Promoting Competition in Trans Pacific Aviation

Peter Forsyth
Department of Economics
Monash University
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The Issue

Is it in Australia’s economic interest to permit foreign airlines, such as Singapore Airlines, to serve the Trans Pacific route to the USA?
Outline

• Benefits and Costs of Competition
• Tourism Benefits
• Opening up the route- does Australia gain?
• Alternative scenarios
• Conclusions
The Trans Pacific Route

- Australia to the USA
- Biggest aviation policy issue of the moment
- Route dominated by Qantas and United
- Fares are high
- Very profitable for Qantas (40% of international profits?)
- Few US or Australian airlines willing/able to enter
- But Singapore Airlines wants to enter - a capable competitor (also Emirates?)
- Entry would lower fares, stimulate tourism to Australia, but
- Qantas profits would fall
Benefits and Costs of Competition

- **International dimension critical** - Australian and foreign travellers, airlines
- **More competition leads to lower fares**
- **Benefits to Australian travellers** (fare reduction, Australian share of travellers)
- **Cost**: profit reduction to Australian airlines (Qantas partly foreign owned)
- **Benefits from increased inbound tourism**, costs of increased outbound tourism
Tourism Benefits

- Recognised, though rarely measured rigorously
- $100 of extra tourism expenditure less valuable (net) to recipient country than $100
- Cost of providing the goods and services tourists buy
- Need to measure impacts of extra tourism expenditure on GDP, employment, net benefits
Sustainable Tourism CRC Model

- Computable General Equilibrium (CGE) model of NSW and Australia
- Models the economy as an integrated whole
- Incorporates negative as well as positive effects, e.g. shifting of resources away from other industries, exports
- CoPS Monash MMRF model adapted to pay particular attention to tourism issues
- Modelling of tourism benefits- taken as the change in value of output (GDP), less additional costs of factors needed such as labour
How Large are Tourism Benefits?

- Extra inbound tourism expenditure leads to increase in employment, GDP
- Because of offsetting factors, not large relative to expenditure change (GDP < 20%)
- In simulations, not much macro simulation of the economy
- Net benefits - subtract the cost of extra factors used - 5%-15% of expenditure change
- Conservative assumption - higher if lower cost of unemployed labour is used
- Is this small? What about the costs of outbound tourism?
Base Case

- Qantas - 56% of Trans Pacific market
- Aust travellers - 45% of market
- Av air fare $3000, av cost, $2600
- Fares fall by 10%
- Total trip cost $6000 - Aust component $5000
- Inbound demand elasticity 3.0; outbound 1.0
- Qantas share falls to 41% after entry
- 70% of Qantas profits accrue to Australia
- Benefit to Australia of $10 tourist expenditure is $1
Benefits and Costs

- Gain to Australian travellers-$124.2m
- Loss to Australian shareholders of Qantas-$95.53m
- Net gain from extra inbound tourists-$60.28m
- Net loss from extra outbound travellers-$9.00m
- Balance of benefits-$71.95m
Alternative Scenarios

• 1 Part Australian owned foreign subsidiary enters: Attractive option, since profits to airline partly accrue to Australia- $94.51m
• 2 Limited entry with minimal impact on fares: negative balance of benefits since market share is lost by Australian airline
• 3 Low impact entry-$27.52m
• 4 Higher tourism benefits (e.g. 61% of tourism expenditure): much larger gain to Australia-$341.48m
• 5 Qantas reduces costs-$109.74m
• 6 Lower demand elasticity-$50.63m
Conclusions 1

- Possible to use a benefit/cost framework to assess economic gain and loss from opening up an international route
- Need to have a rigorous means of measuring tourism benefits
- Gains likely in this case- could be different (Australia Japan route?) Biggest benefits and costs to home country travellers and airlines
- Tourism benefits smaller, but significant- could tilt the balance
- Letting foreign countries’ airlines operate on routes to third countries can be in a country’s economic interest
Conclusions 2

• Benefits from increased competition outweigh losses
• Could be different if new competitor did not induce much price competition
• An Australian subsidiary as the entrant would be better- but would this happen?
• Largest gains if entry is not confined to a small scale