



**Australian Government**  
**Productivity Commission**

Australia's International  
Tourism Industry

Productivity Commission  
Research Paper

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### **The Productivity Commission**

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## **Disclosure of interests**

The *Productivity Commission Act 1998* (Cwlth) requires that Commissioners must disclose where they have or acquire interests, pecuniary or otherwise, that could conflict with the proper performance of their functions during an inquiry. The Commission considers it is good practice to extend this to where Commissioners actively participate in other work of the Commission.

Dr Warren Mundy has advised the Commission that he is the Managing Director of Bluestone Consulting Pty Ltd, a company that provides advice to governments, investors and companies on policy, regulation and commercial issues in the infrastructure sector, including airports. Neither he nor Bluestone Consulting have provided any advice to any company in relation to this project.



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Dr Warren Mundy  
Commissioner

26 February 2015

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# Abbreviations

ABS	Australian Bureau of Statistics
EPBC Act	<i>Environmental Protection and Biodiversity Conservation Act 1999</i> (Cwlth)
GBR	Great Barrier Reef
GDP	Gross Domestic Product
GSP	Gross State Product
LCC	Low cost carrier
PMC	Passenger Movement Charge
SATC	South Australian Tourism Commission
TEQ	Tourism and Events Queensland
VCEC	Victorian Competition and Efficiency Commission
VFR	Visiting Friends and Relatives
UNWTO	United Nations World Tourism Organisation

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# OVERVIEW

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## Key points

- Australia's international tourism industry has grown strongly over the past two decades — the number of international visitors to Australia has more than doubled, rising from 2.5 million in 1992 to almost 6.7 million in 2014. The composition of the industry has also changed.
  - Markets in Asia, particularly China and India, have grown in importance as a source of international visitors to Australia, with China now the second largest source of visitors after New Zealand. Alongside this, there has been a slow down (and, in some cases, a decline) in growth in the number of visitors to Australia from some historically important source countries, such as the United States, the United Kingdom and Japan.
  - Growth in the industry overall means regional visitation has increased, but the change in the composition of source countries has contributed to a decline in the proportion of expenditure and the proportion of international visitors travelling to regional areas of Australia (of about 5 percentage points between 2006 and 2014).
  - There has been an overall decline in international tourism activity in some regions — in Tropical North Queensland there was a 20 per cent decline in the number of international visitors travelling to the region, particularly from Japan, and a 40 per cent decline in real expenditure between 2006 and 2014.
- The way businesses in the international tourism industry innovate and adapt to changing trends will largely determine how successful Australia is in continuing to attract international visitors. Governments also have a role, and a number of reforms would benefit the tourism industry and the economy more broadly.
  - Many national parks are hampered by tired infrastructure and persistent funding shortfalls. Greater user charging and more private investment would provide an additional source of funding and facilitate innovation in the provision of tourism-related infrastructure.
  - Poor approval processes for tourism-related infrastructure investments are not only costly to developers, but to businesses and communities. There is a need for governments to continually review and reform these processes so that they are flexible and risk based, and keep pace with innovations in the tourism industry.
  - There can be a case for governments to be involved in attracting international visitors to Australia through the provision of international destination marketing and support for major events. However, assessments often overstate the net economic benefits of these activities — and consequently the basis for government support — highlighting a need for rigorous and transparent economic analysis to determine whether government expenditure is warranted.
- Although Australia's international aviation policy settings have served Australia well, it is expected that further liberalising access to Australia's major gateway cities — Brisbane, Melbourne, Perth and Sydney — would provide net benefits to the international tourism industry and the Australian community.
  - It is difficult to see how restricting access to secondary airports serving the major gateways, such as Avalon and the proposed airport at Badgerys Creek, creates benefits for the Australian community. If any restrictions are to remain, the case for all restrictions, except those at Sydney Kingsford Smith Airport, is quite weak, and open access could be extended accordingly.

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# Overview

## **Tourism is a significant contributor to the Australian economy**

Tourism is important to Australia's economy — people are travelling further, and more frequently for a range of reasons including leisure, business and education.<sup>1</sup> In 2014, total tourism spending contributed almost 3 per cent of Australia's GDP — about one-third of this (\$11 billion) was by international visitors. International tourism's share of total service exports was just over 60 per cent in 2014.

**The number of international visitors to Australia has more than doubled over the past two decades**

Demand for international tourism in Australia has grown strongly over the past two decades — the number of international visitors has increased from 2.5 million in 1992 to almost 6.7 million in 2014. Tourism is expected to continue to be important to the Australian economy, with strong growth projected in the number of international visitors travelling to Australia over the next decade.

Important drivers of demand for international tourism include foreign household incomes, the cost of travel and the relative price of tourism in Australia compared with other destinations. For example, rising real incomes, particularly in emerging countries in Asia, have given many more people the opportunity to travel for the first time. Globally, airfares have fallen significantly (by about 60 per cent in real terms) over the past four decades, which has contributed to an increase in demand for international air services.

**The global market for international visitors is heavily contested**

Despite strong growth in the total number of visitors travelling to Australia, Australia's market share of global international visitors has declined, in line with most other developed countries. Australia's share of global international visitors declined from 0.7 per cent in the year ending 2000 to 0.6 per cent in the year ending 2013.

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<sup>1</sup> In this report, an international visitor is taken to be any person not normally resident in Australia visiting for less than one year for any purpose. There is no precise definition of the tourism industry because it encompasses many different industries. The Commission has used the definitions of tourism adopted by the ABS and Tourism Research Australia but emphasises that these include travel for a broad range of activities in addition to leisure activities, such as travel by international students. All data in the Overview are reported for year ending June unless otherwise stated.

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Research commissioned by Tourism Australia shows that the decline in Australia's share of the global tourism market is beginning to stabilise for some of its historically important source countries, such as the United States and Singapore. Market share for visitors from key emerging countries, such as China, remains heavily contested. China is the world's fastest growing source of international tourism, with expenditure increasing almost tenfold since the year ending 2000. Visitors from China now lead the world in total international tourism expenditure. As a result, there is strong competition amongst countries to attract visitors from China, with the national tourism agencies of many countries (for example, the United States and the United Kingdom) running international destination marketing and other programs focused on attracting visitors from China. Other countries, including the United Kingdom, Thailand and India, have implemented reforms to improve visa arrangements, particularly for visitors from emerging Asian markets. This intense competition means that maintaining market share from heavily contested source countries is likely to remain a challenge for Australia.

The actions of competitor countries to attract international visitors are beyond the influence of the policies of governments in Australia, as are some other important factors that have a significant influence on decisions to travel abroad, such as favourable exchange rates, or the unique attributes of a destination that appeal to particular visitors. Nonetheless, there are actions that can be taken by Australian governments to help facilitate the most efficient level of investment in the international tourism industry.

A key role for governments is to ensure that their policies and regulations do not unnecessarily impede the international tourism industry from adapting to changes in consumer preferences and technology. As visitors' preferences to undertake different activities or to travel to different destinations within Australia change, there will be a need for tourism-related businesses to adapt their tourism product offerings or make new investments. This can include private sector investments in tourism-related infrastructure, such as accommodation or resorts, and visitor attractions such as casinos and theme parks. Investment decisions in these areas can be strongly influenced by development assessment and approval processes (including planning and zoning processes) and the posture adopted by regulators when administering them.

Other government policies and regulations can influence visitors' decisions to travel to Australia. These include policies and arrangements that govern air travel between Australia and other countries — the principal way by which visitors travel to and from Australia — and arrangements for facilitating international visitors, such as visa processes. Government provision of international destination marketing, and support for major sporting, cultural and business events can also influence decisions to travel to Australia.

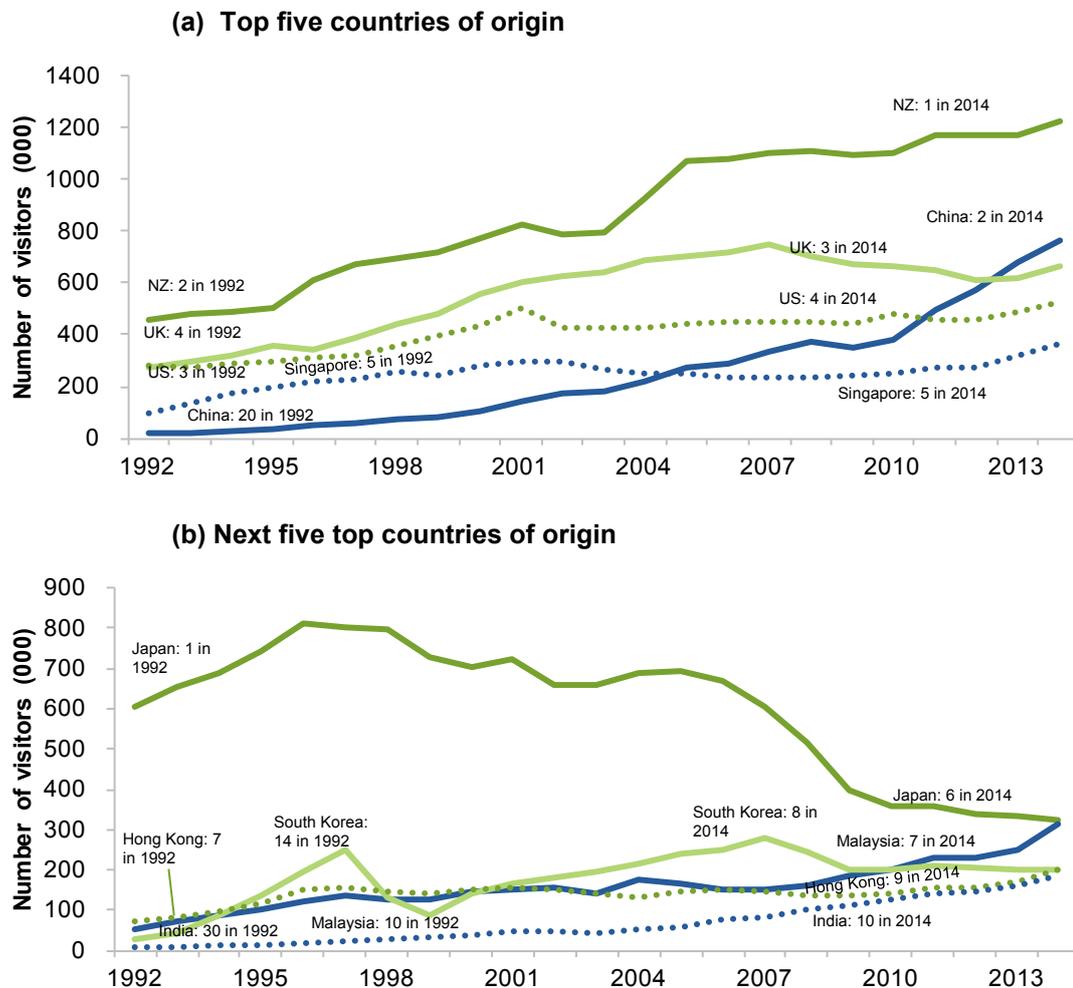
This research project has considered these areas of policy and regulation with a view to identifying whether they are posing significant barriers to future growth in international tourism activity in Australia. It has also examined the role of government. The overriding objective of any government involvement in the international tourism industry, and any reforms to policies and regulatory settings that may be posing a barrier to growth in

international tourism activity, should be to increase the welfare of the Australian community as a whole.

### Emerging countries in Asia have grown in importance for Australian tourism

Growth in the number of visitors to Australia over the past decade has coincided with a change in the composition of Australia's international visitors. More people are now visiting Australia from emerging countries in Asia, particularly from China and India (figure 1).

Figure 1 **Australia's international short-term visitors, top ten source countries in 2014**



Visitors from some Asian countries are becoming proportionally more important to Australia's international tourism industry, as growth in visitors from Australia's historically important source countries (such as New Zealand, the United Kingdom, the

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United States and Japan) has slowed. China is now the second-largest source of international visitors to Australia after New Zealand and is likely to continue to be a significant source of growth in visitor numbers as real incomes rise.

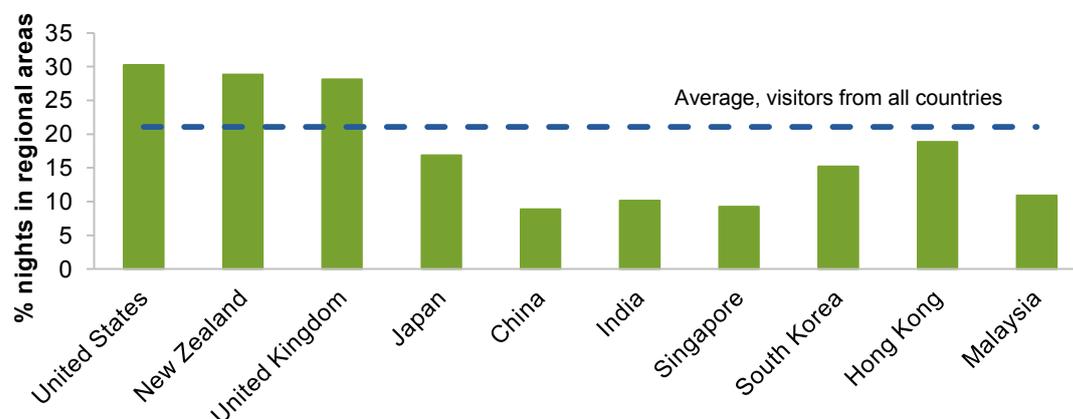
### Changes in the composition of Australia’s international visitors may have implications for international tourism in regional areas

Visitors from some countries in Asia (particularly China, India and Singapore) have a lower tendency to travel to regional areas, and spend fewer nights in regional areas on average, than visitors from other countries, preferring instead to visit capital cities or destinations primarily on the east coast of Australia (figure 2).

Increased reliance on visitors from emerging Asian markets, and a slowdown in the growth of visitors from some historically important source countries, such as the United States, the United Kingdom and Japan, has resulted in a decline in the *proportion* of international tourism activity that takes place in regional areas of Australia. Although the total number of international visitors and nights spent in regional areas has increased, estimates provided by Tourism Research Australia suggest that there was a 5 percentage point decline in the proportion of expenditure and the proportion of international visitors travelling to regional areas of Australia between 2006 and 2014. There was also an overall decline of almost 4 per cent in real expenditure by international visitors in regional areas over this period. However, no firm conclusions can be drawn from these figures as sufficient data are not available to accurately analyse regional tourism activity in Australia.

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Figure 2 **Nights spent in regional areas by international visitors, top ten source countries in 2014**



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Within some regions of Australia, there has been an overall decline in international tourism activity — an example being Tropical North Queensland, where there was a 20 per cent

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decline in the number of international visitors travelling to the region between 2006 and 2014. There was also a 40 per cent decline in real expenditure in Tropical North Queensland by international visitors over this period. These declines can be largely attributed to a decline in the number of visitors from Japan, who have historically been an important source of tourism activity for the region.

Governments have a range of programs aimed at encouraging regional tourism, such as the \$110 million Regional Tourism Infrastructure Fund in New South Wales, and Tourism and Events Queensland's Regional Development Program. There have also been calls from stakeholders for further government action to encourage international visitors to travel to regional areas. Suggestions include greater investment in transport infrastructure in regional areas, and greater emphasis on regional areas in governments' international marketing materials.

Calls for government investment to stimulate tourism in regional areas need to be considered carefully to avoid misallocating funds to costly white elephants based on claims of 'build it and they will come'. Any government support for regional areas should be based on hard evidence and a sound rationale for government intervention. Failure to do so means assistance to one region will simply divert resources away from other regions (or other industries in that region), without achieving an overall increase in welfare for Australia.

An example of where government support may have shifted expenditure from one region in a state to another is the Margaret River Gourmet Escape. An evaluation of this event estimated that the direct expenditure in the Margaret River region by visitors from outside the region who attended the event was about \$11 million. However, expenditure by visitors from outside of Western Australia was about \$4 million (that is, about \$7 million of the increased expenditure in Margaret River was by visitors from other regions in Western Australia).

### Emerging digital technologies are changing the way people travel

The emergence of digital technologies has affected the way visitors research and book tourism-related products. More visitors are now researching and booking components of their trip on the internet, especially airfares and accommodation. Digital sharing platforms, such as Airbnb and Stayz, are also growing in popularity (box 1).

Digital platforms that enable sharing of tourism-related products present an opportunity to stimulate innovation in the tourism industry by providing an additional source of competition to traditional providers of these products, such as travel agents and hotels. They enable property owners to earn income from underused assets and provide visitors with greater choice and more lower-priced tourism options. Airbnb and Stayz, for example, can broaden accommodation options available in areas that lack the various types and levels of accommodation to suit different budgets and preferences, particularly during peak periods. This could help facilitate additional visitors to a destination.

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Growth in the use of digital platforms raises policy and regulatory issues. For example, the use of digital platforms for the letting of short-term residential accommodation has raised some concerns for local governments. Some local governments have prohibited the use of short-term residential letting due to complaints about external costs imposed on neighbours through noise and antisocial behaviour. In some local government areas, it is uncertain whether short-term letting of residential accommodation is allowed under existing regulatory frameworks, especially where they do not meet the requirements normally expected of bed-and-breakfast accommodation. This has created regulatory uncertainty for providers of short-term residential letting.

**Box 1      The influence of digital technologies on the tourism industry**

More visitors are now researching and booking components of their travel online, such as transport and accommodation. Between 2006 and 2014, the proportion of international visitors who booked part of their travel online increased from 22 per cent to almost 50 per cent. In general, younger visitors and those travelling for holiday purposes are more likely to research and/or book their trip via the internet.

Innovative digital platforms have also enabled tourism products, especially accommodation and transport, to be provided through non-traditional means. Sharing platforms such as Airbnb and Stayz enable residential property owners to directly engage in short-term letting. Although there is insufficient data to accurately measure the contribution of sharing platforms in Australia, it has been estimated that as many as 425 000 people worldwide stay in Airbnb homes on a peak night, and Airbnb was reported to have a market capitalisation of over US\$10 billion in early 2014. Platforms for sharing other types of tourism-related products have also been used internationally. For example, in the United States, FlightCar allows people parking at airports to rent out their vehicles to other travellers.

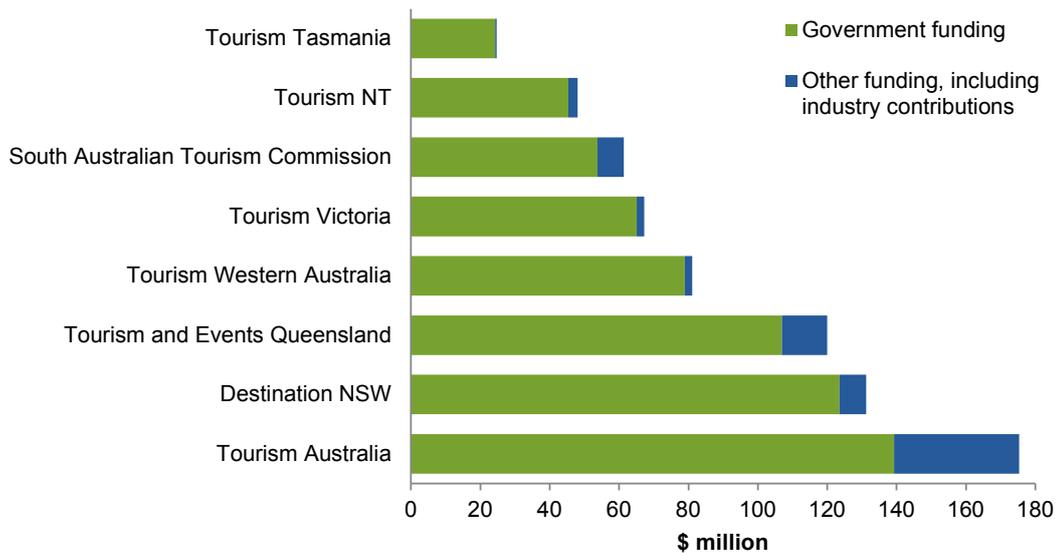
Regulation of private property markets may be warranted when markets fail, for example, where the use of land imposes costs on others, such as excessive noise for nearby residents. However, regulations to address any external costs should be sufficiently flexible to accommodate alternative models of product delivery so as not to stifle innovation within the tourism industry. It is important that governments continue to monitor these types of innovations in the tourism industry and ensure their regulatory processes keep pace with technological advances and consumer trends, and are able to adequately manage relevant issues. This broader issue of regulatory adaptation to technological and business model change will be dealt with in more detail in the Commission's inquiry into Business Setup, Transfer and Closure.

### **Should governments be involved in attracting international visitors?**

The principal objective of Australia's tourism agencies, both at the Australian and state and territory government level, is to attract visitors to Australia or its regions. Tourism agencies seek to do this through the provision and funding of destination marketing, and support for some major sporting, cultural and business events. The total expenses of

Australia's tourism agencies in 2014 was over \$700 million, of which more than \$630 million was from government funding (figure 3). This is the lower bound of the total amount of government funding for destination marketing and major events as it does not include funding for some major events that does not go through tourism agencies. Events such as the Commonwealth Games and the Formula 1 Grand Prix are typically managed by separate bodies.

Figure 3 **Total expenses of Australia's tourism agencies, 2014**



The effectiveness of Tourism Australia and its state and territory equivalents has not been considered by the Commission in this project. Nor has the Commission evaluated the programs undertaken by these agencies. The focus has instead been on the role of government in attracting international visitors to Australia and options for how to best provide and fund these activities.

### The rationale for government support for destination marketing and major events

The benefits arising from destination marketing and major events have 'public good' characteristics. The benefits from destination marketing (increased international visitor activity for tourism-related businesses) are able to be captured by any tourism-related business in that destination, and it is infeasible to exclude businesses that benefit from the campaign but do not contribute to the costs. If a hotel, say, were to market a destination, it is likely to create benefits in the form of increased visitor activity for other tourism-related businesses in that destination, such as restaurants and sightseeing operators. It would be difficult for the hotel to recoup its costs from those businesses that benefit. Further, where one tourism-related business benefits from the marketing or a major event, this does not diminish the quantity of the benefits that are available to others.

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As tourism-related businesses cannot be prevented from obtaining benefits from destination marketing and major events, they face an incentive to free ride on the destination marketing or major events provided by other businesses. Free riding *may* mean that such activities will be underprovided where the benefits of the activity to all tourism-related businesses outweigh the costs of provision. The presence of free riding is not sufficient to justify government provision of destination marketing or major events. The test for government involvement is whether it would generate net benefits to the community as a whole, relative to no government involvement.

Where government involvement in the international tourism industry is justified, including in relation to international destination marketing and major events, there is an in-principle case for government provision and sharing of research, such as research on tourism markets, that improves the effectiveness of government activities.

Careful analysis is needed to determine whether government support to attract international visitors is warranted

Whether government support for international destination marketing and major events would provide net benefits to the community is strongly dependent on whether these activities would take place without government involvement. A business may have sufficient incentives to provide destination marketing or a major event if it can capture substantial private benefits from the activity, even where free riding exists. Governments should be mindful of this possibility and take care not to crowd out private provision of international destination marketing and major events.

Where they have been undertaken, economic assessments of international destination marketing and major events are often based on inappropriate analytical techniques, a poor application of the appropriate technique, or analysis of metrics (such as visitor expenditure or gross domestic product) that do not equate to net benefits to the community. The assessments are often based on simplistic or partial multiplier analysis rather than rigorous cost–benefit analysis and can significantly overstate the contribution of these activities to the economy. Analyses have often inadequately accounted for costs, including the flow-on effects to other industries caused by government involvement in the tourism industry, the costs of additional labour and capital used to produce tourism goods and services, the opportunity costs of government funds, and the potential for crowding out of private investment in destination marketing and major events.

Some independent cost–benefit analyses of major events have reported very low (or negative) net benefits associated with government funding. A cost–benefit analysis conducted on the 2005 Australian Grand Prix estimated that the event resulted in a net cost to Victoria of about \$6.7 million — a previous economic impact assessment had estimated that the Grand Prix increased Victoria’s gross state product by \$166 million. An audit of government funding for V8 Supercar races at Sydney Olympic Park found that the benefits of the races had been overstated, as the analysis overstated visitor numbers and used input–output multipliers, rather than cost–benefit analysis.

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To the extent that studies have overstated the net benefits of international destination marketing and major events, they would have also overstated the extent to which governments should be involved. This highlights the need for rigorous and transparent economic analysis to justify any government expenditure. Making economic evaluations of destination marketing and major events transparent would improve the quality of decision making by allowing additional scrutiny. It would also improve accountability to the community of the use of taxpayer funds.

International destination marketing has the best chance of providing net benefits when it is supplemented with relevant research — as noted above, there is a case for government provision of research to support government policy. This research needs to consider factors such as: which potential visitors are most likely to be persuaded by destination marketing to come to Australia; what aspects of Australia’s tourism product are most likely to persuade visitors to come to Australia; and which potential visitors are likely to result in the greatest net benefits to Australia if they do come (which will be related to the visitors that are likely to have the greatest expenditure).

### How should international destination marketing and major events be funded?

Government provision of international destination marketing or major events does not imply that governments should fully fund these activities. There are advantages to recovering the costs of destination marketing and major events from the international tourism industry. It encourages those who benefit to recognise that there are resource costs (capital and labour costs) involved, and decreases the burden on the community of funding these activities.

Australia’s tourism agencies receive voluntary contributions from industry toward their destination marketing, often in the form of funding for joint marketing campaigns with airlines, but also in other instances. For example, Tourism Australia’s ‘Best Jobs in the World’ campaign was supported by around 50 commercial partners. Tourism Australia estimates that in 2015, 24 per cent of its total funding will be from industry contributions (including contributions to joint marketing campaigns).

There are both policy and administrative design issues associated with recovering the costs of international destination marketing and major events from the businesses that benefit from these activities. To efficiently recover costs from the international tourism industry it is necessary to identify the beneficiaries — businesses that supply products to international visitors. This is administratively complex and costly as the industry comprises a large number of varied businesses that supply products to both domestic and international visitors, as well as to local residents.

Although some cost recovery options are available, such as accommodation taxes and increasing the Passenger Movement Charge and visitor visa charges, these also have administrative and efficiency costs. There are also concerns that Australia’s visitor visa

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charges and the Passenger Movement Charge have a negative effect on Australia's attractiveness as a tourism destination (discussed below).

Although there are difficulties associated with recovering the costs of international destination marketing and major events from the international tourism industry, tourism agencies should continue to seek voluntary industry contributions to fund these activities where possible.

### Cooperation, rather than competition, between governments is the best way of attracting international visitors

There has been some cooperation between Tourism Australia and the state and territory tourism agencies. For example, Tourism Australia shares its market research with the state and territory tourism agencies, and Tourism Australia's 'Best Jobs in the World' campaign was supported by the tourism agencies of New South Wales, Victoria, Queensland, South Australia, Western Australia and the Northern Territory. State and territory tourism agencies also sometimes collaborate on marketing campaigns, such as for the 'Explorer's Way' drive between Adelaide and Darwin.

However, some participants considered that Australia's international destination marketing effort would be more effective if tourism agencies' activities were better coordinated. For example, it was suggested that multiple Australian tourism agencies had established overseas offices and launched marketing campaigns to promote their own 'patch' in key markets, such as in China and the United States. Insufficient coordination between agencies can create inefficiencies that reduce the effectiveness of Australia's destination marketing as a whole. These inefficiencies include potential confusion for visitors from competing voices, marketing campaigns that lack the scale to be effective, and costly duplication of administrative functions. Greater coordination between Australia's tourism agencies could increase the net benefits from Australia's international destination marketing.

Increased cooperation between state and territory governments to attract major events would also be beneficial for the community, particularly if it reduces the likelihood that governments enter into 'bidding wars' to secure major events. If a government overbids or overinvests to ensure an event is hosted in its jurisdiction, this will dissipate the benefits accruing to the Australian community.

Economic evaluations of major events based on increased visitation to a state are likely to overstate the net benefits to Australia if they do not consider the offsetting decreases in expenditure in other states. If an event generates net benefits in the host state or territory, the overall net benefits to Australia will be lower if the benefits flowing to tourism-related businesses within the host state come at the expense of businesses in other regions in Australia. The same sorts of outcomes can arise for destination marketing where competition between tourism agencies simply leads to people visiting one jurisdiction over another.

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## **Competitive international air services are essential to tourism**

Australia is a long-haul, island destination and as such, international visitors are reliant on air services to travel to and from Australia. About 99 per cent of international visitors travel to Australia by air, with international airfares comprising a considerable share (almost one quarter on average) of total trip spending by international visitors in 2014.

International air services are regulated through a series of bilateral (and some multilateral) air services arrangements between countries or regions. These arrangements involve treaty-level agreements or other instruments, such as memoranda of understanding, that include provisions outlining the routes that airlines can fly, and capacity entitlements (the number of seats or flights that can be operated).

Australia has negotiated air services arrangements with 94 economies and, for over a decade, the Australian Government has had a policy of pursuing international aviation liberalisation where it is in the national interest. A key feature of Australia's international aviation policy framework has been to seek to ensure that capacity available under bilateral arrangements remains ahead of demand. Australia's air services arrangements include open skies arrangements that involve unrestricted capacity to and from a country, and via and beyond third countries, or open capacity arrangements with a number of countries. They include the United Kingdom, the United States, Singapore, Switzerland, New Zealand and Japan. Other arrangements contain limits on the number of international air services that can be operated to and from Australia's major gateway cities — Sydney, Melbourne, Brisbane and Perth. Under the 'regional package', unlimited direct route access and capacity is provided for international air services to and from other Australian international airports (regional gateways).

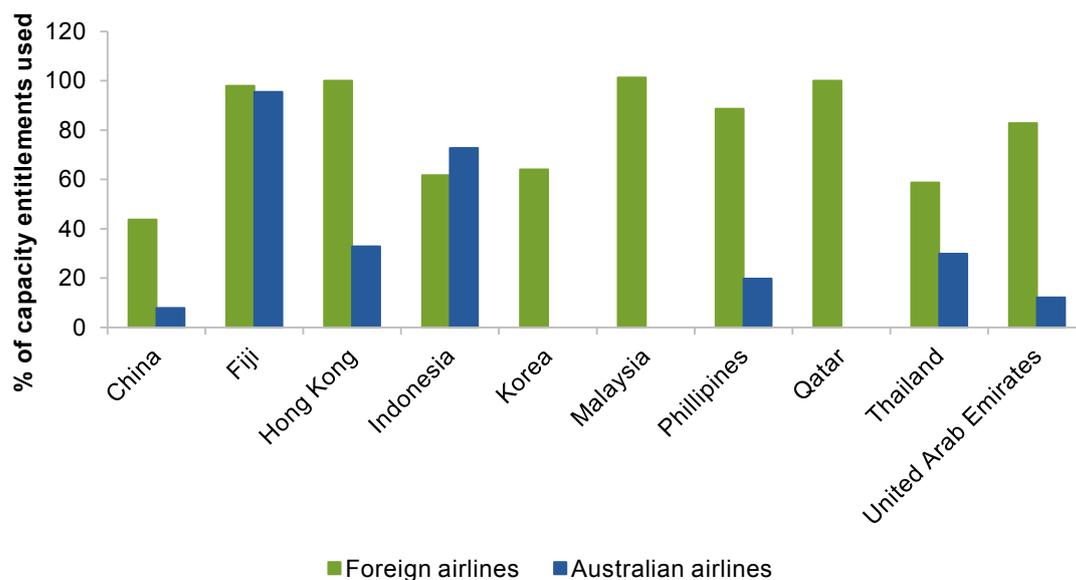
Participants to this project raised three key issues relating to Australia's air services arrangements. The first issue is that international air services are being constrained on some routes due to capacity limits within bilateral arrangements. The second is that the application of Australia's international aviation policy has been detrimental to the interests of the Australian domestic tourism industry, the Australian aviation industry, and the national economy as a whole. The third is that there is a lack of transparency in the Australian Government's process for prioritising and negotiating air services arrangements, including in relation to how it assesses the national interest when negotiating air services arrangements.

### **Is there a constraint on international aviation capacity into and out of Australia?**

In some markets, international airlines are constrained from increasing supply to and from Australia's major gateway airports. This is primarily an issue for the airlines of Hong Kong, Malaysia and Qatar — Australian airlines operating to these locations are not similarly constrained (figure 4). In other markets, including Indonesia and Thailand, capacity entitlements are not being fully used either by foreign airlines or Australian

airlines, although in most cases there is significantly more unused capacity for Australian airlines than there is for foreign airlines.

Figure 4 **International aviation capacity expected to be used as a proportion of capacity entitlements, October 2014 to March 2015<sup>a</sup>**



<sup>a</sup> Data are provided for the 15 largest uplift/discharge markets by passenger traffic. There are five countries within the 15 largest uplift/discharge markets where Australia has in place open capacity or open skies arrangements and hence there are no capacity constraints — these are the United Kingdom, the United States, New Zealand, Singapore and Japan.

Some participants, including Sydney Airport, Perth Airport and Austrade, suggested that a lack of capacity within some bilateral arrangements was constraining international air services and limiting competition on a number of routes, including routes between Australia’s major gateways and Malaysia, the Philippines and Hong Kong.

An agreement with China was announced by the Australian Government on 23 January 2015 which more than doubled capacity entitlements for Australian and Chinese airlines (this additional capacity is reflected in figure 4). Further capacity increases are scheduled for October 2015 and October 2016. Prior to this agreement, capacity was constrained for Chinese airlines flying to and from Australia’s major gateways. The Australian Government has also secured a commitment from authorities in Malaysia and Qatar to hold formal air services talks during 2015.

An inability to negotiate capacity increases may, in some instances, be attributable to an unwillingness to negotiate on the part of the bilateral partner, rather than the unwillingness of the Australian Government. It could also be the case that airlines may not be offering services (or may be offering limited services) because it is not in their commercial interests

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to increase supply. Commercial decisions made by airlines should not be mistakenly attributed to restrictions within bilateral arrangements.

Nonetheless, where capacity is constrained by air services arrangements, airlines cannot choose to operate additional services to and from Australia's four major gateways in response to actual or anticipated growth in demand. Further, where capacity is expected to soon be constrained, airlines will not choose to operate additional services. Capacity restrictions may also prevent new airlines from entering a market if there are insufficient capacity entitlements available to warrant servicing a route. These effects could result in higher prices for international flights to and from Australia, and constrain the growth of Australian international tourism (where demand exceeds capacity entitlements).

### **Air services arrangements should serve the community, not airlines or the tourism industry**

In a written contribution to this study, Qantas suggested that the Australian Government's policy of negotiating capacity ahead of demand has resulted in the emergence of negative and unintended effects. Qantas considers that an increase in capacity for the purpose of promoting inbound travel has instead promoted outbound travel, resulting in a tourism trade deficit, with jobs and investment being exported to competitor destinations to the ultimate detriment of Australia's tourism industry and Australian airlines.

The Commission does not share Qantas' view. An imbalance between outbound and inbound tourism does not represent a net cost to the Australian community. There are welfare benefits associated with Australian residents travelling abroad, particularly if they are able to travel at a lower cost and access more frequent air services to a wider range of destinations. Further, it is not necessarily the case that Australians would instead travel domestically if they were not taking international trips. The decision depends on the travellers' preferences, or business needs, for international travel compared with domestic travel, and whether domestic travel provides greater benefits than purchasing other goods and services.

In any case, the Commission considers that the objective of international air services arrangements should be to enhance the welfare of the Australian community as a whole rather than to protect or promote any particular industry or commercial interests.

### **The transparency of international aviation policy decisions could be improved**

On balance, the Commission considers that Australia's international aviation policy settings are broadly working well, and a wide ranging review of international aviation policy (such as the review conducted by the Commission in 1998) is not warranted at this time. This is not to say that there is no scope for improvement.

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Decisions and outcomes could be improved with greater use of transparent cost–benefit analysis, which includes a clear statement from the Australian Government about how it assesses the aggregate national interest when negotiating international air services arrangements, including what factors are considered, such as the benefits to the community of outbound travel, and how any trade–offs are made when balancing the interests of different stakeholders. This would help to boost the confidence of stakeholders that the costs and benefits of different options are being appropriately weighed, and that decisions are being made in the interests of Australia as a whole.

### The scope for further liberalisation of international air services arrangements

The bilateral system works on the basis of negotiation. Without a negotiated arrangement with a country, airlines cannot operate international air services to and from that country, either for the residents of their home country or for residents of the other country. As long as international aviation is dominated by this system, the greatest scope to achieve net benefits for the Australian community is likely to come from further liberalisation within the bilateral framework, with the Australian Government continuing to work toward a multilateral approach to liberalisation in relevant international forums.

#### *Extension of the regional package could facilitate additional air services*

In the absence of further liberalisation through, for example, open skies or open capacity arrangements, it is expected that further liberalising access to Australia’s major gateways would provide net benefits to the international tourism industry and the Australian community. Extension of the regional package to some or all of Australia’s major gateway airports could result in greater international tourism and benefits to Australians wishing to travel overseas.

There is no guarantee that additional air services will be provided to particular airports included within the regional package as airline route decisions are ultimately based on the commercial interests of airlines — this has largely been the experience of the regional package to date. Nonetheless, it would simplify airlines’ assessment of what services to operate and enable decisions to be driven solely by commercial considerations, unhampered by regulation of capacity.

Extension of the regional package would not be without costs if it results in a loss of negotiating power for the Australian Government. However, the value of the leverage lost should not be overstated, especially if Australian airlines are not seeking to operate additional services under the relevant bilateral arrangements. Where restrictions are considered necessary to provide leverage for the Australian Government in its international air services negotiations, the benefits of this leverage should be transparently weighed against the costs (in terms of foregone community-wide benefits of providing unrestricted access to particular airports).

