



MCKELL INSTITUTE VICTORIA

Australian Aviation after COVID-19

THE URGENT NEED *for an*
AUSTRALIAN AVIATION PLAN

JUNE 2020

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For more information phone (03) 9456 1608
or visit www.mckellinstitute.org.au

AUTHOR

JAMES PAWLUK is the Executive Director of the Mckell Institute Victoria.

ACKNOWLEDGEMENTS

The Mckell Institute would like to thank TWUSUPER for their sponsorship of this report. TWUSUPER is the industry super fund for Australia's aviation and transport workers



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EXECUTIVE SUMMARY

Just like in 2001, Australia is looking down the barrel of losing its second largest airline.

If Virgin Australia fails to climb out of administration it would threaten the livelihoods of some 10,000 workers, 6,000 contractors, and 4,000 suppliers. The impact would be felt across Australia, but particularly in Queensland where the corporate and operational headquarters are based.

This would be most immediately devastating not just to those who are employed by Virgin Australia, but also the many hundreds of thousands of Australians employed in aviation supply chains and dependent industries such as tourism and hospitality.

A ravaged aviation sector would also be a drag on Australia's long-term recovery. The benefits for consumers from any short-term price cuts would be outweighed by the negative effects of reduced competition and capacity once it is safe to lift

travel restrictions. The future looks particularly bleak for the estimated 666,000 people working in tourism if domestic customers become beholden to one carrier, or if their international markets experience prolonged fragmentation.

Saving Virgin Australia from collapse is obviously the immediate issue. But we should simultaneously define what kind of skies we want to be flying in and the steps Australia must take to make our aviation sector less susceptible to future shocks.

There is now an urgent need for an Australian Aviation Plan.

This paper aims to set out principles for developing such a plan and providing increased policy direction to the private capital that is

seeking to ensure Australia's aviation sector is ready to fly.

It draws on existing statements by government ministers to articulate how well-established principles around competitive neutrality, market-led solutions and protecting taxpayer interests should be brought bear in aviation. This in part is designed to minimize a repetition of the mixed signals caused by the Australian Government's provision of direct support for Regional Express airlines and the late exclusion of Dnata from its JobKeeper program.

Crucially, this paper examines what economic sovereignty should mean in developing aviation policy — a most vital sector of the Australian economy and fundamental to overcoming the tyranny of distance that shapes the fortune of this continental trading nation:

- Prolonged fragmentation of international aviation as travel restrictions are lifted and the inevitability of future shocks, make it prudent to ensure Australia is not overly dependent on individual countries for access to critical markets.

- We must do more to ensure the benefits of liberalisation are shared evenly amongst all Australians and not just captured by the largest cities.
- How prioritising a larger domestic network, can support more sustainable domestic competition and expanded international competition.
- Recognising that despite the attraction of flying non-stop, transiting via major hubs will remain the reality for most Australians and most destinations, and therefore Australia needs to examine what hub arrangements best support our interests.

The time is right to develop a plan for a sustainable future of the aviation sector that will serve Australia's interests through the remainder of the 21st century, and the challenges we know the future will bring.

PRINCIPLES FOR AN AUSTRALIAN AVIATION PLAN

I ECONOMIC SOVEREIGNTY	II PROTECT TAXPAYER INTERESTS	III MARKET-LED SOLUTIONS	IV COMPETITIVE NEUTRALITY
<ul style="list-style-type: none"> ○ Aviation links that can withstand international fragmentation & future shocks. ○ The interests of all parts of Australia must be served. ○ Support competition by prioritising a larger domestic aviation market. ○ Hub operations that serve Australia's national interests. 	<ul style="list-style-type: none"> ○ Maintain domestic competition. ○ Public input on future network decisions. ○ Openness to government equity to help protect jobs. 	<ul style="list-style-type: none"> ○ Clear expectations of an aviation market looks like. ○ Clarity on timing and conditions for lifting restrictions. ○ Confidence in strength of economic recovery. 	<ul style="list-style-type: none"> ○ Assistance available on the same terms to all domestic airlines. ○ Cannot allow one airline to restructure cost-base to unfairly disadvantage another. ○ Direct support should strengthen competitive dynamics.





PART ONE: COVID-19 AND AUSTRALIAN AVIATION

KEY POINTS

- 1** COVID-19 has decimated Australia's aviation market and jobs, leading to Virgin Australia entering voluntary administration.
- 2** The aviation industry's recovery will be much slower than the downturn, due to the staggered reopening of international travel routes, the impacts of a broader economic downturn, and the collapse of consumer and business confidence.
- 3** Governments around the world have offered major support packages; compared to which, the Australian Government's current support package remains modest.

The COVID-19 crisis has re-exposed the vulnerability of global aviation networks to sudden shocks and along with it the dependence of Australia's economic interests on them, as an open and liberal trading nation.

All around the world, governments have taken major steps to first contain the virus and then put their aviation sectors on life support. By the beginning of April, at least 144 countries had enacted containment measures including shutting borders to foreigners, ceasing international passenger flights and even closing airports.¹

The impact on airlines and their supply chains of these measures was immediate and escalated rapidly.

By 21 April, an estimated 12,400 aircraft had been placed into storage and passenger revenues for 2020 were forecast to be down \$314 billion on the previous year, a drop of 48% compared to around 16% that occurred during the GFC. The International Air Transport Association (IATA) estimates that at the start of the year 75% of its members had less than three months cash to cover costs² and predicts that many will run out cash before the recovery even begins.

FIGURE 1.1 INTERNATIONAL AIR TRANSPORT ASSOCIATION IMPACT ASSESSMENT ON THE AVIATION INDUSTRY.

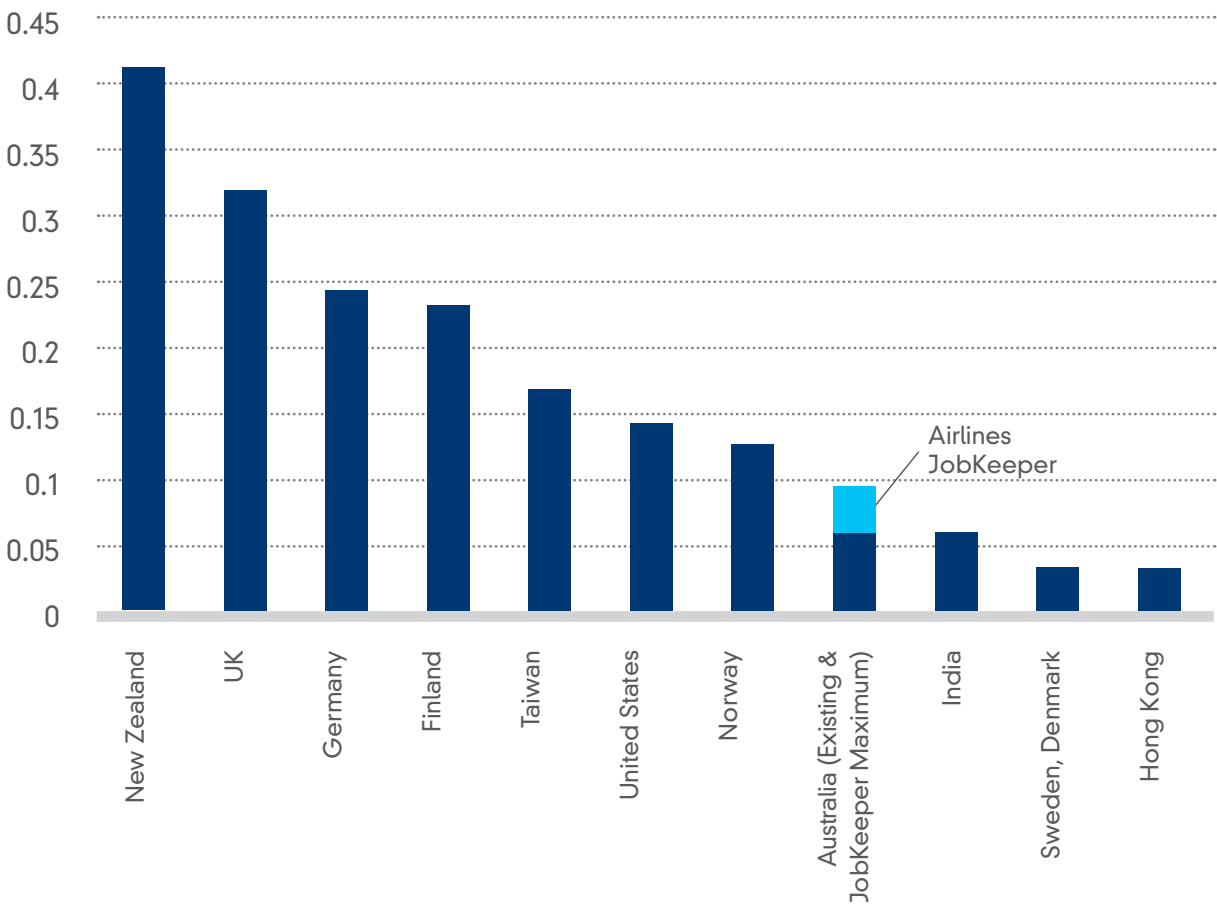
IATA IMPACT ASSESSMENT	INITIAL 20 FEB ³	SECOND 5 MAR ⁴	THIRD 27 MAR ⁵	FOURTH 14 APR ⁶
Forecast	-\$29.3 billion -4.7%	-\$113 billion -19%	-\$252 billion -28%	-\$314 billion -48%

