

Deregulation of Domestic Aviation in Australia 1990-1995

Information Sheet

This Information Paper discusses the impact of deregulation of domestic aviation for the period 1990 to 1995 including the impact on fares, passenger numbers, quality of service and competition.

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BUREAU OF TRANSPORT AND COMMUNICATIONS ECONOMICS

INFORMATION SHEET 6

DEREGULATION OF DOMESTIC AVIATION IN AUSTRALIA 1990-1995



The Commonwealth's regulation of interstate aviation, in place for over thirty years, came to an end on 30 October 1990. The Bureau of Transport and Communications Economics (BTCE) first undertook an analysis of the impact of domestic aviation deregulation in late 1991. The results of this analysis were published in Report 73, *Deregulation of Domestic Aviation - The First Year*.

Based on the first year's evidence, it was concluded that deregulation had been very successful from the consumer's perspective. Consumer benefits included deeper and more readily available discount fares, increased flight frequency and non-stop service, and improved on-time performance and in-cabin and on-ground services. These consumer benefits resulted in record levels of patronage despite the economic recession at the time.

From the carrier's perspective the impact of deregulation was not unambiguously positive. There was clear evidence that production efficiency in the industry had improved, with lower costs of providing service. However, greater price competition and the large increase in overall capacity had an adverse impact on the airlines' profitability. This was aggravated by a decrease in high yield business traffic due to the recession.

Further work on the impact of deregulation and other aviation reforms was undertaken during 1992 and 1993. The results of this work were published in Report 80, *Quality of Service in Australian Passenger Aviation*, and Report 81, *The Progress of Aviation Reform*.

Conclusions on the consumer benefits from deregulation were unchanged from the initial study. In addition, it was estimated that the net benefits of interstate aviation deregulation were in the order of \$100 million in the year following deregulation.

The BTCE has continued to monitor the performance of the domestic aviation industry; however, after almost 5 years of interstate aviation deregulation it is increasingly difficult to differentiate the impact of deregulation from other aviation reform measures and overall economic and market developments. Some aspects of industry conduct and performance which continue to be influenced by deregulation are discussed below.

SUMMARY OF BENEFITS

- Lower average air fares
- More people travelling by air
- Increased competition
- More efficient carriers
- Improved quality of service
- Continuing aviation reform

FARES

Prior to deregulation, domestic air fares for scheduled passenger services were set by the Commonwealth's Independent Air Fares Committee (IAFC). Under this regime, there was very little price competition in the market, with the two interstate domestic carriers (Australian Airlines and Ansett Airlines) having almost identical schedules of discount fares. Post-deregulation movements in air fares can therefore be largely attributed to deregulation.

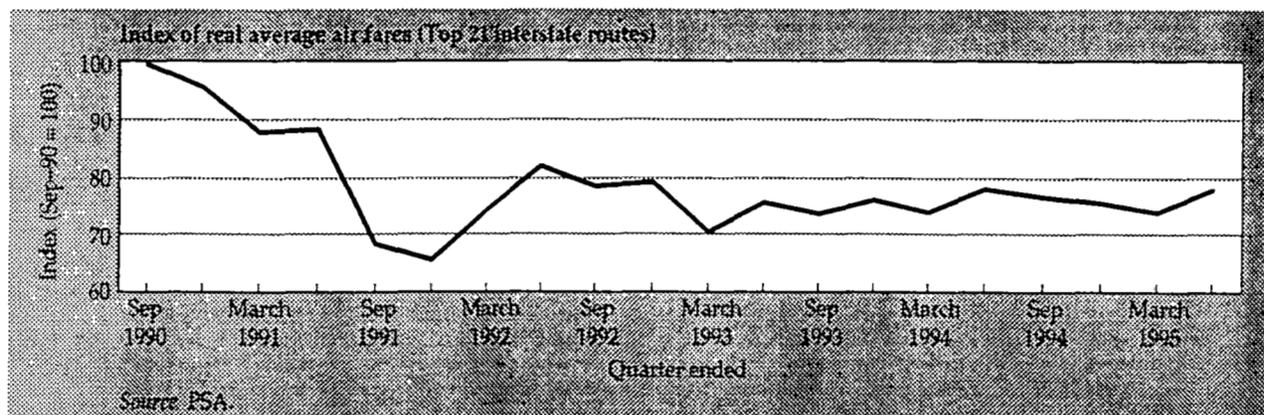
Average Air Fares

Following deregulation and the disbanding of the IAFC, the Prices Surveillance Authority (PSA) was directed by the Government to monitor movements in average air fares paid by travellers on interstate routes. Using data provided by the airlines, the PSA calculates route specific average air fares by dividing the total revenue generated on a route by the total number of fare paying passengers carried on that route. The index of real average air fares below reflects changes in the various fare levels, traffic mix and number of passengers carried on the major interstate routes in Australia.