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The negotiating leverage of the Australian Government attached to particular airports will vary. Of the gateway airports, it is likely to be weakest at Perth Airport. In 2014, around 12 per cent of international passengers travelling to or from Australia used Perth Airport, compared with 15 per cent at Brisbane Airport, 24 per cent at Melbourne Airport, and 41 per cent at Sydney Airport. The geographical position of Perth Airport also means that travellers arriving in Australia via Perth are less likely to travel to the east coast, and thus Perth Airport largely serves a separate market for international air services. Given its location, Adelaide Airport, which is not considered a major gateway and where unrestricted access is provided, is more likely than Perth to be part of the same market as Sydney, Melbourne and Brisbane.

Perth Airport also has the lowest share (similar to that of Adelaide) of international passengers carried by Australian airlines out of all the major gateway airports. In the case of Perth, Australian carriers now only operate regular services to Bali and Thailand. The potential costs to Australian airlines from liberalising access to Perth Airport are therefore likely to be limited.

Under the current policy, access is restricted to Avalon Airport and the proposed airport at Badgerys Creek, yet not to Gold Coast and Sunshine Coast airports, despite the fact that, for all practical purposes, they are roughly equidistant from the relevant major gateway airport. Extending the regional package to all secondary airports will help mitigate the effects of long-term capacity constraints at major gateway airports that cannot be relieved through efficient investment at those airports. Even in circumstances where the primary and the secondary airports are jointly owned, the availability of additional capacity would be expected to stimulate demand in both domestic and international aviation markets.

The Commission thinks there is very little leverage to be gained in international negotiations from restricting access to any Australian airport, with perhaps the exception of Sydney Kingsford Smith Airport, and the regional package could be extended accordingly.

### **Facilitating the flow of international visitors to Australia**

Participants to this project raised a number of issues relating to the facilitation of the entry and exit of international visitors to Australia. These issues primarily related to visitor visa charges and the Passenger Movement Charge, and to visa application processes. Participants suggested that Australia's visa application processes for some visitors, particularly visitors from China, were more demanding than comparable countries' visa processes.

The objective of Australia's visitor visa program is to facilitate the entry of genuine visitors, while minimising non-return rates and breaches of visa conditions. The requirements and restrictions attached to different visa types, including which nationalities are eligible for each visa type, should be designed to meet this objective in the most efficient manner (table 1). Given the current and growing importance of China as a source country for visitors to Australia, and strong competition from other countries to attract

visitors from China, it is particularly important that Australia's visa processing arrangements for Chinese visitors are efficient.

**Table 1 Visa types under Australia's visitor visa program**

<i>Visa type</i>	<i>Visitor visa (subclass 600)</i>	<i>Electronic Travel Authority (subclass 601)</i>	<i>eVisitor visa (subclass 651)</i>
Eligibility	All nationalities	34 'low risk' nationalities	All EU nationals and some non-EU European nationalities
Eligible countries (of top 15 countries of origin for short term visitors to Australia, 2013-14) <sup>a</sup>	China, India, Indonesia	United States, Singapore, Japan, Malaysia, Canada, Hong Kong, South Korea, Taiwan	United Kingdom, Germany, France
Cost	\$130	\$20	Free
Lodgment	Paper lodgment available to all nationalities, online lodgment being expanded to all nationalities (197 as of November 2014)	Online lodgment	Online lodgment
Documentary evidence	Required	Not required	Not required but can be requested
Processing time service standard	1 month	1 working day	1 working day
Validity	12 months, multiple entry	12 months, multiple entry	12 months, multiple entry
Maximum stay per entry	3 months	3 months	3 months
Permitted activity	To visit, study, or for business, depending on stream	To visit, study, or for business	To visit, study, or for business

<sup>a</sup> Visitors from New Zealand are eligible for a Special Category visa (subclass 444).

Other countries, including the United States, the United Kingdom, India and Thailand, have taken steps to simplify their visa application processes for Chinese citizens. The Australian Government has also recently taken steps to simplify some visa processes. The Department of Immigration and Border Protection has indicated that it is aiming to make online visa applications available to visitors from all countries by the end of 2015. In February 2014, the Australian Government introduced three-year multiple-entry visas for Chinese business visitors. It also recently reviewed document requirements for Chinese visitors, and has combined two document checklists into one shorter checklist.

The Commission supports the steps being taken by the Australian Government to simplify visa application processes, particularly the introduction of online visa applications for visitors from China.

Participants also raised other issues potentially impeding the flow of international visitors to Australia. These include: the adequacy of resources devoted to passenger facilitation

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(including border protection services); airport and aviation security requirements; and implementation of a premium visitor processing option (to facilitate faster processing) at Australian airports on a cost recovery basis. These issues are best addressed in the review of border fees, charges and taxes being undertaken by the Department of Immigration and Border Protection and the Australian Customs and Border Protection Service (to be completed in early 2015), and the Inquiry into Airport and Aviation Security (being undertaken by the Senate Rural and Regional Affairs and Transport References Committee — due to report by April 2015).

## **Improving the provision of tourism-related infrastructure**

International visitors are attracted to Australia not only because of its unique natural and heritage assets, such as the Great Barrier Reef and Uluru–Kata Tjuta National Park, but also because of the quality of tourism products such as restaurants, hotels, and convention and exhibition centres. Investment in these and other types of tourism-related infrastructure is crucial to the continued growth of Australia’s international tourism industry.

Much of the infrastructure used by international visitors is provided by the private sector, including cafes, restaurants and hotels, and some major airports. But governments also have a role to play in funding or maintaining some of the infrastructure used by international visitors (as well as domestic visitors and residents). For example, they provide and fund infrastructure in national parks and other protected areas, such as walking tracks, signage and information centres. They also provide and fund a range of cultural, sporting and transport infrastructure, such as regional airports, cruise ship terminals, sporting stadiums and art galleries.

Of equal importance, governments are responsible for policies and regulations that influence the investment decisions of tourism-related businesses, most notably, development assessment and approval processes.

### **There are concerns about the adequacy of some tourism-related infrastructure**

Participants to this project have raised concerns about the adequacy of tourism-related infrastructure, principally in the areas of:

- short-term accommodation (such as hotels, motels, resorts and serviced apartments). For example, it was noted that the supply of new rooms in Queensland is far below its projected *Tourism 2020* target, and that existing accommodation is ‘more aged’ than that of Australia’s global competitors
- infrastructure in national parks. Studies have suggested that infrastructure, such as boardwalks and signage, is in a state of disrepair in national parks in some regional areas. Participants also suggested that infrastructure in national parks was tired and not of the required standard

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- cruise ship terminals. There are concerns that cruise ship infrastructure in Sydney and Brisbane (Australia's major destinations for cruise ships) is at capacity, and will be unable to cope with the expected growth in the industry.

Approaches to addressing issues with tourism-related infrastructure are not unique to the tourism industry. Government frameworks for investing in, and regulating, tourism-related infrastructure could be improved by the adoption of general reforms recommended by the Commission in previous studies, including studies into: Australia's Public Infrastructure; Major Project Development Assessment Processes; Planning, Zoning and Development Assessments; the Role of Local Government as Regulator; and Regulator Engagement with Small Business. Reforms from these studies of particular relevance to tourism-related infrastructure are discussed below.

### Improvements in project selection processes could help to address concerns about inadequate tourism-related infrastructure

Where governments are responsible for the provision or funding of tourism-related infrastructure, they should adopt project selection processes that promote the projects that are expected to provide the highest net benefits to the community. Good project selection requires the use of well-informed, high-quality and consistently applied cost-benefit analysis. This needs to take into account trends in tourism demand, such as the locations visitors are travelling to.

### Greater user charging could provide an additional funding source for tourism-related infrastructure

Inadequate tourism-related infrastructure may also reflect a lack of funding available for this infrastructure. In particular, the burden of funding the costs of infrastructure in national parks has generally fallen on parks agencies (through general government revenue), as user charging is less prevalent in these areas. For example, in 2014, Parks Victoria received about 6 per cent of its budget from accommodation charges, rents and licences, and Tasmania Parks and Wildlife covered about 25 per cent of its expenses from own-source income. The low level of user charging in these areas may partly be a result of legislated objectives for parks agencies to provide equitable access to national parks. There are, however, some options available to parks agencies to increase user charging in national park areas:

- Some governments, including New South Wales and Tasmania, have access fees for some national parks. Access fees are likely to be more suitable in heavily visited national parks, where there may be congestion effects of additional tourism on the environment, and the cost of collecting the fee (per person) is likely to be lower. Mechanisms, such as concessions, could be used to meet social equity objectives.
- Charges could be applied for the use of certain infrastructure in national parks. For example, although most states have fees to use campgrounds, these may not fully

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recover the costs of providing the service — until recent price changes in Victoria, fees for the use of campgrounds recovered about 35 per cent of the cost of providing the relevant services for campgrounds. There is also likely to be scope to examine the cost of these services, to ensure that they are being provided in the most efficient way.

- Parks agencies require operators to hold a licence (with fees) to undertake commercial activities, such as tours, on public land. However, studies have suggested that these fees appear to be low in many cases — the Tourism and Transport Forum suggested that license fees have generally not been perceived as funding opportunities for parks agencies to improve infrastructure. The Victorian Government and Parks Australia have noted that their fees do not fully recover the administration costs involved. The Environment Management Charge for commercial activities on the Great Barrier Reef is one example of a charge on tourism operators designed to increase funding available for the management of a protected area.

Given the persistent funding constraints on parks agencies to construct and maintain infrastructure within national parks, there would likely be benefits from governments reviewing their fee structures for national parks, while considering social equity objectives.

### Involving the private sector could facilitate innovation and efficiency in the provision of tourism-related infrastructure in national parks

A complementary approach to increased application of user charging may be to seek greater private investment in national parks. Private sector investment in national parks, if done well, could facilitate innovation, lead to increased efficiency, and ultimately lead to better tourism experiences. However, governments should remain mindful of conservation objectives in national parks, as in some cases the costs of development, such as environmental degradation, may not be well captured in prices.

Historically, in some states such as Victoria and Queensland, there has been a limited role for private-sector investment in protected areas. Other states have allowed this investment. For example, Tasmania allowed a private investor to build huts along the Overland Track in 1987. State and territory governments have now begun to take steps to facilitate this type of investment. For example, the Queensland, Northern Territory and Tasmanian governments have open expression of interest processes for investment in national parks, with the Tasmanian Government suggesting that appropriate private-sector development in its national parks will encourage visitation, and broaden the range of experiences on offer in national parks. As these processes are ongoing or have recently closed, there is little basis to assess how successful these initiatives have been, although the Tasmanian Government reported that it received 37 proposals through its 2014 expression of interest process. Of these, 24 have proceeded to the second stage of the process.

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Continual review and reform of development assessment frameworks is required to keep pace with the dynamic nature of the tourism industry

If not designed and applied well, state and territory development assessment frameworks can impose unnecessarily high costs and delays on proposed tourism-related investments, especially small and low-impact investments. Poor approval processes for tourism-related infrastructure investments are not only costly to developers, but to businesses and communities.

Participants cited development approval processes, including planning and zoning requirements, as one of the main impediments to tourism investment. One participant cited timeframes of 8–12 months to obtain approvals for hotels, and noted that this creates an impediment to generating greater tourism activity. Approval processes for the Wolgan Valley Resort and Spa in New South Wales have been cited as adding \$16 million, or 10–15 per cent, to the costs of the project. This was due to delays in the planning process caused by miscommunication between the proponents and authorities, and duplication of regulatory processes.

These concerns may be partly addressed by reforms to development assessment frameworks made by Australian governments, including through the *Tourism 2020* process. All ministers responsible for tourism have agreed to remove unnecessary barriers to tourism investment at both the state and national level, including streamlining environmental assessment processes, removing duplication of regulation, and simplifying planning systems. Queensland and Tasmania have in place processes that allow for significant tourism projects to be assessed at the state (rather than local) level. Some other states, including New South Wales and South Australia, have recently completed reviews of their planning systems. It is too early to judge the success of these reforms, although in the Commission's view it would be appropriate for this reform process to be independently reviewed by 2020.

There is a need for ongoing review and reform of development assessment frameworks to ensure that the investment decisions of tourism-related (and other) businesses are not unnecessarily impeded. The review and reform process should ensure that:

- *development assessment and approval regulation is risk based.* Participants noted that in some cases, tourism developments are required to go through the same development approval processes as high-impact uses such as mining. For example, a proposed zipline ecotourism project in Queensland was delayed due to native title processes, despite the support of the traditional owners of the site. Risk-based principles, such as scaling project assessment requirements depending on the nature of the project, should be incorporated into assessments where feasible, so that development assessment processes for tourism are only as thorough as necessary to ensure that regulatory objectives are met
- *planning and zoning systems are flexible.* In some cases, inflexible planning and zoning arrangements have restricted tourism development. For example, until recent reforms,

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tourism developments were restricted in certain zones in Victoria, and concerns were raised in a 2012 review of the New South Wales planning system that land-use zones exclude short-term accommodation developments from areas where they would otherwise be suited, such as in rural and business park areas. Flexibility in planning and zoning systems would help to ensure that tourism-related activities are able to occur where they are suited, and would enable tourism-related businesses to respond to new technologies and changes in demand. The need for flexibility in planning systems is heightened by the dynamic nature of the tourism industry — the industry is constantly changing due to product innovations and changing patterns of demand

- *local governments are provided with sufficient guidance and resourcing.* The majority of development assessments occur at the local government level and are relatively small and low impact. Local governments may not be used to managing, or may not have the expertise and resourcing to manage, tourism-related development issues. For example, in Victoria, tourism development applications have been perceived to be more complex, and taken longer to process, than other applications. There would be benefits in state and territory governments engaging with local governments, and ensuring they are adequately equipped to manage tourism-related development issues. This may include the development of guidelines for the consideration of tourism in planning schemes, where this guidance has not already been established.

### A strategic approach to resolving land-use conflicts should be adopted

Many tourism activities in Australia occur in high natural amenity areas that appeal to visitors. The use of these areas is often subject to conflicts, particularly when other high-value uses like agriculture and mining also occur in the same location. There have been concerns that the value that tourism-related businesses derive from environmental and cultural assets are not taken into account in making decisions around conflicts over the use of these assets. This is a particular concern in the Great Barrier Reef region — the Reef and surrounding regions support a range of activities including tourism, agriculture commercial fishing, research, and exports from ports adjacent to the Reef.

Strategic assessments may be better able to consider the cumulative effects of development than traditional development assessments, and may assist with managing conflicts around the use of environmental and cultural assets. A strategic assessment was completed in 2014 for the Great Barrier Reef region that made several recommendations on how to improve the management of the Reef, including to provide clearer guidance on how the cumulative effects of activities on the Reef should be assessed. Strategic assessments can be complex and time consuming, but are nonetheless a valuable tool for improving development assessment and approval processes. They may help to improve decision making with respect to the effect of developments on the tourism industry.

Where strategic assessments are not in place, for whatever reason, it is important that effects on tourism activity as a result of other land uses are more rigorously and transparently assessed than may have been the case previously.



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# 1 About this report

## 1.1 Why is the Commission interested in Australia's international tourism industry?

Australia's international tourism industry has undergone substantial change over the past two decades. The number of short-term international visitors to Australia has grown from 2.5 million in 1991-92 to 6.7 million in 2013-14 (ABS 2014a). International tourism contributes significantly to Australia's GDP — almost 1 per cent (\$11 billion) in 2013-14 (ABS 2014c), although the relative contribution of tourism to GDP is much higher in some regions than others. International tourism comprised just over 60 per cent of Australia's service exports in 2013-14 (ABS 2014b).

There has been a change in the composition of Australia's international visitors over the period 1991-92 to 2013-14 — Australia has become proportionally more reliant on visitors from emerging countries in Asia, such as China and India, relative to visitors from historically important source countries, such as the United States and Japan. The changing composition of Australia's international visitors has been driven by a number of factors, including rising real household incomes in many Asian countries and lower airfares, which combined have facilitated greater international travel.

The composition of Australia's international tourism industry is likely to continue to change over the coming decade. The number of international visitors to Australia is projected to grow by 4.5 per cent per year on average until 2022-23 (TRA 2014e) — it is expected that visitors from emerging Asian countries will drive much of this growth. This will likely have implications for the tourism industry, as these visitors have different preferences for travel, in particular they have a lower tendency to travel to regional areas, than visitors from Australia's historically important source countries.

Advancements in, and greater use of, digital technology will also likely affect the tourism industry. For example, a significant number of international travellers now research and book tourism products, such as air travel and accommodation, via the internet. Growth in the use of digital technologies has had implications for traditional providers of these types of services, such as travel agents and hotels, and has raised policy and regulatory issues for governments.

The economic significance of the tourism industry, and the changes that have occurred and are expected to continue to occur, has seen the Australian, state and territory governments become actively involved in the industry. Under the *Tourism 2020* policy, governments have collectively agreed to pursue a goal of at least doubling the size of overnight tourism

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expenditure between 2009 and 2020, among other things. Governments are pursuing this goal through a number of activities, including providing and funding international marketing of destinations and major events.

Although the private sector has a large role to play in providing the goods and services consumed by international visitors, the investment decisions of tourism businesses are influenced by government policy and regulation in a range of areas, including development assessment processes. Governments are also responsible for providing and funding a range of tourism-related infrastructure, including some infrastructure in national parks. There could be scope to use alternative models of provision and funding to provide additional sources of funding and to facilitate innovation in the provision of tourism-related infrastructure.

The Commission has initiated this research project to examine the trends and drivers of growth in Australian international tourism with a view to understanding their implications for government policy. The Commission has also assessed the role for government in the tourism industry, and considered whether there are significant barriers to future growth in international tourism in Australia that are amenable to policy reform.

## **1.2 Understanding tourism and the tourism industry**

Understanding the scope and size of the Australian international tourism industry is necessary to examine the trends and drivers of growth, and to identify barriers to growth. However, identifying and measuring ‘tourism’ and the ‘tourism industry’ is challenging. There is no precise definition of tourism because it encompasses many different industries. Unlike other industries, tourism is defined by what visitors do and what they spend their money on (that is, by consumption) rather than by the supply (production) of goods and services by an industry. This sets the tourism industry apart from other industries and can pose challenges for economic and policy analysis.

The Commission is interested in examining the trends and drivers of, and barriers to, growth in the numbers of short-term international visitors who travel to Australia for a range of purposes, including for a holiday. For the purposes of this report, the Commission has used the definitions of tourism adopted by the ABS and by Tourism Research Australia (box 1.1) but emphasises that these include travel for a broad range of activities in addition to leisure activities, such as travel by international students. (The Commission is examining international education services in a separate research project.) Strictly speaking, these activities are more accurately defined as ‘visitor activities’ rather than ‘tourism’. The term ‘visitor economy’ is sometimes used (for example by the New South Wales Government, comm. 18) to reflect this broad concept of tourism.

Where relevant, the Commission has disaggregated its analysis by purpose of travel but for ease of exposition has used the term ‘tourism’ generally to cover the activities of all short-term visitors to Australia. This is different to the definition adopted by the

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Commission in its 2005 research report on assistance to tourism, which for the purposes of that analysis focused on the activities of holiday and leisure travellers, rather than the activities of visitors generally (PC 2005).

### **Box 1.1      What is tourism and who is a tourist?**

Although tourists are commonly understood to be people taking trips away from home for experiences of recreation, culture or pleasure, most tourism statistics are based on a broader definition of tourism. The United Nations World Tourism Organization defines tourism as the activity of visitors and defines a visitor as a traveller taking a trip to a main destination outside their usual environment, for less than one year, for any main purpose (that is, leisure, business or other personal purposes), other than to be employed by a resident entity in the place visited and some other minor exclusions, such as people who travel as a major part of their job (including pilots and bus drivers) or for military duties. This definition has been broadly adopted by the ABS in the Tourism Satellite Accounts (ABS 2014c).

Tourism Research Australia's International Visitor Survey measures the activity of visitors who come to Australia for less than one year, although they exclude visitors who are under 15 and include visitors coming to Australia for employment purposes (TRA nd).

Visitors can be both international (inbound) and domestic visitors. International visitors are those persons who travel to a country other than that in which they have their usual place of residence. Domestic visitors are Australian residents who travel outside their usual environment, whether for an overnight stay or a day trip (ABS 2014c).

*Sources:* ABS (2014c); PC (2005); UNESA and UNWTO (2010).

## **What is the tourism industry?**

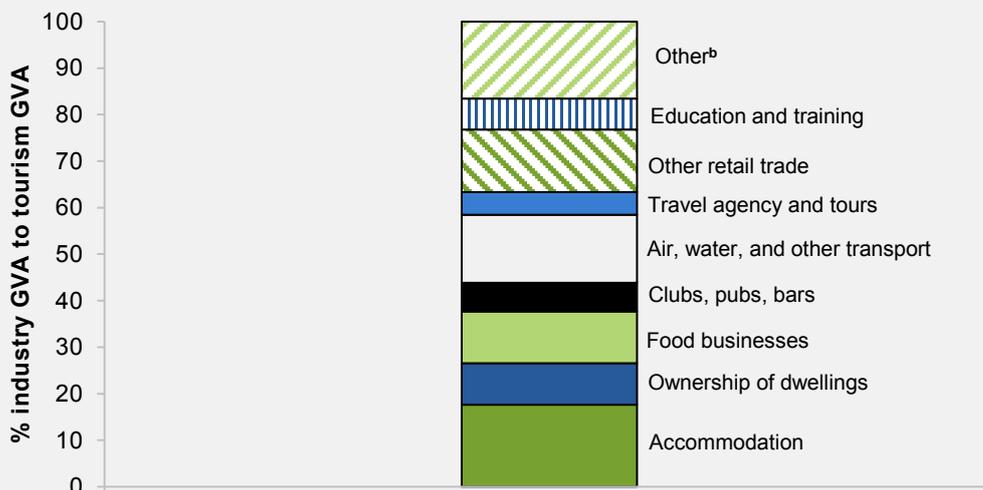
The tourism industry comprises businesses from a range of different industries that provide goods and services to visitors, such as accommodation, retail and transport industries (box 1.2). Tourism businesses are therefore diverse, encompassing businesses such as travel agencies and tour operator services, motor vehicle hiring companies, retail traders, providers of hospitality services, and education and training providers (ABS 2014c). Visitors may not be the primary consumer of the goods and services sold by many of these businesses and many business owners may not perceive their business to be in the tourism industry. Thus, throughout this report the Commission has often used the term 'tourism-related' business to reflect the different categories of businesses that provide goods and services to visitors (regardless of whether these visitors are international or domestic visitors and their purpose of travel).

### Box 1.2 Tourism ‘industries’

The ABS defines tourism-related industries as either tourism characteristic or tourism connected. For an industry to be tourism characteristic, visitors must consume at least 25 per cent of its output. These are industries that would either cease to exist in their present form, or would be significantly affected, if tourism were to cease. An example of a tourism characteristic industry is the accommodation industry. A tourism-connected industry, on the other hand, provides goods or services directly to visitors, but this accounts for less than 25 per cent of its output. An example of a tourism-connected industry is retail trade.

For industries to be considered either tourism characteristic or tourism connected, they must serve visitors directly. For instance, a manufacturer of tourism goods would not be counted by the ABS as a tourism-related industry.

**Australian direct tourism gross value added (GVA), by industry<sup>a</sup>**  
2013-14

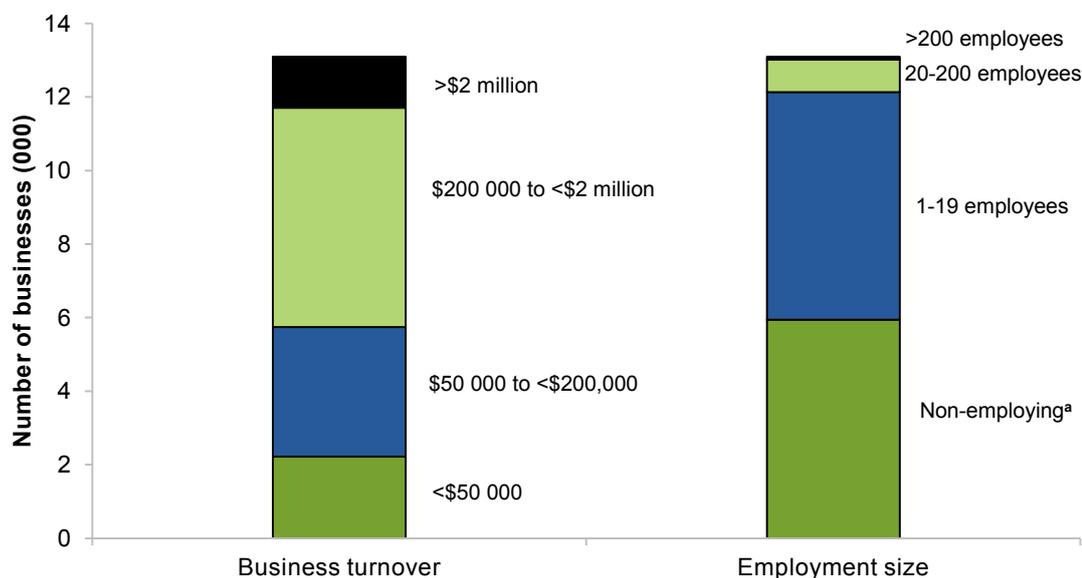


<sup>a</sup> Figures include both domestic and international tourism. <sup>b</sup> Other industries include automotive fuel retailing, sports and recreation activities, casinos and other gambling services, cultural services, motor vehicle hiring, other road transport, taxi transport, and rail transport.

Source: ABS (2014c).

Almost all tourism-related businesses, including accommodation businesses, employ less than 20 employees (figure 1.1). Although medium and large businesses are a small proportion of total tourism businesses in Australia (about 5 per cent as at June 2013), they generated almost 70 per cent of total tourism revenue in 2012-13. There were around 267 000 businesses in tourism-related industries in Australia as at June 2013. These businesses accounted for 13 per cent of the total number of businesses in Australia. The majority of tourism-related businesses (approximately 80 per cent) are located in New South Wales, Victoria and Queensland, and most are located in capital cities (62 per cent) (TRA 2014c, 2015c).

Figure 1.1 **Accommodation businesses in Australia<sup>a</sup>**  
As at June 2013



<sup>a</sup> A non-employing business includes sole traders. Employment size represents number of full time equivalent employees.

Source: ABS (2014c).

## Measuring the economic contribution of the international tourism industry

Tourism activity is included in Australia's national accounts — the products purchased by visitors and produced by suppliers are all measured. However, as discussed above, tourism is not considered an industry in the usual sense as it is defined by consumption of, rather than production of, goods and services. Thus, the products purchased by visitors and produced by suppliers are not readily apparent in the national accounts (ABS 2014c).

The ABS derives a Tourism Satellite Account that makes the link between the demand generated by visitors and the supply of tourism products by domestic producers. Only the direct effects of tourism are included in the Tourism Satellite Account. However, these direct effects are broad given that the definition of tourism encompasses the activities of all types of visitors. For example, the direct effects of tourism include the services provided by airlines for international visitors travelling to Australia using an Australian airline, including international visitors whose primary purpose is business.

The Commission has focused on the direct effects of international tourism in this report (as reported by the ABS) and has been careful not to relate the economic contribution of tourism as measured in statistical accounts to a more narrow definition of tourism (that is,

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one that focuses on holiday travel). To do so would be to significantly overstate the economic contribution of tourism, as holiday visitors account for around 40 per cent of total international visitor expenditure (chapter 2). Further, in this report the Commission has been cautious when considering the indirect (or economic ‘multiplier’) effects associated with tourism expenditure, such as the effects on food manufacturers from the purchase of a meal by a visitor, as multipliers have significant methodological issues (chapter 3).

### **1.3 The analytical approach and scope of the report**

The Commission’s approach in this report has been to examine the trends and drivers of growth underpinning the Australian international tourism industry. The analysis also considers the role of government in the industry, and whether there are significant barriers to future growth that may be amenable to policy reform. Where policy-relevant issues were identified, the Commission has canvassed possible approaches to address these barriers.

The analysis in this report is underpinned by an economic efficiency framework — with the overriding objective being to increase the welfare of the Australian community as a whole. This framework involves:

- an assessment of whether there are any ‘market failures’ associated with international tourism to Australia. A market failure exists where a market, left to its own devices, does not lead to an efficient allocation of resources across the community
- the application of cost–benefit principles to a number of policy areas. Cost–benefit analysis provides insight into whether government involvement in the tourism industry is likely to provide net benefits to the community, and whether existing policies and regulations are unnecessarily impeding tourism activities or investment.

In applying this framework, the Commission has also given consideration to equity objectives and the social and environmental effects of tourism.

#### **Examining trends and drivers of international tourism to Australia**

An understanding of the trends and drivers of growth underpinning the Australian international tourism industry is important for informing government policy and the operations of tourism businesses. In particular, understanding the importance of tourism to Australia, changes in the profile of international visitors, and factors that influence international demand for tourism, is important to ensure that any government involvement in the tourism industry provides net benefits to the community as a whole. Understanding these trends and drivers is the focus of chapter 2.

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## **Applying an economic framework to government support for tourism**

Chapter 3 applies the Commission’s economic framework to an examination of the rationale for, and the costs and benefits of, government involvement in tourism. The areas considered by the Commission in this chapter include the provision and funding of international marketing of destinations, major events, and government provision of tourism research. This chapter also considers processes that facilitate the flow of international visitors to Australia, including visa processing arrangements.

## **Assessing impediments to competitive international air travel**

The regulation of international air services, both in terms of policy design and the administration of policy, has a significant effect on the efficiency of air travel, and as a consequence, can affect travel to and from Australia. Using a qualitative framework, chapter 4 considers whether there is scope to improve the administration of Australia’s international air services arrangements, and to further liberalise Australia’s international air services within the existing bilateral system of international aviation regulation.

## **Evaluating barriers to investment in tourism-related infrastructure**

Development assessment and approval processes are important in creating a positive environment for investment in tourism-related infrastructure (while balancing this against the social and environmental effects of tourism development), both on private land and in areas of land that are managed by government, such as national parks. Chapter 5 examines some of the key aspects of development assessment and approval processes and considers whether they are fit for purpose, sufficiently flexible, and risk based, so they do not impose an unnecessary burden on proponents of tourism-related investment projects. The chapter also considers the role of government in selecting and funding public tourism-related infrastructure projects.

## **1.4 How the Commission conducted the project**

The Commission initiated this research project in August 2014. Soon after the commencement of the project, the Commission contacted a number of stakeholders to inform them of the project and to invite them to participate in a consultation process and provide written comments on the project. Written comments from 33 participants were received (appendix A).

The Commission met with a range of stakeholders, including representatives from Australian and state and territory government departments, government tourism agencies, tourism industry groups, academics, airports and airline representatives.

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The consultation process included a roundtable held in Brisbane on 2 December 2014. The roundtable focused on the role of government in tourism investment and the effect of government policy and regulations on investment in tourism-related infrastructure.

The report was released on Thursday 26 February 2015.

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## 2 Trends in Australian international tourism

### Key points

- International tourism is important to the Australian economy. In 2013-14, international tourism contributed almost 1 per cent of Australia's GDP (about \$11 billion) and comprised just over 60 per cent (\$36 billion) of total service exports.
- The number of international visitors travelling to Australia has more than doubled over the past two decades, rising from 2.5 million in 1991-92 to almost 6.7 million in 2013-14.
- Much of the growth in visitor numbers has come from emerging countries in Asia (particularly China and India), largely due to growth in real household incomes in the region. China is now the second largest source of international visitors to Australia (after New Zealand), and visitors from China spend the most per trip in Australia on average.
- Australia's market share of total international visitors declined from 0.7 per cent in 2000 to 0.6 per cent in 2013. There are indications that this trend is beginning to stabilise for some historically important source countries, such as the United States and Singapore. However, in heavily contested markets such as China, retaining market share remains a challenge.
- Preferences for international travel are affected by many factors, vary by country of origin and can change over time. For example, growing environmental awareness has motivated demand for ecotourism products. Visitors' type and purpose of travel also affects their travel patterns. For example, holiday visitors and backpackers travel to regional areas more on average than other international visitors. Visitors from Asia have a lower tendency to travel to regional areas than visitors from other countries.
- Growth in the industry overall means regional visitation has increased, but the change in the composition of source countries has contributed to a decline in the proportion of expenditure in regional areas and the proportion of international visitors travelling to regional areas. There has also been an overall decline in international tourism activity in some regions. There has been a 20 per cent decline in the number of international visitors travelling to Tropical North Queensland, particularly from Japan, and a 40 per cent decline in real expenditure, between 2005-06 and 2013-14.
- Advances in, and greater use of, digital technologies and platforms mean more visitors are now planning and booking their trip through the internet. Online sharing platforms, such as Airbnb, are also growing in popularity as a method of researching and purchasing tourism products. Sharing platforms present an opportunity to stimulate innovation by providing an additional source of competition for traditional providers of these services.
- Understanding the trends in, and drivers of, international tourism is important to inform the policy priorities of government in a range of areas, including destination marketing, international aviation regulation, and regulation and funding of investments in tourism-related infrastructure.

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Australia's international tourism industry is growing. People are travelling further and more frequently for a range of reasons, including leisure, business, events, conferences, and education. Rising real household incomes and falling airfares have contributed to this increased mobility. There have also been significant changes in Australia's tourism industry over the past two decades. More visitors are coming to Australia from Asia. In general, these visitors have different preferences for travel than those from Australia's historically important source countries, such as the United States and New Zealand. Changing digital technologies and platforms are also affecting the way visitors research and book tourism products.

Governments are involved in the tourism industry — through policies directly aimed at the tourism industry, such as *Tourism 2020*, and indirectly through a range of other policies, including those affecting aviation and land use planning. Current and future drivers of demand in the tourism industry should be taken into account when formulating government policies and determining priorities for the use of government resources. For instance:

- Australian governments are involved in destination marketing of Australia and its regions and also fund major sporting, cultural and business events (chapter 3). Identifying key growth markets and understanding visitor preferences informs decisions about whether and how to engage in destination marketing and major events.
- Undertaking research and developing forecasts of changes to the number of international visitors from specific countries is necessary to inform government decisions, including the Australian Government's negotiations regarding capacity increases and other air services rights under bilateral air services arrangements (chapter 4).
- Governments also provide infrastructure that benefits the tourism industry, such as national parks infrastructure, and roads and public amenities (chapter 5). The type and location of these investments should consider where visitors travel to and what activities they engage in so that government investment is directed to areas that are expected to achieve the highest net benefits for the community as a whole.

To understand the changes in demand for Australian international tourism, it is necessary to examine: the importance of tourism to Australia as a whole, and to each of the states and territories; changes in the country of origin, travel and expenditure patterns of international visitors; and changes in factors that influence demand, including real household incomes, relative prices of tourism in substitute destinations, and digital technologies.

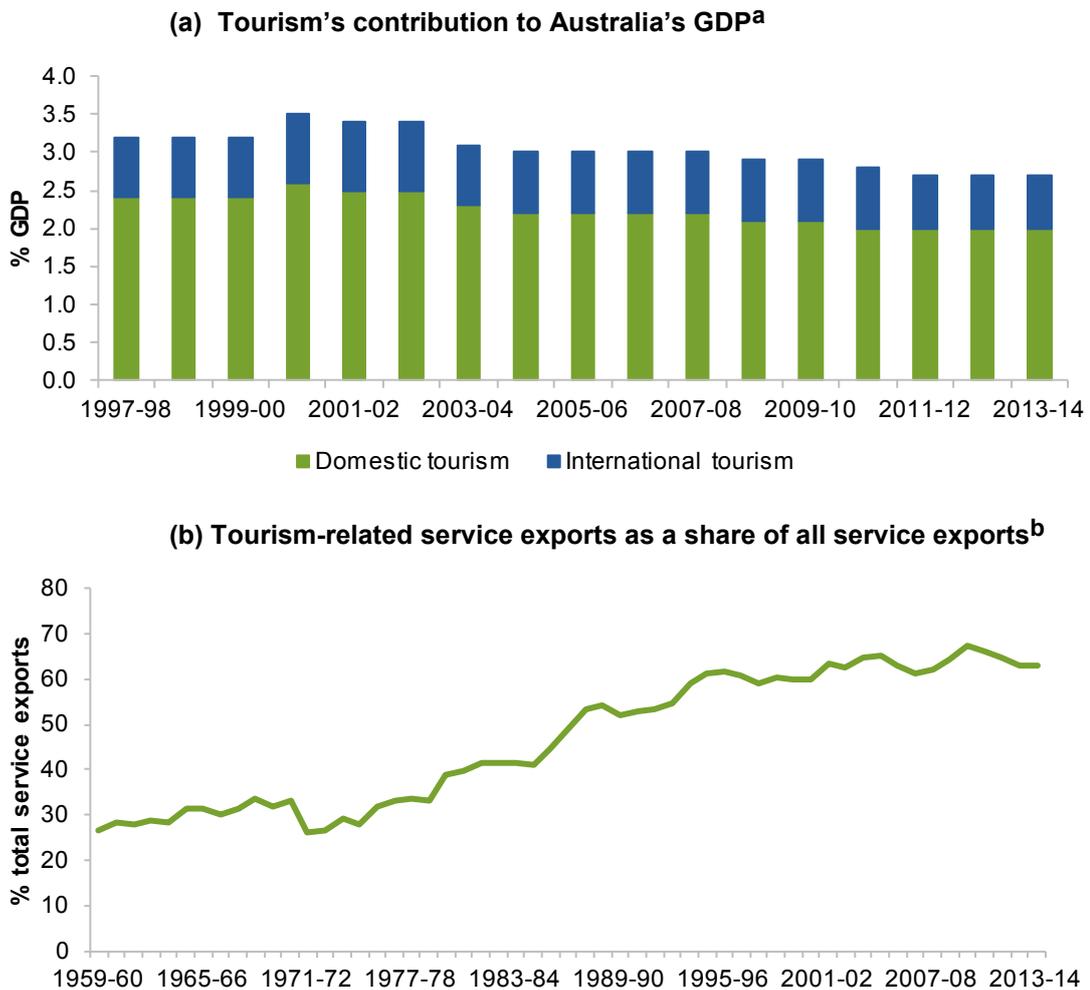
## **2.1 Demand for Australian international tourism**

### **Tourism is a significant part of the Australian economy**

Tourism is important to Australia's economy. In 2013-14, total tourism spending contributed almost 3 per cent to Australia's GDP (figure 2.1, panel a). About one-third of this was by international visitors (\$11 billion) and two-thirds of this was by domestic

visitors (ABS 2014a) (figure 2.1, panel a). International tourism contributed just over 60 per cent of Australia’s service exports (\$36 billion) in 2013-14 (figure 2.1, panel b). As discussed in chapter 1, measuring the contribution of the tourism industry to Australia’s economy is complex, as the tourism industry is made up of businesses from a number of different industries that provide a range of tourism products to visitors. These challenges also arise when estimating tourism productivity (box 2.1).