The recovery is anticipated to be much slower than the downturn, drawn out in part by the need for a staged return to air travel, with domestic travel beginning to recover in the September quarter at the earliest and international restrictions only partially beginning to ease in the December quarter. Even once restrictions are fully lifted, overall demand for air travel is expected to be weighed down by low consumer and business confidence, themselves driven by ongoing concerns for infection and the global downturn.⁷

This bleak future, coupled with the crucial role of the aviation sector and the cancellation of flights being a direct consequence of government restrictions on travel, has seen national governments across the world intervene, offering various forms of financial support to struggling airlines. This ranges from direct grants, like in the United States, to the full nationalisation of Alitalia in Italy. However, a majority of countries offering support have extended liquidity to private airlines, typically offering lines of credit or a deferral of fees, taxes and charges associated with running an airline – or a combination of both. In most cases, support packages have been conditional, and in some cases, such as that of Singapore, have included governments taking further equity in the airline itself.

Governments have announced substantial support worldwide

FIGURE 1.2 AIRLINE SUPPORT PACKAGES AS PERCENTAGE OF GDP, WITH AUSTRALIA'S EXISTING AND PROPOSED SUPPORT PACKAGES INCLUDED. *SINGAPORE'S MUCH LARGER PACKAGE HAS BEEN EXCLUDED.



Middle Eastern countries, such as Qatar and the United Arab Emirates, whose Qatar Airways, Etihad Airways, and Emirates airlines are flagship carriers, have also announced unspecified commitments guaranteeing support for those carriers. These airlines are excluded from the preceding chart due to the lack of available details.

Figure 1.3 shows the value of these various support packages compared to the \$1.3 billion of direct support announced by the Australian Government in four tranches so far. It shows that support so far is relatively low compared to other nations, even when including a potential \$0.8 billion in JobKeeper payments to the full workforce of both airlines.

FIGURE 1.3 EXISTING AUSTRALIAN AVIATION COVID-19 SUPPORT PACKAGES

SUPPORT PACKAGE	DETAIL	COST
Initial Relief Package	Valued at \$715 million encompassing a waiver of excise on aviation fuel, Air Services charges on domestic operations and domestic and regional aviation security charges. \$159 million of this support was provided upfront in the form of reimbursements for payments from 1 February. NB: full value of these waivers has been called into question given the reductions in flying announced on 18 March 2020. ⁸	\$715m
Regional Air Network Assistance Package	Package covering 1 service per week to 138 regional communities at a cost of \$198 million and direct financial support to smaller regional airlines of \$100 million (announced 28 March 2020). ⁹	\$298m
International Repatriation	International aviation network for repatriation and exporters comprising flights to the four key overseas hubs of London, Los Angeles, Hong Kong and Auckland (announced 3 April 2020). ¹⁰	Undisclosed
International Freight Assistance Mechanism	International Freight Assistance Mechanism of \$110 million in support for high value agricultural and fisheries exports to access international markets (announced 9 April 2020). ¹¹	\$110m
Domestic Aviation Network Guarantee	The guarantee of Domestic Aviation Network involving \$165 million to underwrite critical metropolitan and regional routers over an 8-week period (announced 16 April 2020). ¹²	\$165m
TOTAL		\$1.288b

A lot hangs in the balance for Australian workers

Australia's wake-up call came on 22 April 2020 when Virgin Australia management placed the airline into voluntary administration. Not discounting the efforts underway to recapitalise the airline, Australia is for the second time in as many decades facing the possibility of seeing its second largest carrier collapse.

With no additional policy measures, this means right now Australia remains as close to getting the response right as it is wrong.

Most obviously are the direct jobs and livelihoods at stake. Australia's aviation sector is a significant employer with over 40,000 direct employees at the two big airline groups and more than 50,000¹³ additional employees employed in the rest of the supply chain or by smaller carriers.

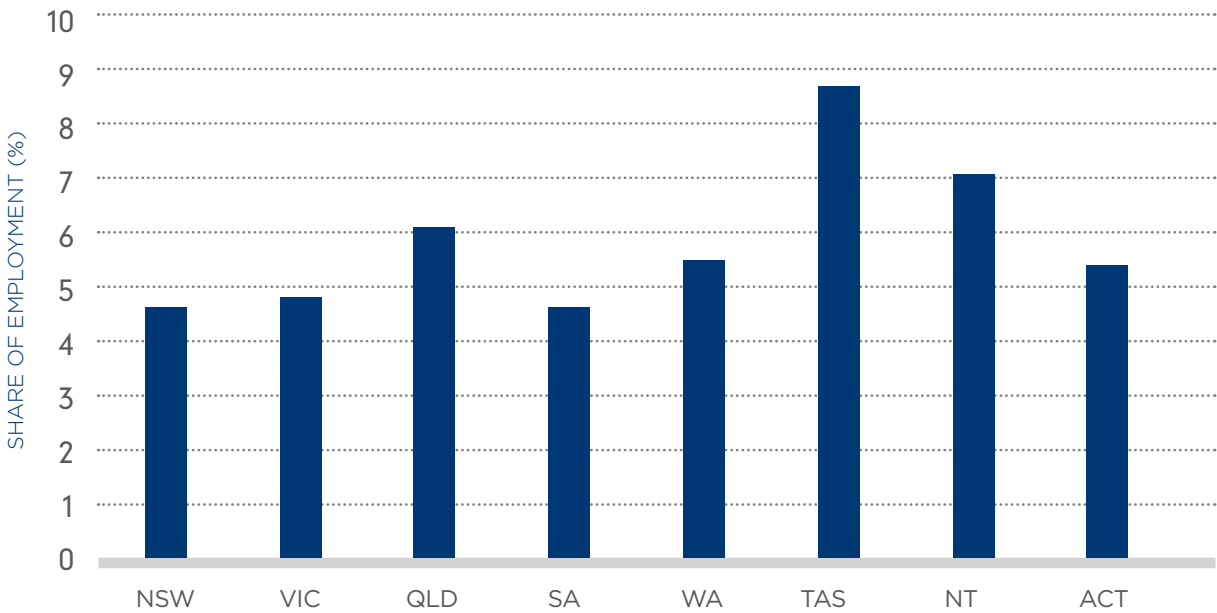
The failure of Virgin Australia to climb out of administration would threaten the livelihoods of its 10,000 workers, along with more than 6,000 contractors and 4,000 suppliers.

The importance of aviation to indirect employment is perhaps even greater.

