location specific charging for air traffic services, even on the proposed "basin" basis, therefore needs to be re-examined to determine whether it in fact delivers a net national benefit sufficient to offset its regional disbenefit, as has been taken as given. While economic theory suggests that location specific charges maximize economic efficiency and they are clearly appropriate in some environments, in the airport context they introduce the inefficiencies and inequities described above.

In summary, DTUP's position is:

1. The Price Notification entrenches a level of price disparity between large and small gateway airports that imposes significant disadvantage to regional Australia. However, given that the existing disparity does not materially change under the Prices Notification and that the Prices Notification provides a workable pricing regime for the secondary towered airports, your draft decision should accept the "basin" cross-subsidies underpinning it and approve it on an interim basis;
2. I remain opposed to the continuation of the pricing disparity between the gateway airports. Network pricing through cross subsidisation is one means of correcting it, and the extent of disadvantage and the inefficiencies imposed by the present and proposed pricing practice suggest that is justified;
3. During the period of interim approval of the Prices Notification proposed, the following should be properly investigated:
  - the extent of disbenefits at regional gateways imposed by their prices disparity with the major gateways;
  - the extent of disbenefits at secondary towered airports caused by the prices increase proposed; and
  - what policy options might be implemented to mitigate the disbenefits, including a return to network pricing or the implementation of federal subsidies;

4. I suggest you recommend to your Minister that he require the Productivity Commission to conduct an appropriate inquiry into these issues as soon as possible.

Yours sincerely



Tim O'Loughlin

**CHIEF EXECUTIVE**  
**DEPARTMENT OF TRANSPORT AND URBAN PLANNING**