Figure 2.1 **Significance of the Australian tourism industry**



<sup>a</sup> Direct contribution only. There is no precise definition of the tourism industry because it encompasses many different industries. The Commission has used the definitions of tourism adopted by the ABS and Tourism Research Australia, but emphasises that these include travel for a broad range of activities in addition to leisure activities, such as travel by international students. <sup>b</sup> Tourism-related service exports include expenditure by short-term visitors to Australia with the exception of international students and medical patients who are in Australia for more than one year. It combines total travel services (goods and services acquired for personal use by travellers) and passenger transportation services (of non-residents by resident carriers).

Sources: ABS (2014b, 2014c).

## Box 2.1 Estimating tourism productivity

Productivity is the productive efficiency with which firms and organisations, industries, and the economy as a whole, turn inputs such as labour, capital and raw materials into output (PC 2014b). Productivity increases when output grows faster than inputs, which means that more output is being produced from a given quantum of inputs used. Tourism Research Australia (2014g) publishes estimates of labour productivity (value-added output per unit of labour input), capital productivity (value-added output per unit of capital input) and multifactor productivity (value-added output per unit of capital and labour inputs).

Estimating productivity for the tourism industry is complex, as tourism comprises a range of different industries that provide tourism goods and services to visitors (TRA 2010). Unlike other industries, the tourism industry is defined by the consumption of, rather than the production of, goods and services (chapter 1). Further, price data are only available for the outputs produced by some industries that contribute to the tourism industry. Because of this, Tourism Research Australia's estimates exclude the education and training, health care and social assistance, and public administration and safety industries (TRA 2014g). Tourism is a largely service-based industry, and the quality of a service is typically an important part of how it is evaluated by consumers (Li and Prescott 2009). However, it is often practically difficult to decompose expenditure by visitors on hotels, restaurants, parks and other tourism products into the quantum of services needed to estimate productivity and the unit price of those services. Where quality is not adequately taken into account, tourism output could be over or understated (Long and Shah 2010).

### Tourism Research Australia estimates of average annual productivity growth in tourism compared with growth in all industries<sup>a</sup>

	1998-99 to 2003-04		2003-04 to 2007-08		2007-08 to 2012-13	
	Tourism	All	Tourism	All	Tourism	All
	%	%	%	%	%	%
<b>Labour productivity</b>	2.0	2.4	1.6	1.1	0.7	1.8
<b>Capital productivity</b>	-1.5	-0.9	-2.6	-2.7	-1.9	-3.1
<b>Multifactor productivity</b>	1.0	1.1	0.1	-0.5	-0.3	-0.3

<sup>a</sup> The tourism industry includes the accommodation and food services, transport postal and warehousing, retail trade, administrative and support services, arts and recreation services, rental, hiring and real estate services, information, media and telecommunications, other services, financial and insurance services, and professional, scientific, and technical services industries. All industries includes industries in the tourism industry as well as agriculture, mining, manufacturing and construction. Both estimates exclude education and training, health care and social assistance, and public administration and safety. (The Commission (PC 2014b) has since released productivity estimates which differ from these estimates for all industries. The differences arise because the Commission estimates include 12 not 16 industries, and growth is estimated as a log difference rather than a percentage change.)

Source: TRA (2014g).

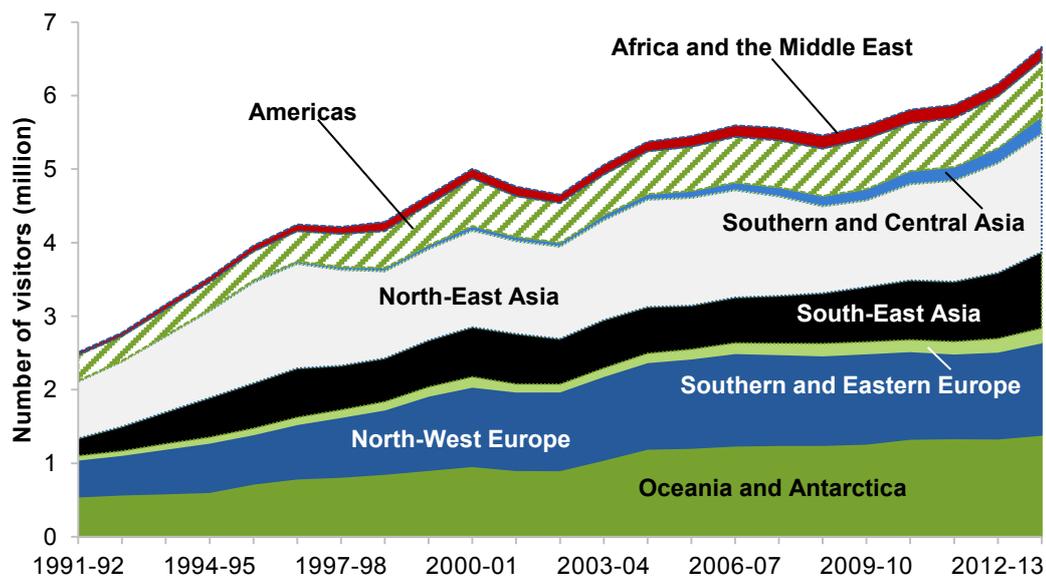
The relative importance of tourism as a percentage of GDP has declined over the past decade. This is, in part, due to rapid growth in goods exports, which increased by about

150 per cent between 2003-04 and 2013-14,<sup>1</sup> compared with a 50 per cent increase in tourism service exports over this period (ABS 2014b).

## More people are visiting Australia from emerging countries in Asia

Demand for international tourism in Australia has grown strongly over the past two decades. The number of international short-term visitors to Australia has more than doubled, rising from 2.5 million in 1991-92 to almost 6.7 million in 2013-14 (figure 2.2).<sup>2</sup> Tourism Research Australia (2014e) forecasts that the number of international visitors to Australia will grow strongly by 4.5 per cent per year on average to reach about 9.6 million by 2022-23. It is expected that visitors from emerging Asian countries will drive much of this growth.

Figure 2.2 **Number of international visitors to Australia by region<sup>a</sup>**  
1991-92 to 2013-14



<sup>a</sup> Number of border movements. All short-term visitors who come to Australia for less than one year.

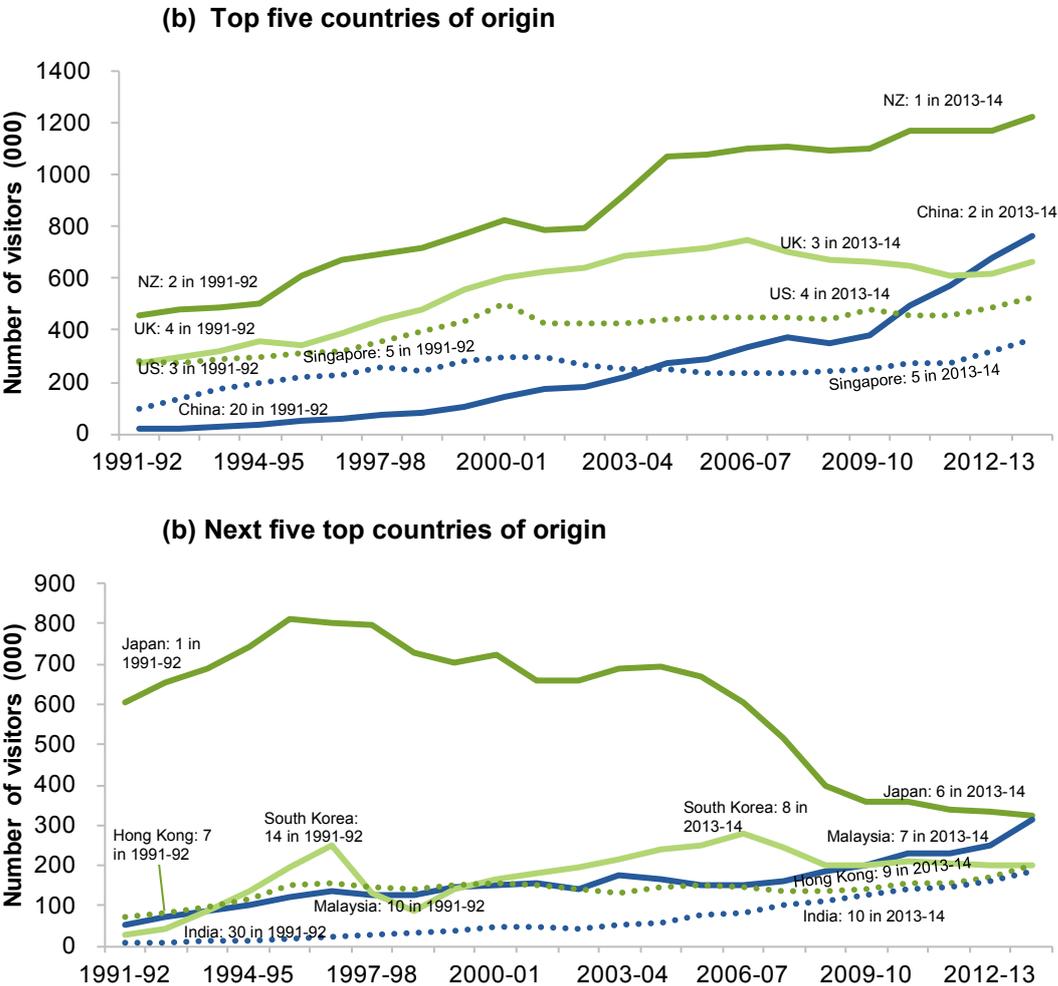
Source: ABS (2014a).

<sup>1</sup> Length of the time series presented in this chapter varies depending on data availability.

<sup>2</sup> Tourism Research Australia's International Visitor Survey indicates that 6.1 million international short-term visitors came to Australia in 2013-14. Discrepancies are due to the exclusion of those under the age of 15 from the International Visitor Survey.

The countries of origin of Australia’s international visitors have also changed significantly over the past decade. Historically, most of Australia’s international visitors have come from New Zealand, the United Kingdom, the United States and Japan — some of Australia’s historically important source countries (figure 2.3). Although these countries remain a significant source of visitors to Australia, they are becoming proportionally less important to Australia’s international tourism industry, and visitors from emerging countries in Asia are becoming proportionally more important.

Figure 2.3 **Australia’s international short-term visitors, top ten source countries in 2013-14<sup>a</sup>**



<sup>a</sup> Number of movements across the border. Includes all short-term visitors who come to Australia for less than one year.

Source: ABS (2014a).

The number of visitors from some countries in Asia, particularly China and India, has grown strongly, primarily due to rising real household incomes in the region. North-East

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Asia, which includes China and Hong Kong, is the largest source region of visitors to Australia, and visitors from China now contribute the most to total tourism expenditure by international visitors within Australia.<sup>3</sup>

Tourism Research Australia projects that the number of visitors to Australia from China will be about equal to those from New Zealand, which is currently Australia's largest source of visitors, by 2022-23 (TRA 2014e).

The number of visitors from Japan has significantly declined in recent times, and growth in visitor numbers has slowed or declined for some other historically important source countries, including the United States, the United Kingdom, and New Zealand. In general, growth in the number of visitors from Australia's historically important source countries has been, and is forecast to continue to be, slower than growth in the number of visitors from some emerging markets in Asia, such as China and India, and the Middle East.

Australia's top growth<sup>4</sup> countries by number of international visitors to Australia between 2002-03 and 2012-13 were India (15 per cent), China (14 per cent), France (9 per cent), and countries in the Middle East (8 per cent). The fastest-growing source countries for international visitors to 2022-23 are projected to be China, Malaysia, countries in the Middle East, and India (TRA 2014e).

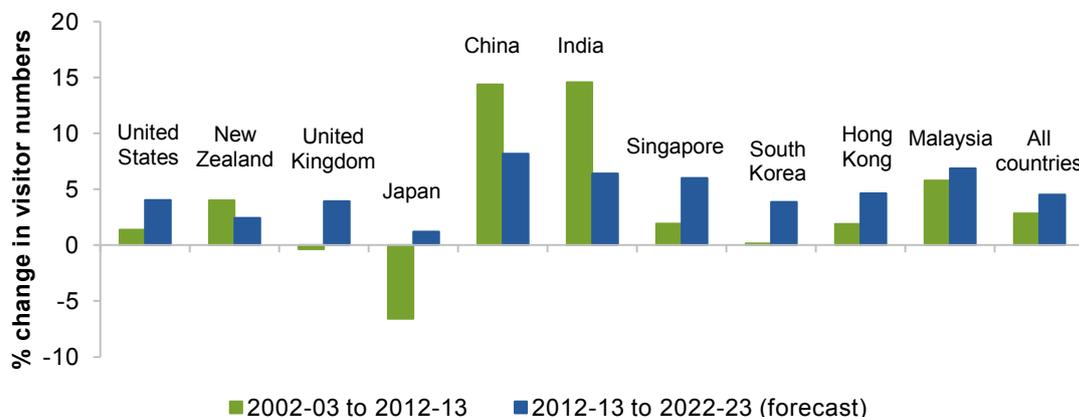
Strong growth in visitor numbers from some emerging countries in Asia and slower growth in visitor numbers from some historically important source countries is also evident when looking at Australia's top ten source countries (figure 2.4). High rates of growth in visitor numbers from mature markets may be difficult to achieve (Graham, Papatheodorou and Forsyth 2010). People in mature markets are more likely to travel internationally than visitors from emerging markets. However, growth in the number of visitors from mature markets is more likely to come from travellers taking additional trips rather than first-time travellers. Those in mature markets who do not take additional trips may lack disposable household income and/or leisure time to travel.

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<sup>3</sup> When education-related expenditure is removed, visitors from the United Kingdom contribute the most to total tourism expenditure, followed by visitors from China and New Zealand. Where comparisons are made between countries in this chapter using International Visitor Survey data, the Commission has used data for New Zealand, Japan, Hong Kong, Singapore, Malaysia, Indonesia, Taiwan, Thailand, Korea, China, India, the United States, Canada, the United Kingdom, Germany, Scandinavia, France, Italy, the Netherlands, and Switzerland, and aggregated the remaining countries into three regions — other Asia, other Europe, and other countries, due to the small sample size in these remaining countries.

<sup>4</sup> Using a ten year annual average growth rate.

Figure 2.4 **Growth in the number of visitors to Australia by country of origin, top ten source countries<sup>a</sup>**



<sup>a</sup> Ten year average annual growth rate. Tourism Research Australia’s forecasts are produced using an iterative approach. The first stage involves estimating activity and expenditure using a combination of econometric and time series models. These models provide forecasts based on aviation capacity, price, disposable household income and seasonality as well as significant events affecting source markets. The second iteration involves a sub-committee (the Tourism Forecasting Committee) made up of senior researchers and economists as well as independent advisors reviewing the model-based forecasts and applying qualitative adjustments. The final iteration involves industry and government experts adjusting the forecasts by consensus.

Sources: TRA (2013a, 2014e).

Changes in the composition and growth of international tourism have implications for Australia’s tourism industry. Visitors from different countries tend to have different purposes of travel, different patterns of expenditure, and different preferences for the type of travel they undertake. For example, about 50 per cent of visitors from Asia and 65 per cent of visitors from Japan travelled to Australia for the purpose of a holiday in 2013-14. This is higher than the average (45 per cent) for visitors from all other countries who travelled to Australia (TRA 2015d unpub.). Preferences for travel are discussed later.

### The global market for international visitors is heavily contested

Globally, the number of international visitors to advanced economy destinations, such as the United States, has been growing at a slower rate than visitors to destinations in emerging economies such as Brazil (Hooper and van Zyl 2011). The United Nations World Tourism Organization (UNWTO) forecasts that international visitors will increase by about 3 per cent a year to reach 1.8 billion by 2030. By 2030, 57 per cent of global international visitors are projected to be travelling to emerging economy destinations, compared with 47 per cent in 2011 (OECD 2014b; UNWTO 2012).

Australia’s share of global international visitors has declined from 0.7 per cent in 2000 to 0.6 per cent in 2013 (Tourism Economics 2014). Research commissioned by Tourism

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Australia shows that the decline in Australia's market share is beginning to stabilise for some of Australia's historically important source countries, such as the United States and Singapore. Maintaining market share remains a challenge in heavily contested key emerging markets such as China (Tourism Economics 2014).

Visitors from China are the world's fastest-growing source of international tourism, with total tourism expenditure by visitors from China increasing almost tenfold since the year ending 2000. Visitors from China now lead the world in total international tourism expenditure (UNWTO 2014). As a result, there is strong competition amongst countries to attract visitors from China. As observed by Crown Resorts Limited (comm. 28, p. 5):

Like Australia, competitor destinations such as the United States, the [United Kingdom] and Singapore ... are working hard to increase their market share, particularly among Chinese outbound tourists. As a result of greater competition, Australia has been losing market share. The pace of growth in mainland Chinese visitor arrivals to Australia has nearly halved over the last year ... (growth in visitors from China has fallen from 19.3 per cent to 10.5 per cent). At the same time, destinations such as the United States are increasing their Chinese visitor growth rates. Chinese visitors to the [United States] increased by 23 per cent and Canada by 30 per cent.

### **Some states and territories are more reliant on tourism than others**

Just three states — New South Wales, Victoria and Queensland — comprise almost 80 per cent of the total gross value added by the tourism industry (domestic and international), but it is Queensland, Tasmania and the Northern Territory that are most reliant on tourism as a share of their total economic activity (figure 2.5). The tourism industry is the second largest economic sector and largest employer in the Northern Territory, accounting for about 5 per cent of direct gross value added in 2011-12 (Northern Territory Government 2014; TRA 2014d). States and territories vary in their reliance on tourism because they have different economies and unique tourism assets. For example, although a significant number of international visitors travel to New South Wales (mainly Sydney) and Victoria (mainly Melbourne), these states have other, larger sectors that generate a substantial proportion of their economic activity.

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Figure 2.5 **Tourism's share of direct state gross value added (GVA)**  
2012-13



Source: TRA (2014d).

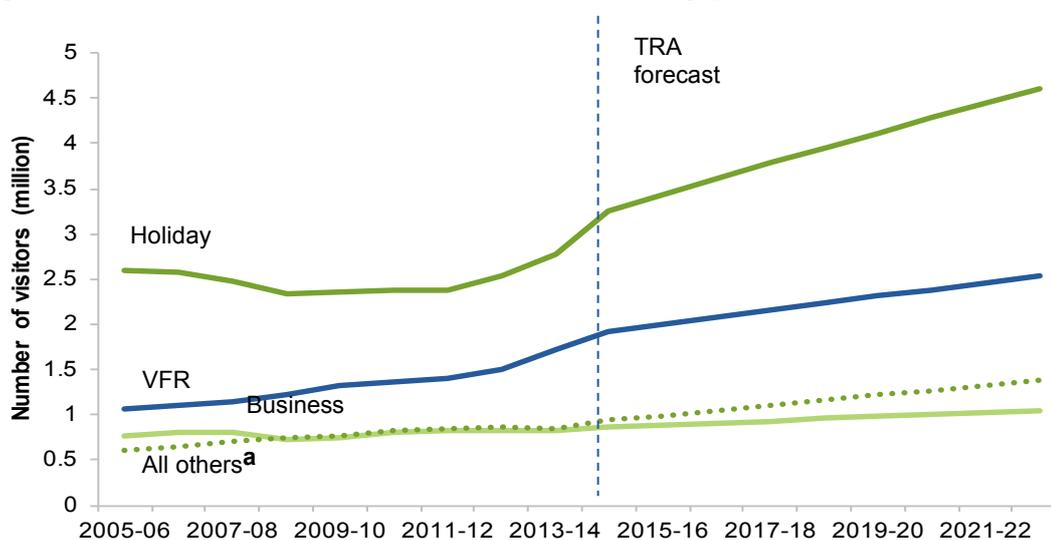
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## 2.2 Visitors' purpose of travel to Australia has changed

### Leisure travel is forecast to be the fastest-growing purpose of travel

Most international visitors come to Australia for a holiday (about 45 per cent in 2013-14) (figure 2.6). and these visitors contribute the most to total tourism expenditure (about 40 per cent in 2013-14). Visiting friends and relatives (VFR) is the second-largest, and fastest-growing, purpose of travel, with visitor numbers increasing by about 62 per cent between 2005-06 and 2013-14 (TRA 2015d unpub.). Tourism Research Australia has forecast that leisure travel (holiday and VFR travel) will be the fastest-growing purpose of travel to 2022-23 (TRA 2014e).

Figure 2.6 International short-term visitors by purpose of travel



<sup>a</sup> For employment, education, and other personal purposes for less than one year.

Sources: TRA (2014e, 2015d unpub.).

Visitors' travel patterns, in terms of how much they spend and how long they stay in Australia, vary depending on their purpose of travel (table 2.1). On average, there is a trade-off between expenditure per night and duration of stay — those who stay in Australia for longer tend to spend less per night. Visitors' propensity to make a repeat trip also varies by purpose of travel. In 2013-14, holiday visitors were the least likely to make a repeat trip, and VFR visitors the most likely.

Table 2.1 Average travel patterns of international visitors by purpose of travel<sup>a</sup>

2013-14

Purpose of travel	Spend in Australia per night	Duration of stay	Total spend in Australia	Repeat trip
	\$	nights	\$ per visitor	%
Holiday	91	26	2 393	51
VFR	57	29	1 635	75
Business	171	14	2 336	69
Employment	75	118	8 856	74
Education	120	140	16 745	67
Other reason <sup>b</sup>	85	28	2 400	67
All purposes	92	35	3 256	63

<sup>a</sup> Repeat trip denotes the percentage of visitors who were making a repeat trip. <sup>b</sup> Other reason includes in transit and travelling for other personal purposes such as personal appointments or health-related.

Source: TRA (2015d unpub.).

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## More people are visiting their friends and relatives in Australia

More people are travelling to Australia to visit their friends and relatives, which could have been influenced by increased migration to Australia (Seetaram and Dwyer 2009; Seetaram 2012) (box 2.2). A greater number of people coming to Australia to visit friends and relatives has implications for expenditure patterns on particular tourism products. This is because VFR visitors spend less per night, but are more likely to make repeat visits, than other types of visitors. However, the effect on total expenditure is unclear, as measures of VFR expenditure do not take into account how much VFR visitors' hosts spend.<sup>5</sup>

### Box 2.2 Visiting friends and relatives

The proportion of international visitors who travel to Australia to visit their friends and relatives has increased from 21 per cent to 28 per cent of all international visitors between 2005-06 and 2013-14 (TRA 2015d unpub.). Tourism Research Australia (2014e) forecasts that the visiting friends and relatives (VFR) category will broadly retain its market share to 2022-23. However, this could understate the size of the VFR market. VFR is measured as both a purpose of travel and an accommodation type, and some people who report coming to Australia for a holiday might also stay with friends and relatives (Backer 2012).

Increased migration to Australia (travel to Australia for more than one year) is one factor that could have contributed to growth in the number of VFR visitors. The greater number of migrants to Australia, the larger is the number of friends and relatives in the home country who may visit Australia (Hunter-Jones 2008; Seetaram and Dwyer 2009; Seetaram 2012). Davidson et al. (2010) found that 78 per cent of the international students surveyed in the study in 2009 reported hosting visitors from their home country while studying in Australia.

VFR visitors have a slightly longer duration of stay than holiday visitors but spend much less per night on average (TRA 2015d unpub.). One potential reason for this is that they tend to stay with friends and relatives rather than use commercial accommodation. Measures of tourism expenditure only focus on what VFR visitors spend, and do not consider what their hosts spend on food and transport — one study in the United Kingdom estimated that host spend was about 120 per cent of total VFR visitor spend (The Tourism Company 2011).

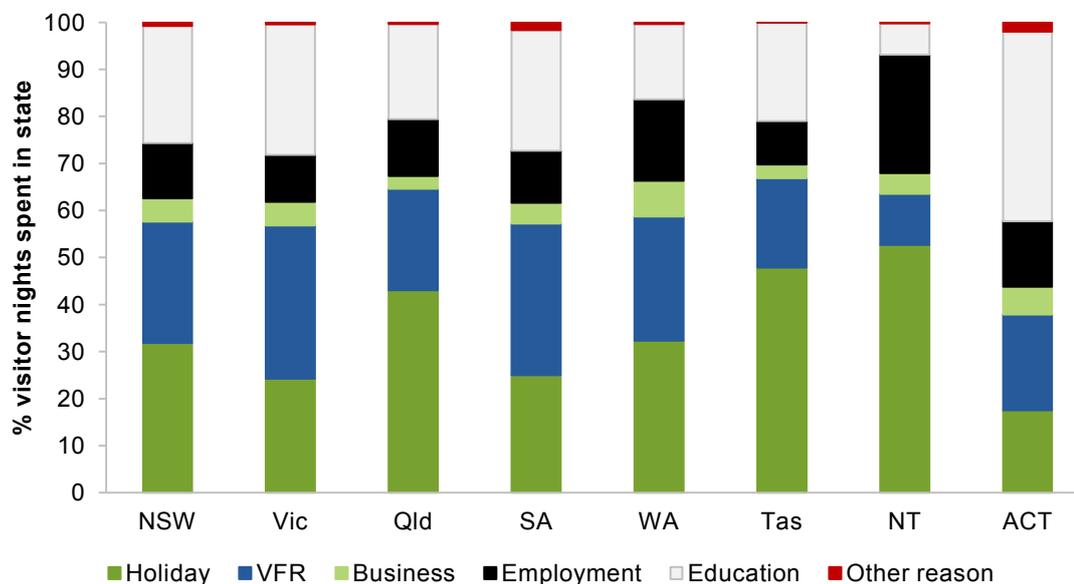
## People travel to different states and territories for different purposes

States and territories have unique tourism products, and visitors with different purposes of travel are more likely to go to some states and territories rather than others. For example, more international visitor nights are spent in the ACT for education than in any other state or territory, and Tasmania and the Northern Territory have the highest proportion of nights spent as holiday nights of all the states and territories (figure 2.7).

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<sup>5</sup> While the ABS imputes a value for host spend as part of tourism consumption in the Tourism Satellite Account, these figures are not able to be disaggregated (ABS 2014c).

Figure 2.7 **International visitor nights spent within a state or territory by purpose of travel<sup>a</sup>**  
2013-14



<sup>a</sup> Excluding the categories 'no other reason' and 'visitors who are in transit'. 'Other reason' includes visitors who are travelling for other personal purposes such as personal appointments or health-related reasons.

Source: TRA (2015d unpub.).

Changes in international visitors' purpose of travel will likely affect some states more than others. For example, Perth Airport (comm. 31, p. 16) notes that in Western Australia:

... travel for education is down, while travel for employment is up slightly. Similarly, travel for holiday is down, while travel to visit friends and relatives is a higher proportion of the total. These trends reflect the economic strength of Western Australia which is drawing new migrants seeking employment and the friends and relatives who come to visit them. While the WA economy is slowing, these trends are expected to continue given the strength [of the WA economy] relative to other parts of the world where unemployment remains high.

States and territories will also be affected by visitors' preferences to travel to different areas of Australia and to consume different tourism products. This includes preferences to stay in Australia's major cities or travel to regional areas (discussed in the following section). Some states and territories also have more popular tourism products in regional areas than others. For example, many international visitors to Queensland travel to Brisbane and the Gold Coast, as well as regional areas such as the Sunshine Coast or Tropical North Queensland, whereas visitors to Victoria and New South Wales on average, travel to fewer destinations within these states.

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## 2.3 Preferences for travel

### Visitor preferences are influenced by a range of factors

Determining visitor preferences for what destination they travel to and what activities they undertake once in a destination is complex. Many factors could affect visitors' preferences, including their country of origin, purpose of travel, demographics, and sociocultural factors (box 2.3). Nonetheless, an understanding of visitor preferences is important for deciding whether, and how, to target efforts to attract visitors to Australia (such as destination marketing and hosting major events) (chapter 3). An understanding of visitor preferences is also important for tourism businesses when considering the type of products they are offering and where to make investments, and for governments when deciding which infrastructure, including tourism-related infrastructure, to provide (chapter 5).

When making a decision to travel to a particular country, visitors consider what attributes of a destination they prefer to consume. In general, people who travel to Australia prefer destinations that have beaches, natural beauty and wildlife (Song, Dwyer and ZhengCao 2012; Tourism Australia nd).

Tourism Research Australia's International Visitor Survey provides information on what activities visitors choose to undertake while visiting Australia, and hence can provide some insight into the preferences of international visitors for particular activities. In 2013-14, almost 75 per cent of international visitors to Australia engaged in outdoor or nature-based activities, such as going to the beach, bushwalking or visiting a national park. Social activities (such as shopping and eating out) were also popular, with 95 per cent of international visitors engaging in those activities in 2013-14 (TRA 2015d unpub.).

The activity data also suggest that visitors from Asia are less likely to engage in some regional activities than visitors from other countries. In 2013-14, about 4 per cent of all visitors from Asia went to the outback, compared with about 7 per cent of all other international visitors. About 2 per cent of visitors from Asia visited an Indigenous site or community, compared with about 4 per cent of all other international visitors (TRA 2015d unpub.).

However, there are significant variations in how likely visitors from different countries within Asia are to engage in regional activities. Of visitors from Asia in 2013-14, visitors from Taiwan were the most likely to visit the outback (11 per cent of all visitors from Taiwan), and visitors from India the least likely (2 per cent of all visitors from India). Increases in the number of visitors from emerging countries in Asia, and slower growth in the number of visitors from some of Australia's historically important source countries is perhaps why the proportion of international visitors engaging in these regional activities declined by about 2 percentage points between 2005-06 and 2013-14 (TRA 2015d unpub.). Some of these results could be caused by volatility due to a small sample size, and it is difficult to draw firm conclusions from activity data alone.

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### Box 2.3 What influences visitor preferences?

A range of factors could influence visitor preferences for travel and hence visitor expenditure, including:

- *Country of origin*: visitors from different countries tend to, on average, have different preferences for the type of travel they engage in. These differences could be explained by a range of factors within the country, including the proximity of the destination, language barriers, and annual leave arrangements (Cho 2010; Jonsson and Devonish 2008; Tourism Australia nd).
- *Purpose of travel* affects where visitors travel (figure 2.7) and what activities they engage in (Morrison, Sheauhsing and O’Leary 1995).
- *Demographic and social changes*, including:
  - the tendency for people to have smaller families later in life, or not to have children at all, means that there is an increasing number of younger people travelling who have less constraints on their time and household income (Graham, Papatheodorou and Forsyth 2010)
  - the over-55s demographic is becoming increasingly important (UNWTO and European Travel Commission 2010). This could, for example, increase demand for caravanning and camping, particularly among domestic visitors (Caravan Industry Association of Australia, comm. 29)
  - more people are living in single-person households and have a desire for more authentic social interaction with local people and cultures (Jonsson and Devonish 2008).
- *Cultural changes*, such as increased interest in the environment and wellbeing:
  - *Ecotourism*: growing environmental awareness is driving an increase in environmentally focused tourism (‘ecotourism’). The United Nations World Trade Organisation reports that more than one-third of travellers favour environmentally friendly tourism and are willing to pay between 2 and 40 per cent more for it (UNEP and UNWTO 2012).
  - *Wellness and sustainability*: consumers are increasingly seeking experiences that have a positive benefit to their health and wellbeing (Service Skills Australia, comm. 13). This has led to an increase in wellbeing-related activities, such as spas and yoga (Tourism Victoria nd).
- *Changing digital technologies* have led to changes in the way visitors research and book tourism products, and changed the way people travel (discussed later).
- *Other factors*, such as greater work pressures increasing the demand for shorter, more flexible breaks (Graham, Papatheodorou and Forsyth 2010), the quality of the healthcare system within a country affecting demand for medical tourism (Deloitte Access Economics 2011), visitors’ preferences for different types of sporting events, the climate and seasonality of the destination (Cho 2010), and perceptions of the tourism assets and amenities of a destination (Lohmann and Beer 2013).

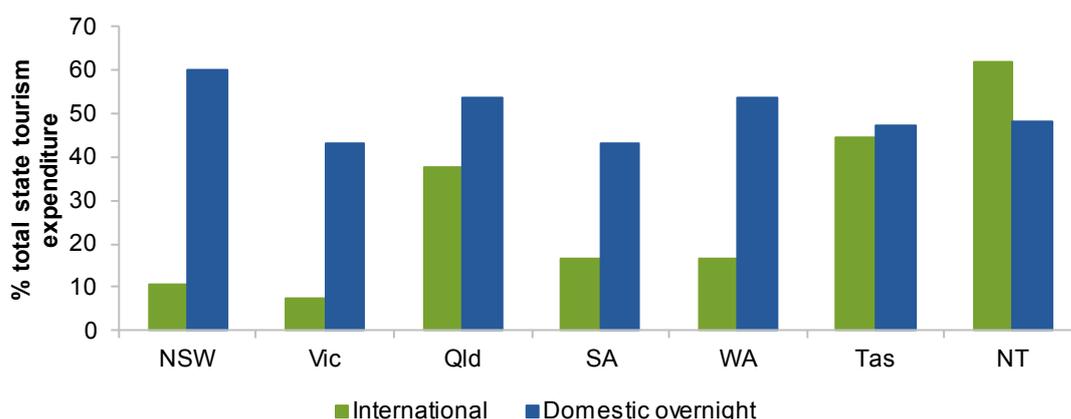
The activities visitors choose to engage in can also change over time. The activity data indicate that, between 2005-06 and 2013-14, there was almost a 5 percentage point decline in the *proportion* of international visitors going to national parks while in Australia. However, the number of international visitors travelling to national parks continued to

increase over this period, and about 40 per cent of all international visitors travelled to a national park in 2013-14 (TRA 2015d unpub.).

## Visitor preferences for regional travel

About 44 per cent of all (domestic and international) visitor expenditure occurs in regional areas — that is, areas outside capital cities (TRA 2014c). International visitors are generally less likely than domestic visitors to travel to regional areas. The highest percentage of international visitor expenditure in regional areas occurs in Queensland, Tasmania and the Northern Territory (figure 2.8).

Figure 2.8 **How much of total tourism expenditure within a state was in regional areas?<sup>a</sup>**  
2013-14



<sup>a</sup> Regional areas are destinations in a state outside capital cities. The Gold Coast is not considered to be a regional area. The ACT has been excluded because it does not have any regional tourism areas. Percentages shown indicate the percentage of total international visitor expenditure in that state occurring within regional areas, and the percentage of total domestic overnight visitor expenditure in that state occurring within regional areas. Nominal regional expenditure is sourced from Tourism Research Australia modelling.

Sources: TRA (2014a, 2014b).

Although domestic visitors have historically been a more important source of visitors to regional areas than international visitors, growth in domestic tourism activity has been subdued and growth in overseas trips taken by domestic residents has been strong (box 2.4). If these trends continue, it is unlikely that travel by domestic residents will contribute to strong growth in tourism activity in regional areas.<sup>6</sup>

<sup>6</sup> Modelling by Tourism Research Australia provides data for nominal expenditure by international and domestic visitors to Australia. All expenditure figures are nominal unless otherwise stated. Throughout this chapter, where real expenditure figures are given, the Commission has converted Tourism Research

## Box 2.4 Growth in domestic tourism activity has been subdued

In most states and territories (with the exception of the Northern Territory), a larger share of spending by domestic visitors occurs in regional areas than the share spent by international visitors (figure 2.8). The number of overnight trips within Australia taken by domestic residents has not grown strongly over the past decade, and real domestic expenditure on tourism activity has declined.

### Growth in domestic overnight tourism activity, by purpose of travel<sup>a</sup>

2000-01 to 2013-14

	<i>Holiday visitors</i>	<i>VFR visitors</i>	<i>Business</i>	<i>Other reason</i>	<i>Total</i>
	%	%	%	%	%
Number of domestic overnight trips	1	17	1	23	7
Total nights	-9	11	10	23	1
Expenditure per night (real)	3	2	-20	-8	-5
Total expenditure (real)	-7	13	-12	13	-3

<sup>a</sup> Other reason includes travel for employment, education, and other personal purposes (such as medical appointments). In 2013-14, travel for other reasons accounted for about 5 per cent of total domestic overnight trips taken.

Sources: TRA (2014b unpub. 2015a unpub.).

In line with the subdued growth in domestic tourism activity, growth in regional domestic tourism activity has also been subdued, with slight increases in the number of visitors, nights and real expenditure between 2000-01 and 2013-14.