Australia's tourism industry employs an estimated 666,000 people¹⁴ and higher education sector another 134,122,¹⁵ and both are fundamentally dependent upon domestic and international aviation for access to customers. On the non-services side, primary producers of high-value perishables ranging from lobsters to dairy cannot access key markets without reliable air freight capacity.

While Australia's economy benefits generally from its diversification, the second-round effects of a debilitated aviation sector can be expected to be concentrated on some regions more than others, such as Queensland, Tasmania and the Northern Territory where tourism is more heavily relied upon for jobs.

FIGURE 1.4 TOURISM CONTRIBUTION TO STATE AND TERRITORY EMPLOYMENT¹⁶



Meanwhile the jobs that the aviation sector tends to provide are typically more secure and better remunerated than average. The Australian Government's JobOutlook service compiles data on earnings and jobs growth across non-managerial positions. It shows the four classes of jobs in the sector are well remunerated, particularly when compared to other jobs of a similar skill level.

FIGURE 1.5 PAY AND JOB PROSPECTS FOR NON-MANAGERIAL JOBS IN THE AVIATION SECTOR, COMPILED IN THE JOBOUTLOOK BY THE AUSTRALIAN GOVERNMENT. SOURCE: JOBOUTLOOK

	AIR TRANSPORT PROFESSIONALS ¹	AIRCRAFT MAINTENANCE ENGINEERS	AIRCRAFT BAGGAGE HANDLERS AND AIRLINE GROUND CREWS	FLIGHT ATTENDANTS
Weekly Full-Time Pay (Median)	\$2,558	\$1,890	\$1,375 ²	\$1,340
Rank overall	13 of 306	79 of 306	166 of 306	183 of 306
Rank by skill	11 of 103	8 of 54	16 of 65	28 of 54
Anticipated jobs growth	Moderate	Stable	Strong	Moderate
Unemployment	Lower	Lower	Lower	Lower
Jobs	19,400	10,900	5,800	8,500
Skill level	Very high	Medium	Lower	Medium
Full-time share	78%	94%	63%	51%
Female share	9%	3%	13%	74%

1. Air Transport Professionals includes: 8,000 aeroplane pilots; 1,700 Air Traffic Controllers; 870 Flying Instructors; 1,100 Helicopter Pilots; 1,200 Other.
2. Weekly Full-Time Pay for Other Mobile Plant Operators of which Aircraft Baggage Handlers and Airline Ground Crews represent 44%.

The sector is of course not immune to other structural inequalities embedded in the Australian economy: for instance, with flight attendants being the lowest paid of the four jobs despite a higher skill level, their full-time pay is on par with the national median of \$1,342. Once the significant over-representation of females in the profession is accounted for, flight attendant pay is actually 8.5 per cent higher than the median full-time female of \$1,235 per week in 2018. A reminder that aviation employers have as much work to do on improving the gender pay gap as employers in other industries.



Open Skies may have made Australian aviation vulnerable in downturns

Australia's economy has experienced substantial benefits from the practice of liberalising air transport under bilateral and multilateral aviation treaties known as Open Skies. The sheer increase in capacity, competition and connectivity over the last two decades is a testament to this but is not without downsides either.

Aviation is an industry notorious for its exposure and sensitivity to regular global shocks so it's not enough to merely deliver for Australians during periods of strong global and regional growth.

A sustainable and healthy aviation sector should be confident in providing reliable and competitive services across the economic cycle, particularly given how much our broader economy depends upon it.

Yet of the three global shocks since deregulation are anything to go by, our second largest carrier has only managed to survive unscathed just once.

Australia has one of the most hands-off approaches to aviation, and in particular the ownership structure of its airlines. While this may have helped Australia avoid some of the significant losses incurred by other countries that have taken a more interventionist approach, the current crisis shows Australia has still not been able to avoid significant costs from being pushed on to employees, taxpayers or the or those reliant on aviation services.

The viability of any airline is also vulnerable to the financial health of its investors, something exacerbated by the current COVID-19 downturn.

This means Australia cannot necessarily avoid becoming collateral damage when strategic bets by other governments, prioritising their economic sovereignty, go horribly wrong as was seen with the UAE's poorly executed expansion of Etihad.¹⁸

As a tool of Abu Dhabi's economic strategy Etihad Airways had attempted to accelerate its expansion via strategic stakes in other airlines, one of them being Virgin Australia. Another, Alitalia, declared bankruptcy in 2018 and is currently in the process of being re-nationalised by the Italian government, while a third major strategic investment, Air Berlin, went insolvent and ceased operations in 2017.

A liberal approach to aviation can be maintained

Australia does not necessarily need to wind back the clock on the liberalised approach to Air Services Agreements or head down the path of nationalising our own carriers. But if it aims to foster a greater sense of economic sovereignty in the wake of COVID-19, then any distortionary impacts or risks to taxpayers, employees and travellers posed by 'strategic' investments must be better understood.

Working through these issues should be the subject of a new Aviation White Paper that sees the development of an Australian Aviation Plan.

Of course the urgency of the current crises mean we need to accelerate some of the thinking and investigation required and hence this paper's efforts to describe a set of principles that could help the government ensure a more robust and consistent framework for charting a way out of the current crisis and towards more sustainable skies that serves all Australians.

PART TWO: PRINCIPLES FOR AN AUSTRALIAN AVIATION PLAN

KEY POINTS

- 1 Australian leaders have voiced support for a bridge to the 'other side' of the COVID-19 crisis.
- 2 This rhetoric must be paired with a principled framework to helping the Australian aviation sector through the crisis.
- 3 Four key principles should guide an Australian Aviation Plan: *Economic Sovereignty; the Protection of Taxpayers; Market-Led Solutions; and Competitive Neutrality.*

Throughout the COVID-19 crisis, Australian government ministers have articulated a number of preferences or requirements for how they would like to see Australia's aviation sector supported so that there are two airlines competing on the 'other side'.

The Australian Government has indicated a preference for a "market-led solution" including more support from company shareholders, and also talked of the need for competitive neutrality and not "picking winners".¹⁹

Given the need to move quickly and adapt to evolving circumstances, this paper argues for the need to build on the markers already provided by the Australian Government, and to use these statements of support as a basis for establishing four overarching principles to guide the sector through the current turmoil and lay the foundations for developing an Australian Aviation Plan.



Principle I: Economic Sovereignty

- a. Australian aviation must have sufficient independence to climb out in a fragmented pre-vaccine international market and provide resilience to future shocks and world events.**
- b. The interests of all parts of Australia must be served, not just the major cities.**
- c. The size of Australia's domestic market is fundamental to sustaining meaningful competition, and domestic competition is fundamental to international competition that can service all of Australia. Promoting a larger domestic aviation market is a core priority.**
- d. Recognising the disproportionate role of aviation hubs in Australian travel.**

Of the four overarching principles, *economic sovereignty* is the one that requires the most urgent work and attention.

Australia has largely been operating on auto-pilot under the Open Skies framework, and while this has served much of our economy well via the proliferation of connections and competition, it has left us increasingly dependent on other countries to maintain continuity of key export industries.

Prime Minister Scott Morrison has made clear that economic sovereignty is not about nationalizing but ensuring we have appropriately diversified and economically sustainable supply chains that don't live off the taxpayer but rather off of "genuine, credible viable commercial operation"²⁰ and the end game is ensuring our parliaments and institutions can remain free of coercion to preserve "our capacity and freedom to live our lives as we choose in a free, open and democratic society".²¹

In responding to the unfolding challenges in aviation, Australia must specifically contemplate the future implications for Australia's economic sovereignty of how the industry is structured.

This extends beyond mere notions of Australian ownership and can be managed without a wholesale rewrite of Air Services Agreements, but in an environment where most other countries are intervening in their national interests we must be pragmatic and open about the need to look after our own.