The air fares index shows an immediate drop in average air fares with the commencement of deregulation. The continuing decline in air fares throughout 1991 corresponds to the operations of a third domestic interstate carrier, Compass Airlines, which commenced on 1 December 1990 and ceased operations on 20 December 1991.

Following the Compass collapse there was an increase in average air fares during the first two quarters of 1992 to a level some 20 per cent lower than immediately before deregulation. On 31 August 1992, Compass Airlines recommenced operations under new ownership and management. Average air fares again went into decline until the collapse of the second Compass Airlines in March 1993.

Over the two year period ending June 1995 there was a 2.8 per cent increase in real average air fares. However, in real terms, average air fares during the June quarter 1995 were about 22 per cent lower than just prior to deregulation.



Discount, Economy, Business, and First Class Fares

The BTCE's work in 1993 (Report 81) on evaluating the progress of aviation reforms concluded that post-deregulation air travel had not been cheaper for all passengers. It was estimated that economy fares in the December quarter 1992 were about 14 per cent more expensive in real terms than just prior to deregulation, while business and first class fares were up by 12 per cent and 6 per cent respectively.

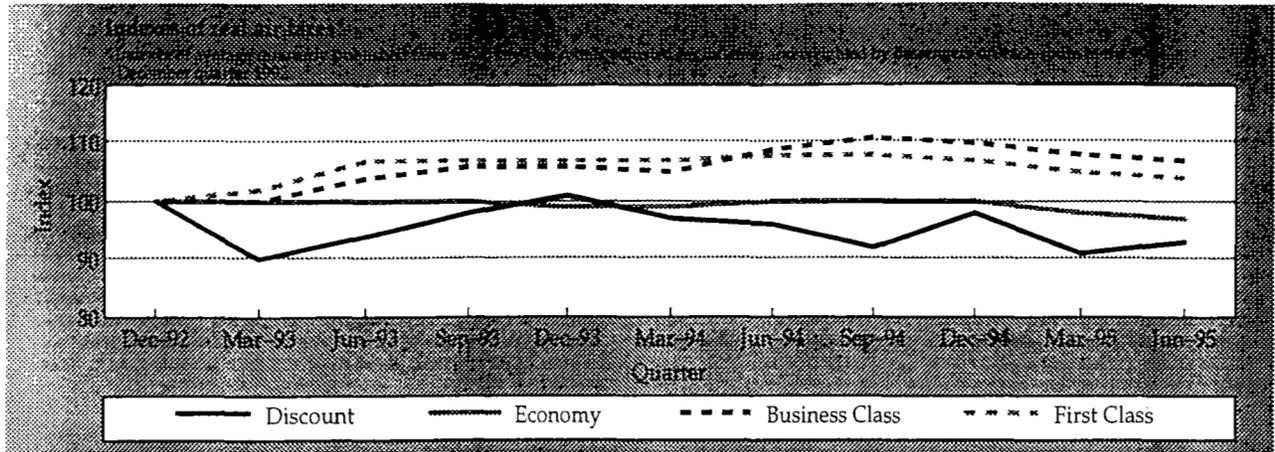
A survey of published air fares was commenced in October 1992 as part of the Bureau's ongoing monitoring program. Indexes of standard discount, economy, business and first class fares are published in the BTCE's quarterly *Transport and Communications Indicators*. The indexes to the end of June 1995 are reproduced below.

The fare indexes show a different competitive response by the airlines in the different fare markets. Real full economy fares remained constant during 1993 and 1994 with fare increases just keeping up with inflation. During the first half of 1995 there was no change in nominal economy fares resulting in a 3 per cent decrease in real terms.

Business and first class fares also remained unchanged over much of the period. The BTCE's index of first class fares rose by about 7 per cent following the collapse of the second Compass Airlines in March 1993. The index of business fares increased by 6 per cent during the June and September quarters of 1993 and by a further 5 per cent in the June and September quarters of 1994.