At the same time, the number of overseas trips taken by Australians has increased (by 85 per cent), with holiday travel increasing the fastest (almost 120 per cent) between 2005-06 and 2013-14 (TRA 2014b unpub.). The strong growth in the number of overseas trips taken by Australian residents has been attributed to the appreciation of Australia's exchange rate, rising real household incomes, and a decrease in real international airfares (discussed later).

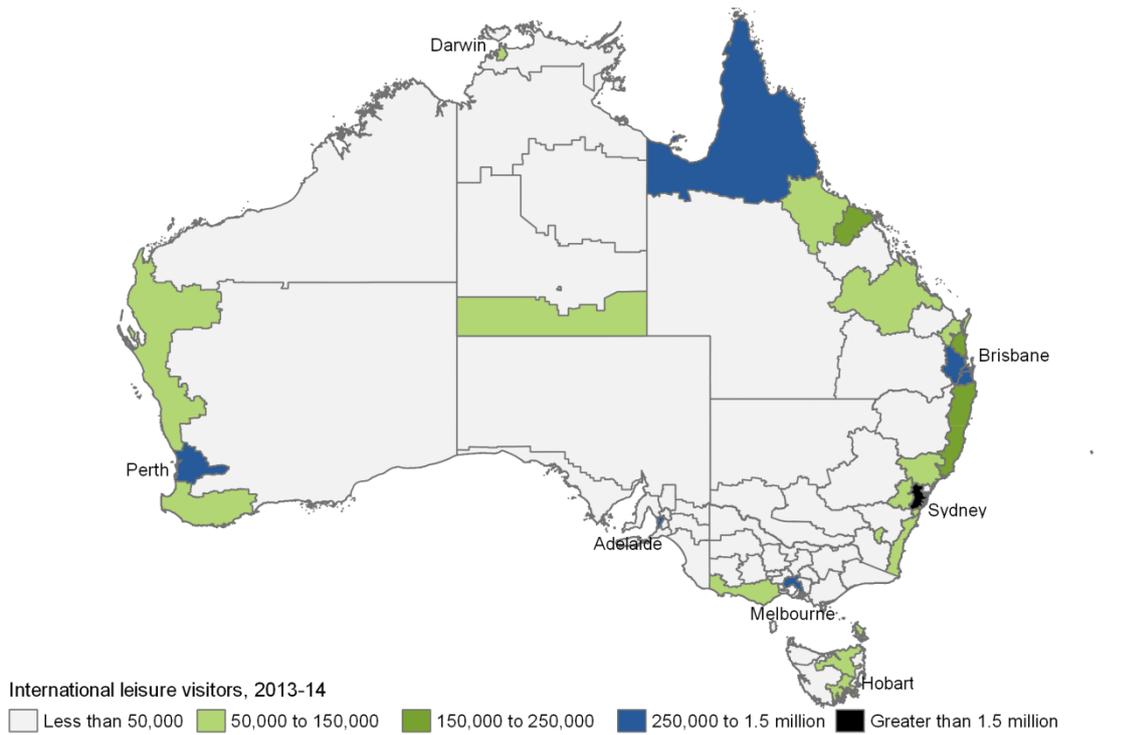
## Most international tourism activity occurs in capital cities

Most international tourism activity (including leisure tourism — figure 2.9) is concentrated in capital cities and along the east coast of Australia. The propensity of international visitors to travel to regional areas varies depending on, for example, their purpose of travel. Holiday visitors are the most likely to spend nights in regional areas, and employment

Australia (2015a, 2015b) modelled nominal expenditure figures (that include expenditure on package tours) to real expenditure by using the direct tourism GDP implicit price deflator contained in the ABS Tourism Satellite Accounts (2014c). However, where real expenditure for a single state or region is cited, the Commission has deflated Tourism Research Australia's estimates by the December 2014 ABS (2015) Consumer Price Index for the relevant state, as regional implicit tourism price deflators are not publicly available from the ABS.

visitors the least likely. Backpackers are also more likely to travel to regional areas than other types of travellers, but spend less per night on average.

**Figure 2.9 Where do international leisure visitors travel in Australia?<sup>a</sup>**  
2013-14



<sup>a</sup> By tourism region. Leisure denotes those who travel for a holiday or to visit friends and relatives. Visitors may travel to more than one region.

Source: TRA (2015d unpub.).

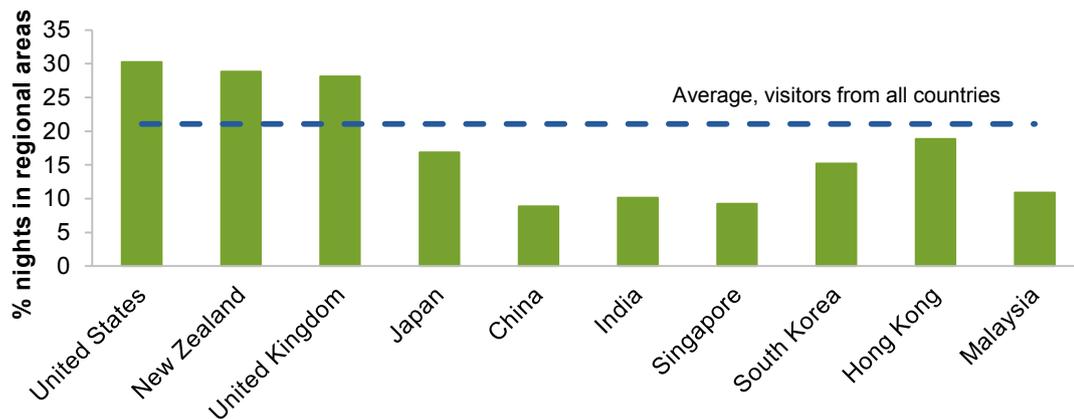
Visitors from Asia have a lower tendency to travel to regional areas than visitors from other countries. Based on data collected from a sample of 140 000 visitors from Asia between 2005 and 2012, Tourism Research Australia (2013b) found that:

- 62 per cent of visitors from Asia were unlikely to visit multiple destinations, destinations in regional Australia, or capital cities other than Sydney, Melbourne, Brisbane and Perth
- 84 per cent of visitors from Asia were unlikely to visit destinations in regional Australia or capital cities other than Sydney, Melbourne, Brisbane and Perth, although they might visit multiple destinations.

Where visitors from Asia did visit regional destinations, these were primarily located on the east coast of Australia (TRA 2013b). Of Australia's top ten source countries, visitors from China, India and Singapore tend to be less likely to spend nights in regional areas than visitors from historically important source countries (such as the United States, New

Zealand, the United Kingdom and Japan). These visitors also spend a lower proportion of their nights in regional areas than the average for all international visitors (figure 2.10).

Figure 2.10 **Nights spent in regional areas, top ten source countries<sup>a</sup>**  
2013-14



<sup>a</sup> Excludes visitors in transit, unknown state, offshore and migratory, other territories, and not asked. Regional areas are defined as those outside of capital cities and the Gold Coast. The Canberra tourism region does not have any regional areas. For all countries of origin in the International Visitor Survey.

Source: Commission analysis of TRA (2015d unpub.).

There is evidence to suggest that regional visitation has increased due to growth in the industry overall, but the change in the composition of source countries has contributed to a decline in the *proportion* of international tourism activity that takes place in regional areas of Australia. Between 2005-06 and 2013-14:

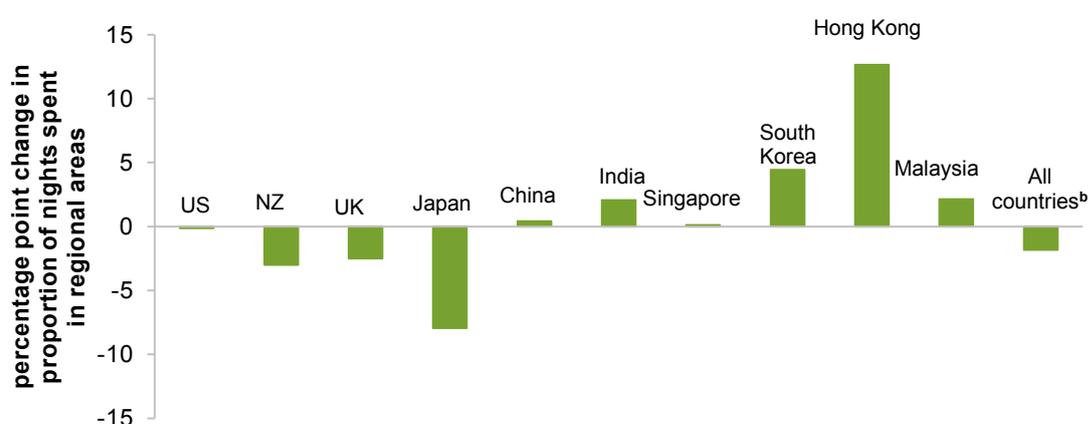
- the number of nights spent by international visitors in regional areas increased by about 40 per cent, but the proportion of nights spent by international visitors in regional areas declined by almost 2 percentage points (TRA 2015d unpub.)
- modelling by Tourism Research Australia (2015b unpub.) also suggests that:
  - there was an increase in the number of international visitors travelling to regional areas (7 per cent), but a decline in real expenditure (of almost 4 per cent) in regional areas by international visitors
  - the proportion of international visitors travelling to regional areas and the proportion of expenditure in regional areas both declined by 5 percentage points.

No firm conclusions can be drawn from these figures as sufficient data are not available to accurately analyse regional tourism activity in Australia.<sup>7</sup> Further, the decline in the

<sup>7</sup> Data are not available within the International Visitor Survey or National Visitor Survey for expenditure in regional areas, and insufficient data are available to determine trends in international visitor numbers in

proportion of regional tourism activity, such as nights spent in regional areas, has not been uniform across source countries (figure 2.11). For example, the proportion of nights spent in regional areas by visitors from Hong Kong increased significantly between 2005-06 and 2013-14, but there was very little change in the proportion of nights spent in regional areas by visitors from China and Singapore. The proportion of nights spent in regional areas by visitors from Japan and New Zealand declined over this period.

**Figure 2.11 Change in the proportion of international visitor nights in regional areas, top ten source countries in 2013-14<sup>a</sup>**  
2005-06 to 2013-14



<sup>a</sup> Excludes visitors in transit, unknown state, offshore and migratory, other territories, and not asked. Regional areas are defined as any nights spent outside of capital cities and the Gold Coast. The Canberra tourism region does not have any regional areas. <sup>b</sup> All source countries, not limited to the top ten.

Source: Commission analysis of TRA (2015d unpub.).

Trends in international regional tourism activity could also change over time. For example, an increase in the number of backpackers travelling to Australia could increase the number of international visitors travelling to regional areas, as backpackers are more likely to travel to regional areas than other visitors. The number of backpackers from Asia has increased over the past decade (by almost 60 per cent). The proportion of visitors from Asia travelling as backpackers also increased from almost 5 per cent to almost 6 per cent (TRA 2015d unpub.).<sup>8</sup>

regional areas. The Commission has relied on modelling by Tourism Research Australia for all regional visitor numbers and nominal regional expenditure figures. Modelled regional expenditure excludes prepaid international airfares, motor vehicles, other major equipment and 70 per cent of prepaid package expenditure.

<sup>8</sup> Backpacker arrivals from New Zealand, Canada, the United States, the United Kingdom and Europe, which accounted for 70 per cent of all backpackers in 2013-14, only grew by 2 per cent between 2005-06 and 2013-14 while the total number of backpackers travelling to Australia increased by 14 per cent over this period. Backpackers from Asia accounted for 25 per cent of all backpackers travelling to Australia in 2013-14 (TRA 2015d unpub.).

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## Some regions will be more heavily affected by the trends in regional tourism activity

Trends in international regional tourism activity differ between regions, with increases in regional tourism in some areas and decreases in others. Modelling by Tourism Research Australia (2015b unpub.) indicates that, between 2005-06 and 2013-14, visitor numbers in regional New South Wales increased by about 9 per cent, whereas visitor numbers in the regional Northern Territory declined by about 35 per cent. There was also an overall decline in international tourism activity in Tropical North Queensland both in terms of the number of international visitors and their expenditure in that region. This decline can be largely attributed to the falling number of visitors from Japan travelling to Australia, who have historically been an important source of tourism activity for the region (box 2.5).

Regions that rely heavily on tourism are more vulnerable to any fluctuations in tourism demand. As Austrade noted (comm. 19, p. 7):

With 44 per cent of all visitor expenditure occurring in regional Australia, tourism can be an industry that diversifies a region's economy. In the case of international tourism, this is 22 cents to every dollar. Tourism can provide job opportunities outside of traditional industries such as agriculture and mining and deliver improved amenity and facilities to a region. Many regions across Australia rely on tourism as part of their economic base.

Patterns of tourism expenditure, including in regional areas, can vary depending on the type of visitor. For example, backpackers tend to have a lower spend per night, but travel to regional areas more and stay in Australia for longer, than other types of visitors. In 2013-14, 68 per cent of backpackers visited at least one regional area, compared with 36 per cent of all international visitors. Backpackers also spent an average of \$58 per night in regional areas, compared with \$74 per night for all international visitors in regional areas (TRA 2014a).

By contrast, visitors from China are 'high-yielding' visitors, who on average, spend more per trip than the average for all international visitors. In 2013-14, visitors from China spent about \$5400 in Australia per trip, compared to about \$3300 for all international visitors (TRA 2015d unpub.).<sup>9</sup> Thus, the type of visitor travelling to regional areas will have an effect on the amount of expenditure and the type of tourism products in that area that are consumed by visitors.

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<sup>9</sup> If education-related expenditure is excluded, visitors from Italy spent the most in Australia per trip, followed by visitors from France and Taiwan.

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**Box 2.5      The effect of declines in the number of Japanese visitors on Tropical North Queensland**

Tropical North Queensland (TNQ) was estimated to be Australia's ninth most tourism-reliant region in 2007-08 (Deloitte Access Economics 2012a; TRA 2011c). The number of international visitors travelling to TNQ declined by 20 per cent between 2005-06 and 2013-14 (TRA 2015d unpub.). Real expenditure in TNQ also declined by about 40 per cent over that period.

**The number of visitors from Japan has declined**

Visitors from Japan have historically been an important source of high-yielding international visitors to TNQ. They generally enter Australia on 'reef, rock, bridge' packages and travel through TNQ, Central Northern Territory and Sydney (TRA 2013b). However, the number of visitors travelling to Australia from Japan declined by about 50 per cent between 2005-06 and 2013-14, and the number of visitors from Japan travelling to TNQ declined by almost 65 per cent. In 2005-06, almost 30 per cent of international visitors to TNQ were from Japan, while in 2013-14, this figure was about 12 per cent (TRA 2015d unpub.).

The decline in the number of visitors from Japan is not isolated to Australia — similar trends have occurred in other long-haul destinations such as Canada (Canadian Tourism Commission 2013). Although the number of visitors from Japan who travel overseas has remained largely unchanged over the past decade, they are increasingly travelling to short-haul destinations. Between 2002 and 2013, the number of visitors from Japan who travelled within northeast Asia increased by 20 per cent, and the number of visitors from Japan travelling to long-haul destinations outside northeast Asia decreased by 11 per cent (Canadian Tourism Commission 2013; IPK International 2011). This could be due to a range of reasons. For example, some studies have found that repeat visitors are less likely to travel to long-haul compared with short-haul destinations (Okamura and Fukushige 2010; Taks et al. 2009; Tifenbacher, Day and Walton 2000).

**Broader trends in international tourism have also affected TNQ**

Increases in the number of visitors travelling to Australia from other parts of Asia, such as China, has seen these visitors become proportionally more important to TNQ. Between 2005-06 and 2013-14, visitors from China increased from 4.5 per cent of all visitors to TNQ to about 21 per cent. However, visitors from China have a lower propensity than visitors from some other countries to visit regional areas, including TNQ (TRA 2013b). In 2013-14, about 20 per cent of total visitors to Australia from China travelled to TNQ, compared with about 29 per cent of total visitors to Australia from Japan and about 8 per cent of visitors from India (TRA 2015d unpub.).

## The implications of changes in regional tourism for tourism businesses

A number of participants pointed to the importance of tourism activity for regional areas and expressed concerns about the effect of the decline in the proportion of international tourism activity in regional areas. Regional Cities Victoria (comm. 9, p. 2) commented:

Dispersal of international tourists into regional areas is a substantial issue, with many cities, especially those in more remote geographical locations, finding it difficult to attract people due to the significant travel times involved. As noted above, there has been a significant decline in international overnight visitor expenditure in regional Victoria, due to a decline in visitation from western countries. Coupled with this and the rise of China as 'Victoria's largest and most

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valuable source of international arrivals and expenditure’, is the fact that Eastern visitors have ‘substantially lower rates of dispersal into regional Victoria than markets from the Western hemisphere.’

Austrade (comm. 19, p. 8) also suggested that the changing composition of Australia’s international tourism industry could influence future regional tourism activity:

Growth in Chinese visitation is likely to drive progress towards the *Tourism 2020* potential. However, challenges remain in encouraging Chinese visitors to disperse more widely. This, combined with the competition outbound destinations pose to domestic holiday travel is likely to have an effect on visitation and tourism spending in regional Australia.

This could have implications for businesses that rely heavily on tourism, as Regional Cities Victoria (comm. 9, p. 1) noted:

A decline in tourism to regional areas impacts more heavily on local communities and businesses than it does in Melbourne, due to tourism contributing 13.9 per cent of total Gross Regional Product (GRP) and 12.8 per cent of employment [in regional Victoria], compared to 3.2 per cent and 4.5 per cent respectively for Melbourne.

A larger number of more diverse visitors with different preferences and travel patterns can help businesses exploit economies of scale and scope in the provision of tourism-related infrastructure and facilities, such as accommodation and transport. International visitors can also have different patterns of seasonality to domestic visitors, which can help businesses smooth fluctuations in demand for tourism products.

A number of Australian governments have implemented policies aimed at encouraging more international and domestic visitors to travel to regional areas. These policies include promoting regional attractions in destination marketing and supporting major events in regional areas. However, governments should be cautious in taking policy action to address concerns about the distribution of tourism between capital cities and regional areas (chapter 3).

## **2.4 Factors influencing demand for tourism**

A number of factors are important drivers of demand for Australian international tourism, including increasing real household incomes, changes in the relative price of tourism in substitute destinations, and declining travel costs (in real terms). Changes in household income and relative prices are the most significant drivers of demand for Australian international tourism. Additionally, emerging digital technologies have affected the way people travel, including the way visitors research and book tourism products. Understanding the factors that drive current and future demand for international tourism helps to ensure that any government involvement in the tourism industry is directed to where it is expected to provide the highest net benefits for the community as a whole.

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## The effect of household incomes and relative prices

### People travel more as their household incomes increase

Household income has been found by a number of studies to be the primary driver of demand for tourism in Australia (Algeri and Kanellopoulou 2009; TRA 2011a; Webber 2001). As real household incomes grow, people shift their discretionary expenditure to consume ‘experiences’ rather than products (Hajkowicz, Cook and Boughen 2013). Changes in wages affect people’s decisions about their preferred combination of work and leisure — an increase in the wage rate means that people can afford more leisure, and hence, more tourism (Graham, Papatheodorou and Forsyth 2010; Park et al. 2011; TRA 2011a). In general, demand for tourism is a luxury good. That is, demand increases more than proportionally for any given increase in real household income.<sup>10</sup> This will likely affect leisure travellers the most as they have the greatest discretion about when and where they travel.

The significant growth in visitor numbers from some emerging countries in Asia has been predominantly driven by increases in real household incomes in the region, giving many more people the opportunity to travel for the first time. The European Travel Commission and the UNWTO (2012, p. 7) noted that one of the most important drivers of outbound travel from China has been the increase in real household incomes, reaching an average of about US\$6800 per capita in 2013, up from about US\$190 per capita in 1980 (World Bank 2014).<sup>11</sup> Strong real household income growth in China is likely to continue (OECD 2014a), which is likely to further stimulate demand for international travel.

### The role of prices in demand for tourism

#### *Relative prices of tourism in substitute destinations*

When deciding to travel to a destination, visitors consider the price of the basket of goods they will consume at the destination relative to the price in their home country and the price in substitute destinations (box 2.6). Some participants have argued that Australia is a relatively high cost destination for visitors, and tourism businesses, and that this adversely affects Australia’s tourism industry (Allan Lowther Porter, comm. 1; Tourism and Transport Forum, comm. 20; QTIC, comm. 17).

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<sup>10</sup> However, different tourism products will have different income elasticities. For example, demand for first class air travel or luxury accommodation is likely to be income elastic (elasticity exceeding 1, a luxury good), whereas some tourism products might be normal goods, such as the price of public transport (elasticity about 0), or inferior goods — there is a negative relationship between disposable household income and tourism demand, such as for a domestic caravan park (elasticity less than 0) (Dwyer, Forsyth and Dwyer 2010).

<sup>11</sup> Data given in current US dollars.

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Appreciation of Australia's exchange rate against most leading currencies in recent years has made travelling to Australia relatively more expensive and reduced the purchasing power of visitors once in Australia. This may have caused some visitors to substitute away from Australia to more affordable destinations — visitors seeking a beach holiday might choose to travel to Bali or Thailand instead of Queensland (Hajkowicz, Cook and Boughen 2013). However, the Australian dollar fell against most leading currencies in 2014, which has improved the price competitiveness of Australian exports, such as international tourism (RBA 2015).

A relatively higher price of tourism in Australia compared with other destinations is likely to affect leisure travellers more than business travellers. Leisure travellers have more discretion about whether or not to travel and are more likely than business travellers to personally bear the full cost of their travel. Thus, they are more sensitive to changes in price than business travellers (TRA 2011a). However, some visitors to Australia might see high prices as a reflection of the quality of Australia's holiday product. The unique aspects of an Australian holiday might also cause visitors to be less price sensitive than they might otherwise be (Hajkowicz, Cook and Boughen 2013).

#### **Box 2.6      What factors affect the relative price of tourism?**

Visitors consume a range of goods and services from different industries when visiting a destination, including accommodation, food, sightseeing tours and retail shopping (Graham, Papatheodorou and Forsyth 2010).

Factors that can affect the relative price of tourism include:

- *Exchange rates:* if a country's exchange rate appreciates, its competitiveness as a tourism destination falls, since tourism in that country becomes more expensive (relative to other countries) and the purchasing power of visitors in the destination is reduced. The effect of the exchange rate will be particularly significant when a country's exchange rate increases relative to substitute destinations (Maloney and Rojas 2001).
- *Overall price levels:* Differences between the overall price levels in a home and a destination country, and changes to those levels (inflation) could affect the purchasing power of a visitor (Forsyth and Dwyer 2009).

When modelling demand for tourism, relative prices for tourism products are often proxied by using the consumer price indices of the origin and destination countries, adjusted for the exchange rate between the countries, although the basket of goods consumed by visitors is unlikely to be the same basket of goods consumed by residents. Tourism Research Australia (2011a) found that a 1 per cent increase in relative prices through exchange rate appreciation reduced tourism demand by 0.24 per cent in the short run and 0.46 per cent in the long run, although estimates and methods vary (Algeri and Kanellopoulou 2009; Webber 2001).

#### *Travel costs*

The price of air travel has had a significant effect on demand for Australian international tourism. Australia is a long-haul, island destination, and about 99 per cent of international

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short-term visitors come to Australia by air — a very small number of visitors arrive by other means, such as cruise ships (box 2.7). International airfares are a significant part of the total cost of travel to Australia, accounting for almost 25 per cent of total trip spend by international visitors in 2013-14 (TRA 2015d unpub.).

Over the past four decades, the real cost of providing air travel has fallen by about 60 per cent, and the ticket price for consumers fell by a similar amount. This decline in travel costs was enabled by increasing efficiency of new aircraft, higher utilisation of existing aircraft, better operational performance of airlines, and more efficient business models, including the development of low-cost carriers (IATA 2011). The International Air Transport Association (2014) projects that the real cost of providing air travel will continue to fall and that return airfares will decline a further 5 per cent between 2014 and 2015.

### **Box 2.7      How big is Australia's cruise ship industry?**

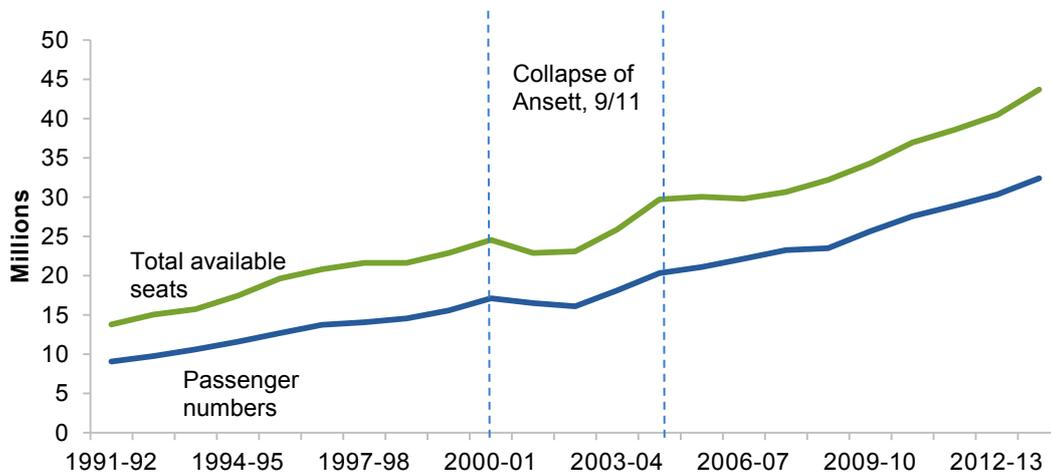
Cruise ships are both a means of transport and a visitor attraction. A small proportion of visitors arrive in Australia via cruise ship, and others travel around Australia visiting coastal locations close to ports. While no comprehensive data exist on the size of the Australian cruise ship industry, AEC Group (2012) estimated that, in Australia in 2011-12:

- 42 visits were made to Australia by cruise ships and these ships made 736 visits to ports around Australia
- total passenger capacity was about 54 000 (less than 1 per cent of international visitors in that year)
- these passengers spent about 1.5 million days at port
- direct expenditure, which includes both domestic and international passengers, crew, operator and corporate expenditure, was \$1.39 billion, of which just under \$450 million was spent by passengers
- most of this expenditure occurred in New South Wales (53 per cent) and Queensland (24 per cent).

AEC Group (2012) projects that most future growth in cruise ship visits is expected to occur in Sydney and Brisbane. However, South East Asia is a fast-growing cruise ship market, which could increase demand for tourism in northern Australia (Joint Select Committee on Northern Australia 2014). Any changes in demand for cruise ship tourism could have implications for what investment is required in related infrastructure, such as cruise-ship terminals (chapter 5).

The decline in the real price of airfares has contributed to an increase in demand for international air travel. Between 1991-92 and 2013-14, the number of international passengers travelling to and from Australia increased by almost 260 per cent (figure 2.12).

Figure 2.12 Supply and demand of Australian international airline seats<sup>a</sup>



<sup>a</sup> This graph shows the sum of inbound and outbound seats. Excluding in transit passengers.

Source: BITRE (2014c).

Increases in the number of aircraft seats allowed under international air services arrangements have been necessary to meet this increase in passenger demand. Between 1991-92 and 2013-14, the number of seats offered by airlines increased by about 220 per cent (BITRE 2014c). (The greater increase in passengers compared with seats was enabled by improved capacity utilisation). The process for negotiating capacity through international bilateral air services arrangements is discussed in chapter 4.

## Changing digital technologies

### More visitors are using the internet to plan and book their trip

The emergence of digital technologies has affected the way visitors research and book tourism products. Visitors are increasingly obtaining information about tourism products, and booking and purchasing these products, through the internet. Between 2005-06 and 2013-14, the proportion of international visitors obtaining information on the internet increased from 50 to almost 60 per cent and the proportion of international visitors booking part of their travel online increased from 22 to almost 50 per cent. Items most commonly booked online in 2013-14 were international airfares (by about 40 per cent of international visitors), and accommodation (by about 20 per cent of international visitors) (TRA 2015d unpub.). The business models of low-cost carriers, which involve direct online bookings with the airline, have in part facilitated this.

People travelling for a holiday were the most likely to use the internet for information prior to visiting Australia in 2013-14 (TRA 2015d unpub.). In 2013-14, visitors from France and the Netherlands were most likely to use the internet to obtain information when visiting Australia, and visitors from India and China were among the least likely (TRA 2015d

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unpub.). Visitors from China tend to source travel information from friends or relatives living in Australia, or from travel agents (TRA 2011b). Greater use of the internet also means that interactions are now taking place across multiple devices, such as personal computers, laptops and mobile devices (Tourism WA, comm. 8). Consumers are relying more on word of mouth and social media when making decisions about their travel. It has been estimated that a 10 per cent increase in positive reviews, or decrease in negative reviews on sites such as TripAdvisor, can result in a 1.5–2 per cent change in bookings (Colmar Brunton 2014).

Increased use of the internet has changed the way people travel. Visitors are increasingly using the internet to plan and book their own trip rather than travel via a package tour (box 2.8).

### **Box 2.8      The internet has changed the way people travel**

Visitors are increasingly preferring to research and book their own travel, rather than book a package tour. This type of visitor is sometimes referred to as a ‘free and independent’ traveller (although there is no single definition) (PwC 2013). About 25 per cent of international visitors to Australia travelled on package tours in 2005-06, but this fell to about 15 per cent by 2013-14 as the number of free and independent travellers increased from about 75 per cent to 85 per cent over this period (TRA 2015d unpub.). Many of these free and independent travellers use the internet to plan and book trips — up to 90 per cent in the case of free and independent travellers from China (TEQ nd). Many different factors could affect visitors’ propensity to travel independently, including their familiarity with the destination and language barriers.

Younger people are more likely than other travellers to use the internet to plan their trip, with almost 70 per cent of international visitors aged between 25 and 34 using the internet as an information source prior to their visit to Australia in 2013-14 (Tourism Australia 2013d; TRA 2015d unpub.). Youth travel is a significant market segment, accounting for approximately 20 per cent of global, and 25 per cent of Australia’s, international short-term visitors in 2013-14 (ABS 2014d; UNWTO and Wyse Travel Confederation nd; Wyse Travel Confederation 2013). Youth travellers’ increased reliance on the internet is likely to have a significant effect on the tourism industry and tourism operators.

The majority of backpackers are youth travellers, and backpackers accounted for approximately 10 per cent of Australia’s international visitors in 2013-14 (TRA 2015d unpub.). Backpackers have different travel patterns to other visitors. In particular, they are more likely to visit regional areas (TRA 2015d unpub.). More backpackers are relying on the internet, particularly word of mouth and social media, rather than printed guidebooks, to plan their trip (Clarke 2004; TRA 2015d unpub.).

## **Advancement of the sharing economy**

Not only are consumers increasingly obtaining information from their peers through social media and peer review sites like TripAdvisor, but they are increasingly able to purchase products through peer-to-peer sharing platforms. Peer-to-peer sharing involves people lending and sharing assets and services with each other, coordinated by a sharing network,

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usually the internet. Peer-to-peer sharing does not just involve individuals — many businesses are using these platforms to sell their goods in non-traditional ways, such as short-term rentals of showroom cars or hotel meeting rooms. Estimating the size of the ‘sharing economy’ is difficult because of the diffuse nature of the market — estimates range between \$110 billion and \$530 billion globally in 2013 (PwC 2014).

Peer-to-peer sharing has allowed visitors to book and consume tourism products through these digital platforms. Sharing platforms, such as Airbnb and Stayz, allow residential property owners to directly engage in short-term letting of residential accommodation (box 2.9). Platforms for sharing other types of tourism-related products are used internationally. In the United States, FlightCar allows people parking at the airport to rent out their vehicles to pre-approved travellers (Warren 2013).

### **Box 2.9      The ‘sharing economy’ and Airbnb**

Peer-to-peer sharing of accommodation is enabled through websites such as Airbnb and Stayz. Through the Airbnb website, hosts list their spare rooms or apartments, establish their own price, and offer accommodation to Airbnb guests. Airbnb derives revenue from both guests and hosts for this service. Airbnb’s business model currently operates with minimal regulatory controls in most locations. Airbnb hosts and guests both use signalling mechanisms such as online reviews to build trust and maximise the likelihood of a successful booking.

Since its launch in 2008, Airbnb has had over four million guests and ten million nights of cumulative bookings worldwide at the end of 2012 (Zervas and Proserpio 2014). As many as 425 000 people worldwide stay in Airbnb homes on a peak night and Airbnb was reported to have a market capitalisation of over US\$10 billion in early 2014 (McKinsey & Company 2014; Rusli, Macmillan and Spector 2014).

There are insufficient data to accurately measure the contribution of sharing platforms in Australia. Most Airbnb stays are likely captured in the International Visitor Survey category of ‘private accommodation (not a friend or relative)’, which accounted for almost 0.8 per cent of visitor nights in 2013-14. However, it is possible that some Airbnb stays are not captured by the survey, and some could also be captured in other categories, such as ‘rented house or apartment (not serviced on a daily basis)’, which accounted for about 38 per cent of visitor nights in 2013-14 (TRA 2015d unpub.). Tourism Research Australia have introduced a question in their 2015 International Visitor Survey intended to better capture accommodation provided via peer-to-peer sharing.

The effect of Airbnb on the accommodation industry is difficult to assess. In the United States it has been estimated that a 1 per cent increase in Airbnb listings in Texas resulted in a 0.05 per cent decrease in quarterly hotel revenues between 2008 and 2013. These effects were distributed unevenly across the industry, with cheaper hotels and hotels not catering to business travellers the most affected (since most Airbnb listings are at the lower end of the market) (Zervas and Proserpio 2014). Similar studies do not appear to have been conducted for Australia.

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## Implications of emerging digital technologies for the tourism industry

Increased use of the internet by visitors to plan and book their trip has implications for more traditional providers of these services, such as travel agents and visitor information centres, as well as for those tourism-related businesses seeking to market tourism products. For example, Tourism SA and Tourism Research Australia (2011, p. 1) have noted that:

... distribution of tourism and travel information has become fragmented in recent times with the increased usage of the internet and interactive web and mobile services. Independent travellers are now more likely to make decisions about their itineraries — including what they will see and do at a destination — as they travel, rather than booking through a visitor information centre.

Travel agents and tour operators still play an important role when people are deciding what destination to visit. People tend to rely on travel agents and tour operators more in countries where familiarity with Australia is lowest, or the complexity of their trip is greatest due to government visa requirements or the nature of their itinerary (which may involve multiple flights and destinations). The internet is more commonly used for trip planning and booking after the decision to come to Australia has been made (PwC 2013).

Many tourism-related businesses have adopted digital technologies in response to the increased use of the internet by visitors. In June 2013, about 75 per cent of 2172 tourism-related businesses surveyed had representation on a third party website such as Bookeasy Australia. Of the tourism businesses surveyed, 90 per cent accepted email bookings and about 80 per cent had their own website. Digital capability in the tourism industry was found to vary by sector and by the size of the business, with smaller businesses generally having lower digital capability (Mistilis and Gretzel 2013).

The sophistication of tourism businesses' digital capability is not always high. In 2010, about 42 per cent of tourism operators offered instant confirmation of the online bookings they accepted. However, there is evidence that this has improved — in 2014, about 62 per cent of tourism businesses offered instant confirmation of the online bookings they accepted (TRA 2014c). Despite these improvements, digital capability in some tourism-related sectors remains low. In 2011-12, the most recent ABS data available, the ABS (2013) estimated about 58 per cent of businesses in the accommodation and food services sector did not have an internet presence. *Tourism 2020* is directed at improving the digital capability of tourism businesses (chapter 3).

The development of the sharing economy has also had implications for the tourism industry. The benefit of sharing platforms such as Airbnb and FlightCar is that they allow individuals to make use of assets that would otherwise be underutilised. Travellers are also able to rent tourism products such as accommodation at a lower price than they otherwise would (Fremstad 2014; Zervas and Proserpio 2014). They present an opportunity to stimulate innovation in the tourism industry by providing an additional source of competition to traditional providers of these products, such as travel agents and hotels. They also provide visitors with greater choice — Airbnb and Stayz, for example, can

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broaden accommodation options available in areas that lack the various types and levels of accommodation to suit different budgets and preferences, particularly during peak seasons. This could help facilitate additional visitors to a destination.

However, concerns have been expressed about the potential for Airbnb users to impose costs on residential neighbours through noise and antisocial behaviour (Horton 2014). Other accommodation providers have raised concerns that they face costs imposed by health and safety regulations that Airbnb providers do not, placing them at a competitive disadvantage (Sundararajan 2014). This is discussed in chapter 5.