Navigating fragmented international markets and responding to future shocks

Globally, IATA is forecasting domestic travel to fall by 40% and return to 2019 levels by the end of 2021, with demand for international travel falling by 60% and not recovering until the end of 2023.²²

In a positive twist, Australian carriers should be facing less uncertainty and downside risk compared to many of their global peers or their historical counterparts:

- Australia has a domestic market for its carriers to fall back on, unlike countries that are relatively small in size; and
- Australian carriers are capturing a diminishing share of international passengers into Australia, down from 39% in 1999 to 29% in 2019.²³

But this upside for the airlines isn't necessarily great news for the Australian economy, particularly those parts of it that are dependent on other international carriers for distributing their products to customers, participating in global supply chains or receiving tourists from around the world.

International aviation is likely to be highly fragmented, at least until a vaccine has been developed and adequately deployed. Travel between countries will most likely be re-opened on a bilateral basis where two countries believe they present an acceptable level of risk to one another

and are comfortable with containment measures they each have in place.

This means many of the carriers Australia's economy has come to rely upon could struggle to re-establish the pre-existing connections, particularly where viable plane-loads can only be achieved by mixing passengers travelling between multiple countries.

Even once we are through this crisis we know that international aviation will be at risk of other external shocks. Extreme weather and geological events, acts of war or terror, or diplomatic rifts can all cause aviation links to be cut or damaged, as could the occurrence of a new pandemic.

Asserting its economic sovereignty does not mean Australia shouldn't look to benefit from the connections Open Skies has allowed, but that we need to make sure they don't leave us too vulnerable in times of disruption. Instead we should give thought to how we best maintain adequate independence to ensure our needs are met during these inevitable periods of service disruption where Open Skies themselves are effectively put on hold.

Aviation services must serve all Australians

Commercial aviation is inevitably drawn to the largest centers of economic activity. Australia's high level of urbanization and wealth, as well as our geographic positioning as an island, means Australia as a whole is unlikely ever to be at risk of not having access to aviation.

Despite Australia's relatively small population we are home to some of the busiest and most lucrative air routes in the world.

Melbourne-Sydney is the fifth busiest domestic route in the world and the second highest earning route globally for any individual airline (bringing in \$861million for Qantas in 2018/19). Meanwhile Sydney-Singapore is the 9th most lucrative route in the world (for Singapore Airlines).²⁴

A sprawling land mass means the risk of underservicing, including misuse of market power, is all too present for remote and regional

communities. Yet fair and accessible aviation services should be non-negotiable for all Australians to share in future opportunities and prosperity, and if we are to maintain our unity as a federation.

This is in keeping with broader policy goals that are bipartisan in nature. Decentralization of population growth is a goal shared by both major parties, and aviation is a key enabler of that. For migrants, convenient affordable flights to their home country so that they can visit or host relatives is a material factor in settlement decisions. There is also a stated agenda to develop Northern Australia, which is dependent on economical and reliable air services.

Australia must ensure that our aviation networks are structured in the interest of all Australians – in the cities and the regions – which means policy settings that recognize the inevitable bias towards large urban centers rather than attempt to ignore them, and respond with practical, cost effective solutions that keep Australia connected and together.

Australia needs a larger domestic aviation market

One of the long-perceived barriers to sustaining competition in Australia has been the sense that the market is too small to fully support multiple carriers. This view has been backed up more recently by a cross-section of industry veterans:

"It's not a three-player market. There's enough money for two players"²⁵

TONY WEBBER,
FORMER QANTAS CHIEF ECONOMIST

"It's the right size for a two-and-a-bit market, but the 0.1 is always going to struggle."²⁶

MARK KORDA, FORMER ADMINISTRATOR
OF ANSETT AUSTRALIA

"I believe the market can support two ... but it's a tough business and these airlines have to be well run to survive."²⁷

SIR ROD EDDINGTON, FORMER CEO OF
BRITISH AIRWAYS AND CHAIR OF
ANSETT AUSTRALIA

The constraints of a small population are also implicit in much of the advice that a restructured Virgin Australia will need to be a leaner, smaller outfit that might even service less of the country.

If it is preferable for Australia to maintain two viable competing national airlines, then we should look for opportunities to increase the size of a domestic market so that two carriers can operate and compete with reasonable scale.

Domestic competition is also an enabler for international competition, particularly for a long haul tourist destination like Australia. Because it is such a long journey it's appealing for tourists to be able to come for long vacations and see more than one part of the country. This is evident in travel bookings, with Qantas indicating that the average visitor from China usually completes 2-3 domestic sectors.²⁸

The absence of a competitive domestic aviation market could be expected to severely limit inbound competition if international carriers are not able to access domestic capacity that can offer their customers affordable, convenient routes across Australia.

Australia needs an Aviation Plan that seeks to enlarge the domestic market as means to ensuring competition domestically and in turn to promoting international competition.

The critical role of aviation hubs must be recognised

Ongoing improvements in aircraft capability can be expected to open up new routes and non-stop flights that previously were not technically or economically feasible. The most notable example of this is the Qantas' Project Sunrise, promising non-stop services between Sydney and London and New York, which plans to exploit an upgraded Airbus A350-1000 and sophisticated route planning to by-pass the airline's Singapore hub.²⁹

Less notorious, but perhaps more disruptive and impactful will be the routes that can be opened

up by the A321XLR which will exceed the range of Airbus's existing narrow-body aircraft by more than 15% to 8,700km.³⁰

The benefit for airlines is the opportunity to establish routes previously only possible with wide-body aircraft while selling significantly fewer tickets to make the service viable.

For the Qantas Group, which has ordered 36 A321XLRs, that means an extra 2,600 to 3,200 km compared to existing narrow-body aircraft in their fleet and depending upon the cabin configuration, 12 to 30% fewer seats to fill than their wide-bodies.³¹

As exciting as these prospects are, it's important to recognise the inevitable limitations of point-to-point networks, particularly for a country like Australia:

- Firstly, to the extent that people prefer direct flights, airlines are usually good at extracting much of the value created for themselves via yield maximisation. A good example of this is the premium Qantas claims it can extract from their non-stop Perth-London flights and the confidence that gives them for being able to charge a 30% premium on their much-hyped Project Sunrise flights.³²
- Secondly, when it comes to long-haul travel (7+ hours), that is pretty much all of Australia's international connection except New Zealand and Bali. Flying nonstop is the exception for most Australians and likely to remain so.

Using consolidation hubs like Singapore or the three Middle East hubs to mix and match passengers with planes travelling between many destinations is the most efficient way to provide connections to a wide choice of destinations, which means it's also the most affordable. This next table shows the number of connections available from Australia's top 22 population centres either non-stop or with one stop.

FIGURE 2.1
NUMBER OF INTERNATIONAL CONNECTIONS AVAILABLE FROM AUSTRALIA'S AIRPORTS.

CITY	AIRPORT	ZERO STOPS	ONE STOP
Sydney	SYD	49	867
Melbourne	MEL	36	694
Brisbane	BNE	22	545
Perth	PER	17	463
Adelaide	ADL	7	380
Gold Coast-Tweed Heads	OOL	6	221
Newcastle-Maitland	NTL	0	59
Canberra-Queanbeyan	CBR	1	152
Sunshine Coast	MCY	0	55
Geelong	AVV	0	49
Hobart	HBA	0	57
Townsville	TSV	0	61
Cairns	CNS	12	310
Darwin	DRW	7	265
Toowoomba	TWB	0	52
Albury-Wodonga	ABX	0	54
Launceston	LST	0	57
Mackay	MKY	0	57
Rockhampton	ROK	0	21
Coffs Harbour	CFS	0	54
Bundaberg	BDB	0	21
Wagga Wagga	WGA	0	54

What this illustrates is that even for travellers departing from Sydney, the number of international destinations that can be reached with one transit is incomparably greater.