In contrast to the stability of economy, business and first class fares, discount fare levels have varied in response to fluctuating demand in the leisure market. The airlines have increased capacity in the post-deregulation period by expanding their fleets, using larger aircraft on some routes, and increasing flight frequency on most routes. The large capacity increase has been a major factor in keeping the level of discount fares below their pre-deregulation level. In real terms, average discount fares were 7 per cent lower in the June quarter 1995 than in the December quarter 1992.

Based on the BTCE's conclusions on air fares in Report 81 and subsequent fare survey data, it is estimated that real economy and first class fares were about 10 per cent dearer in mid 1995 than they were just prior to deregulation, while business class fares had risen by almost 20 per cent in real terms. Real average discount fares had fallen by about 15 per cent in mid 1995 compared to their pre-deregulation level.



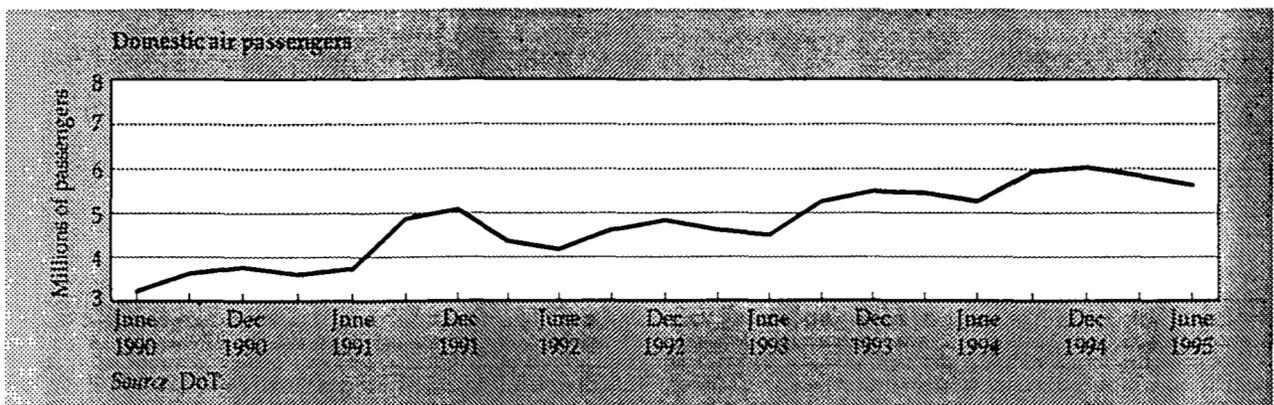
PASSENGERS

Deregulation has had a significant impact on domestic passenger numbers. The average annual growth rate in passenger numbers was 12.6 per cent over the four year period ending June 1995. In 1991-92 passenger numbers increased by 25 per cent over the previous year, in spite of the recession at the time.

The growth in Revenue Passenger Kilometres (RPK's) over the 1990-91 to 1994-95 period was 74.3 per cent or an annual average of 15.5 per cent. The higher growth in RPK's can be attributed to the increase in traffic on leisure routes which are generally longer than the business routes in Australia.

The BTCE's 1993 analysis of the impact of aviation reform concluded that there had been about a 30 per cent increase in the propensity of Australians to travel by air in the first two years following deregulation. By the end of 1994 this had increased to over 50 per cent.

It was also found that the proportion of travellers purchasing discount fares had increased from around 45 per cent prior to deregulation to about 70 per cent in the December quarter 1991. In its September 1993 to May 1995 reports on *Monitoring of Movements in Average Air Fares*, the PSA indicated that less than 10 per cent of total passengers travel on first and business class fares. Given that the proportion of premium fare passengers has remained the same, there was a 26 per cent increase in business and first class passengers over the two year period to mid 1995.