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## 3 The role of government

### Key points

- Destination marketing and major events produce benefits (in the form of increased visitor activity) that display public good characteristics: once provided the benefits are available to all tourism-related businesses, and it is infeasible to exclude businesses that benefit from these activities, but 'free ride' by not contributing to the costs of provision.
  - Free riding *may* mean destination marketing campaigns or major events will be underprovided, or not provided at all, where the benefits of the activity to all tourism-related businesses outweigh the costs of provision.
- Free riding does not necessarily mean that governments should provide or fund destination marketing or major events. The overriding test for government involvement must be that it would generate net benefits to the community relative to no government involvement.
  - The benefits of destination marketing and major events are related to the effectiveness of these activities in increasing international visitor expenditure in Australia (although the net benefits to Australia are normally significantly lower than any additional expenditure from international visitors).
  - The costs of destination marketing and major events include increases in resource costs (such as capital and labour) for other industries caused by increased output in the international tourism industry, the opportunity costs of government funds, and the potential for crowding out of private investment in marketing or major events.
- Economic analyses of international destination marketing and major events are often based on inappropriate analytical techniques, a poor application of the appropriate technique, and/or analysis of metrics (such as GDP) that do not equate to net benefits to the community.
  - Making economic evaluations of, and expenditure on, marketing and major events transparent would improve the quality of decision making by allowing additional scrutiny.
- Seeking cost recovery of government expenditure on tourism-related activities is likely to be difficult in practice, due to the diffuse nature of the international tourism industry.
  - Nonetheless, governments should seek industry funding where possible, such as through joint marketing arrangements.
  - While there may be some scope to cost recover via taxes (including visitor visa charges), changes to these should be considered alongside other taxation issues as part of the white paper on tax reform.
- Where government involvement in the tourism industry is justified, there is an in-principle case for government provision and sharing of research that improves the effectiveness of government activities.
- There are benefits to the tourism industry of reforming visa application processes, particularly those applying to visitors from key tourism markets such as China, although these must be weighed against other public policy objectives.

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### 3.1 Government involvement in international tourism

Australian governments are involved in activities that directly affect the international tourism industry. The industry's development is guided by tourism-specific policies and plans. The Australian Government has implemented a *Tourism 2020* strategy — with commitments from all state and territory governments — which targets an increase in annual overnight visitor expenditure to \$115–\$140 billion by 2020 (from about \$70 billion in 2009-10) (DRET 2010).

The Australian Government, and all state and territory governments, support the international tourism industry, primarily through the provision of destination marketing to promote Australia (or its regions), and through the funding of major sporting, cultural and business events. Dedicated government tourism agencies — Tourism Australia and the state and territory tourism agencies — play a key role in managing these activities.

The total expenses of Australia's tourism agencies in 2013-14 were over \$700 million, of which more than \$630 million (90 per cent) was sourced from government funding (figure 3.1). This is a lower bound of the total amount of government funding for destination marketing and major events as it does not include funding for some major events that does not go through tourism agencies — events such as the Commonwealth Games and the Formula 1 Grand Prix are typically managed by separate bodies.

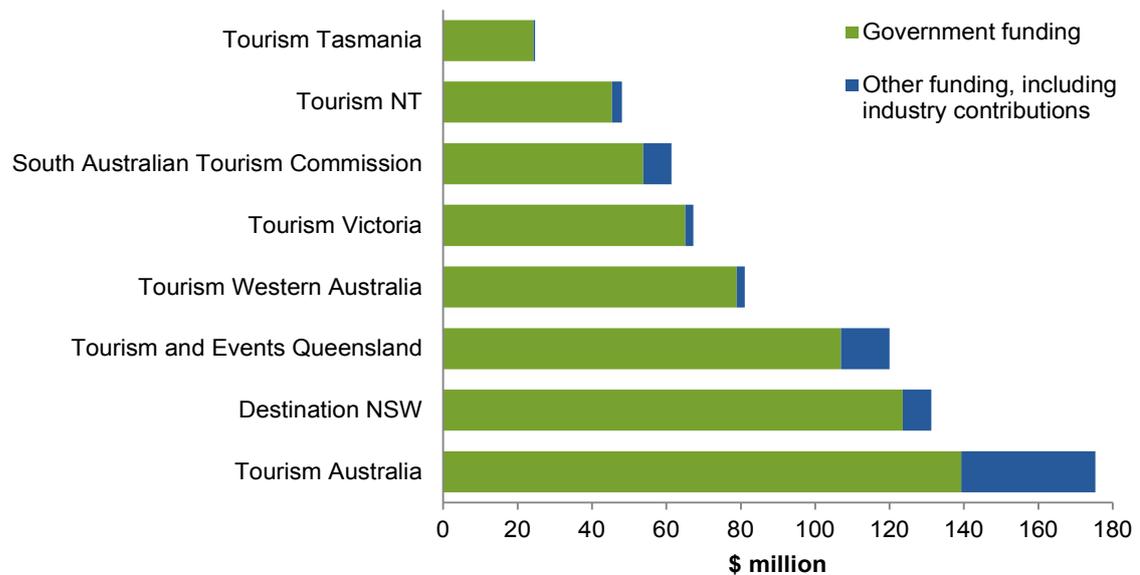
Government agencies are also involved in the provision of tourism-related research, including the collection, compilation, analysis and/or dissemination of information. For example, agencies such as Tourism Australia and Tourism Research Australia (an independent agency located within Austrade) undertake tourism-related research and analysis to support destination marketing (such as analysis of the International Visitor Survey), and the Australian Bureau of Statistics provides general tourism-related research (such as the Tourism Satellite Accounts).

Some government policies and activities that are not tourism specific also have a significant effect on the international tourism industry. Since more than 99 per cent of international visitors arrive in Australia by air, aviation policy is particularly important (chapter 4), and the Australian Government plays a central role in border processing (section 3.4). Investment in areas such as accommodation, visitor attractions and transport infrastructure is also necessary to facilitate international tourism in Australia, and governments have a role both in providing some tourism-related infrastructure, and in ensuring that regulatory frameworks do not pose an unnecessary barrier to private investment in this area (chapter 5).

In 2005, the Commission produced quantitative estimates of government support for the tourism industry (PC 2005). This project does not update these estimates (box 3.1). Nor does it consider the effectiveness of government tourism agencies or evaluate the programs undertaken by these agencies. The focus has instead been on the role of government in

attracting international visitors to Australia and options for how best to provide and fund these activities.

**Figure 3.1 Total expenses of Australia’s tourism agencies, 2013-14<sup>a</sup>**  
Including employee benefits, payments to suppliers, grants and depreciation



<sup>a</sup> Data for Visit Canberra are not available. Government funding is composed of government appropriations and agencies’ operating surplus/deficit attributable to government. Other funding includes industry contributions, rent and interest. Industry contributions may not be included in the figures where they are provided directly to a marketing campaign.

Sources: Destination NSW (2014); SATC (2014); TEQ (2014); Tourism Australia (2014); Tourism NT (2014); Tourism Tasmania (2014); Tourism Victoria (2014); Tourism Western Australia (2014).

**Box 3.1 Estimates of government assistance to the tourism industry**

Some studies have estimated the level of government assistance provided to the tourism industry. For example, L.E.K. Consulting (2011) estimated that the tourism industry received about \$158 million in assistance from the Australian Government in 2008-09 (about 0.5 per cent of its value added in that year) and the Queensland Tourism Industry Commission (comm. 17) stated that the industry received \$154 million in assistance.

These estimates focus primarily on the assistance received through Tourism Australia, and are likely to understate the overall assistance received by the industry. The tourism industry receives assistance through a variety of forms, including: destination marketing by state and territory tourism agencies; investment in tourism-related infrastructure, attractions and major events; and generally available tax concessions and research and development funding. The Commission has previously estimated that, in 2002-03, the (leisure tourism) industry received about \$880–\$1071 million of assistance (estimated to be between 1.1 and 1.4 per cent of the industry’s gross value added) through these types of programs (PC 2005).

Comparing levels of assistance across industries does not suggest what the ‘right’ level of assistance is. Some assistance provided to industry may be justified if, for example, it is targeted at addressing a market failure or to address the equity objectives of governments.

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## 3.2 A framework for assessing the rationale for government involvement in tourism

### When should governments intervene in markets?

In general, well-functioning markets will maximise community wellbeing by allocating resources to their highest-value use. Where markets function well (that is, in the absence of any market failure), government intervention on efficiency grounds will impose costs on the economy that outweigh the benefits to the assisted industry. Governments may also provide support to individuals or groups in the community for reasons of social equity and fairness, for example, to help minimise the hardship experienced by those most affected by structural change.

Government involvement in the international tourism industry should be limited to cases where there is a clear market failure or a strong social equity rationale, and the benefits of government involvement exceed the costs. A market failure means that participants in the market under- or over-provide a good or service relative to what would occur if the market functioned well. Some possible causes of market failure are:

- public goods — goods which are non-rivalrous (consumption by one person will not diminish consumption by others) and non-excludable (it is difficult to exclude anyone from benefiting from the good)
- externalities — these occur where an activity or transaction has positive or negative effects on the welfare of those who are not direct parties to the transaction.

### Do the benefits of government intervention outweigh the costs?

Although the presence of a market failure provides an in-principle rationale for government intervention, it does not mean that government *should* intervene in the market. Even where there is a market failure, governments should only intervene when the benefits of intervention outweigh the costs. The relevant benefits and costs are those to Australia as a whole, rather than those in any particular industry or region.

The potential benefits from government intervention include:

- greater efficiency — where there is a market failure, government intervention may lead to an allocation of resources that provides greater total benefits to the Australian community
- greater equity — government intervention may lead to resources being distributed more fairly among society's members.

The potential costs of government intervention include:

- a misallocation of resources. An assisted industry is likely to invest and employ more resources than would otherwise be the case. Thus assistance to an industry is likely to

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increase input costs (land, labour and capital) for other industries, and divert resources away from other, potentially more productive, industries

- the opportunity cost of public funds. Government involvement in one industry will use public funds that may have higher-value uses in other parts of the economy. Alternatively, if additional taxes are raised to fund the intervention, this will also have costs
- demonstration effects. Providing assistance to one industry may encourage lobbying for assistance to other industries. This lobbying has resource costs. It may also increase the risk of assistance being provided to other industries at a net cost to the community
- administrative costs to the government (such as the costs of administering assistance programs) and compliance costs for businesses (for example, the assistance may be contingent on the business demonstrating it meets certain criteria) (PC 2014a).

Where there is not a market failure or social equity rationale for assistance, these costs will outweigh the benefits to the assisted industry. Participants have pointed to some alternative rationales for government involvement in the international tourism industry, including:

- to increase the regional dispersal of visitors to support tourism-related businesses in regional areas (QTIC (2014a); Regional Cities Victoria, comm. 9; Tourism Victoria (2013)). For example, Regional Cities Victoria (comm. 9) suggested that some governments should place a greater emphasis on regional areas in their international destination marketing. Some existing government programs aim to encourage regional tourism by supporting events — such as Tourism and Events Queensland’s Regional Development Program — or by investing in infrastructure (chapter 5)
- to grow exports (Regional Development Australia — South West, comm. 3).

Providing assistance for exports will draw resources away from other activities. For assistance to exports to generate net benefits to the community as a whole, the value of the exports needs to exceed the value that could have been obtained if the resources were used to supply the domestic market (Banks 2008). Similarly, providing assistance to specific regions will draw resources away from other regions (or potentially from other industries in the same region), and will only have net benefits if the benefits to the assisted region exceed the costs to other regions. In both cases, the benefits of government intervention will only exceed the costs if there is a clear rationale for why the market is not functioning well.

It is also important that the anticipated benefits of government intervention are carefully evaluated and scrutinised as they can be overstated. For example, some assessments of the benefits of major events and destination marketing assume substantial multipliers arising from that investment — an approach that has limitations (box 3.2). In addition, there is the potential for ‘optimism bias’ — a demonstrated tendency for project appraisers to both overstate the benefits and understate the costs associated with a project (PC 2014c).

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### Box 3.2 Measurement issues — multipliers

Analyses of the benefits of government assistance to the tourism industry have often used input–output analysis to estimate multipliers. Multipliers seek to account for the indirect changes in output flowing through the economy from the increase in tourism expenditure stimulated by government intervention such as investment in a major event. In some cases, input–output analyses have been used to estimate simplistic and partial multipliers — an approach likely to overestimate the benefits associated with supporting the tourism industry for a range of reasons. Input–output analysis:

- assumes that there are no restrictions on the amount of labour, capital and land available in the economy. In reality, these resources are scarce and increases in the consumption of resources in one industry will increase the price of these resources, leading to a reduction in output in other industries
- does not take into account the opportunity cost of government funds. While government spending in the tourism industry may have multiplier effects, so too would that spending if it were employed in other areas such as education or health, or simply left in the hands of taxpayers
- assumes a multiplier effect in line with historical average relationships between outputs, inputs and employment. Over the past two decades, there have been changes in the composition of the tourism industry, and the types of activities undertaken by visitors to Australia (chapter 2). As a result, multipliers that are based on the historical average composition of the industry are unlikely to provide a meaningful indicator of the effect of a future increase in visitor expenditure.

Sources: Banks (2002); Gretton (2013).

## How should government involvement in the international tourism industry be funded?

Although there may be a case for government involvement in the provision of tourism-related activities, this does not necessarily mean there is a case for government *funding* of those activities. Where governments provide a good or service, recovering the costs of government provision from those benefiting may improve resource allocation, in line with the ‘beneficiary pays’ principle:

The ‘beneficiary pays’ principle ... is based on the notion that those that benefit from the provision of a particular activity or product should pay for it. ... It encourages those who benefit from the activity or product to recognise that there are resource costs involved, and it decreases the taxation burden on those who do not benefit. (PC 2002, p. 15)

These benefits must be weighed against the administrative and compliance costs of identifying and charging those benefiting from government provision of a tourism-related activity (in proportion to the benefits they receive, which will not be uniform throughout the industry).

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### 3.3 Assessment of government support for tourism

Using the economic framework outlined in section 3.2, this section examines the rationale for, and the costs and benefits of, government involvement in international tourism marketing, major events and tourism-related research.

#### International tourism marketing

The success of tourism-related businesses is dependent on, among other factors, the popularity of the destination in which they are located. To persuade visitors to come to Australia, Australian governments — through Tourism Australia and the state and territory tourism agencies — undertake destination marketing aimed at promoting Australia (or its regions) abroad. International marketing of Australian destinations has included advertising, website provision, earned media (such as articles in travel magazines), and the Aussie Specialist Program, which provides ‘Australia training’ for overseas travel agents.

International marketing is one way that countries compete to attract international visitors. For example, the boom in outbound tourism from China has led to the national tourism agencies of many nations, including the United States and the United Kingdom, running destination marketing programs focused on attracting Chinese visitors (Brand USA 2014e; British Tourist Authority 2014).

Is there a role for governments in international tourism marketing?

#### *Destination marketing*

The benefits arising from destination marketing (increased visitor activity for tourism-related businesses) have public good characteristics. In particular, the benefits are non-excludable: they are available to any tourism-related business at that destination, and it is infeasible to exclude businesses that benefit from the destination marketing but do not contribute to the costs. For example, if a hotel were to market a destination, it is likely to create increased visitor activity for other tourism-related businesses in that destination. It would be difficult for the hotel to recoup its costs from those who benefit. The benefits from destination marketing can also be seen as non-rival, as consumption of the benefits by tourism-related businesses does not diminish the benefits available to others.

As the benefits of destination marketing are non-excludable, tourism-related businesses face an incentive to free ride on the destination marketing efforts of other firms. While each firm may have an incentive to provide some destination marketing (where they receive benefits from the marketing), they will not take into account the benefits received by other firms from that marketing (as they are unable to recoup the costs of the marketing from these businesses). As a result, destination marketing may be underprovided where the benefits of the activity to all tourism-related businesses outweigh the costs of provision. This creates an in-principle case for government involvement.

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As discussed in section 3.2, an in-principle case is necessary but not sufficient to justify government involvement. The overriding test is whether government involvement generates net benefits for the community relative to no government involvement. As a result, empirical estimates of the costs and benefits of international destination marketing are needed. These empirical estimates can include:

- estimates of the total net benefits to Australia of destination marketing, which inform judgments as to whether (and to what extent) destination marketing makes Australia, as a whole, better off
- estimates of the marginal benefits of destination marketing, which inform judgments as to the efficient amount of destination marketing.

Estimates of the net benefits of destination marketing should account for all the relevant costs and benefits (section 3.2). In particular, whether government involvement in destination marketing is warranted will be strongly dependent on whether those activities would take place without government involvement (box 3.3).

**Box 3.3      The ‘crowding out’ effect of government involvement in international destination marketing**

Government involvement in international destination marketing may crowd out private provision, even where a free-rider problem exists. In particular, where the benefits captured by an individual business are large enough, that business will have an incentive to undertake destination marketing, even where some benefits also flow to other businesses. Government involvement is therefore more likely to crowd out private destination marketing in regions where ownership of the international tourism industry is highly concentrated, such as in some resort regions.

In regions where ownership of the industry is *not* highly concentrated, the benefits of international destination marketing are spread (to varying degrees) among numerous tourism-related businesses. In these regions, it is unlikely that businesses will individually capture enough of the benefits to undertake destination marketing without government involvement, so crowding out is less likely.

Several publicly available studies have estimated the effects of Tourism Australia’s international destination marketing. However, there are few publicly available studies of the international destination marketing undertaken by the state and territory tourism agencies. Most publicly available studies have estimated the additional number of international visitors to Australia or additional international visitor expenditure induced by destination marketing (for example, Kulendran and Divisekara (2007); Kulendran and Dwyer (2009)). Reviewing this literature (as well as some unpublished studies), Tourism Australia found that:

The consensus of recent studies is that Tourism Australia delivers a [return on marketing investment] typically in the order of 15:1, although some individual campaigns can be higher or lower. (comm. 12, p. 16)

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A return on marketing investment of 15:1 implies that \$1 million of government expenditure on an international marketing campaign generates \$15 million in additional visitor expenditure within Australia. Government expenditure on a campaign does not include overheads, which Tourism Australia estimates add an additional 25 per cent to campaign costs (Tourism Australia, comm. 12).

While estimates of increased visitor expenditure provide some information about the effects of destination marketing, the net benefits to the community of international tourism are normally significantly lower than visitor expenditure (Dwyer and Forsyth 1997). One reason is that resources are used in the production of the goods and services that visitors consume, and these resources must be paid for (Dwyer and Forsyth 1993). Forsyth (2006) estimated that the net benefits to Australia of additional visitor expenditure is about 6–7 per cent of that expenditure, and Dwyer and Forsyth (1993) estimated it to be about 5 per cent.

More recent Australian studies of destination marketing have estimated its effect on other economic variables:

- Webber Quantitative Consulting (2014) estimated both the average and marginal return on marketing investment, and used multiplier analysis to estimate ‘benefits for the wider economy’ (box 3.2).
- Deloitte Access Economics (2013b) estimated the effect of Tourism Tasmania’s destination marketing on Tasmania’s employment and gross state product.
- Dwyer et al. (2014) estimated the effect of Tourism Australia’s marketing on Australia’s employment, output, and gross operating surplus.

Studies that have estimated the change in Australia’s output resulting from a change in international visitor expenditure have produced varying results. Forsyth (2006) estimated that the change in output stemming from a change in international visitor expenditure is about 7–11 per cent of that expenditure, and Forsyth et al. (2014) estimated it to be about 8 per cent. Dwyer et al. (2014) estimated that the change in output is about 62–75 per cent of visitor expenditure. The difference in results between Dwyer et al. (2014) and the other two studies is largely explained by differences in modelling approaches and assumptions (although the studies use slightly different measures of visitor expenditure and output).

Again, while estimates of changes in output and other economic variables (such as gross operating surplus and employment) provide information about the effects of destination marketing, changes in these variables are in general not equivalent to the net change in community welfare resulting from destination marketing efforts. For example:

- a change in output does not fully account for the cost of additional inputs, such as labour and capital, that are used to produce tourism goods and services. ‘The additional cost of those resources must be deducted from the value of the additional output to obtain a measure of the welfare gain ...’ (Dwyer, Forsyth and Spurr 2004, p. 312)

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- a change in output within one state also fails to account for flow-on effects to other Australian jurisdictions
  - a change in gross operating surplus is not equivalent to the change in welfare, as the change in gross operating surplus does not fully account for the cost of additional capital used
  - a change in employment only reflects part of the economywide changes relevant to welfare. For example, it does not take account of changes in output or wages.

In sum, studies that have attempted to estimate the effect of Tourism Australia's international destination marketing have focused on metrics that are not equivalent to a change in community welfare. Some studies have also used flawed techniques, such as multiplier analysis, to estimate the economic effects of destination marketing. While studies suggest that Tourism Australia's destination marketing expenditure significantly increases visitor expenditure in Australia, the net benefits to Australia are likely to be significantly less than the additional expenditure, and may even be negative. Future studies should explicitly attempt to estimate the net benefits to Australia of the international destination marketing undertaken by Tourism Australia, and by the state and territory tourism agencies.

### *Product-specific marketing*

In contrast to the significant involvement of Australian governments in international destination marketing, product-specific tourism marketing — which is aimed at selling a particular product, such as a cruise or a holiday resort — has largely been undertaken by businesses. The ability of tourism-related businesses to market their product internationally has been enhanced by the availability of targeted marketing platforms on the internet. For example, international visitors can book accommodation in Australia on global websites such as Booking.com and Hostelworld. The Tourism Council of Australia, the Property Council of Australia and the Tourism Task Force (1997, p. 27) have suggested that:

In practice, product-specific marketing can and does assist and complement [destination marketing] by demonstrating to consumers that the destination concerned is a realistic travel option by showing specific product available at an affordable price.

In this way, product-specific marketing may generate benefits for other businesses that are not captured by the provider of the marketing. However, these benefits will tend to be small. Where this is the case, the costs of government involvement in product-specific marketing are likely to outweigh the benefits.

### *Destination marketing campaigns to support international air routes*

The Australian, Northern Territory and state governments provide incentives to airlines, typically in the form of support for joint marketing campaigns, aiming to encourage the establishment or growth of international flight routes servicing particular destinations in

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Australia (Destination NSW (2014); Forte Hospitality, comm. 2; TEQ (2014); Perth Airport, comm. 31). For example:

- the South Australian Government provided ‘substantial financial support’ to encourage the establishment of Emirates’s Adelaide–Dubai route in 2012 and AirAsia X’s Adelaide–Kuala Lumpur route in 2013 (SATC, comm. 7, p. 4). The former route was also supported by Tourism Australia (Tourism Australia 2013b)
- Tourism Victoria (2014, p. 4) has stated that ‘attracting more airline services to Victoria continues to be a major focus for [Tourism Victoria] as this helps ensure increased visitation from our international markets’
- in 2013-14, funding from the Australian Government’s Asia Marketing Fund (discussed below) was used in part to grow capacity ‘on existing and new routes via cooperative marketing activities’ (Tourism Australia 2014, p. 43)
- Tourism Australia partnered with a total of 19 international airlines to promote Australia in 2013-14, with a collective spend of more than \$30 million (including joint marketing that was not directly linked to the establishment or continuation of particular flight routes) (Tourism Australia 2014).

An airline’s decision to operate a route is based on the commercial viability of the route, which is determined by a range of factors, including whether there is sufficient demand for the service, airport capacity, and regulations (chapter 4). In some cases, government incentives may be sufficient to affect route decisions (at least for a period of time), leading to additional flights to and from that destination. However, information asymmetries between airlines and governments mean that governments may provide incentives even where the route would be established or maintained without incentives.

It may be worthwhile for governments to run joint destination marketing campaigns with airlines, even if they do not affect airlines’ route decisions. However, this will only be the case where the campaign itself has net benefits to the community and would not have been undertaken by the private sector (including the airline).

There is limited publicly released information on the government funding provided to support international air routes. There are likely to be benefits from increasing the transparency of this funding, including increasing governments’ accountability to the taxpayer (the benefits of transparency are discussed further below).

### Who should provide destination marketing?

Historically, the Australian, state and territory governments have provided destination marketing. However, this is not the only possible model of government involvement in this area. Governments could instead support the provision of destination marketing by an industry body, with input from its members. Governments could support the industry body either by giving grants, or by authorising the industry body to collect a mandated levy from businesses (as is the case in some agricultural sectors, such as dairy).

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Government support for industry provision of destination marketing may have some benefits relative to government provision. There may be economies of scope. For example, in some agricultural sectors, allowing industry bodies that undertake research and development to also undertake marketing has resulted in some administrative cost savings (PC 2011c). However, since government bodies play a key role in tourism-related research (discussed below), economies of scope may be greater if destination marketing is provided by government.

A tourism industry body may be better placed than governments to collaborate with tourism-related businesses on the design and targeting of international destination marketing. However, tourism-related businesses are likely to have different preferences, and there may not be a consensus among these businesses on how international destination marketing should be designed and targeted.

Government support for industry provision of destination marketing will also have costs. In particular, there will be administrative and compliance costs — such as the costs involved with ensuring that the correct levies are being collected by the industry body, and that government funds are being spent to achieve the highest net benefits for the community. There are also likely to be substantial switching costs involved with changing from the current model of government provision, such as costs associated with the loss of expertise within existing tourism agencies and potentially the costs of establishing a new body.

Relative to government provision of international destination marketing, industry provision (supported by government grants or an industry levy) is likely to have additional costs, without clear benefits. On balance, the Commission considers that continued government provision of destination marketing is likely to be preferable (where this marketing has net benefits to Australia). However, this does not imply that governments should fund destination marketing.

### How should government provision of destination marketing be funded?

Australian destination marketing is funded largely from general revenue, although some funding comes from other sources such as industry contributions to joint marketing campaigns (see below and figure 3.1). As the benefits of destination marketing flow primarily to tourism-related businesses, funding it from general revenue constitutes an implicit subsidy to these businesses from taxpayers. This subsidy may be justified if taxpayer funding of destination marketing is part of the optimal response to a free-rider problem (discussed above). However, where effective cost recovery is possible, there are advantages to doing so (section 3.2).

The costs of international destination marketing may be recovered either from tourism-related businesses or from international visitors. In either case, cost recovery is likely to also impose costs on other parties.

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### *Recovering costs from tourism-related businesses*

To effectively recover the costs of international destination marketing from businesses, it is necessary to identify the businesses that supply products to international visitors, and how much these businesses benefit from international destination marketing. However, the tourism industry is difficult to define, consisting of a large number of varied businesses (chapter 1). Additionally, tourism-related businesses supply products (to varying degrees) to domestic and international visitors, and often to local residents also (chapter 2). This means that efficiently recovering the costs of international destination marketing from businesses will be administratively difficult and costly.

Recovering costs from tourism-related businesses imposes direct costs on businesses. If businesses pass through some of these costs as higher prices, it will also impose costs on their customers — including both domestic and international visitors, and perhaps local residents also.

One possible method of cost recovery is a tax on a particular type of business. For example, accommodation taxes are widely used in cities in the United States and Europe; and both New South Wales and the Northern Territory had accommodation taxes until 1 July 2000, when they were abolished as part of the national tax reforms that included the introduction of the GST (Australian Government 2007).

However, there are issues with recovering the costs of international destination marketing through a tax on a particular type of business. It would:

- not be efficient to tax most business types, as few tourism-related businesses cater only to visitors, and even fewer cater only to international visitors. For example, some restaurants or retail shops receive a large part of their business from local residents
- be inequitable, as it would only apply to part of the tourism industry. For example, in 2013-14 accommodation accounted for only 18 per cent of tourism industry gross value added in Australia (ABS 2014c)
- be administratively difficult to identify the extent to which each tourism-related business is benefiting from international destination marketing, in part because most tourism-related businesses supply both domestic and international visitors.

Another approach is for local councils to recover the cost of destination marketing by charging higher rates to those benefiting from increased visitation. The NSW Visitor Economy Taskforce (2012) argued that ‘special rate variations’ can be used to address the free-rider problem in the provision of destination marketing. Since 2004-05, the Gosford City Council has levied a special rate on business properties, and properties being used for tourism and short-term holiday letting, in Terrigal, North Avoca and Wamberal. The rate funds special development works in the Terrigal area (Gosford City Council 2014).

Special rate variations are most likely to be an effective cost-recovery mechanism where it is easy to identify which businesses will benefit from increased visitation to a destination.

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However, in most cases the difficulties outlined above in identifying businesses that benefit from international destination marketing will also apply to special rate variations. In particular, special rate variations are unlikely to be useful as a cost recovery mechanism in destinations with a large and diverse international tourism industry. It is precisely those destinations where government involvement in international destination marketing is most likely to have net benefits.

Although special rate variations and taxes on a particular type of business are unlikely to be effective means of recovering the costs of international destination marketing, where possible, tourism agencies should continue to seek industry funding on a voluntary basis. In particular, some government-provided destination marketing incorporates product marketing, and is partly funded by contributions from businesses. For example, Tourism Australia's 'Best Jobs in the World' campaign was supported by around 50 commercial partners including Virgin Australia, STA Travel, Citibank, Dell, IKEA and Sony Music (Tourism Australia 2013c). Tourism Australia estimates that, of its \$194 million in total funding in 2014-15, \$47 million (24 per cent) will be from industry contributions (including contributions to joint marketing campaigns) (Tourism Australia, comm. 12).

#### *Recovering costs from international visitors*

International destination marketing could alternatively be funded through charges on inbound visitors, rather than on tourism-related businesses. The simplest way to do this would be to recover costs through existing charges that are paid by international visitors:

- Visa charges are typically paid by non-Australians wishing to come to Australia to visit, study or work. Visa charges vary by visa type and by the applicant's nationality. Currently, visa charges must be paid by citizens of most countries visiting Australia, although citizens of many European countries (including all EU countries) and New Zealand are exempted (table 3.1).
  - In 2010, the United States introduced a charge on international visitors travelling to the United States under its Visa Waiver Program, partly to fund its national destination marketing organisation (box 3.4).
- The Passenger Movement Charge (PMC) is a departure tax levied by the Australian Government on all passengers (including Australian residents) departing Australia by air or sea. It is typically added to the price of international air or cruise tickets at the point of sale. The PMC is currently \$55, and the Australian Government has committed to not increase the charge during its current term (Robb 2013).
  - The PMC is currently used to fund some destination marketing. In 2012, the Australian Government increased the PMC from \$47 to \$55. Of the expected increase in revenue over the four years following, 10 per cent (\$48.5 million) was allocated to establish the Asia Marketing Fund (Swan, Clare and Ferguson 2012).

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### Box 3.4      **Brand USA**

Established in 2010, Brand USA is a destination marketing organisation which aims to increase international visitation to the United States. Prior to 2010, the United States did not have a national destination marketing program, and was the only developed country without one (Brand USA 2014a, 2014c). In the year ending September 2013, Brand USA's total expenditure was about US\$180 million (Brand USA 2014b). Oxford Economics (2014) estimated that, in the same year, Brand USA marketing generated 1.1 million incremental trips to the United States (a 2.3 per cent increase).

Brand USA receives no funding from general government revenue. It is funded through voluntary contributions and through matched funding (of up to US\$100 million annually) from a charge on international visitors travelling to the United States under the Visa Waiver Program. Most voluntary contributions come from state, regional and city tourism agencies, hotel chains, airlines, travel agents and media companies (Brand USA 2014d). In the year ending September 2013, Brand USA received just over US\$100 million in cash and in-kind contributions, and (the maximum) US\$100 million in matched funds (Brand USA 2014b).

The US Visa Waiver Program allows citizens of 38 countries, including Australia, Japan and most EU countries, to travel to the United States for short stays without a visa. Since the formation of Brand USA in 2010, applicants to the Program have been required to pay a charge of US\$14, of which US\$10 is earmarked for matched funding to Brand USA, and US\$4 is used to cover the Visa Waiver Program's administration costs (USCBP 2010).

Recovering costs from international visitors (through, for example, higher visitor visa charges) imposes direct costs on visitors, but also imposes costs on tourism-related businesses if the higher cost of visiting Australia reduces demand for tourism products in Australia. One advantage of recovering costs through visitor visa charges or the PMC, as opposed to directly charging tourism-related businesses (discussed above), is that any costs will be borne by those businesses that cater to international visitors, rather than the tourism industry as a whole. The size of the costs imposed on businesses (through reduced visitor demand) from increasing visitor visa charges or the PMC will depend on the extent to which these charges affect visitors' decisions to come to Australia.

In contrast to visitor visa charges, which are levied only on international visitors coming to Australia, the PMC is also levied on outbound Australian travellers. For this reason, relative to visitor visa charges, the PMC is less well targeted at those benefiting from international destination marketing.

Many participants suggested that visitor visa charges and the PMC are already high (with some suggesting that they should be reduced) and that they deterred tourists from visiting Australia (BARA, comm. 5; Decisive Consulting, comm. 14; QTIC, comm. 17; Tourism NT, comm. 6; TTF, comm. 20). (Participants also raised other issues regarding visa applications — section 3.4.) However, visa charges and the PMC are constituted as general taxation. The levels of these taxes, therefore, reflect considerations beyond the international tourism industry — including the Australian Government's revenue requirements.

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The Australian Customs and Border Protection Service and the Department of Immigration and Border Protection are currently undertaking a review of border fees, charges and taxes (to be completed in early 2015). This review is well placed to consider some of the issues related to the PMC and visa charges, including the effect that these charges have on the international tourism industry. However, as the review has been tasked with proposing reforms that ‘achieve at minimum a revenue neutral position’ (Australian Government 2014b, p. 3), it is not able to give sufficient consideration to whether changes in the levels of these taxes are in the best interests of the community.

The Commission considers that the Australian Government’s White Paper on the Reform of Australia’s Tax System (to be completed by the end of 2015) is best placed to consider the level of the PMC and visa charges alongside other taxation issues. The White Paper is also well placed to consider some other tourism-related taxation issues previously raised by the Tourism and Transport Forum (2011b), such as depreciation rates for accommodation fit-outs, and taxes on rental vehicles.

### Improving government provision of international destination marketing

#### *Destination marketing should aim to achieve the highest net benefits for Australia*

For a given level of expenditure, the objective of destination marketing should be to achieve the highest possible net benefits for the Australian community. Some participants suggested that Australia’s destination marketing could be better targeted. For example, the Queensland Tourism Industry Council stated that ‘given ... the potential for growth from the Asian visitor market, a dollar of additional marketing to Asia may be expected to generate greater visitor expenditure than a dollar of marketing into traditional source countries’ (comm. 17, p. 11). Sydney Airport (comm. 27, p. 7) suggested that Tourism Australia should ‘take a more proactive role in consulting with industry to identify target markets for demand development’.

Several academic studies have estimated significant differences in the effectiveness of Australia’s international destination marketing across markets (see Dwyer et al. (2014) for a summary of published results). This suggests that targeting certain markets will lead to higher net benefits for Australia. For example, Kulendran and Dwyer (2009, p. 283) found that:

... a dollar of marketing expenditure allocated to Asia gives a better return in terms of injected expenditure than for the established inbound markets taken as a group.

The benefits of international destination marketing are related to its effectiveness in increasing international visitor expenditure in Australia. However, as discussed above, net benefits and expenditure should not be confused in determining whether (and to what extent) international destination marketing provides net benefits to the community, or what amount of marketing expenditure provides the highest net benefits.

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Destination marketing has the best chance of being effective where it is supplemented with research that examines the drivers of tourism demand in Australia (section 3.3). This research needs to consider factors such as:

- which potential visitors are most likely to be persuaded by the destination marketing to come to Australia
- what aspects of Australia's tourism product are most likely to persuade potential visitors to come
- which potential visitors are likely to result in the greatest net benefits to Australia if they do come (which will be related to which potential visitors are likely to have the highest expenditure).

*There is scope for greater coordination between Australia's tourism agencies*

There has been some cooperation between Tourism Australia and the state and territory tourism agencies in destination marketing (Queensland Government, comm. 21). For example, Tourism Australia shares its market research with the state and territory tourism agencies (SATC, comm. 7); and Tourism Australia's 'Best Jobs in the World' campaign was supported by the tourism agencies of New South Wales, Victoria, Queensland, South Australia, Western Australia and the Northern Territory (Tourism Australia 2013a). State and territory tourism agencies also sometimes collaborate with each other on marketing campaigns, such as for the 'Explorer's Way' drive between Adelaide and Darwin.

However, some participants considered that Australia's international destination marketing efforts would be more effective if tourism agencies' activities were better coordinated. For example, it was suggested that multiple tourism agencies had established overseas offices and launched marketing campaigns to promote their own 'patch' in key markets, such as in China and the United States. Insufficient coordination between agencies can create inefficiencies that reduce the effectiveness of Australia's destination marketing as a whole, for example:

- Australia's message to potential visitors may be confused by competing voices (Dixon 2011)
- marketing campaigns may lack the resources to be provided at a scale that is effective at persuading visitors to come to Australia (Dixon 2011)
- there may be costly duplication of administrative functions, stemming, for example, from separate relationships with advertising and public relations firms in different markets
- state and territory tourism agencies have an incentive to maximise the benefits to their jurisdiction. For example, the charter of Tourism and Events Queensland states that it 'is responsible for achieving social and economic benefits for Queensland' (TEQ 2015). Where marketing simply results in visitors going to one Australian

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jurisdiction at the expense of another Australian jurisdiction, it is likely that it is not leading to the highest possible net benefits for Australia as a whole.

Geoff Dixon, the current chairman of Tourism Australia, has argued that Australia should adopt a more coordinated approach to international destination marketing:

To speak with one voice about Australia, especially in Asia, and to collectively sell Australia through stronger singular joint federal and state government backed campaigns would, without a doubt, be a more effective and efficient way of our doing business. (Dixon 2011, p. 1)

The Commission agrees that greater coordination between Australia's tourism agencies could increase the net benefits to Australia from international destination marketing.

#### *Destination marketing expenditure and evaluations should be transparent*

Australian governments have commissioned evaluations of their destination marketing, but have published these evaluations selectively. In particular, while there are numerous publicly available studies estimating the effects of Tourism Australia's international destination marketing, there have been few publicly released studies of the destination marketing undertaken by the state and territory tourism agencies. Additionally, government tourism agencies often do not disclose details of their destination marketing expenditure, such as the amounts spent on marketing to various countries or regions, and the amounts spent in joint marketing campaigns, such as those with airlines.

Non-disclosure is typically defended on the basis that this information could be used by tourism agencies in other jurisdictions (or countries) to gain a competitive advantage. While the Commission acknowledges this concern, it considers it unlikely that the potential costs would outweigh the benefits gained from greater transparency. Even where commercial agreements necessitate some confidentiality, all non-confidential information should be made publicly available.