If you're an Australian and you have somewhere specific to go, then chances are you will need to make at least one transit stop to get there. If you live in regional Australia or one of the smaller capital cities, then you'll most likely need to make two stops.³³

Unsurprisingly, this makes Australia a significant contributor of traffic to major overseas hubs, as at March 2018:

- 16.9% of Singapore Airlines' capacity in and out of its Changi hub was to/from Australian airports (more than any other country);
- Australia accounts for 8.4% of Etihad Airways capacity which was second highest after the UK; and
- Even at 4.6% of capacity to its Dubai hub, Australia is number 4 in the Emirates network.³⁴

Indeed, part of the reason why Etihad and Singapore Airlines have taken equity stakes in Virgin Australia is to feed additional traffic into their hub operations.





Yet as much as these hubs are a great source of capacity and competition for Australians, from an economic sovereignty perspective they operate first and foremost to serve the economic interest of their host governments and economies.

So this downturn is an important opportunity to ask a fundamental question: how well do existing hubs serve Australia's interests and what could be done to achieve better outcomes for travelling Australians, key export industries and Australian taxpayers (that seem to have to foot the bill when there is a major problem)?

When we look at services available to regional Australia in the Figure 2.1, it's hard to argue they're particularly well-served. That's mostly because they don't have direct access to any of the major hubs that connect to major Asian and European destinations.

This can be seen in the difference in the number of destinations available to Darwin compared to cities like Townsville, Mackay or Albury-Wodonga,

which is primarily due to Darwin's connection into Singapore's hub.

Unfortunately for these cities, even the A321XLR mentioned before may not see them connected to an existing hub as the aircraft is likely to be too large for current levels of demand. Meanwhile, the smaller aircraft that typically service these cities aren't capable of flying 5,000-plus kilometres to reach Singapore.

Thus, most regional Australians and tourists wishing to visit them are not only forced to transit at least twice to reach most overseas destinations, but they are usually forced to backtrack via capital cities on the eastern seaboard (or even drive).

What would it take to put in place improved hub arrangements that better connect all Australians, with our overseas markets, rather than remaining dependent on overseas operations that are rightly focused on their own interests?

Principle II: Protecting Taxpayer Interests

- a. Domestic competition is critical.**
- b. There must be public input on major network decisions.**
- c. Openness to government equity-stakes is required**

While the sight of Australia's economic stimulus deployed to cushion the impacts of the pandemic is almost unprecedented in size, it is paramount that the interests of taxpayers be protected if we are going to be able to return our public finances to good health, and ensure government programs don't sow the seeds of future moral hazard or make the industry less sustainable.

In the context of the aviation industry, there are a number of key steps to take in upholding this principle.

Maintain domestic competition

The most straightforward of these is maintaining domestic competition. Failure to achieve this will make it much harder for the government to ensure value for money for any of the other measures it implements.

Underwriting domestic operations or repatriation flights can be done more effectively when there's adequate competitive tensions in the aviation market as opposed to a single monopoly provider.

Likewise, subsidising remote or regional services can also be provided with greater confidence in a competitive market.

Even if Regional Express airlines were to build up a meaningful replacement to Virgin Australia as had been mooted,³⁵ this would not occur overnight and would face significant obstacles that may not be overcome without even more drastic government intervention to promote a level playing field (e.g. seeking to mitigate the anti-competitive impacts of loyalty programs on carrier selection, capacity warfare, etc).

Public input on future network decisions

Unfortunately, the various causes of disruption to aviation services listed above under Principle I (a) mean there is an ever-present risk that governments will have to step in and provide some sort of financial support to the sector to help it get through these challenging periods or to ensure critical flights (including regional services) can be operated when they might otherwise be uncommercial.

This makes it legitimate for public and taxpayer interests to be protected by expecting input into major networking route or alliance decisions rather than simply leaving these to airlines to make on their own.

Major decisions need to be tested to ensure that they won't leave Australia more vulnerable through either a lack of services or higher costs of financial support.

Governments must remain open to taking equity stakes

The Federal Government has strongly affirmed that it is not in the business of owning airlines, however we have also seen state governments identify a strong aviation sector as key to their state's post COVID-19 recovery.

The federal government's position is a legitimate preference to take and it's also reasonable for the government to take steps to avoid it.

On the other hand, it's not necessarily prudent to completely rule out the option either, if only to be able to drive a stronger bargain with other shareholders and creditors for any support a government or governments might provide to make the industry more sustainable:

- If prospective airlines investors believe a government intends to ensure strong competing airlines — but that same government will also avoid owning them at all costs — then investors have more leverage to extract concessions than might otherwise be the case.
- Putting public capital on the table with conditions attached is a way of ensuring private bidders give fuller attention to recapitalisation plans that will preserve as much of the broader economic benefits of an airline, in particular the quantity and quality of local jobs.

The Australian Government should seek to clarify its position to state that it would strongly prefer a market-based solution, where it is not required to take an equity position in an airline, but if that were in the best interests of taxpayers and the Australian economy, then it would be prepared to do so. This should include making any government-backed loan convertible to equity in the event of arrears or default.

Such an approach would be consistent with the one taken by the government in relation to Western Sydney Airport, where in a non-crisis period it took the decision to fund and build a second, competing airport in the country's national interest after first giving the market first rights to develop the Badgerly's Creek site.

Principle III: Market-Led Solutions

- a. Clear expectations are required of what government thinks a market looks like.**
- b. Clarity on when domestic and international aviation markets will resume.**
- c. Confidence on the strength of the economic recovery.**

Federal Government ministers have continuously emphasized the “solution should be private sector and market-led” and that they “don't want to end up owning an airline”³⁶

To maximise the prospects of this outcome, the government should be striving to provide clarity and confidence around three key areas:

- what it believes a functioning aviation market looks like;
- the timetable for lifting travel restrictions; and
- the strength of the economic recovery.

Government must provide clear expectations of what a market looks like

If the Australian Government wants to see private interests develop a solution, then it is critical that the government clearly articulates its view of what a market solution looks like, most obviously for consumers but also for providers of capital and labour.

This ensures all interested parties, stakeholders and the administrator can more readily fashion their propositions in a way that meets the government's expectation and presumably test them with their appointed emissary.

At a high level, the statements by various ministers, including the PM are a good foundation: “our plan was always about seeing two viable airlines that would be there not just one year from now, but five years and 10 years”³⁷ Underneath

this are additional criteria “to see as many people employed as possible and obviously, to see strong competition.”³⁸

As the Virgin Australia administration process progresses the government should seek to further define the critical features of a market solution it would like to see, using some of the principles we have provided in this paper.

- This includes strengthening public perception that the competitive neutrality will be upheld. While the government has already committed the ACCC to ensuring other players in the market don't abuse their market power, confidence could be improved further if it committed to an ACCC review of all government support measures for the sector (including in the post-administration period).
- Similarly, the anti-competitive impacts of non-compliant labour practices, including wage theft, can be more pronounced in an industry typified by thin margins and high levels of price competition, this makes effective scrutiny and enforcement of labour conditions essential to a well-functioning labour market.

The Government should strive for clarity on the resumption of aviation

In the meantime, government, as the decision maker to restrict international and domestic travel, will also preside over the decisions to lift those restrictions. While it's too early for government to



know with full certainty what it will do, by sharing its thinking and clarifying any known principles it might adopt, it can help parties more effectively plan for a return to 'normal' in international services.

Interstate travel should resume over coming months as individual states and territories move on to Steps 2 and 3 of the agreed roadmap³⁹ whereas international travel restrictions are expected to be in place until 2021.⁴⁰

While it would be unhelpful to provide false hope of an early recovery, the more clarity that governments can provide around when travel restrictions can be expected to be lifted – or more critically the criteria or approach that they expect to take, the more readily all market participants can assess their capacity to recover – whether that is investors seeking to purchase Virgin Australia, or Qantas making decisions about its fleet and workforce and future route plans.

In the absence of a set timetable and being able to give aviation markets certainty as to when they will be able to safely recommence operations then the Australian Government needs to be realistic about the need for ongoing support for the whole of the aviation supply chain beyond September 2020, whether that be extending JobKeeper or a targeted package for the aviation industry.

Confidence in strength of economic recovery

The timing of the lifting of travel restrictions is one critical variable, however the strength and pace with which the broader economy bounces back will also be fundamental to the viability of airlines and their supply chains.