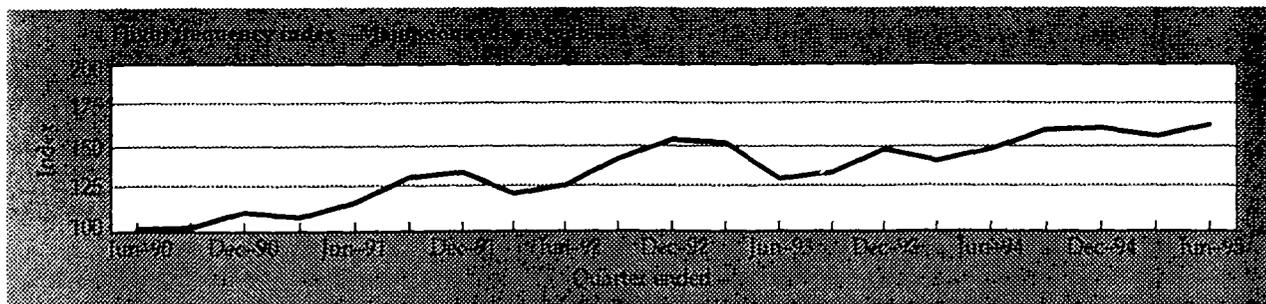


QUALITY OF SERVICE

Measures of service quality complement the more traditional measures of industry conduct and performance such as price levels and passenger numbers. The BTCE's analysis of the quality of service provided to domestic aviation passengers during the first two years following deregulation concluded that there had been an overall improvement in service quality. A key, measurable indication of higher quality service can be found in flight frequency improvements. In order to assess the impact of deregulation on frequency of service, a quarterly index of flight frequency for the top 50 domestic airline routes was constructed.

The BTCE's index of flight frequency increased by 29 per cent between the September quarter 1990 (the last full quarter prior to deregulation) and the September quarter 1991. By the September quarter 1994 the index was 58 per cent higher than its pre-deregulation level. Comparing the June quarters in 1990 and 1995, there was an estimated 63 per cent increase in flight frequency.

The BTCE's index of flight frequency has risen in 14 of the 20 quarters between the June quarters 1990 and 1995. Of the six quarters where flight frequency decreased, five were March quarters, reflecting the usual seasonal decline in demand (with a larger than normal drop in the March quarter 1991 due to the demise of the first Compass Airlines). The large decrease in the June quarter 1993 was due to the collapse of the second Compass Airlines.



COMPETITION

Two unsuccessful attempts by Compass Airlines to operate in the interstate market indicate that the scope for entry at a major level is quite restricted. However, even though the number of interstate carriers is now the same as before deregulation, the fare, patronage and quality of service data indicate that the two major carriers are competing much more vigorously in the deregulated environment. Although the initial large drop in average airfares can be attributed to the increased competition of a third market participant, the continuing low average fares with two participants indicate that competitive market forces are still present.

There is also clear evidence of competition through frequency of service improvements since the demise of the second Compass Airlines. Competition for market share can be solely attributed to deregulation as market shares were broadly fixed in the pre-deregulated market through the government's regulation of airline capacity.

Continuing increases in patronage are also evidence that the incumbent airlines are market responsive. Competition between the airlines for the non-leisure market has generally taken the form of improvements in service quality including large investments in terminal facilities (such as well-appointed club lounges), and an expanded range of services such as valet parking provided to premium fare passengers.

CONCLUSIONS

Even though deregulation has not resulted in sustained competition by new entrants, there is clear evidence that competition between the incumbents is much more vigorous than before deregulation. The structure of the market for interstate air travel has also clearly changed with the large increase in the 'discount fare' market.

The available fare and passenger data indicate that in excess of 70 per cent of the interstate air passenger market can now be categorised as price sensitive. The deeper and more widely available discount fares following deregulation have resulted in a large increase in demand as well as a shift away from economy fares. In the premium fare market (currently less than 10 per cent of the total market) both fares and demand have increased in the two year period ending mid 1995. This is attributed to improving economic conditions over the period, with this market segment considered to be price inelastic. It is thought that the economy fare market (currently 15 to 20 per cent of the total market) would exhibit a small degree of price elasticity.

The increase in the propensity to travel by air and the growth of the discount fare market have brought about a fundamental change in the conduct of the two major interstate carriers. Discounting is used by the airlines to a much greater degree than before deregulation to stimulate demand in the price sensitive discount market. The carriers are also much more market oriented and responsive to consumers' needs as evidenced by continuing improvements in the quality of service provided to air passengers.

Deregulation of interstate aviation was an essential step and a catalyst for the continuing reform of the aviation sector in Australia. Subsequent reform initiatives have included the integration of domestic and international aviation operations, and privatisation of Qantas.

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