Government provision of destination marketing would be improved by greater transparency of government destination marketing expenditure, and of evaluations of that expenditure. Transparency ensures that governments can be held accountable for their use of taxpayer funds. There are likely to be substantial benefits from the increased accountability and public scrutiny that would arise from disclosure of the costs and benefits of destination marketing. Such scrutiny can test the assumptions and methodologies of analyses of destination marketing, and draw attention to where information may be missing, there may be unintended effects, or the methodology is flawed (PC 2010).

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## Major events

Australia hosts a range of major cultural, sporting and business events. While there are no comprehensive data on the importance of major events to Australia's international tourism industry, in 2013-14:

- about 71 000 international visitors reported that one of the purposes of their trip was to participate in or watch organised sport
- 18 000 international visitors reported that one of the purposes of their trip was to attend a specific leisure event or festival
- 43 000 international visitors reported that one of the purposes of their trip was to attend a convention, conference, seminar, trade fair or exhibition (TRA 2015d unpub.).

In terms of the activities international visitors undertake, in 2013-14:

- about 670 000 visitors reported attending a festival, fair or cultural event
- about 380 000 visitors reported attending an organised sporting event (TRA 2015d unpub.).

According to Tourism Research Australia's International Visitor Survey, major events in Australia tend to attract international visitors to major cities, rather than regional areas. In 2013-14, about 14 per cent of the international visitor nights spent within Australia, where the purpose of the stopover was for a sporting, leisure or business event, were to regions outside of capital cities and the Gold Coast (TRA 2015d unpub.).

Governments are heavily involved in the funding and provision of such events (box 3.5). Most state and territory governments have a major events office, either located within their tourism agency or as a separate entity, which aims to attract major events to their jurisdiction. Governments either provide funding to assist with the operational costs of the event, provide infrastructure (such as sports stadiums), provide marketing support for the event or, in some cases, directly provide the event (sometimes with support from the private sector, such as through sponsorships). Governments, including the Australian Government, also provide funding to convention bureaus that hold business events — in 2011-12, state and territory governments provided over \$20 million to convention bureaus (Deery 2013).

Project participants generally considered that major events are a strong driver of tourism in Australia. The Association of Australian Convention Bureaux (comm. 4) stated that one in five dollars spent by international visitors in Australia is by a visitor attending some form of business event. In addition, the South Australian Tourism Commission (comm. 7), the Queensland Government (comm. 21) and the Queensland Tourism Industry Commission (comm. 17) suggested that events are an important driver of visitation to their states.

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### Box 3.5 Selected examples of major events funding in Australia

#### Australian Government

The Australian Government does not have a dedicated major events office, although Tourism Australia provides some support to business events. The Australian Government has also provided funding, in conjunction with state governments, for some major events (this funding is not provided through Tourism Australia):

- In the 2014-15 budget, the Government announced \$156 million of funding for infrastructure for the 2018 Gold Coast Commonwealth Games (Dutton 2014).
- The Australian, Queensland, New South Wales, ACT and Victorian governments committed to provide up to \$61 million for the Asian Football Confederation Asian Cup, of which 50 per cent was to be provided by the Australian Government (Department of Health 2013).

#### South Australia

The South Australian Government manages and funds major events through the South Australian Tourism Commission (SATC). The SATC manages three major annual events (the Santos Tour Down Under, the Credit Union Christmas Pageant and Tasting Australia), and, in 2013-14, sponsored another 15 major events. In 2013-14, the events branch of the SATC received \$14 million from the South Australian Government (SATC 2014).

#### Queensland

The primary agency responsible for major events funding in Queensland is Tourism and Events Queensland (TEQ). In 2013-14, TEQ provided support for over 40 major events (including cultural events, such as the Cai Guo-Qiang art exhibition, and sporting events such as the Gold Coast Marathon), 85 regional events, and confirmed support for 17 future business events. In total, in 2013-14 the TEQ provided \$35 million of funding for events, plus \$4.5 million of funding for event promotion support (TEQ 2014).

The Queensland Government is also providing substantial support to the 2018 Gold Coast Commonwealth Games. The Commonwealth Games bid anticipated about \$1.1 billion of state government subsidies for the event (Queensland Government 2011).

### What is the rationale for government involvement in major events?

In general, governments justify support for major events based on the benefits to other businesses in the tourism industry from holding the event (box 3.6). A major event in a region will likely attract visitors from outside the region or, in some cases, from other countries. These visitors will purchase tourism-related products such as accommodation, sightseeing tours and restaurant meals. As in the case of destination marketing, the benefits to businesses in the tourism industry are difficult to capture for the provider of the event.

It is important to consider the counterfactual when evaluating the case for government involvement in major events. Where an event generates net benefits that can be captured or charged for by the provider of the event it is likely to proceed without the support of the government. If this is the case government support would crowd out private investment,

and result in unnecessary costs (such as the opportunity cost of government funds, or the costs of raising additional taxation revenue).

### Box 3.6 Major events: a conceptual framework

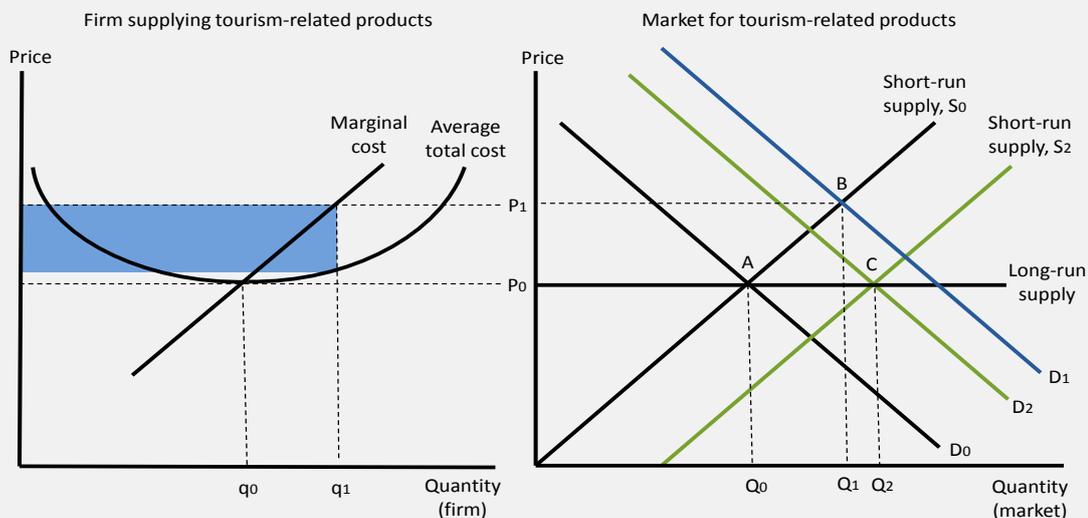
The effect of the provision of a major event on the broader tourism industry in the region is illustrated in the figure below. This is a stylised example, which assumes a perfectly competitive market for tourism-related products.

Prior to the major event, demand for tourism-related products is represented by  $D_0$ , and the market for tourism-related products (shown in the right-hand panel) is in equilibrium at  $P_0, Q_0$ . At this equilibrium, each firm (shown in the left-hand panel) produces the profit-maximising quantity  $q_0$  (at the point where price is equal to marginal cost) and earns zero economic profits (as price is equal to average total cost). The provision of a major event leads to an increase in demand to  $D_1$ . This results in an increase in both the price of tourism-related products (to  $P_1$ ) and the quantity of tourism-related products supplied (to  $Q_1$ ). At this new short-run equilibrium, each firm is producing the new profit maximising quantity  $q_1$ , and is earning positive economic profits equal to the blue shaded area.

The economic profits accruing to firms can be seen as a positive externality arising from the provision of the major event — it represents benefits that are difficult for private providers of the event to capture. The size of the external benefits is strongly related to the responsiveness of demand for tourism-related products to the provision of the major event.

After the event, two outcomes are possible: the event has minimal legacy effects, demand for tourism-related products in the region falls back to  $D_0$ , and the market returns to its pre-event equilibrium; or, if the major event has legacy effects, demand remains above  $D_0$ , at  $D_2$ . If the event has legacy effects and the number of firms in the market remains constant, this would imply that these firms would continue to earn positive economic profits in the long run. Therefore, in the long run, additional firms will enter the market, shifting out the short-run supply curve to  $S_2$ , and returning the market to a new equilibrium ( $P_0, Q_2$ ) where firms earn zero economic profits.

Note that the long-run supply curve may slope upwards if resources used in production (such as land) are scarce, or where costs vary between firms (Gans, King and Mankiw 2001).



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In addition to the direct effects on the tourism industry, major events are also often cited as having ‘legacy effects’ — an increase in tourism after the provision of the event, such as through advertising effects, or due to the influence on tourism demand of permanent infrastructure provided for the event, such as sporting stadiums. There has been limited empirical work examining the existence of such effects. Fourie and Santana-Gallego (2010) find some evidence of an increase in the number of international visitors both prior to and during the holding of a ‘mega event’ (such as the Olympic Games). However, they find little evidence of an increase in the number of visitors (above what would have occurred in the absence of the event) in the years following the event.

Some independent cost–benefit analyses of major events have reported very low (or negative) net benefits associated with government funding of these events (discussed below). This may be because the external net benefits associated with a major event are likely to be, for most events, small, relative to the private costs and benefits associated with the event. While there may be a rationale for government support for major events, such support is only likely to offer net benefits where the external net benefits are relatively large. Thus, government support needs to be considered on a case-by-case basis.

### Evaluating the economywide contribution of major events

In consultations, some state and territory tourism agencies informed the Commission that they undertook evaluations of the economic contribution of major events they have funded both prior to, and following, the event. These evaluations have typically focused on the increase in tourism expenditure or gross state product (GSP) as a result of the event, and have often claimed that increases in these indicators mean that there are substantial net benefits to the state or territory from holding major events. (As discussed above, these measures are not equivalent to the net benefits to the community.) For example:

- an evaluation of the 2011 Melbourne Formula 1 Grand Prix suggested that it increased GSP in Victoria by about \$40 million, relative to a situation where the event was held in another state (Ernst and Young 2011)
- an evaluation of the Margaret River Gourmet Escape estimated that the direct expenditure in the Margaret River region by visitors from outside the region was about \$11 million, although expenditure by visitors from outside of Western Australia was estimated to be about \$4 million (that is, about \$7 million of the increased expenditure in Margaret River was by visitors from other regions in Western Australia) (Metrix 2014).

Economic analyses of major events commissioned by state governments are generally not made publicly available. However, some independent studies have suggested that the analyses that are publicly released have often substantially overestimated the net benefits that result from major events (see, for example, Abelson (2011); Jago and Dwyer (2006); VAGO (2007)). This is because these studies use inappropriate analytical techniques (such as multiplier analysis), or poor application of the appropriate techniques.

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A key reason why the economic effects of major events may be overestimated is because studies often assume that all spending by visitors from outside the region is new spending in the region. This can exaggerate the additional spending induced by the event because some visitors to the region may have visited the region at that time regardless of the event, or rescheduled a planned trip to the region to coincide with the event (Barclay 2009). The event may also result in people who would have visited the region in the absence of the event not travelling to the region, and result in some local residents avoiding the region while the event is being held (Matheson 2006).

Studies of international ‘mega-events’ suggest that factors that reduce the number of visitors travelling to the region as a result of a major event can be substantial. For example, over 300 000 international visitors attended the 2010 FIFA World Cup in South Africa (Bob and Potgieter 2013). However, du Plessis and Maennig (2011) estimated that the total number of international visitors to South Africa only increased by 90 000–108 000 over the period (relative to what would have occurred without the event). Further, de Nooij and van den Berg (2013) note that several studies of FIFA World Cups and Olympic Games events have suggested that there has been either a net decrease in the number of visitors arriving to the region holding the event, or no net change in the number of visitors arriving.

In addition, evaluations of major events generally use input–output or computable general equilibrium models to report on the increase in tourism expenditure as a result of the event, and/or the increase in GSP as a result of the event. However, for the reasons outlined in the above section on destination marketing, these approaches will tend to overstate the net benefits resulting from the provision of the event, relative to a comprehensive cost–benefit analysis (box 3.2, box 3.7). For example, an audit of government funding for V8 Supercar races at Sydney Olympic Park found that the benefits of the race had been overstated, as the analysis overstated visitor numbers and used input–output multipliers, rather than cost–benefit analysis (Audit Office of New South Wales 2010).

Governments need to consider all the (expected) costs and benefits of a major event when deciding whether to fund the event. The Queensland Audit Office (2013) noted that Events Queensland did not have information on the extent of assistance events receive from the private sector and other government agencies. This information is crucial to determining the viability of an event, and the effect that government funding would have on the decision to hold the event. Not accounting for all the costs and benefits of a major event increases the risk that government may choose to fund an event that would not provide net benefits to the community.

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### Box 3.7 Cost–benefit analysis versus economic impact analysis

Studies examining the effect of major events are often economic impact analyses, which estimate the effect of the event on metrics such as GDP or gross state product (GSP). However, increases in GDP or GSP resulting from an event are not the same as the net benefits of the event — rather, it would be expected that increased GDP or GSP will generally overstate the net benefits.

On the other hand, cost–benefit analysis is primarily focused on estimating the changes in producer and consumer surplus as a result of the event, as well as considering the range of other costs and benefits associated with the provision of the event.

Cost–benefit analysis can be used to estimate the net benefits to the community resulting from the provision of a major event to inform the decision as to whether the event should proceed. Multi-criteria analysis, input–output analysis and computable general equilibrium modelling are not suitable replacements for traditional cost–benefit analysis (PC 2014c).

There are some examples where both (ex post) cost–benefit analysis and economic impact analysis have been applied to examine a major event, allowing for a comparison of their relative results:

- In 2002, the ACT Auditor-General’s Office undertook a cost–benefit analysis of holding V8 Supercar races in the ACT. The analysis estimated that the race had a net cost of \$4.6 million in 2000 and \$2.8 million in 2001. An economic impact analysis estimated an increase in GSP of \$13.2 million in 2000 and \$11.2 million in 2001 as a result of the race (ACTAGO 2002).
- In 2007, the Victorian Auditor-General’s Office commissioned a cost–benefit analysis of the Australian Grand Prix in 2005. The cost–benefit analysis estimated that the event was a net cost to Victoria of about \$6.7 million. An economic impact assessment commissioned by the Australian Grand Prix Corporation had estimated that the Grand Prix increased Victoria’s GSP by \$166 million (VAGO 2007).
- The New Zealand Ministry of Business, Innovation and Employment established a cost–benefit framework for evaluating events funded by its Major Events Development Fund (NZMBIE 2013). Based on this framework, it estimated the costs and benefits of 18 events it had funded. It estimated the net benefits to New Zealand from these events to be about \$32 million. Economic impact studies had estimated the effect of these events on GDP to be about \$144 million (NZMBIE 2013).

Government support for an event may not be in the best interests of the community if the economic analyses justifying the support are methodologically flawed. Jurisdictions should adopt a consistent approach to evaluating major events, both prior to and after the event, based on cost–benefit analysis. The cost–benefit analysis should examine a broad range of costs and benefits, which have often not been accounted for in analyses of major events, including:

- the private costs and benefits of holding the event, including operating costs and ticket and sponsor revenue. Importantly, this should consider whether the event would be held without government support (that is, whether government support would crowd out private investment)

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- the increased (or decreased) profitability of firms not associated with the event, as a direct result of the event being held. This would need to consider the increase in tourism expenditure as a result of the event, including any crowding out effects, and the flow on effects of the event to the broader economy
  - the costs of additional labour or capital used to produce additional tourism-related products
  - the cost of infrastructure provided for the event. Major events can result in the construction of infrastructure, such as sporting stadiums, that are costly to construct and may not be justified
  - the opportunity cost of government funds (section 3.2)
  - any other external costs and benefits, such as noise and other environmental effects (Jago and Dwyer 2006). For example, homes were damaged by compaction work undertaken as part of the construction of the Melbourne Grand Prix track in Albert Park (Hoye, Nicholson and Houlihan 2010).

Only where the cost–benefit analysis suggests that there would be net benefits to the community from the provision of an event would there be a case for government support. Even then, the government should consider factors such as the scope for government failure and optimism bias in its decision making (section 3.2).

Given the scope for the net benefits of major events to be overstated, and the need for accountability to the community for government spending, there is a strong case for evaluations of the net benefits of major events to be made publicly available. This would enable additional public scrutiny of the benefits and costs of the event, a full consideration of the assumptions and methodologies of major event analyses, and increasing confidence that government support for major events has net benefits.

Governments must also consider how support for major events should be funded. While it would be desirable for the primary external beneficiaries of major events to fund them, consideration should be given to whether this is feasible in practice for the same reasons as discussed above in relation to destination marketing. In particular, the dispersed nature of the tourism industry will make cost recovery difficult in practice.

### The costs of competing for major events

Increased cooperation between state and territory governments to attract major events would also be beneficial for the community, particularly if it reduces the likelihood that governments enter into ‘bidding wars’ to secure major events. If a government overbids or overinvests to ensure an event is hosted in its jurisdiction, this will dissipate the benefits accruing to the Australian community.

Economic evaluations of major events based on increased visitation to a state are likely to overstate the net benefits to Australia if they do not consider the offsetting decreases in

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expenditure in other states. If an event generates net benefits in the host state or territory, the overall net benefits to Australia will be lower if the benefits flowing to tourism-related businesses within the host state come at the expense of businesses in other regions in Australia (IC 1998).

Economic evaluations of major events based on increased visitation to a state are likely to overstate the net benefits to Australia if they do not consider the offsetting decreases in expenditure in other states. For example:

- evaluations of four major events held in South Australia in 2012 (Adelaide Festival, Adelaide Fringe, the Clipsal 500 and WOMADelaide) estimated the increase in expenditure within South Australia as a result of these events to be about \$80 million (McCann 2012). However, of the 46 000 visitors from outside South Australia who attended these events, the majority (over 36 000) were from interstate. This suggests that a significant proportion of the benefits to businesses in South Australia (through increased visitor expenditure) would have been transferred from businesses in other states and territories in Australia
- an economic impact analysis of the 2005 Australian Grand Prix suggested that, while the increase in Victoria's GSP was estimated to be between \$62–\$102 million, the increase in Australia's GDP was estimated to be between \$2–\$13 million. The report noted that 'the Grand Prix shifts expenditure around the economy, and does little to create new resources for production' (VAGO 2007, p. 147)
- where the net benefits are considered from the perspective of a region within a state, these benefits can come at the expense of other regions in the state. As noted above, much of the increased expenditure in the Margaret River region resulting from the Margaret River Gourmet Escape was from a region elsewhere in Western Australia.

State and territory governments have previously recognised these risks. In 2003, all state and territory governments (except Queensland) signed the Interstate Investment Cooperation Agreement, whereby the governments agreed to end unnecessary bidding wars to attract investment (including major events). This agreement lapsed in 2011.

There are likely to be net benefits to Australia from increased cooperation between the state and territory governments in the attraction of major events. The best-case scenario would be if state and territory governments only sought to attract events which would have net benefits for Australia as a whole (and the event were held where it would have the greatest net benefits to Australia), rather than focusing on net benefits to a particular jurisdiction. However, in the absence of this, increased cooperation between the state and territory governments in attracting events to Australia would be beneficial. Tourism Australia has noted that it may take on an expanded role in coordinating and marketing major events in Australia (comm. 12).

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## Tourism-related research

The provision of tourism-related research includes the collection, compilation, analysis and/or dissemination of information. This section considers research either performed or commissioned by government bodies, including:

- the ABS — which presents Overseas Arrival and Departure statistics, and publishes the Tourism Satellite Account (which provides estimates of the contribution of the tourism industry to Australia's economy) as part of the Australian National Accounts
- Tourism Research Australia — which commissions and publishes the results of the International Visitor Survey and National Visitor Survey, produces tourism industry forecasts, and publishes a range of other tourism-related research, such as the 'State of the Industry' report
- Tourism Australia — which produces market research to inform the direction of its destination marketing, and the destination marketing of the state tourism agencies
- the Bureau of Infrastructure, Transport and Regional Economics — which provides domestic and international aviation statistics.

### The rationale for government provision of tourism-related research

Where government involvement in the tourism industry is justified, including in relation to destination marketing and major events, there is an in-principle case for government provision and sharing of research, such as research on tourism markets, that improves the effectiveness of government activities. Where there is an in-principle case, government should only provide research where the benefits exceed the costs (section 3.2).

Participants provided other reasons that, in the Commission's view, do not provide a sufficient rationale for government provision of research. These include that:

- some research is not being (or would not be) provided by the private sector in the absence of government involvement. The absence of private sector involvement in research does not justify government provision of the research. Rather, governments need to consider whether there is an in-principle case for the provision of the research, and whether the provision of that research would have net benefits
- the tourism industry consists of mostly small- and medium-sized businesses (NTA, comm. 23; SATC, comm. 7). While it may be most efficient for a single organisation to carry out some particular research and distribute it to businesses, government need not perform this task. It is commonly performed by private research providers such as STR Global and IBISWorld.

Some participants considered it paramount that the ABS continue to provide the Survey of Tourist Accommodation, which examines the occupancy rates of short-term accommodation. (The ABS announced the discontinuation of the survey in June 2014; the survey was continued for 2013-14 contingent on funding from Austrade.) The survey data

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are primarily used by private developers as part of their assessment of whether a proposed accommodation investment is feasible — they do not appear necessary to support government policy. As a result, the Commission does not consider that there is a strong in-principle rationale for the ABS to continue to provide this research. In the event that it does continue to provide the Survey of Tourist Accommodation, it should seek cost recovery from the users of the research.

### **3.4 Facilitating the flow of international visitors to Australia**

Participants to this research project raised a range of issues relating to the facilitation of the entry and exit of international visitors to Australia, mostly relating to visitor visa charges and the PMC (section 3.3), and to visa application processes. Some participants suggested that Australia's visa processes for some visitors were more demanding than comparable countries' visa processes (Crown Resorts, comm. 28; QTIC, comm. 17; TTF, comm. 20). Participants also suggested that visa applications should be available in languages other than English (Austrade 2014; Crown Resorts, comm. 28; TTF, comm. 20); and that Australia's visa requirements for transit passengers from China and India — mostly travelling to New Zealand — were onerous and unnecessary.

Above all, participants were concerned about the visa processes for Chinese visitors. Chinese visitors to Australia must apply for a Visitor visa (subclass 600), while visitors from many of Australia's other key tourism markets are eligible to apply for an Electronic Travel Authority (subclass 601) or eVisitor visa (subclass 651) (table 3.1).

The objective of Australia's visitor visa program is to facilitate the entry of genuine visitors, while minimising non-return rates and breaches of visa conditions (DIBP, comm. 32). The requirements and restrictions attached to different visa types, including which nationalities are eligible for each visa type, should be designed to meet this objective in the most efficient manner. Given the current and growing importance of China as a source country for visitors to Australia (chapter 2), and strong competition from other countries to attract visitors from China (box 3.6), it is particularly important that Australia's visa processing arrangements for Chinese visitors are efficient.

The Australian Government has taken steps to make Australia's visa processing arrangements more efficient. Most notably, it is expanding online visa applications to visitors from all countries:

Since the introduction of online lodgment for the Visitor (Subclass 600) visa in March 2013, passport holders of 197 countries or regions have become eligible to apply online. ... The [Department of Immigration and Border Protection] is aiming to have this service available for all nationalities by the end of 2015. (DIBP, comm. 32, p. 5)

As part of this expansion, the Australian Government has launched online visa application pilots in China (in December 2014) and India (in January 2015) (Robb 2014b, 2015).

The Australian Government has taken additional steps to simplify visa processes for Chinese citizens:

- In February 2014, the Government introduced three-year multiple entry visas for Chinese business travellers (Robb 2014b).
- The Government recently reviewed document requirements for Chinese travellers, and combined two document checklists into one shorter checklist (DIBP, comm. 32).

The Commission supports the steps the Australian Government is taking to simplify visa application processes, particularly the introduction of online visa applications for visitors from China.

**Table 3.1 Visa types under Australia’s visitor visa program**

<i>Visa type</i>	<i>Visitor visa<sup>a</sup> (subclass 600)</i>	<i>Electronic Travel Authority (subclass 601)</i>	<i>eVisitor visa (subclass 651)</i>
Eligibility	All nationalities	34 ‘low risk’ nationalities	All EU nationals and some non-EU European nationalities
Eligible countries (of top 15 countries of origin for short term visitors to Australia, 2013-14) <sup>b</sup>	China, India, Indonesia	United States, Singapore, Japan, Malaysia, Canada, Hong Kong, South Korea, Taiwan	United Kingdom, Germany, France
Cost	\$130	\$20	Free
Lodgment	Paper lodgment available to all nationalities, online lodgment being expanded to all nationalities (197 as of November 2014)	Online lodgment	Online lodgment
Documentary evidence	Required	Not required	Not required but can be requested
Processing time service standard <sup>c</sup>	1 month	1 working day	1 working day
Validity	12 months, multiple entry	12 months, multiple entry	12 months, multiple entry
Maximum stay per entry	3 months	3 months	3 months
Permitted activity	To visit, study, or for business, depending on stream	To visit, study, or for business	To visit, study, or for business

<sup>a</sup> Standard Visitor visa for offshore clients. <sup>b</sup> Visitors from New Zealand are eligible for a Special Category visa (subclass 444). <sup>c</sup> The Department of Immigration and Border Protection aims to process applications within these times, although actual processing times may vary. Processing time service standards given are for typical applicants: ‘low risk’ visitor for eVisitor, ‘high risk’ tourist or business visitor for Visitor visa.

Sources: ABS (2014a); DIBP (comm. 32; 2014).

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**Box 3.6 International reforms to visa arrangements for Chinese visitors**

Internationally, a range of reforms have been implemented or proposed to improve visa arrangements for Chinese citizens:

- In 2012, the US Government made significant investments to dramatically reduce wait times for interviews and streamline application procedures. In 2014, the US Government agreed to issue multiple-entry visas valid for up to 10 years for short-term visitors from China.
- In 2014, the UK Government introduced a service which allows Chinese visitors to apply for a UK visa and EU (Schengen Area) visa at the same time, launched a new online application form with fewer questions, and reduced document requirements for repeat visitors.
- In 2014, the Indian Government announced it would offer visas on arrival to visitors from 180 countries, including China.
- In 2014, the Thai Government extended existing visitor visas by 30 days and is now offering free visas for Chinese visitors.

*Sources:* Crown Resorts, comm. 28; Melbourne Airport, comm. 24; TTF (2014); US Department of State (2014b); US Department of State and US Department of Homeland Security (2012).

Participants raised some other issues regarding visitor entry and exit, including:

- a decline, in real terms, of the resources devoted to passenger facilitation, leading to longer queue times in recent years (Sydney Airport, comm. 27)
- border protection agencies appear unable to adequately cope with changing airline demand patterns or unplanned issues such as weather delays (BARA, comm. 4)
- poor delivery of border protection services imposes costs on airlines — for example, as a result of passengers missing connecting flights — that are not adequately taken into account by border protection agencies (BARA, comm. 4)
- airport and aviation security requirements impose a disproportionate cost burden on low passenger volume airports (Tourism NT, comm. 6; Regional Development Australia — South West, comm. 3)
- there is no premium visitor processing option at Australian airports — The Australian Customs and Border Protection Service could provide the option of faster processing at major international airports on a cost-recovery basis (Crown Resorts, comm. 28; Sydney Airport, comm. 27).

These issues are best addressed in the review of border fees, charges and taxes referred to above, and the Inquiry into Airport and Aviation Security being undertaken by the Senate Rural and Regional Affairs and Transport References Committee (due to report by April 2015).

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## 4 International air services

### Key points

- Australia is a long-haul island destination and as such visitors are reliant on air services to travel to and from Australia — about 99 per cent of international visitors to and from Australia travel by air. The efficiency of international travel can be significantly affected by the way international air services are regulated through bilateral air services arrangements.
- Some of Australia's bilateral arrangements have reached or are approaching capacity for foreign airlines (including arrangements with Hong Kong, Malaysia, and Qatar), although capacity for foreign airlines is not being fully used under other arrangements. There is also significant scope for Australian airlines to increase capacity under most of the bilateral arrangements with Australia's largest fifteen countries by passenger traffic.
  - Care should be taken to not mistakenly attribute commercial decisions made by airlines to restrictions within bilateral arrangements. Airlines may not be offering services because it is not in their commercial interests to operate a particular route or to increase supply on established routes.
- Unilateral reform of air services arrangements will not necessarily generate net benefits for Australia as long as international aviation arrangements are dominated by the current bilateral framework.
  - The greatest scope to achieve net benefits for the Australian community is likely to come from further liberalisation within the bilateral system, with the Australian Government continuing to work toward a multilateral liberalisation approach in relevant international forums.
- Although Australia's international aviation policy settings have served Australia well, it is expected that further liberalising access to Australia's major gateway cities — Brisbane, Melbourne, Perth and Sydney — would provide net benefits to the international tourism industry and the Australian community.
  - It is difficult to see how restricting access to secondary airports serving the major gateways, such as Avalon and the proposed airport at Badgerys Creek, creates benefits for the Australian community. If any restrictions are to remain, the case for all restrictions, except those at Sydney Kingsford Smith Airport, is quite weak, and open access could be extended accordingly.
- There is also scope for greater transparency in the process used by the Australian Government when deciding whether changes to Australia's international air services arrangements are in the community's interest.
  - Greater use of transparent cost–benefit analysis, which includes a clear statement of how the Australian Government assesses the aggregate national interest, including what factors are considered and how trade-offs between different groups are made, would help increase confidence that decisions are being made in the interests of the community.

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## 4.1 International air services and tourism

Australia is a long-haul island destination and as such international visitors rely on air services to travel to and from Australia. About 99 per cent of international visitors travel to and from Australia by air and, on average, international airfares comprise around a quarter of total trip spending of international visitors to Australia (chapter 2).

The regulation of international air services, both in terms of policy design and the administration of policy, has a significant effect on the efficiency (price and availability) of international air services, and hence on travel to and from Australia. If international air services regulations limit competition between airlines and/or reduce the availability of international flights, this can increase air transport costs and the time taken for international visitors to fly to Australia. This can influence the number of international visitors to Australia and Australia's export of tourism services — higher travel costs affect decisions to visit Australia (chapter 2) and may reduce visitors' expenditure on other tourism services, such as accommodation, restaurants and tours. Higher international airfares, and/or reduced availability of international flights, also reduce the travel choices of Australians wishing to travel overseas.

This chapter examines some key aspects of Australia's international aviation policy and its implications for international tourism and the welfare of the Australian community more broadly. Whilst a number of participants raised issues about the provision and regulation of airport services, these have not been considered in this report given the Commission considered these issues at length in an inquiry released in 2012.

## 4.2 The Australian international airline industry

### Australia's international aviation market

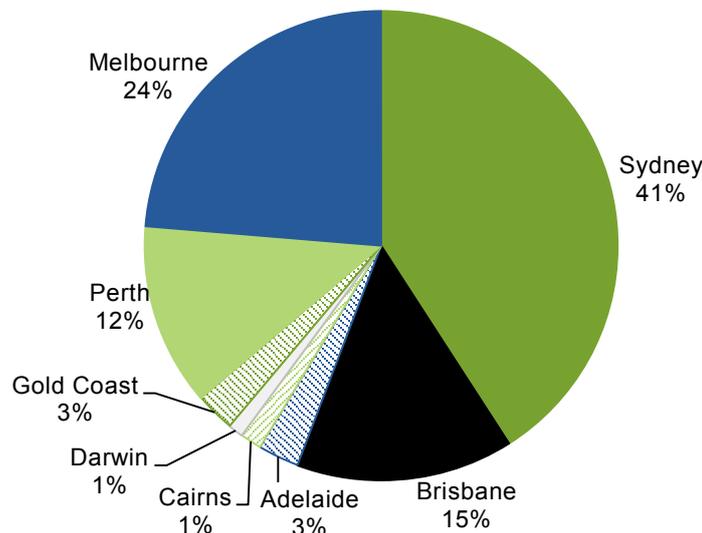
During 2013-14, 54 licensed international airlines (including five dedicated freight operators) operated scheduled services to and from Australia (BITRE 2014a). The number of international airlines servicing Australia has grown steadily, up from 50 in 2002 (BTRE 2002) and 41 in 1992 — of those 41, only 21 operate services to and from Australia today (BITRE 2015). Three Australian airlines provided international air services in 2013-14 — Qantas, Virgin Australia and Jetstar.<sup>1,2</sup>

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<sup>1</sup> An Australian airline granted an allocation of capacity to operate international flights must be designated by the Australian Government before it is able to operate international air services. Intending Australian carriers are required to meet a number of national interest criteria including that: the Chairperson of the Board must be an Australian citizen; the airline's head office must be in Australia; the airline's operational base must be in Australia; and no more than 49 per cent of the total value of the issued share capital can be held by foreign persons (DIRD 2014c).

Australia's international airports are generally described as either major international gateway airports (Sydney, Melbourne, Brisbane and Perth) or secondary international gateway airports (all other international airports). However, the terminology used to categorise airports can vary, for example, secondary airports are sometimes referred to as regional international airports (Airbiz Aviation Strategies 2012; Australian Government 2009; DIRD 2014b, 2014d). In 2013-14, ten international airports in Australia serviced international passengers, although the vast majority of international passengers arrived in, and departed from, Australia via the four major international gateway airports (figure 4.1).

Figure 4.1 **Share of international passenger traffic through Australian international airports, 2013-14<sup>a</sup>**



<sup>a</sup> Not shown are Norfolk Island (which had 0.04 per cent share of international passenger traffic) and Sunshine Coast (which had 0.02 per cent share of international passenger traffic).

Source: BITRE (2014a).

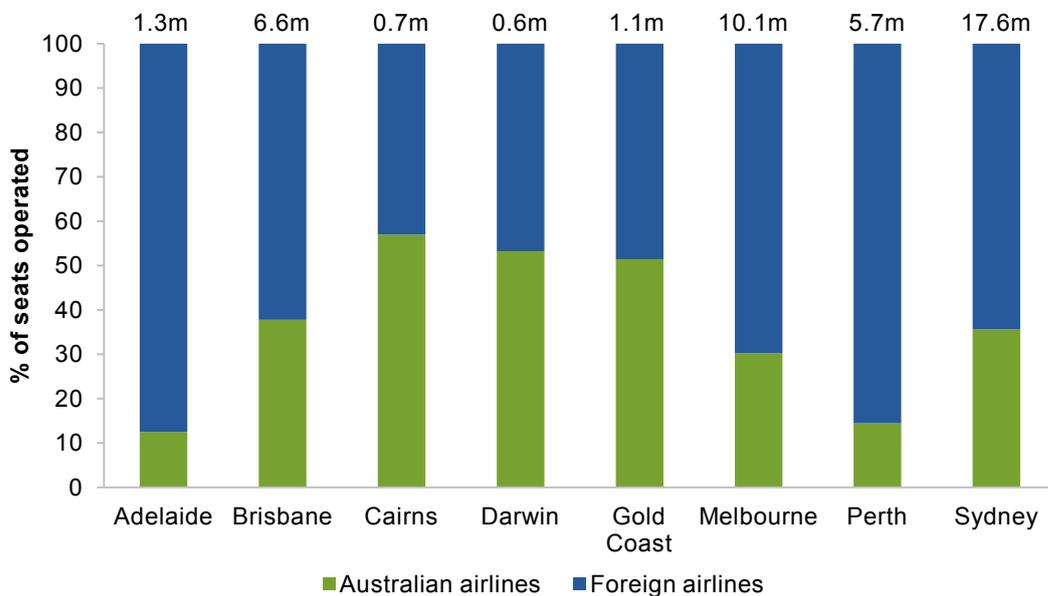
Both international and domestic airlines operate from these international airports and different airports have a different mix of Australian and foreign airlines (figure 4.2). For example, in 2013-14 only one international airline (Air New Zealand) operated out of the Sunshine Coast, offering flights to and from New Zealand. In contrast, 37 international airlines operated out of Sydney Airport, offering international air services to multiple destinations around the world (BITRE 2014b).

<sup>2</sup> Airnorth also operates weekly services between Darwin and Dili in Timor-Leste although these services are not included within aviation statistics provided by the Bureau of Infrastructure, Transport and Regional Economics.

## Trends in international aviation in Australia

Significant changes have occurred in the international aviation industry over the past four decades. Improved technology, changing business models of airports and airlines, and increased competition from new entrants have changed the way airlines do business, leading to significant cost reductions and falls in airfares. Lower airfares and additional services, as well as other factors such as rising incomes, have led to a significant increase in the number of international visitors to Australia (chapter 2).

Figure 4.2 **Total number of international seats operated to/from Australian airports, and proportion of seats operated by foreign and Australian airlines, 2013-14<sup>a,b</sup>**



<sup>a</sup> Australian international airlines are Qantas, Virgin Australia and Jetstar. <sup>b</sup> Norfolk Island and Sunshine Coast are not shown. There were around 18 000 and 11 000 international seats operated to/from these airports respectively.

Source: BITRE (2014b).

There have been a number of changes in the Australian international aviation industry. Significant among these is the rise of low-cost carriers (LCCs) which have grown rapidly in the past decade and increased the level of competition for passengers, particularly price-sensitive leisure travellers (PC 2011a). In 2013-14, LCCs<sup>3</sup> accounted for around 16 per cent of total international passenger traffic in Australia (BITRE 2014a).