The aviation industry needs state and federal governments to get the rest of their economic responses right.

Put simply the sharper the recovery the more the aviation industry will be to carry itself out of the downturn without further call on the taxpayer. It's impossible to predict or promise what the eventual recovery of the wider economy will look like, however the more confidence aviation investors and employers can have that it will be V-shaped, rather than U- or L-shaped, the more they will feel able to do this on their own.

It won't matter if people are allowed to travel if they don't feel safe to do so, or if too many Australians are out of work, or those still in jobs have had their pay cut or have no annual leave left in the bank.

The economy will only bounce as far as people's wages and conditions let them. Therefore the more widely these have been preserved, the more confidence airlines can have that tourism will pick up quickly. The industry should lead by example and be part of a public push to maintain wages and adequate entitlement to annual leave.

Principle IV: Competitive Neutrality

- a. Government assistance available on same terms to all domestic carriers.**
- b. One airline cannot be allowed to restructure its underlying cost-base to unfairly disadvantage the other.**
- c. Direct support should strengthen competitive dynamics.**

The Australian Government has clearly stated that any solution should not involve picking winners or losers, but must be a sector-wide approach. At its heart, this goes to the notion of *competitive neutrality*, and ensuring an intervention by government doesn't favour one competing party over another.

To give proper effect to this principle, government policy responses should meet at least the following three tests:

Test 1: Financial assistance must be on equal terms

The simplest interpretation of competitive neutrality is that any support provided to one airline should be provided to another on equal or equivalent terms.

In the context of a much discussed government-backed loan for Virgin Australia, including in a resurrected form under a new ownership structure, this means that if the Australian Government were to provide a loan as part of providing a bridge to the other side, that it should also make a comparable loan available to Qantas.

In seeking to ensure any financial assistance is on equal terms, two important distinctions are worth making.

- Firstly, just because a loan is made available to both airlines doesn't mean that it's necessary for both to take up the government's offer

for this test to have been met. It might be that one airline judges the conditions of any potential loan offer to not be in their shareholder's interests (e.g. the terms of a convertible note) and it wouldn't make sense to prevent the government from being able to assist the sector, simply because one company insisted on the terms being less favourable to the taxpayer.

- Secondly, timing is crucial. This applies not just to when any support is provisioned but also when it is actually flagged. For instance, a key inhibitor to a private capital solution for Virgin Australia's prior to entering administration was the absence of certainty regarding when it will be safe to resume flying, and this is likely to remain a factor is securing a viable buyer.

Now that Virgin Australia has entered voluntary administration there is the increasing risk that it might collapse without government support forthcoming.

If flying does resume in time for Qantas not to require any financial support, then this won't breach the test of assistance on equal terms. However, if it does take longer than expected for travel restrictions to be lifted such that Qantas ends up requiring government support, then this test will have been breached.

To ensure the best prospects of meeting this test, the Australian Government should seek to anticipate what support could be required and articulate this as soon as possible.

Test 2: Non-financial assistance must not provide an unfair advantage

It's not only direct financial support that has the potential to inhibit a level playing field in the sector, there is also the risk of non-financial interventions, or a lack thereof bestowing an unfair advantage to one competitor over another.

Capacity or operational interventions by governments such as altering the allocation of traffic rights within Air Services Agreements or regulating the allocation of landing slots at airports could materially improve the operational and revenue performance of an airline, as well as harm the performance of a competitor, if done arbitrarily rather than as part of an even-handed policy reform or modernisation.

Another material area where this could occur pertains to an airline's labour costs (typically 22% of a flight's operations).⁴²

This is where Virgin Australia entering voluntary administration has made the overall situation risky, wherein should buyers seek to relaunch the airline with cuts to wages and conditions of its workforce (that were otherwise sustainable), then this would unduly threaten Qantas' competitiveness and viability.

Put simply, it's not in Australia's economic interests to allow crises to trigger a race to the bottom.

So while the Government see administration as an opportunity for a restructured Virgin to emerge stronger, its emissary should steer interested parties away from achieving strength at the expense of their workforce and towards alternative strategies.

Test 3: Direct support that strengthens competition

The government has already been forced to introduce temporary measures to support aviation capacity and connectivity, for both domestic and international passenger services and for international freight.

There's a high possibility of these measures being extended, even if in a different form, and it's critical that this occurs in a manner that strengthens competitive dynamics rather than deliberately institutionalises existing market share or allows one airline to initiate a capacity war with a competitor.

This is consistent with remarks by the Prime Minister that a resuscitated airline should be able to "go forward in a viable way, that it is also not crushed by any anti-competitive actions that might be put in place by any other player in the market".⁴³

The risk of poorly designed support negatively impact or threatening competition can be seen by the announcement of Regional Express (Rex) that it is exploring competing on capital city routes.

- While this would be enough to make Virgin Australia more vulnerable, the regional carrier's capability is arguably nowhere near a replacement as a competitor to Qantas.
- Yet Rex is arguably only in a position to consider extending its network because of preferential support that was only available to regional carriers — unless of course the "no-strings attached \$54 million cash flow injection"⁴⁴ was not actually needed.

This example highlights the need for far much more integrated response from governments on the 'road out' of the crisis.



CONCLUSION

The initial shock and surprise of the pandemic may well be behind us, but the future is still uncertain and full of risk for Australia's aviation sector.

This is particularly true for the tens of thousands of workers who have been stood down, placed on JobKeeper, or already let go.

For these Australians, along with the many businesses and communities that depend on aviation to survive, it is critical that we do not allow government policy uncertainty to be another risk that exacerbates their situation.

The principles outlined in this report are intended to help the Australian Government avoid that outcome and to get Australia's policy makers thinking about what we need to do to make sure we aren't having the same conversations the next time there's a global shock to the industry.

Negative shocks are sadly inevitable, and in some form even predictable, so government policy must plan for them.

This means having a clearer assessment of the risks that exist under Australia's liberalised policy settings and thinking more about how we intend to manage them over the longer term.

As taxpayers, that includes recognising that although we're "not in the business of owning airlines" we seem to be unavoidably on the hook for short term financial support when there's a major problem, as seen with four aviation packages deployed during the initial stages of the pandemic, as well as for larger scale investments to support growth such as building Western Sydney Airport or a rail link to Melbourne Airport.

As travellers, that means recognising our safety when we travel is ultimately dependent upon the professionalism of every single worker in the aviation supply chain and that policy settings consign them to the scrap heap during tough times will only make it harder to maintain the high standards we've come to rely on.

And as Australians, that means recognising that the airline industry's highly mobile capital structure can just as readily result in unsustainable competition as it can result in no competition.

Despite the proliferation of capacity since deregulation, under-servicing for many regional towns remains a persistent problem in a market that's skewed towards servicing the biggest cities.



APPENDIX 1: QUANTITY OF INTERNATIONAL AIRLINE SUPPORT PACKAGES

KEY POINTS

- 1** 19 countries' airline support packages have been assessed.
- 2** It is clear that, though any Australian support.
- 3** Governments around the world have offered major support packages; compared to which, the Australian Government's current support package remains modest.

The COVID-19 economic downturn and associated travel-bans have caused existential challenges for the airline industry globally. Across the world, national governments have intervened, offering various forms of financial support to struggling airlines.

This ranges from direct grants, like in the United States, to the full nationalisation of Air Italia in Italy.

However, a majority of countries assessed have extended liquidity to private airlines, typically offering lines of credit or a deferral of fees, taxes and charges associated with running an airline – or a combination of both.

In most cases, support packages have been conditional, and in some cases, such as that of Singapore, have been included taking equity in the airlines themselves.

Middle Eastern countries, such as Qatar and the United Arab Emirates, whose Qatar Airways, Etihad Airways, and Emirates airlines are flagship carriers, have also announced unspecified commitments guaranteeing support for those carriers. These airlines are excluded from the following analysis due to the lack of detail.

Australia’s existing support package

On 18 March, the Australian Government announced a \$715 million support package for the airline industry, focused primarily on a deferral of fees and charges associated with the airline industry.

The Australian Government has also introduced a wage subsidy program — the JobKeeper package — accessible to businesses with a demonstrable 30% decline in revenue.

Virgin Australia, which has 10,000 direct employees, is a likely recipient of the JobKeeper package, which if fully implemented throughout the airline would cost the government \$150 million per fortnight (at \$1500 per fortnight, per employee). Were Virgin Australia to receive a wage subsidy for the entirety of the six month period it is designed to operate, it would cost

the Australian Government \$1.8 billion for Virgin Australia alone.

Unfortunately, key employers in the aviation supply chain have been excluded from JobKeeper such as the Dnata Group.

Proposals for further Australian Government support

Australia’s airline industry is an effective duopoly, with its four main airlines (Qantas, Virgin Australia, Jetstar and Tiger) owned by two entities, Qantas, and Virgin Australia.

Regional Express (REX) also services regional and rural destinations often not serviced by the major carriers. COVID-19 has seen a collapse in revenue for all airlines. In April, Virgin Australia entered voluntary administration, calling for a \$1.4 billion line of credit to remain operational.

The Federal Opposition has argued that any Australian Government support should see the Government take an equity stake in Virgin Australia, rather than simply offering a line of credit. The following analysis demonstrates that, in any case, the proposals for the Australian Government to support Virgin Australia are modest when compared to international support packages.

At least 19 developed countries are offering support for their airline industries

The mean support offered by the analysed countries’ is 0.24% of GDP.

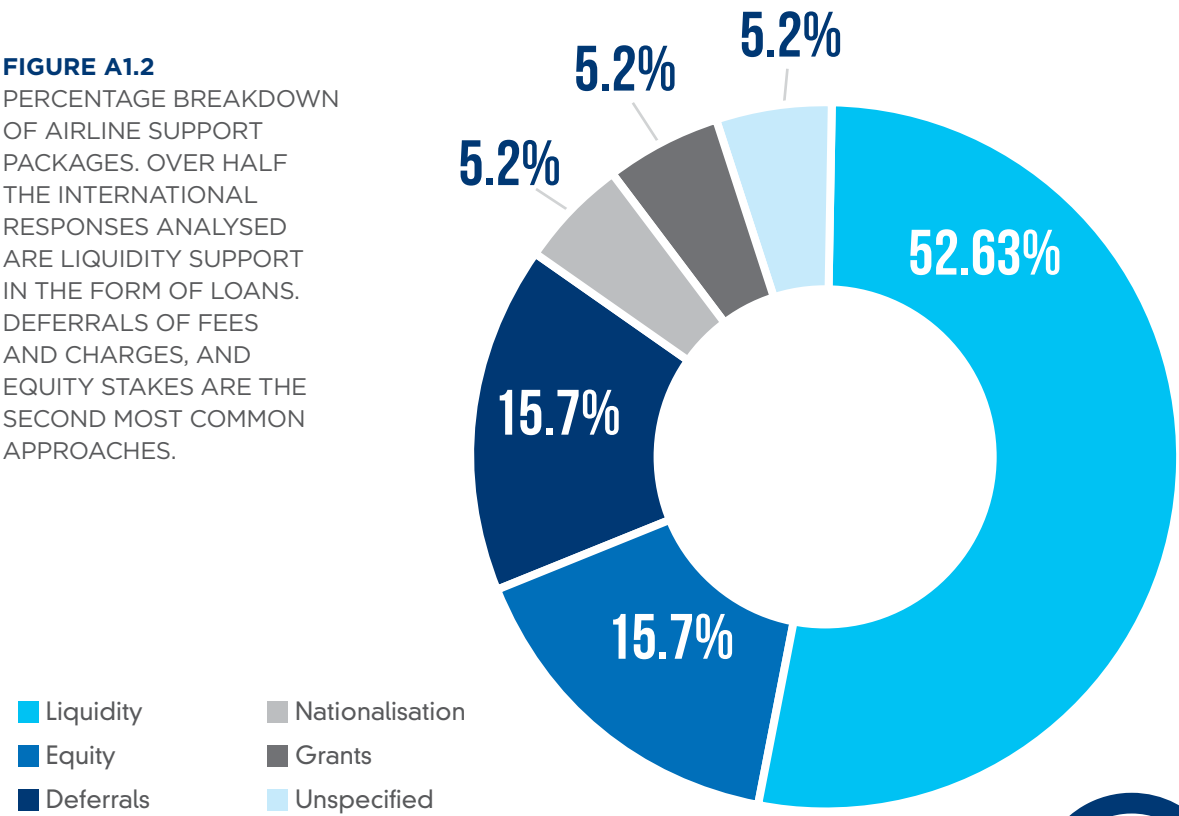
FIGURE A1 MEDIAN, MEAN, MAX AIRLINE SUPPORT PACKAGES, AS PERCENTAGE OF GDP.

MEDIAN SUPPORT AS % OF GDP	MEAN SUPPORT AS % OF GDP	MAX SUPPORT AS % OF GDP
0.11	0.24	1.74



Australia’s existing and proposed airline support measures are among the most modest packages among countries offering financial support for their airlines.

FIGURE A1.2 PERCENTAGE BREAKDOWN OF AIRLINE SUPPORT PACKAGES. OVER HALF THE INTERNATIONAL RESPONSES ANALYSED ARE LIQUIDITY SUPPORT IN THE FORM OF LOANS. DEFERRALS OF FEES AND CHARGES, AND EQUITY STAKES ARE THE SECOND MOST COMMON APPROACHES.



APPENDIX 2: CHARACTERISTICS OF INTERNATIONAL SUPPORT PACKAGES

KEY POINTS

- 1 International responses are typically revolved around providing liquidity to airlines.
- 2 Many details of international responses remain forthcoming.

Overview of International Government Support packages for international airlines

AS OF 28 APRIL 2020

CHINA

- The Chinese Government has offered an unspecified quantity of cash support to its domestic airline sector, aimed to alleviate cashflow pressure.
- The international package revolves the provision of cash support for every available seat kilometre of 0.016 yuan for routes with multiple carriers and 0.0528 yuan for routes that a serviced by only one carrier.⁴⁵

SINGAPORE

- Singapore Airlines has received US\$3.52 billion in financial support from the Singapore Government in the form of an equity injection. A further \$6.8 billion worth of 'convertible notes', which are 'bonds that can be converted into equity stakes in the company',⁴⁶ have been distributed to the airline.
- Singapore Airlines have also secured a \$2.8 billion loan from a private lender.
- The various measures total US\$13.32 billion.

CANADA

- The Canadian Government has 'promised' support for both Air Canada and WestJet.⁴⁷
- Both airlines are receiving wage subsidies as part of the Canadian Government's broader economic support package.
- There are reports that the airlines will receive an approximate CAD\$10 billion 'credit bridge' to provide liquidity during the crisis.

UK

- The United Kingdom has offered support for four airlines or airline groups: Easy Jet, British Airways, International Airlines Group, and Virgin Atlantic.
- The package is believed to include:
 - State backed credit
 - A deferral or freeze of the standard air traffic control charges
 - A ban on small customer refunds for a period of time

- Support with the costs of labour, utilising the UK's broader wage subsidy package.
- Though yet to be formally announced, there is an expectation that the airlines will receive around £7.5 billion, (US\$8.7 billion).

NEW ZEALAND

- The New Zealand Government has both provided liquidity to Air New Zealand, as well as providing broader support to the airline sector to maintain freight links.
- Air New Zealand has been provided NZ\$900m (US\$ 534) in loans,⁴⁸ while a further NZ\$600m has been provided to ensure freight connections remain open.⁴⁹
- The package is equivalent to 0.4% of New Zealand's GDP.

FINLAND

- The Finnish Government has offered a 600 million euro loan to Finnair, the flag-carrier. The airline is already majority state-owned.⁵⁰
- The loan guarantee is equivalent to 0.23% of Finland's GDP.