The emergence of LCCs has had implications for full service airlines. Qantas' share of international passengers has declined over the past decade from about 31 per cent in

<sup>3</sup> AirAsia X, Indonesia AirAsia, Jetstar, Jetstar Asia, Scoot and Tigerair Singapore.

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2003-04, to 16 per cent in 2013-14. However, Qantas still has the largest share of international passenger traffic of all international airlines operating in Australia, with its LCC subsidiary Jetstar accounting for a further 7.7 per cent in 2013-14 (BITRE 2014a). The rise of LCCs has also increased the level of competition between airports to attract airlines. LCCs often have more discretion as to the destination to which they fly (as leisure travellers, unlike business travellers, can potentially use a range of airports in a region, or even a country, to start or end their journey).

Increased competition and the drive to lower airline costs have contributed to the adoption of innovative business models, such as alliances. Many international airlines have sought to form alliances to realise greater commercial and operational efficiencies through a range of initiatives (Virgin Australia, comm. 16). For example, the strategic alliance between Qantas and Emirates provides broad cooperation across passenger and cargo transport operations, including in relation to sales and marketing, code sharing<sup>4</sup>, mutual recognition of frequent flyer programs, and planning, scheduling, operating and capacity (ACCC 2013; Qantas 2012). Qantas and China Eastern have also recently announced their intention to extend their relationship from a code share one into a broader alliance that allows them to cooperate in a number of areas including scheduling, development of new fare products and promotions, and terminal co-location in Shanghai (Qantas 2014). Virgin Australia also has a number of alliances, including with Etihad. This alliance involves code sharing, reciprocal frequent flyer programs and airport lounge access.

Alliances have traditionally been the domain of full service airlines, although some LCCs have entered into alliances and further LCCs are expected to adopt alliance models as their operating models change (CAPA Centre for Aviation 2011).

New air services have commenced, particularly by carriers from Asia and the Middle East, in response to changes in demand for air travel. There has been a significant expansion of the Middle-Eastern hubs, which have the geographical ability to reach destinations anywhere in the world through nonstop services. In 2013-14, passengers uplifted or discharged in the Middle East accounted for 10.4 per cent of all international passengers carried to and from Australia on a single flight number service (BITRE 2014a). A decade ago this number was just 3.1 per cent (BTRE 2004). Over the same period, the share of international passengers uplifted/discharged in Europe has declined from 4.9 per cent to 1.4 per cent (BITRE 2014a; BTRE 2004).

Broader global events have, from time to time, also affected demand for international aviation services. Terrorist attacks in the United States and other shocks, such as the outbreak of severe acute respiratory syndrome, the collapse of Ansett, the global financial crisis, and the Icelandic and Chilean volcanic eruptions, have been disruptive to the market (PC 2011a).

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<sup>4</sup> Code sharing involves an airline selling seats on a flight operated by another airline. It allows airlines to share operating costs and enables an airline to establish a market presence on a route without actually operating on it.

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## 4.3 Australia's international aviation policy

### How is international aviation regulated?

Unlike most traded sectors, including international shipping, an international aviation market is restricted unless governments have negotiated arrangements to allow access. This means that without negotiated arrangements, a country's airlines cannot operate international air services, either for the residents of the airlines' home country or for residents of other countries. Access to international aviation markets is governed by a complex web of government-to-government bilateral (and some regional or multilateral) international air services arrangements. These arrangements involve treaty-level agreements and associated arrangements, which can involve a memorandum of understanding and/or similar instruments that have 'less-than-treaty' status (box 4.1). These arrangements involve provisions that set out what air services can be operated by international airlines between countries. The provisions relate to traffic rights, which outline the routes airlines can fly (also referred to as 'freedoms of the air' (box 4.2)), capacity entitlements (the number of seats (or flights) that can be operated on a particular route), airline designation, ownership and control of airlines, prices, and other clauses addressing safety and other issues.

Liberalisation of international air services began in the 1990s with an easing of some of the restrictions on airlines to operate international services. A number of countries, led by the United States, adopted a process of 'open skies' liberalisation within the bilateral structure. There is no single model of open skies. The term is used generally to refer to 'the type of agreement that would create a regulatory regime that relies chiefly on sustained market competition for the achievement of its air services goals and is largely or entirely devoid of a priori government management of access rights, capacity and pricing, and other ancillary rights for airline commercial decisions' (ICAO 2013a, p. 7).

The United States has negotiated reciprocal open skies arrangements with more than 100 partner states, including with the European Union and its member states (US Department of State 2014a).<sup>5</sup> The Australian Government has also negotiated an open skies agreement with the United States and a single aviation market agreement with New Zealand, and has open capacity arrangements with a number of other countries (discussed below). In practice, few open skies arrangements involve full liberalisation. Most include restrictions such as limits on foreign ownership and control of airlines, and limit flights only to nationally designated carriers. The granting of seventh freedom rights for passenger services, and cabotage rights (eighth and ninth freedoms) are not included within most open skies arrangements. There are some exceptions to this — cabotage is allowed for

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<sup>5</sup> The US model of open skies grants unrestricted rights up to sixth freedom rights for passengers and cargo, and up to seventh freedom rights for cargo only, and includes provisions that eliminate government interference in airlines' commercial decisions on capacity and pricing, and establish pro-competitive elements on user charges, 'doing-business' matters and cooperative arrangements (ICAO 2013b).

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carriers within the European Union, and for designated carriers in Australia and New Zealand under the single aviation market (discussed below) (ICAO 2013a; Webb 2006).

#### **Box 4.1 International bilateral air services arrangements**

Before an airline can operate international services to another country, the Australian Government must first negotiate an international air services arrangement with the destination country's government. The underlying regulatory framework supporting international air services arrangements is the 1944 Convention on International Civil Aviation (commonly referred to as the Chicago Convention). The *Air Navigation Act 1920* (Cwlth) gives effect to the Chicago Convention in Australia.

Each international air services arrangement differs but in general they contain provisions on:

- traffic rights — also known as *freedoms of the air* (box 4.2) which are a set of nine distinct rights over which countries negotiate. These rights relate to the routes airlines can fly, including cities that can be served within, between and beyond the bilateral partners
- capacity — the number of flights that can be operated or passengers that can be carried between the bilateral partners
- designation, ownership and control — the number of airlines that bilateral partners can nominate to operate services and the ownership criteria airlines must meet to be designated under the bilateral arrangement. Air services arrangements typically require airlines designated by each party to be 'substantially owned and effectively controlled' by the nationals of that country, although some countries, including Australia, have negotiating criteria within their bilateral arrangements based on 'incorporation and principal place of business'. These criteria focus on where an airline is based and which country has effective regulatory oversight of the airline rather than ownership
- prices — some arrangements require airlines to submit ticket prices to aeronautical authorities for approval, although it is not current practice for Australian aeronautical authorities to require this
- other clauses addressing competition policy, safety and security, and including code sharing.

The international framework of the Chicago Convention has resulted in various market arrangements. These range from highly restrictive arrangements with tightly defined city designations and capacity, to more liberal arrangements that include unrestricted capacity.

*Sources:* Australian Government (2009, 2014a); Forsyth et al. (2013); PC (1998).

Some liberalisation has also occurred at the regional level. The European Union Single Aviation Market, introduced in 1993, provides unrestricted access (including cabotage) for EU airlines. The European Commission has the right to negotiate on behalf of member states as a bloc with other countries, and has negotiated a number of air services arrangements, including with the United States (mentioned above), and with Canada and Brazil (European Commission 2012). The Australian Government has been in negotiations to liberalise international aviation services in the form of an open skies arrangement with the European Union for a number of years.

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## Box 4.2      **Freedom of the air**

**First freedom** — the right of an airline of one country to fly over the territory of another country without landing.

**Second freedom** — the right of an airline of one country to land in another country for non-traffic purposes such as refuelling or maintenance, while en route to another country.

**Third freedom (to)** — the right of an airline of one country to carry traffic (passengers, cargo or mail) from its country to another country.

**Fourth freedom (from)** — the right of an airline of one country to carry traffic from another country to its own country.

**Fifth freedom (intermediate and beyond)** — the right of an airline of one country to carry traffic between two other countries providing the flight originates or terminates in its own country.

**Sixth freedom** — the right of an airline of one country to carry traffic between two other countries via its own country. A sixth freedom is effectively a combination of two sets of third and fourth freedoms. Sixth freedom rights are not typically regulated in bilateral arrangements.

**Seventh freedom** — the right of an airline of one country to operate flights between two other countries without the flight originating or terminating in its own country.

**Eighth and ninth freedoms (cabotage)** — the right of an airline of one country to carry traffic between two points within the territory of another country either as part of a flight that originates or terminates in the home country of the carrier (consecutive cabotage), or as part of a stand-alone flight in the another country (stand-alone cabotage).

*Sources:* ICAO (2014); PC (1998).

Another example of a regional agreement is the Multilateral Agreement on the Liberalisation of International Air Transportation signed in 2001 by Brunei Darussalam, Chile, New Zealand, Singapore and the United States, and later joined by the Cook Islands, Mongolia (cargo only), Samoa, and Tonga. Key features of the agreement include open traffic rights, including seventh freedom cargo services, open capacity and frequency, multiple airline designation, third-country code sharing, and relaxation of restrictions on airline ownership (but not control) requirements. The agreement contains an optional protocol allowing parties to exchange seventh freedom passenger and cabotage rights — Brunei, New Zealand and Singapore have signed this protocol (ICAO 2013c; Kiser 2003).

There have also been moves to develop a regional agreement in the Asia-Pacific region, with the ten-member Association of Southeast Asian Nations (ASEAN) setting a 2015 target to establish a single aviation market.<sup>6</sup> ASEAN's first international aviation agreement as a bloc was with the People's Republic of China, which entered into force in 2011 (ASEAN 2014). The agreement provides third, fourth and fifth freedom rights. The intention was that this agreement would supersede the bilateral agreements between

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<sup>6</sup> ASEAN member states are Brunei Darussalam, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

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individual ASEAN countries and China. The agreement is currently in force among China, Singapore, Malaysia, Thailand, Myanmar and Vietnam, with other ASEAN nations having the right to sign onto the agreement when ready (CAPA Centre for Aviation 2013). Although there have been international efforts to liberalise international air services, restrictions on traffic rights, capacity, designation and ownership remain. In general, restrictions on airlines limit competition in international air services, with consequential effects on passengers, the tourism industry and the broader economy (box 4.3).

#### **Box 4.3 Economic effects of international air services regulation**

International air services regulation affects where airlines fly, the number and frequency of flights they operate, what aircraft they use, and their ownership and access to sources of equity. Regulations influence the nature of competition among airlines through controls on market entry, and the quantity and type of rights allocated to particular airlines. To the extent that more competition between airlines would occur in the absence of regulation, restrictions decrease economic efficiency by raising the price of air travel, reducing the range and quality of services offered, and discouraging innovation and cost minimisation.

The regulatory system also affects an airline's costs. Operating costs are affected by controls on where airlines can fly and how many flights they can provide. These affect airlines' ability to operate efficient networks and reduces potential revenue from operating additional services. If airlines cannot use least-cost combinations of aircraft types, the costs of carrying passengers are likely to be higher than they otherwise might be (technical efficiency). Further, airlines may be prevented from flying the optimum-sized and configured network (allocative efficiency).

A number of features of international air services arrangements restrict the development of efficient networks, including capacity constraints (particularly on third and fourth freedoms), and lack of fifth and seventh freedom rights, which prevent the development of overseas hub operations. Restrictions on capacity may also prevent airlines from responding to changes in market conditions (dynamic efficiency). For example, capacity restrictions may deter airlines from making investments in additional, or larger, aircraft in anticipation of a rise in demand for international air services.

Factor costs (labour and capital) may also be affected if regulations shield airlines from competition, resulting in higher-than-normal returns to labour and capital, and poor productivity.

Higher costs and restricted competition mean that prices for air services are higher than they otherwise might be. These effects are felt by:

- passengers, whose total costs of travel vary with the level of airfares and the range and quality of services offered
- the Australian international tourism industry, which is reliant on efficient international air services for the transportation of visitors to and from Australia
- users of international air freight services, whose competitiveness varies with the level of air freight charges and the range and quality of services offered
- the economy as a whole.

The overall effect of the regulations on the Australian community is determined by the balance of these costs across the economy.

*Source:* PC (1998).

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The International Civil Aviation Organization has stated that although momentum is building toward further liberalisation, some countries remain reluctant to endorse full liberalisation of markets or to go beyond the bilateral approach toward a multilateral arrangement. It points to a number of factors impeding liberalisation including a lack of awareness of, or confidence in, the benefits of market opening, a lack of political will by some governments, and in some cases, the influence of some airlines over government decision making (ICAO 2013a).

## **Australia's international aviation policy**

Australia's international aviation policy has changed significantly over the past 25 years. The interests of Qantas (as Australia's national airline) were the predominant factor guiding international aviation policy for many years. This changed in 1989 when the Australian Government signalled an approach to international air services that involved an analysis of the interests of Australia as a whole as the dominant consideration (PC 1998). A number of reforms to both domestic and international aviation policy were implemented over the following years, including domestic deregulation and privatisation of airlines and airports, multiple designation of airlines, and some liberalisation of Australia's international air services arrangements (box 4.4).

The Australian Government has negotiated air services arrangements with 94 economies in recent decades (DIRD, comm. 22). This includes an open skies agreement with the United States and a single aviation market with New Zealand. The Australia–New Zealand single aviation market provides unrestricted capacity between airports and up to eighth freedom traffic rights. Seventh freedom rights are only available for cargo services. The Australia–United States open skies agreement, signed in 2008, provides unrestricted capacity between airports and up to fifth freedom traffic rights for passenger services and seventh freedom rights for cargo services. Australia also has open capacity arrangements with a number of countries, including with Japan, Singapore, Switzerland and the United Kingdom. These arrangements involve up to fourth freedom traffic rights, and expansive (but not unrestricted) fifth freedom rights. Other arrangements provide market access within predetermined entitlements, which usually involve limitations on capacity and fifth freedom traffic rights. In most cases, open capacity is provided to all international airports in Australia outside the major gateway cities of Brisbane, Melbourne, Perth, and Sydney — this is referred to as the regional package (discussed further below).

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#### **Box 4.4 History of Australian international aviation policy**

Prior to 1989, Australia's international aviation policy was based on strict separation of the international and domestic aviation sectors, with government ownership of airlines in both sectors. Qantas was designated as Australia's national carrier and there was tight regulation of both domestic and international aviation. Several significant changes to air services policy beginning in the 1990s resulted in changes to the structure, efficiency and competitiveness of the Australian international air services market.

##### **Domestic deregulation and privatisation**

The 'two airline' policy (established in 1952) favouring Ansett Airlines and the government-owned Australian Airlines ceased in 1990. This enabled entry of other airlines, such as Compass in 1990-91 and, later on, Virgin Australia. In 1992, the Australian Government also removed restrictions on equity investments between domestic and international operators, which led to the merger of Qantas and Australian Airlines and the integration between domestic and international networks. The Australian Government also decided to fully privatise the Qantas Group (with restrictions on foreign and airline ownership), which occurred in 1993.

##### **Multiple designation of airlines**

Prior to 1992, Qantas was Australia's only international airline. This restricted the ability of other existing and potential carriers to compete for capacity as an Australian international carrier. Multiple designation of airlines in 1992 enabled the emergence of new Australian international airlines. This also necessitated a process for allocating capacity to Australian airlines on particular routes. The International Air Services Commission was established for this purpose in 1992.

##### **Australia–New Zealand Single Aviation Market**

The single aviation market has been in place since 1996, and the Australian and New Zealand governments signed an Open Skies Agreement in August 2002. This agreement enables airlines from either country to operate between Australia and New Zealand without regulatory restrictions on capacity, frequency and routes. It also enables them to operate without these regulatory restrictions within both countries and to third countries on routes with an origin or destination in the home country.

##### **Privatisation of Australian airports**

In 1997, the Australian Government began privatising the 22 airports then operated by the Federal Airports Corporation, concluding with the sale of Sydney Airport in 2002. By breaking up the Federal Airports Corporation network and increasing focus on individual but overlapping markets, privatisation has seen airports become active proponents of air services liberalisation as they have sought to increase throughput and diversify and expand their airport activities, as well as provide necessary infrastructure from private rather than public financing sources.

*Sources:* Australian Productivity Commission and New Zealand Productivity Commission (2012); PC (1998, 2011a).

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Following a Productivity Commission inquiry into International Air Services in 1998, the Australian Government announced its intention to pursue four main strategies relating to international air services. These strategies were to:

- negotiate reciprocal ‘open skies’ style arrangements where these are assessed to be in the ‘national interest’<sup>7</sup>
- seek the most liberal arrangements possible where an open skies arrangement cannot be negotiated, or is not in the national interest. In these circumstances, Australia would offer, within negotiated capacity, all bilateral partners unrestricted rights for foreign airlines to code share on Australian domestic airlines and carry their own stopover traffic to all points in Australia. Also offered was the regional airports access package that includes unrestricted direct route access, and unlimited capacity for all designated international airports other than Sydney, Melbourne, Brisbane and Perth
- support and promote multilateral reform of international aviation in international forums, including the WTO, to further promote liberalisation of the aviation industry
- consider other options of a liberal nature on a case-by-case basis, to assist the continued development of a healthy, competitive international aviation environment (Anderson 2000).

These strategies are broadly consistent with those outlined in subsequent aviation policy statements, including the Australian Government’s 2006 review of international air services policy (Truss 2006), and the 2009 Aviation Policy White Paper (Australian Government 2009). Current international aviation policy (as outlined in the Coalition’s 2013 election policy for aviation) is to: increase global aviation liberalisation while recognising the need to protect the national interest; support the entry of Australian airlines into foreign markets and negotiate to remove barriers that prevent access; and prioritise bilateral air services agreements to ensure aviation capacity necessary to meet future demand (Coalition 2013).

The objective of international aviation policy has also been broadly consistent across policy statements since 2000. The objective as outlined in the 2009 Aviation Policy White Paper is ‘an open and competitive international aviation market that serves the national interest by benefiting tourism, trade and consumers, allows Australian and overseas airlines to expand, and maintains a vibrant Australian-based aviation industry’ (Australian Government 2009, p. 40).

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<sup>7</sup> Open skies arrangements were defined as those which remove restrictions on: capacity and frequency, to, from, between and beyond Australia and its trading partners; code sharing on each other’s airlines; the routes to be operated, including points of access in both countries, as well as access to third-country markets; multiple designation of airlines; and pricing.

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## 4.4 Australian international aviation policy issues

A number of issues have been raised regarding Australia's international aviation policy, both during consultations for this project, as well as in other forums, including the Australian Government's Competition Policy Review. The main issues raised are discussed in the following subsections and relate to:

- insufficient international aviation capacity to and from Australia
- concerns that the application of Australia's international aviation policy has been detrimental to the interests of the Australian domestic tourism industry, the Australian aviation industry, and the national economy as a whole
- the transparency of the process used by the Australian Government to prioritise and negotiate international air services arrangements, including the approach used to assess what is in the national interest.

During consultations it was also suggested that current international aviation policy presumes that liberalisation of air services arrangements must be bilateral, rather than unilateral. Unilateral liberalisation would involve Australia removing restrictions on foreign airlines' access to Australian airports without the arrangements being reciprocated through an air services arrangement with the airlines' home country.

Over the past four decades, Australia has gained significant economic benefits as a result of unilateral reform in other sectors, which involved reducing domestic trade barriers, in some cases without the use of specific international engagement. The main benefits that arise from trade liberalisation result from a country purchasing its inputs and final goods from the lowest-cost sources of supply, and exposing its industries to greater import competition by reducing its own trade barriers. This creates a competitive environment that drives productivity and a more efficient utilisation of resources within the economy. Although unilateral trade liberalisation in other goods and services markets has been found to be beneficial without regard to others' reforms, the greatest gains accrue from reduction in trade barriers on a multilateral basis (PC 2010b).

It is not necessarily the case that unilateral reform of international air services would generate net benefits to Australia whilst international aviation is dominated by the current bilateral system. As noted earlier, without negotiated bilateral (or multilateral) arrangements, a country's airlines cannot operate international air services, either for the residents of the airline's home country or for residents of other countries. Each country is also responsible for designating its airlines that receive the rights and capacity to operate international air services. Thus, there is a risk that if Australia were to unilaterally liberalise its air services arrangements, Australian airlines may not be able to expand their networks and services elsewhere (beyond the extent of access allowed under existing bilateral arrangements). Australia's bilateral partners would be able to control additional capacity on Australian international routes, both for Australian airlines as well as the airlines of the home country and airlines from third countries seeking to operate services to Australia via another country. This could have negative consequences for the Australian

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community if it led to a reduction in choice and quality of air services for passengers on particular routes.

As long as international aviation is dominated by the bilateral system, the greatest scope to achieve net benefits for the Australian community is likely to come from further liberalisation within the bilateral framework, with the Australian Government continuing to work toward a multilateral approach to liberalisation in relevant international forums.

## **International aviation capacity**

Aviation capacity into and out of Australia has grown significantly over the past two decades, from just under 15 million available seats in 1991-92 to over 40 million available seats in 2013-14 (chapter 2). Despite this, a number of stakeholders have pointed to a lack of capacity on some key routes as an impediment to growth in international air services (Austrade, comm. 19; Australian Airports Association, comm. 26; Perth Airport, comm. 31; Sydney Airport, comm. 27).

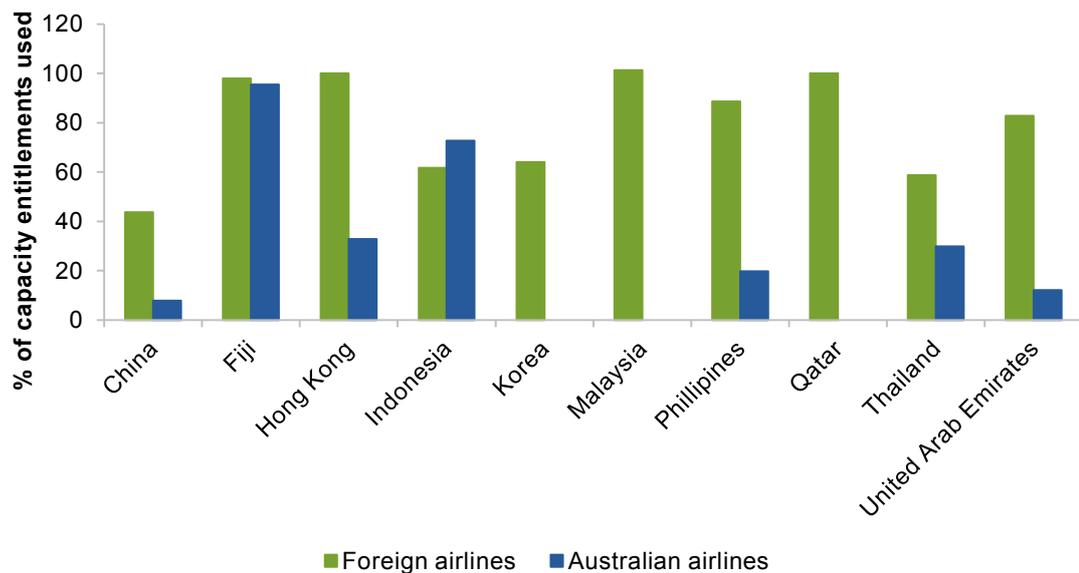
### **Is there a constraint on international aviation capacity into and out of Australia?**

In some markets, international airlines are constrained from increasing supply to and from Australia's major gateway cities (Brisbane, Melbourne, Perth and Sydney). Figure 4.3 shows the proportion of capacity entitlements expected to be used by international airlines between October 2014 and March 2015 for Australia's largest uplift/discharge countries by passenger traffic. As at October 2014, there were no capacity entitlements left for airlines from Hong Kong, Malaysia and Qatar wishing to operate additional services to and from Australia's major gateways. There were also limited capacity entitlements available for foreign airlines from Fiji and the Philippines seeking to operate additional services to and from Australia's major gateways.

Capacity entitlements can also be constrained during peak periods. For example, China exhibits strong seasonal characteristics with a high level of travel over the Chinese New Year period (CAPA Centre for Aviation 2011). In 2014, Chinese airlines were given approval by the Australian Government to exceed their weekly seat number entitlements throughout February 2014 to meet increased visitor demand associated with the Chinese New Year period in Australia (Truss and Robb 2014).

Figure 4.3 **International aviation capacity expected to be used as a proportion of capacity entitlements, October 2014 to March 2015<sup>a</sup>**

Australia's largest uplift/discharge markets by passenger traffic<sup>b</sup>



<sup>a</sup> Capacity entitlements indicate the number of flights or seats foreign airlines are entitled to operate under the relevant bilateral air services arrangement. Capacity used indicates the maximum scheduled capacity based on the 2014-15 Northern Winter timetable (October 2014 to March 2015) and does not necessarily reflect the number of seats filled. Capacity entitlements for China are separated into two dedicated pools. The first pool (26 500 weekly seats) is for services between Australia's major gateways and China's major gateways (Beijing, Shanghai, Guangzhou) — around 79 per cent of these entitlements are currently in use by airlines from China. The second pool (also 26 500 weekly seats) is for services between Australia's gateways and all other cities in China — around 8 per cent of these entitlements are currently in use by airlines from China. <sup>b</sup> Data are provided for the 15 largest uplift/discharge markets. There are five countries within these markets where Australia has in place open capacity or open skies arrangements and hence there are no capacity constraints — these are the United Kingdom, the United States, New Zealand, Singapore and Japan.

Sources: DIRD (comm. 22; pers. comm, 23 December 2015 and 9 February 2015); Truss (2015).

The Department of Infrastructure and Regional Development (comm. 22, p. 3) (the agency responsible for administering and negotiating Australia's international air services arrangements) has indicated that it is aware of the capacity constraints in the bilateral arrangements with the countries outlined in figure 4.3, and 'in accordance with Government policy, actively prioritises consultations with relevant foreign governments'. An agreement with China was announced by the Australian Government on 23 January 2015, which more than doubled capacity entitlements for Australian and Chinese airlines (this additional capacity is reflected in figure 4.3). Further capacity increases are scheduled for October 2015 and October 2016 (Truss and Robb 2015). Prior to this agreement, capacity was constrained for Chinese airlines flying to and from Australia's major

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gateways. The Australian Government has also secured a commitment from authorities in Malaysia and Qatar to hold formal air services talks during 2015 (Robb 2014a).

In other markets (including Indonesia, Korea and Thailand, figure 4.3) capacity entitlements are not being fully used either by foreign airlines or Australian airlines, although in most cases there is significantly more unused capacity for Australian airlines than there is for foreign airlines. Capacity is also unrestricted for international airlines wishing to access any Australian airport under the bilateral arrangements with Japan, New Zealand, Singapore, Switzerland, the United States and the United Kingdom. The regional package also provides foreign airlines with unlimited capacity to any Australian international airport other than those in the major gateway cities.

There is also room within almost all of Australia's bilateral arrangements with the countries shown in figure 4.3 for Australian airlines to increase capacity to and from those countries. Some participants suggested that it was unlikely that Australian international airlines would seek to considerably expand their international networks, and that this was evident from the recent trend of Australian airlines rationalising their international operated networks and becoming more reliant on partnerships and alliances to grow their international presence through virtual networks or code share access (Austrade, comm. 19; North Queensland Airports Group, comm. 15; Tourism Western Australia, comm. 8). Australian international airlines have withdrawn services from a number of markets. For example, in mid-2014 Qantas announced the withdrawal of its Perth to Singapore service, which was its last remaining year-round international service from Perth Airport.

### The consequences of regulatory restrictions on capacity

The effects of regulatory restrictions on capacity (supply) depend on the extent to which capacity constraints are binding, or potentially binding. Where capacity is constrained by air services arrangements, airlines cannot choose to operate additional services to and from Australia's four major gateways in response to actual or anticipated growth in demand. Further, where capacity is expected to soon be constrained airlines will not choose to operate additional services. Capacity restrictions may also prevent new airlines from entering the market if there are insufficient capacity entitlements available to warrant servicing the route. These effects could result in higher prices for international flights to and from Australia and constrain the growth of Australian international tourism (where demand exceeds capacity entitlements).

Commercial decisions made by airlines should not be mistakenly attributed to restrictions within bilateral arrangements. It could be the case that airlines may not be offering services (or may be offering limited services) because it is not in their commercial interests to increase supply (box 4.5).

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#### Box 4.5 **Factors that affect the commercial decisions of airlines**

Determining what air routes to service and what level of capacity to provide is a very complex decision driven by a number of factors (in addition to available capacity within bilateral arrangements), including:

- demand for services from passengers. A route will not be commercially viable if there is insufficient (current and projected) inbound and outbound demand. For example, Cairns Airport's reliance on inbound tourism has presented an obstacle to attracting new international services to the airport over the past decade (North Queensland Airports Group, comm. 15). The commerciality of a route may also be affected by seasonality in demand which may mean that a route cannot be sustained all year round. Holiday travellers have more seasonal patterns of demand, and their demand for air travel is more sensitive to changes in price than business travellers (Smyth and Pearce 2008). Thus, a broad mix of passenger types (holiday, business and visiting friends and relatives) may be required
- the destination's geographic position in respect of a potential route and whether the required aircraft and airport infrastructure match. For example, growth in international air services at Darwin Airport has been the result of its geographic location in reach of short-haul narrow-body aircraft from major Asian hubs (Airbiz Aviation Strategies 2012; North Queensland Airports Group, comm. 15)
- the relative profitability of alternative network configurations
- regulations, such as airport curfews and maximum aircraft movement limits (caps), which can affect an airport's ability to cope with increased demand for airport services from airlines
- insufficient airport capacity which can limit growth in international air services. For example, airport capacity is currently an issue at some airports, including Sydney Kingsford Smith Airport and Brisbane Airport, although some of these constraints are being addressed. The Australian Government has confirmed the development of a second international airport in Sydney to be located at Badgerys Creek, with construction expected to begin in 2016 (Truss 2014). Brisbane Airport is also currently developing a new parallel runway to meet significant expected growth in passenger numbers
- government support, such as government grants for joint marketing with airlines, and other incentives for airlines to operate to particular destinations (including from airports) (chapter 3).

### **The application of Australia's international aviation policy**

In a written contribution to this study, Qantas (comm. 33) suggested that the Australian Government's policy of negotiating capacity ahead of demand (discussed further below) has resulted in the emergence of negative and unintended effects. Qantas considers that an increase in capacity for the purpose of promoting inbound travel has instead promoted outbound travel as inbound travel failed to materialise. It suggested that the rapid growth in outbound travel has resulted in a tourism trade deficit, with jobs and investment being exported to competitor destinations to the ultimate detriment of Australia's tourism industry and Australian airlines. It submitted that the primary focus of bilateral negotiations 'beyond those involving the strategic hubs [for example in Hong Kong],

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should be end-to-end traffic (i.e. third–fourth freedom services) to support inbound tourism’ (p. 8).

The Commission does not share Qantas’ view. An imbalance between outbound and inbound tourism does not represent a net cost to the Australian community. There are welfare benefits associated with Australian residents travelling abroad, particularly if they are able to travel at a lower cost and access more frequent air services to a wider range of destinations. Further, it is not necessarily the case that Australians would instead travel domestically if they were not taking international trips. The decision depends on the travellers’ preferences, or business needs, for international travel compared with domestic travel, and whether domestic travel provides greater benefits than purchasing other goods and services.

In any case, the Commission considers that the objective of international air services arrangements should be to enhance the welfare of the Australian community as a whole rather than to protect or promote any particular industry or commercial interests.

## **The process for negotiating air services arrangements**

In preparation for bilateral air services talks, the Department of Infrastructure and Regional Development undertakes consultation with a range of stakeholders, including the tourism and aviation industries, state governments, exporters and importers, airport operators and other government agencies, including the Department of Foreign Affairs and Trade and Austrade (DIRD 2014c; comm. 22). The Department of Infrastructure and Regional Development (comm. 22) has indicated that advice from these consultations is taken into account in developing a proposed negotiating mandate that reflects Australia’s national interest and the Australian Government’s policy settings.

The Tourism Access Working Group (established under the 2009 National Long-Term Tourism Strategy) also provides a forum for aviation issues to be discussed. The working group is co-chaired by the Australian Government Ministers for Infrastructure and Regional Development and for Trade and Investment, and members include representatives from tourism industry groups, airports and airlines.

### **Assessing the national interest**

Australia’s policy goal for international aviation has sought to balance the interests of the Australian aviation industry and the broader community (Australian Productivity Commission and New Zealand Productivity Commission 2012). This is evident from aviation policy statements mentioned above that refer to open and competitive international aviation markets that serve the national interest by benefiting tourism, trade, consumers and the aviation industry. The Department of Infrastructure and Regional Development also notes that:

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A key aspect of this assessment [of the national interest] (and indeed during the negotiations themselves) is to ensure Australian airlines have a comparable opportunity to compete in foreign markets and to allow them greater flexibility in operating services and building their strategic alliances. As a result, Infrastructure pursues a holistic approach to market deregulation that does not focus exclusively on short-term tourism priorities, such as ‘securing’ a new air service on a specific route. (comm. 22, p. 5)

Assessing whether policy options that seek to achieve more open aviation markets are in the national interest involves weighing up a range of potentially competing costs and benefits. This assessment should not give undue weight to any particular group, and as noted recently by the panel of the Australian Government’s Competition Policy Review, ‘air service agreements should not be used to protect Australian carriers from competition’ (Australian Government Competition Policy Review 2014, p. 116). As noted above, the ultimate objective of the process of assessing the national interest should be to enhance the welfare of the Australian community as a whole.

Some participants to this project suggested that the Australian Government’s approach to negotiating air services arrangements lacks transparency and it is unclear how the national interest is determined (Sydney Airport, comm. 27). Austrade is a representative on Australia’s air services negotiating delegation and seeks to ensure tourism concerns and interests are appropriately considered during negotiations. It indicated that tourism stakeholders have in the past expressed a desire for greater transparency from the Australian Government in relation to information on how the national interest was derived and the dialogue that occurred during negotiations (Austrade, comm. 19).

Sydney Airport (comm. 27) suggested that Australian airports that are subject to air services restrictions should be invited to attend negotiations regarding air services arrangements (as Australian airlines are). It also suggested that industry be allowed a greater level of involvement in the determination of priorities and ability to shape the strategy in negotiating air services arrangements. Virgin Australia (comm. 16) stated that, based on its experience as a member of the Australian Government delegation at many bilateral air services negotiations, the Department of Infrastructure and Regional Development effectively balances the interests of all stakeholders and extracts the maximum value from the (often limited) leverage it holds.

The consultation and negotiation process outlined above should involve representation from all relevant stakeholder groups. This would help to ensure that the range of potential costs and benefits from changes to air services arrangements are adequately taken into account. A suggested approach for improving transparency and outcomes relating to negotiating air services arrangements is discussed further below.

### Negotiating capacity ahead of demand

A key feature of the Australian Government’s international air services policy framework has been to seek to ensure that capacity available to foreign and Australian airlines under

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Australia's bilateral arrangements remains ahead of demand. The purpose of this approach is to ensure that growth is not constrained and airlines can plan for long-term expansion in the Australian market (Australian Government 2009).

A number of participants suggested that a lack of capacity within some bilateral arrangements was constraining international air services and limiting competition on a number of routes, including those between Australia's major gateways and Malaysia, the Philippines, Hong Kong and Qatar. For example:

- Sydney Airport has suggested that a lack of capacity in the Australia–Malaysia bilateral arrangement has blocked an increase in foreign airline capacity into Australia, which has limited competition between airlines. It also suggested that a lack of capacity to operate under the Australia–Philippine bilateral arrangement has prevented the introduction of further competition on various routes between Australia and the Philippines (Sydney Airport Corporation 2014; comm. 27)
- Perth Airport (comm. 31, p. 6) also suggested that for Philippines' airline Cebu Pacific to implement all of its planned capacity over the next few years, the bilateral rights would likely need to triple from current levels. It also suggested that because the Australia–Hong Kong bilateral arrangement was fully utilised on the Hong Kong side, there is no scope for Cathay Pacific to increase frequency to Perth without reducing frequency in one of Sydney, Brisbane or Melbourne
- Austrade (comm. 19) suggested that constraints in the existing arrangements with Hong Kong are not only impeding Cathay Pacific's opportunity to grow its presence in the Australian market, but are also preventing new entrant Hong Kong Airlines from applying for a capacity allocation that would permit it to commence services to gateway airports.

As noted above, capacity constraints within bilateral arrangements limit the ability of airlines to respond to actual or expected changes in market conditions and demand for air services. Airline decisions to invest in new services (including investing in new aircraft) involve considerable lead times and require certainty that capacity entitlements will be available. For the policy of negotiating capacity ahead of demand to be effective it must result in capacity entitlements being increased prior to when demand is expected to increase. An understanding of the trends and expected changes in the number of international visitors from specific countries (chapter 2) is necessary to inform the Australian Government's decisions regarding capacity increases.

### Factors that may impede negotiations

The bilateral system works on the basis of negotiation. In some cases, negotiating traffic rights and capacity entitlements may largely depend on whether the airlines of the bilateral partner will benefit from the use of these. For example, there may be instances where Australian airlines may obtain value from operating more services into a country but the airlines of that country may not obtain value from operating additional services into

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Australia (and vice versa). In this case, the bilateral partner may have little incentive to negotiate increased rights for Australian airlines, and as a result Australia may have little leverage to generate benefits for the Australian community.