TAIWAN

- The Taiwanese Government has offered both subsidies and loans to its two major carriers — China Air and Eva Air.
- The package is worth US\$994 million, and also includes waiving all landing and parking fees.⁵¹
- The package is equivalent of 0.16% of Taiwan's GDP.

UNITED STATES

- The US has offered a US\$32 billion support package to various airlines, which mainly consists of direct grants to keep airlines afloat.
- The package is the equivalent of 0.14% of GDP, and is expected to be extended as the crisis continues.

NORWAY

- Norwegian Airlines has received support from the Norwegian Government in the form of a US\$537 million line of credit.
- The package is the equivalent of 0.09% of Norway's GDP.

INDIA

- The Indian Government, which has offered minimal economic support during the COVID-19 pandemic, has offered IndiGo and SpiceJet waivers and deferrals for fees and taxes levied on the airlines.⁵²
- The package is expected to cost around US\$1.6 billion, or 0.05% of GDP.

SOUTH KOREA

- South Korean airline Korean Air is lobbying for a US\$250m line of credit, however, as of 22 April 2020, the South Korean Government is yet to formalise any direct support to the airline or the industry.⁵³

SWEDEN AND DENMARK

- The Governments of Sweden and Denmark are offering a combined total of US\$300 million in liquidity to keep SAS afloat.⁵⁴
- The package is the equivalent of 0.03% of the combined GDPs of Denmark and Sweden.

HONG KONG

- The Hong Kong Government has provided waivers and deferrals of fees to Cathay Pacific, worth a total of US\$453 million.
- The package is the equivalent of 0.03% of Hong Kong's GDP.

ITALY

- The Italian Government moved quickly to nationalise Alitalia, a flagship carrier that had been struggling prior to COVID-19. The nationalisation cost 500 million euros, or US\$543 million, equating to 0.02% of Italy's GDP.

Formalised Support Packages by Country, Type and Ranked by Percentage of GDP, with Australian comparison

COUNTRY	AIRLINES	SUPPORT 1	QUANTUM LOCAL (B)	QUANTUM USD (B)	SUPPORT 2	QUANTUM LOCAL (B)	QUANTUM USD (B)	TOTAL	GDP
Singapore	Singapore Airlines	Equity	5.3	3.52	Liquidity	4	2.81	6.33	364.2
New Zealand	Air New Zealand	Liquidity	1.5	0.89				0.89	216.199
Germany	Lufthansa	Equity	9	9.88				9.88	3988
UK	EasyJet, British Airways, IAG, Virgin Atlantic	Liquidity	7.5	8.7	Deferrals			8.7	2716.534
Finland	FinnAir	Liquidity	0.6	0.652				0.652	280.709
Taiwan	ChinaAir, Eva Air	Liquidity	30	1	Deferrals			1	590
United States	American, United, Delta, Southwest, Alaska, jetBlue, Spirit	Grant	32	32				32	22321.762
Norway	Norwegian	Liquidity	6	0.537				0.537	422.06
Australia (Existing & Proposal)	Virgin, Qantas, REX	Liquidity	2.15	1.36				1.36	1375.448
Australia (Virgin Equity Proposal)	Virgin	Equity	1.4	0.888				0.888	1375.448
India	IndiGo, SpiceJet	Deferrals	122.4	1.6				1.6	2719
Sweden, Denmark	SAS	Liquidity	3	0.302				0.302	911
Hong Kong	Cathay Pacific	Deferrals	1	0.12				0.12	362
Australia (Existing)	Qantas, REX, Virgin	Deferrals	0.715	0.453				0.453	1375.448
Italy	Alitalia	Nationalisation	0.5	0.543				0.543	2013.67

Source: Author analysis.

Unspecified Support Packages

COUNTRY	AIRLINES	PROPOSED OR SPECULATED NATURE OF SUPPORT PACKAGE
United Arab Emirates	Emirates	The Crown Prince of Dubai has publicly committed to an 'equity injection' to support the airline, though details are forthcoming. ⁵⁵
Japan	Japan Airlines, All Nippon Airways	Though there is no commitment from the Government of Japan, the airlines are seeking US\$18 billion in aid. ⁵⁶
Thailand	Thai Airways	The Thai Government 'expects to concluded a capital injection plan' for the carrier, as of 16 April 2020.
Finland	FinnAir	Liquidity.
China	Cash support	Offering a \$/seat kilometer to keep airlines afloat despite lower patronage.

Source: Author analysis.

APPENDIX 3: THE ROLE OF TWUSUPER IN DEVELOPING POLICY RESPONSES

As the IndustrySuper fund for transport and logistics, TWUSUPER members span the entire aviation sector supply chain: employees at airlines such as ground crew, pilots, cabin crew and call centre staff as well airports and outsourced providers in catering, cleaning, ground handling, security, and refuelling. The concentrated impact that the COVID-19 pandemic response has had on the sector means that its members and their retirement incomes are exposed to multiple risks, including:³

- a. Permanent loss of employment;
- b. Permanent erosion in pay and conditions using 24-hour notice or coming out of administration;
- c. Temporary loss of employment or reduction of income due to reduction in hours worked or being stood down; and
- d. Withdrawal of up to \$20,000 from existing superannuation balances under new early access provisions.

The most effective way to mitigate these risks and their impacts is to ensure continuity within the aviation sector for existing employees and businesses, which means the Australian Government's policy response will be critical. TWUSUPER in seeking to look after its members retirement incomes, and in keeping with its sole purpose test under the SIS Act, has a strong interest if not obligation to assist the Australian Government in developing an adequate response.

TWUSUPER's broad representation of the sector, as opposed to being either a single-employer or fully-diversified fund, means that it is particularly well-aligned to the Australian Government's ambition for sector-wide policy responses.

For instance, it's in the interests of TWUSUPER's members that government financial support can't be soaked up by those at the top of the supply chain but flows right through to all participants.

Furthermore, TWUSUPER's members cannot afford for the fund to let competitive interests get in the way of developing the effective solutions required and being financially dependent on the sector's employees rather than its employers can give it more freedom and flexibility to do this than traditional industry bodies.

From an investment perspective, TWUSUPER has a number of considerations:

- Participating directly in any rescue bid for Virgin Australia. The fund's duties to all its members mean that any involvement would ultimately need to be a sound commercial investment in its own right and would need to avoid excessive exposure to the sector, including for members already exposed by their direct employment. Given TWUSUPER's size this means it could only reasonably be a minority participant in any bid and assuming commercial viability, the bid should be in a position to proceed independent of TWUSUPER's participation.
- Exposure to aviation sector in existing portfolio. TWUSUPER's exposure to assets in the aviation sector, including airport infrastructure, means that its members have an interest in seeing a strong rebound to the aviation sector and continued flow through of payments through the supply chain. Those assets would be unlikely to benefit from industry outcomes that led to greater concentrations of market power within the sector.
- Exposure to downstream customers. TWUSUPER's broader holdings of Australian equities include many businesses whose own supply chains or operations are dependent on aviation and will therefore be negatively impacted by ongoing loss of competition and services more broadly.

3. The impacts of risks (a) to (c) are similar in nature to the scenarios modelled in Stanford, J. (2017) *The Consequences of Wage Suppression for Australia's Superannuation System*. For instance, a permanent erosion of conditions is a kin to Stanford's Scenario D which looked reductions in penalty rates and Scenario G covering the elimination of an EBA and reversion to the award, which project negative impacts on balances at retirement ranging from -8.7% to -37.3%.

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CONTACT THE MCKELL INSTITUTE

VICTORIAN OFFICE

T. (03) 9456 1608
PO Box 21423,
Melbourne VIC 8011

SYDNEY OFFICE

T. (02) 9113 0944 **F.** (02) 9113 0949
E. mckell@mckellinstitute.org.au
PO Box 21552, World Square NSW 2002

 [@McKellInstitute](https://twitter.com/McKellInstitute)  www.facebook.com/mckellinstitute
www.mckellinstitute.org.au