An inability to negotiate capacity increases may, in some cases, be attributable to an unwillingness to negotiate on the part of the bilateral partner, rather than the unwillingness of the Australian Government. The difficulty of negotiating with bilateral partners was recently highlighted by the Secretary of the Department of Infrastructure and Regional Development in the context of its previous attempts to negotiate air services arrangements with government authorities in China:

Tourism and airport stakeholders argue strongly, and have for some time, that Chinese carriers need increased capacity entitlements so they can increase services to Australia ... However, while my Department has sought numerous times over recent years to schedule talks, Chinese Authorities have yet to accept our long-standing proposal to hold a new round of talks ... Looking at the capacity available and the current utilisation, you can see why expanding the air services arrangements from the Australian market does not have the same level of priority for the Chinese ... There were just over 2 million seats available in the Australia-China market over the past year, with around 75 per cent load factor – that equates to almost half a million empty seats over the year. (Mrdak 2014, p. 10)

There may also be instances where the Australian Government may wish to obtain non-capacity related traffic rights for Australian airlines before it will grant additional capacity entitlements for foreign airlines to fly to and from Australia. These may include code share or fifth freedom rights for Australian airlines. An example of this is the Australian Government seeking to obtain rights for Australian airlines to use Hong Kong as a hub. Qantas (comm. 33, p. 7) suggested that negotiated capacity increases in Australia's air services arrangements with Hong Kong have in previous years 'effectively removed the leverage needed to ensure Australian carriers have reciprocal access to the benefits of Hong Kong's extensive hub network'. Code share rights may also be valuable for Australian airlines. Virgin Australia (comm. 16, p. 4) suggested that 'in some cases, foreign carriers are seeking increased access to the Australian market for own-aircraft operations, while at the same time being unwilling to concede rights which would enable Australian airlines to offer code share services to their country'.

There may be benefits (in terms of increased profits) to Australian airlines (or airlines' shareholders) from arrangements that allow airlines to extend their networks using fifth freedom and code share rights. There may also be benefits for Australian passengers wishing to travel on Australian airlines that would not otherwise be able to operate to these destinations if rights were not granted. However, the benefits of this type of negotiating strategy need to be carefully weighed against the costs to the Australian community of delaying increased capacity. These costs include a potential delay in additional services to and from Australia by foreign airlines, and as a consequence, foregone benefits to Australian passengers from additional (and potentially lower cost) services, as well as foregone benefits from increased tourism to Australia.

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There is scope for greater rigour and transparency to be injected into the process. Cost–benefit analysis (chapter 3), is the most appropriate way of assessing whether Australian international aviation arrangements (and any changes to arrangements) are in the national interest. Cost–benefit analysis can be used to estimate the net benefits to the community as a whole resulting from changes in aviation policy and regulation. It allows information to be analysed in a logical and consistent way and encourages decision makers to take into consideration all costs and benefits of a policy option, rather than making decisions based on selected effects on a particular industry or community group. Making cost–benefit analyses public — for example, through existing aviation consultation processes (discussed above) — would strengthen the incentives for decision makers to focus on the overall net benefits of policy options and allow particular assumptions and estimates to be debated and tested (PC 2014c).

Decisions and outcomes could be improved with greater use of transparent cost–benefit analysis, which includes a clear statement from the Australian Government about how it assesses the aggregate national interest when negotiating international air services arrangements, including what factors are considered (such as the benefits to the community of outbound travel) and how any trade-offs are made when balancing the interests of different stakeholders, such as airlines and consumers. This would help to boost the confidence of stakeholders that the range of costs and benefits from different options are being appropriately weighed, and that decisions are being made in the interests of Australia as a whole.

## **4.5 Is there scope for further liberalisation?**

Whether liberalisation of air services arrangements (within the bilateral system) would deliver net benefits to the Australian community depends on the extent to which existing arrangements are constraining market behaviour. For example, there are unused capacity entitlements within some of Australia’s bilateral arrangements (section 4.4) — suggesting that additional capacity would have limited commercial value unless the constraint was expected to be binding in the near-term. Liberalisation of these restrictions would therefore have little effect. In other cases, however, capacity limits do appear to be binding and could be impeding more efficient market outcomes from occurring.

In principle, by reducing constraints on market entry and controls on airlines’ capacity and access to particular routes, liberalisation provides scope to increase competition and achieve higher throughput (international passenger traffic). Greater competition could enhance economic efficiency by encouraging airlines to reduce their costs, including by operating networks more efficiently, and to innovate and expand services. Existing and new passengers would benefit from any lowering of airfares and from greater choice of airlines and/or air services. These benefits flow both to people travelling to Australia from other countries but also to Australians travelling abroad, whose welfare is improved from being able to travel at a lower cost and/or from better quality and more frequent services to a wider range of destinations. Liberalisation may also deliver wider benefits to other parts

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of the economy, including by stimulating inbound tourism activity, and benefiting the many other industries that rely on air services to transport freight or passengers.

The potential costs associated with liberalisation include a loss of future negotiating power on the part of the liberalising government, although this would depend on the scope of further liberalisation, and the extent to which Australian airlines are seeking to expand their services (discussed below). Greater competition and lower fares may also contribute to a potential loss of profits for Australian airlines if they are not able to maintain their position in the market — although some of these lost profits would be borne by shareholders from other countries depending on the extent of foreign ownership. Any loss of profits from a reduction in airfares arising from competition is likely to be offset by the increase in consumer surplus from the fare savings flowing to existing travellers and from additional passengers being able to access air services due to the lower fare. Additional passenger traffic may also partially offset any loss of profits of Australian international airlines.

As noted earlier, the greatest gains to the Australian community are likely to be achieved through further liberalisation of international air services on a bilateral or multilateral basis. Successive Australian Governments have, for more than a decade, had a policy of liberalising Australia's international air services arrangements, including by establishing open skies arrangements, and seventh freedom passenger and cargo rights on a case-by-case basis when these are considered to be in the national interest. Participants to this project have emphasised the importance of continued liberalisation towards open skies (Queensland Government, comm. 21; Tourism Western Australia, comm. 8). As a general rule, the policy of liberalisation has not included cabotage, although the 2009 Aviation White Paper noted that the Government would consider granting cabotage rights strategically where demonstrable benefits can be gained, and provided safety and other concerns are satisfied (Australian Government 2009).

The draft report of the Competition Policy Review suggested that there would likely be considerable benefits flowing from the removal of cabotage restrictions on remote and poorly served domestic routes and that the current blanket cabotage restrictions for air services are inefficient. It considered that cabotage restrictions be removed unless they can be shown to produce outcomes that are in the public interest and those outcomes can only be achieved by restricting competition (Australian Government Competition Policy Review 2014).

In the Commission's 1998 review of international air services, it suggested that allowing foreign carriers some cabotage rights could increase competition and stimulate improvements in efficiency in the Australian domestic market. It also noted that it was unlikely that consecutive cabotage (domestic carriage on a domestic leg of a foreign airline's international flight) would lead to substantial efficiency gains. It noted that one of the disadvantages of consecutive cabotage was the inconvenience of travelling with an international carrier for domestic travel — including poor frequency of service, delays associated with international flights, and poor connections — which could limit the market

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appeal of this type of service, at least for business and full economy passengers. The Commission suggested that cabotage should not be specifically excluded from Australia's open skies negotiations, but should be considered on a case-by-case basis (PC 1998). The Commission has not been presented with sufficient evidence during the course of this project to move away from this position. The Commission also notes that cabotage rights are available to airlines from Australia and New Zealand under the Single Aviation Market agreement (discussed earlier) and that these rights are rarely used.<sup>8</sup>

As an intermediate step, where further liberalisation through open skies or open capacity arrangements cannot be agreed, the Australian Government could extend the regional package and allow foreign airlines to access some or all of Australia's major gateway airports on an unrestricted basis. This option is discussed below.

### **Access to regional international airports by international airlines**

Australia's international aviation policy includes a regional package that provides unlimited direct route access and capacity (that is, open third and fourth freedom capacity) for all designated international airports in cities (regional gateways) other than Sydney, Melbourne, Brisbane and Perth.

The 2009 Aviation White Paper referred to the regional package as a policy 'designed to spread the benefits of international tourism more broadly across Australia, and in particular to regional centres' (Australian Government 2009, p. 45). It noted that, up to that point, few foreign airlines had taken up the opportunity to operate to a regional airport and acknowledged that it is often not commercially viable for an airline to do so. As an additional incentive for foreign airlines to operate to regional airports, the Government amended the regional package so that the capacity of airlines servicing major gateways would not be counted provided that these airlines operate via or beyond to a regional airport (this is sometimes referred to as triangulation). For example, if a foreign airline operates a flight to Sydney via Cairns, this flight would not be counted against the capacity entitlements of that airline's government (up to a limit).

There has been limited take up of the incentives in the regional package. Tourism NT (comm. 6) suggested that the regional package has had very limited effect on the Northern Territory and suggested that the policy required reform to meet its intent of supporting Darwin and Cairns in attracting foreign carriers. The South Australian Tourism Commission (comm. 7) suggested that Adelaide Airport's status as a regional airport brings the strategic advantage of being able to participate in the regional package in situations where bilateral negotiations fail to deliver supply of seat capacity ahead of demand.

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<sup>8</sup> Australia also allows up to 100 per cent foreign ownership of its domestic airlines.

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In 2012, the Tourism Access Working Group commissioned a review into the regional package to investigate the reasons behind its limited uptake by foreign airlines. The review found that the package in itself is not a sufficient reason for an airline to begin a new route as airlines will only decide to fly to a region if the business case to do so is commercially viable (Airbiz Aviation Strategies 2012). This is consistent with the views expressed to the Commission by participants in this project.

The review also suggested that the triangulation aspect of the regional package reduces the overall profitability of a route. In particular, it was stated that ‘triangulation without cabotage results in a “dead leg” for the short sector of any route with a stopover, making the overall route unviable’ (Airbiz Aviation Strategies 2012, p. 10). The Commission considers this aspect of the regional package to be a second best option to expanding capacity entitlements for foreign airlines seeking to access Australia’s major gateways. It could result in an inefficient allocation of international air services within the Australian airport network if airlines choose to use it to access major gateways that they are otherwise unable to access due to capacity constraints within bilateral air services arrangements.

The regional package should not be viewed as one of regional development but rather as a policy of liberalisation of air services aimed at enabling airlines to make commercial decisions about what routes to fly to and from Australia. Consideration of any extension of the package to the airports in the major gateways should be undertaken with this in mind.

### **Should the regional package be extended to other airports?**

In the absence of further liberalisation of air services arrangements (for example, through open skies or open capacity arrangements), it is expected that further liberalising access to Australia’s major gateway cities would provide net benefits to the international tourism industry and the Australian community. Extension of the regional package to some or all of Australia’s major gateway airports could result in greater international tourism and benefits to Australians wishing to travel overseas.

In commenting on the constraints on major gateway airports in Australia’s air services arrangements, Brisbane Airport Corporation (comm. 30, p. 5) suggested that:

... to the extent that limits on international air rights under Air Services Agreements are retained by the Commonwealth as protection for the local carrier, Qantas Airways, the rationale for Brisbane to be captured within the constraints is questionable in the context of Qantas’ increasing focus on Sydney as the hub for its international services.

Perth Airport (comm. 31) commented that as it was the smallest of the four gateways it was usually the fourth market to be served by new airlines entering the Australian market. It proposed that it be moved into the regional package in all future bilateral arrangements. Perth Airport suggested that this would improve competition and choice for Australian and foreign travellers, with Australian airlines being relatively unaffected by any resulting increases in foreign airlines operating to Perth — as Australian airlines are no longer

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operating to Perth, with the exception of key outbound leisure ports. Tourism Western Australia (comm. 8, p. 6) also suggested that ‘reconsideration should be given to the need for Perth to be a major gateway as its market opportunity as well as geographic and economic position is very different compared to the east coast major gateways’.

There is no guarantee that additional air services will be provided to particular airports included within the regional package as route decisions are ultimately governed by the commercial interests of airlines. Nonetheless, it would simplify airlines’ assessment of what services to operate and enable decisions to be driven solely by commercial considerations, unhampered by regulation of capacity.

Extending the regional package to existing airports not currently covered would not be without costs. For example, there would be administrative costs associated with negotiating air services arrangements and it could take considerable time to amend existing arrangements. However, to the extent that the Australian Government is already seeking to renegotiate certain air services arrangements, these costs are unlikely to be material.

Another consideration is any loss of negotiating power to the Australian Government from providing unrestricted access to particular airports. Previous government policy statements have indicated that restricting access to Melbourne, Sydney, Brisbane and Perth airports is necessary so that the Government is left with leverage to extract additional benefits (such as expanded rights for Australian airlines in overseas markets) from bilateral partners when negotiating international air services arrangements (Anderson 2000; Australian Government 2009).

Any loss of negotiating power from extending the regional package to one or all of these airports only represents a cost to the Australian community to the extent that it results in international air services arrangements that deliver fewer net benefits (from a community-wide perspective) than those that could be negotiated under the existing arrangements.

The negotiating leverage of the Australian Government attached to particular airports will vary. Of the gateway airports it is likely to be weakest at Perth Airport. In 2014, around 12 per cent of international passengers travelling to or from Australia used Perth Airport, compared with 15 per cent at Brisbane Airport, 24 per cent at Melbourne Airport, and 41 per cent at Sydney Airport (figure 4.1). The geographical position of Perth Airport also means that travellers arriving in Australia via Perth are less likely to travel to the east coast, and thus Perth Airport largely serves a separate market for international air services. Given its location, Adelaide Airport, which is not considered a major gateway and where unrestricted access is provided, is more likely than Perth to be part of the same market as Sydney, Melbourne and Brisbane.

Perth Airport also has the lowest share (similar to that of Adelaide) of international passengers carried by Australian airlines out of all the major gateway airports. In the case of Perth, Australian carriers now only operate regular services to Bali and Thailand. The

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potential costs to Australian airlines from liberalising access to Perth Airport are therefore likely to be limited.

The value of lost leverage should not be overstated, especially if Australian airlines are not seeking to operate additional services under the relevant bilateral arrangements. As discussed earlier, Australian international airlines are not currently using their capacity entitlements under many of the bilateral arrangements with key destination/origin countries (figure 4.3). There could, however, be other access rights (such as fifth freedom rights) that the Australian Government may wish to obtain to deliver net benefits for the Australian community in the future should market conditions change. Where restrictions are considered necessary to provide leverage for the Australian Government in its international air services negotiations, the benefits of this leverage should be transparently weighed against the costs (in terms of foregone community-wide benefits of providing unrestricted access to particular airports).

Under the current policy, access is restricted to Avalon Airport and the proposed airport at Badgerys Creek, yet not to Gold Coast and Sunshine Coast airports, despite the fact that, for all practical purposes, they are roughly equidistant from the relevant major gateway airports. Extending the regional package to all secondary airports will help mitigate the effects of long-term capacity constraints at major gateway airports that cannot be relieved through efficient investment at those airports — for example, because there are land constraints or other barriers (such as potential amenity effects to nearby residents). Even in circumstances where the primary and the secondary airports are jointly owned, the availability of additional capacity would be expected to stimulate demand in both domestic and international aviation markets.

The Commission thinks there is very little leverage to be gained in international negotiations from restricting access to any Australian airport, with perhaps the exception of Sydney Kingsford Smith Airport, and the regional package could be extended accordingly.

## **4.6 Summing up**

On balance, the Commission considers that Australia's current international aviation policy settings are broadly working well. While international aviation is dominated by the current bilateral framework unilateral reform of air services arrangements will not necessarily generate net benefits for Australia compared with the current approach. The greatest scope to achieve further benefits is likely to come from further liberalisation within the bilateral system, with the Australian Government continuing to work toward a multilateral approach to liberalisation in relevant international forums.

The Commission does not consider that a wide ranging review of international aviation policy (such as the review conducted by the Commission in 1998) is warranted at this time. This is not to say that there is no scope for improvement. Decisions and outcomes could be improved by:

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- greater use of transparent cost–benefit analyses that underpin decisions on further liberalisation (including increased capacity entitlements)
  - a clear statement from the Australian Government about how it assesses the aggregate national interest when negotiating air services arrangements, including what factors are considered (such as the benefits to the community of outbound travel), and how any trade-offs are made when balancing the interests of different stakeholders, such as airlines and consumers
  - allowing foreign airlines to access, on an unlimited basis, Australia’s major gateways, including any secondary international airports established in the major gateway cities, by extending the regional package. There is very little leverage to be gained in international negotiations from restricting access to any Australian airport, with perhaps the exception of Sydney Kingsford Smith Airport.

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## 5 Investment in tourism infrastructure

### Key points

- Investment in tourism-related infrastructure, such as transport infrastructure, accommodation, and recreational, cultural and heritage assets, is crucial to the ongoing success of Australia's international tourism industry. Governments provide (or facilitate the provision of) a wide range of this infrastructure.
- Participants have raised concerns about tired and inadequate infrastructure, particularly relating to short-term accommodation, cruise ship terminals, and national park infrastructure.
  - These concerns should be addressed by implementing best practice project selection processes, including use of transparent cost–benefit analysis that takes into account the trends in tourism demand. Involving the private sector, such as through unsolicited bid processes, can also assist with project selection and facilitate innovation.
  - Greater use of cost recovery and private-sector investment in national parks would help to address funding shortfalls and facilitate innovation in the provision of tourism-related infrastructure. State and territory governments are seeking to facilitate further private-sector development in national parks.
  - There have been instances where governments have provided support for investment where there does not appear to be a strong rationale, such as grants to provide accommodation in regional areas and for visitor attractions such as theme parks.
- Project participants raised concerns with regulation of the private provision of infrastructure, including that: development approval processes generally impose disproportionate costs on smaller tourism-related developments; that tourism is not adequately considered in cases of land-use conflict in planning and zoning frameworks; and that there is uncertainty around whether short-term letting (such as through Airbnb) is allowed in some regions.
- Poor approval processes for tourism-related infrastructure imposes costs on developers, other businesses and communities. There is a need for review and reform of development approval frameworks to ensure that they keep pace with innovations in the tourism industry, including implementing recommendations previously made by the Commission.
  - Development approval processes should be risk based where feasible, so that tourism-related development assessment and approval processes are only as thorough as is necessary to ensure that regulatory objectives are met.
  - Planning and zoning systems should be flexible, and should not unnecessarily impede tourism-related businesses from innovating and adapting to changes in tourism demand.
  - Local governments need sufficient resourcing and guidance so that they can assess development applications in a timely manner.
  - The use of strategic assessments, which consider the cumulative effects of development, could be increased to aid with conflicts around use of environmental and cultural assets. Where these are not in place, it is important that effects on tourism activity as a result of other land uses are more rigorously assessed than may have been the case previously.

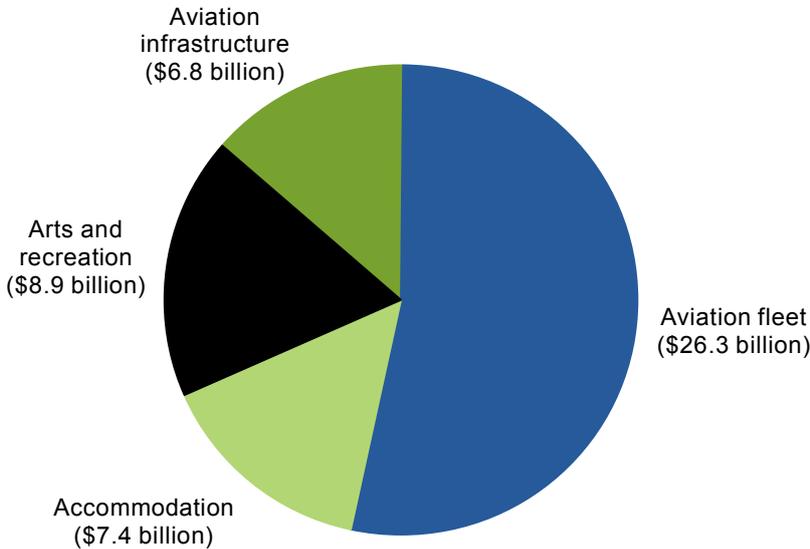
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Investment in tourism-related infrastructure is crucial to the ongoing success of Australia’s international tourism industry. Facilitating visitors to Australia requires investment in airport and seaport infrastructure, restaurants, and accommodation. International tourism can also be boosted by investment in visitor attractions such as theme parks, wildlife parks and zoos, heritage buildings, museums and art galleries — just under 2 million international visitors visited museums and art galleries in 2013-14, while just over 2 million visited wildlife parks and zoos (TRA 2015d unpub.). In 2013-14, about 3 million international visitors visited national or state parks (TRA 2015d unpub.) which require investment in areas such as walking tracks, signage and suitable accommodation, as well as the maintenance of their environmental and cultural values.

There is substantial investment in the tourism industry in areas such as accommodation, attractions and transport. Tourism Research Australia noted that, as of 2013, about \$50 billion of investment was planned within the tourism industry — predominantly in aviation, but also including accommodation, and arts and recreation (figure 5.1). (However, Tourism Research Australia noted that progression of these projects to completion has been slow in recent years.)

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**Figure 5.1 Value of proposed tourism investments**  
2013



Source: TRA (2014f).

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Ensuring that policy and regulatory frameworks do not impose unnecessary barriers to investment by tourism-related businesses is a priority for governments. Governments may also have a role as a provider (and/or funder) of some tourism-related infrastructure, either on public land or where market failures mean the infrastructure is unlikely to be provided (or would be underprovided) by the private sector (section 5.1). Much of the infrastructure

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used by the international tourism industry is provided by the private sector, such as cafes and hotels, and governments regulate this investment to manage the external effects of investment on others, such as environmental effects. However, if not designed and applied well, state and territory development assessment frameworks can impose unnecessarily high costs and delays on proposed tourism-related investments, especially small and low-impact investments. Poor approval processes for tourism-related infrastructure investments are not only costly to developers, but to businesses and communities (section 5.2).

## 5.1 Government investment in tourism

Governments have traditionally supplied a range of infrastructure that has benefits to the tourism industry. This includes infrastructure in national parks and other protected areas (such as walking tracks, signage and information centres) and cultural, sporting and transport infrastructure (such as regional airports, cruise ship terminals, sporting stadiums and galleries). Governments are also involved in the provision of general infrastructure that benefits the tourism industry, such as roads, water and electricity. Some participants raised concerns with shortages in these areas. For example, Regional Cities Victoria (comm. 9) suggested that investment is needed in regional transport corridors to reduce barriers to regional tourism. However, this infrastructure is predominantly provided for non-tourism-related purposes, and is not the focus of this chapter. (The provision of this infrastructure was considered in the Commission's 2014 inquiry into Public Infrastructure (PC 2014c).)

### **There are concerns about the adequacy of tourism-related infrastructure**

Participants to this and other studies have suggested that, in some regions, the quality and quantity of tourism-related infrastructure is poor, including in the areas of:

- short-term accommodation (such as hotels, motels, resorts and serviced apartments) (QTIC, comm. 17; L.E.K. Consulting 2011; TTF 2013). For example, the Queensland Tourism Industry Council (comm. 17) suggested that the supply of new rooms in Queensland is far below its projected *Tourism 2020* target, and that existing accommodation is 'more aged' than that of Australia's global competitors
- infrastructure in national parks (ENRC 2014; TTF 2013). Participants to the Victorian Environmental and Natural Resources Committee's inquiry into heritage and ecotourism suggested that infrastructure in the Melbourne region and major destinations is of good quality. However, there are serious shortages in some other regions, and existing infrastructure, such as boardwalks, barbeque areas and signage, is in disrepair. In consultations for this project, several participants suggested that infrastructure in national park areas was tired and not of the required standard

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- cruise ship terminals (TTF, comm. 20; Regional Development Australia, comm. 3; Tourism Western Australia, comm. 8; QTIC, comm. 17; NSW Trade and Investment, comm. 18). Participants raised concerns that cruise ship infrastructure in Sydney and Brisbane (Australia's major destinations for cruise ships) is at capacity, and will be unable to cope with the expected growth in the industry (box 5.1).

### Box 5.1 Cruise ship infrastructure

The Australian cruise shipping sector grew strongly between 2007-08 and 2010-11, and is expected to continue to grow. In 2010-11, the sector contributed about \$830 million to Australia's gross value add (equivalent to about 2 per cent of the tourism industry's value add), up from about \$580 million in 2007-08. Deloitte Access Economics (2012b) predicted that the sector would grow at about 7 per cent annually between 2013-14 and 2019-20. However, given that about 99 per cent of visitors come to Australia by air (chapter 2), the cruise ship sector is still responsible for only a small proportion of visitor arrivals.

Most cruise ship terminals in Australia are government owned (the terminal at Flinders Port in South Australia is one exception). Strong growth in the sector has led to concerns about the quality of cruise shipping infrastructure at Australian ports, particularly in Sydney and Brisbane, where the majority of cruise ship visits occur. For example, the Tourism and Transport Forum (comm. 20) suggested that cruise ship access to the naval base at Garden Island in Sydney is critical, as within three years many cruise ships will not be able to fit under the harbour bridge (to access other cruise terminals). (A 2012 review of cruise ship access to Garden Island found that the requirements of the Navy at Garden Island are incompatible with cruise ship access to the facilities, except on an ad hoc basis (Hawke 2012).) The Queensland Government (comm. 21) noted that Sydney's Overseas Passenger Terminal is at capacity for most of the summer months. Both the Tourism and Transport Forum (2010) and Deloitte Access Economics (2012b) raised concerns that larger cruise ships are unable to access Brisbane's cruise ship terminal.

There are also growing calls for the development of cruise ship facilities in other population centres and regional ports. For example, Ports North has called for the deepening of the Port of Cairns' shipping channel and an upgrade of wharf facilities to facilitate the further development of the cruise ship sector in Cairns (Ports North 2014). Tourism Western Australia (2012) and Tourism Tasmania (2012) have developed dedicated cruise ship strategies that identified potential improvements to cruise ship infrastructure for ports such as Augusta, Burnie, Hobart, Broome, Exmouth, and Port Headland. The Tourism and Transport Forum (2010) has called for the development of a national strategy to facilitate the development of cruise shipping terminals in regional areas.

There are cruise ship terminal developments proposed, in progress or recently completed, that may ease some of the concerns over the quality of cruise ship infrastructure. For example, ASF Consortium is seeking to construct an integrated resort and cruise ship terminal on the Gold Coast. In Sydney, a new cruise ship terminal at White Bay opened in 2013, and the New South Wales Government has recently commenced an upgrade of its overseas passenger terminal at Circular Quay (Port Authority of NSW 2014).

There are two broad issues to consider with respect to the adequacy of government-provided tourism-related infrastructure. The first is the project selection process — are governments selecting the highest-value tourism projects and is there a

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suitable rationale for government involvement in these projects? Second, the ability of governments to provide tourism-related infrastructure is constrained by the alternative uses and demands of public funding. This necessitates consideration of different approaches to funding and providing tourism-related infrastructure. (Barriers to the provision of tourism-related infrastructure generally provided by the private sector, such as short-term accommodation, are considered in section 5.2.)

Approaches to addressing issues with tourism-related infrastructure are not unique to this industry. Government provision of this infrastructure could be improved by general reforms to the institutional and governance arrangements underpinning decisions to provide all infrastructure. These include those reforms recommended by the Commission in its 2014 inquiry into public infrastructure (box 5.2). The Australian Government supported the majority of the Commission's recommendations in this inquiry. The recommendation to subject investments above \$50 million to cost-benefit analysis was a notable exception — the government maintained the existing threshold of \$100 million (DIRD 2014a).

**Box 5.2 Commission recommendations on institutional and governance arrangements for infrastructure provision**

The Commission's 2014 inquiry into Public Infrastructure made several recommendations designed to improve institutional and governance arrangements for general infrastructure provision. These include:

- defining that the principle objective of infrastructure decisions should be that they are undertaken in the public interest, for the welfare of the community as a whole
- setting clear and transparent infrastructure service standards
- instituting effective processes, procedures and policy guidelines for planning and selecting infrastructure projects
- use of transparent, innovative and competitive processes for the selection of private-sector partners for infrastructure projects
- ensuring efficient allocation and monitoring of project risks between government and the private sector
- reviewing funding and financing policies, including efficient user charging policies
- monitoring and evaluation of project performance
- that governments should commit to subjecting all public infrastructure investment projects above \$50 million to rigorous and transparent cost-benefit analysis prior to the projects being announced
- that Australian Government funding to state, territory and local governments should be conditional on best practice investment principles being adopted, and only where there is evidence of a demonstrable net benefit from the project.

Source: PC (2014c).

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## Selecting appropriate tourism-related infrastructure projects

### *Cost–benefit analysis needs to take tourism trends into account*

Where governments are responsible for the provision or funding of tourism-related infrastructure they should adopt project selection processes that promote the projects that are expected to provide the highest net benefits to the community. In general, along with other reforms to governance and institutional arrangements, such as those previously suggested by the Commission (box 5.2), good project selection for government-provided infrastructure requires the use of well-informed, high-quality and consistently applied cost–benefit analysis. Cost–benefit analysis takes into account all costs (including the opportunity cost of government funds and alternative uses of public land) and benefits (tourism and other) relating to a project to estimate whether it would generate net benefits to the community.

The consideration of the benefits of a project to the tourism industry can enhance the project’s attractiveness. However, in such cases an understanding of the trends in tourism demand is paramount. In particular, estimating the likely benefits of the project to the tourism industry requires consideration of the locations visitors are travelling to, attractions they visit and activities they participate in during their stay in Australia (chapter 2). The analysis will also need to consider the likely effects of the project on the number of visitors to the region. Governments need to monitor any changes and trends in the demand for tourism services, and adapt their provision of general and tourism-related infrastructure accordingly.

The prevalence of ageing tourism-related infrastructure or perceived tourism-related infrastructure shortages does not necessarily mean that funds should be directed toward that infrastructure, as there may be better uses for government funds. There may not be net benefits in upgrading infrastructure if visitors are not travelling to that destination, or have preferences for activities which do not use that infrastructure. Claims that investment will stimulate visitor demand need to be examined rigorously based on hard evidence to avoid costly white elephants based on assurances of ‘build it and they will come’. These assertions are often prevalent when project proponents are seeking support for investment in regional areas where visitor numbers are flagging.

### *Unsolicited bid processes can aid project selection*

The private sector may also bring tourism-related project proposals directly to the government, which can be used to inform project selection. For example, in 2012 Crown Limited proposed the construction of a six-star hotel resort and gaming facilities to the NSW Government (NSW Government 2012). Without a process in place to evaluate these unsolicited proposals, there is the risk that governments could reject proposals outright rather than evaluating them on their merits.

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Most governments have guidelines for unsolicited proposals that create a framework for their evaluation. In general, if the proposal meets relevant criteria (discussed below), governments will negotiate with the proponent exclusively.

Unsolicited bid processes have the potential to allow beneficial infrastructure projects to proceed that would not have otherwise. In particular, unsolicited bid processes can lower the administrative costs for project proponents of getting development approvals, encourage innovation where they provide better protection for innovative business ideas than tender processes, and reduce the burden on governments to identify and fund infrastructure. Unsolicited bid processes can also alleviate some of the costs to government of facilitating infrastructure investment, such as open tender processes.

However, unsolicited bids involve tradeoffs. If the project is not open to other potential proponents through, for example, a competitive tender process, then the government may not receive the best value for money from the project, even if there are processes in place to evaluate the value for money of an unsolicited proposal. On the other hand, if the unsolicited bid is followed by a tender process, the costs to project proponents of the tender process, including real or perceived loss of intellectual property and other business ideas, may reduce incentives for participation. To overcome this, state and territory government guidelines for unsolicited bids generally provide that the unsolicited bid process should only be carried out in situations where no other party could reasonably deliver the same project with the same value for money and timeframe. Given that the unsolicited bid process may provide a proponent with a competitive advantage, it is important that this criteria be rigorously assessed.

In addition, exclusive negotiation arrangements for unsolicited bids can raise probity concerns. To guard against these concerns it is important for governments to ensure that negotiations with the proponent are transparent, that all other regulatory requirements (such as environmental approvals) are met, and that processes are in place to ensure that the resulting arrangement is the best way to procure the asset. That said, probity processes must be proportionate to the risks involved, as concerns have been raised that excessive probity processes have led to sub-optimal infrastructure outcomes (PC 2014c).

## Funding tourism-related infrastructure

### *Governments have used various approaches to fund and finance tourism-related infrastructure*

The ability of governments to provide tourism-related infrastructure is limited by the amount of funding available. In general, the funds to pay for public infrastructure either need to come from the beneficiaries (such as through user charging), or from general government revenue. The Commission's 2014 inquiry into the provision of public infrastructure noted that well designed and efficient user charges are likely to be superior to the taxpayer funding of infrastructure in many situations, and that user charges are already the norm for most types of public infrastructure (PC 2014c).

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Governments have previously undertaken large projects on public land with tourism objectives, and applied user charges to fund these projects (box 5.3). For example, in 1989 the Queensland Government established the South Bank Corporation to oversee the development of land at South Bank in Brisbane to provide recreational, cultural and educational pursuits for local, regional and international visitors. The agency is predominantly self funded, generating revenue from sources such as the convention centre it manages.

Governments have also used the private sector to finance tourism-related infrastructure projects. For example, the New South Wales Government has used a public–private partnership to finance a new convention centre in Darling Harbour (box 5.3). Private sector involvement may improve the efficiency of the project, in particular where private financing ensures that risks are transferred to the parties best able to manage them (PC 2014c).

*There may be scope to increase cost recovery in national parks*

Funding the construction and maintenance of tourism-related infrastructure is a particular issue in national park areas, where user charging is less prevalent, and the burden of constructing and maintaining tourism-related infrastructure has fallen on national parks agencies across the country (through general government revenue) (box 5.4). For example, the Tourism and Transport Forum (2012a, p. 26) has noted that:

As is the case in other parts of the world, funding for protected areas in Australia has not kept pace with growing use and activities that occur within these areas, thereby threatening wildlife habitats, undermining the quality of facilities and leading to poor maintenance of infrastructure.

As discussed above, user charging can reduce the burden of funding the infrastructure on government, and also provide a price signal to consumers to encourage the efficient use of the infrastructure. L.E.K. Consulting (2011, p. 88) has noted that obtaining commercial returns from activities in national parks can increase the quality of tourism-related services in the park:

Experience in Canada further suggests that if government administered national parks and high natural amenity areas are re-organised to focus on commercial returns, including generating returns from tourism, that this can reduce costs for government, and result in some park functions and services becoming fully subsidised through tourism. As a consequence, there can be improvements in the quality, and range, of the tourism offering in these areas.

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**Box 5.3      Examples of investment funding and financing on public land****Darling Harbour precinct development**

The Sydney Harbour Foreshore Authority owns and manages the heritage and cultural precincts at The Rocks and Darling Harbour. The Darling Harbour precinct is undergoing a redevelopment, with the construction of a new convention centre and hotel complex due to be completed by 2016.

The construction and operation of the convention centre is being facilitated by a public–private partnership between the government and a consortium of investors (Darling Harbour Live). The public–private partnership has a contract term of 25 years, and includes the private construction, financing and operation of the convention centre, maintenance of the facilities, and facilitation of commercial development within the precinct (Infrastructure NSW 2013).

**The Sydney Harbour Federation Trust**

The Sydney Harbour Federation Trust is a self-funded agency which is responsible for managing certain land around Sydney Harbour to increase its amenity, maximise public access to the land and preserve the environmental and heritage value of the land. The agency funds its operations primarily through commercial leasing of sites and the provision of (and charging for) accommodation (Sydney Harbour Federation Trust 2014).

**South Bank precinct development**

South Bank Corporation is a statutory authority established to manage and develop the South bank area in Brisbane. The Corporation was established in 1989, and its objectives include to promote, facilitate, carry out and control the development, disposal and management of land within the South Bank area; and to provide for a diverse range of recreational, cultural and educational pursuits for local, regional and international visitors. Until 2013 (when the majority of its management responsibilities transferred to the Brisbane City Council), the Corporation had responsibility for strategic development and urban planning within the South bank precinct, and had the power to approve developments within the region. The Corporation is predominantly self funded through income from assets under its control, including retail tenancies, car parks and the Brisbane Convention and Exhibition Centre (South Bank Corporation 2014).

**Portside Wharf**

Portside Wharf is an integrated cruise ship terminal, retail and residential precinct in Brisbane constructed on Queensland Government land from 2004. The precinct was developed by Multiplex Group (now Brookfield), following a competitive tender process by the Queensland Government. As part of the agreement between Multiplex and the Government, Multiplex was required to construct the cruise ship terminal, and operate it for a period of 15 years (Queensland Government 2005).

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## Box 5.4 Selected approaches to user charging in protected areas

### Victoria

Parks Victoria does not apply an entry charge to Victoria's national parks. Charges apply for the use of 197 of Victoria's 680 national park campsites. Parks Victoria also charges for licenses for tour operators in national parks.

In 2013-14, Parks Victoria received about 6 per cent of its budget from accommodation charges and rents and licences. Most of the remaining budget was sourced from a levy applied on properties in and around Melbourne, and from general government revenue.

### Tasmania

Tasmania Parks and Wildlife requires visitors to Tasmanian national parks to purchase a parks pass, which allows access to all Tasmanian national parks. Tasmania also charges for the use of most campground sites, and requires the purchase of a license for tour operators. A fee is also charged to walk the Overland Track — a 65 kilometre walk through the Cradle Mountain–Lake St Clair National Park — during peak walking season (no charge is applied outside of peak season).

In 2013-14, Tasmania Parks and Wildlife received about \$20 million from the sale of goods and services, fees and fines, and from rent — which covered about 26 per cent of its expenses.

### Parks Australia

Parks Australia manages the Australian Government's terrestrial and marine reserves, including Kakadu National Park, Uluru–Kata Tjuta National Park, Booderee National Park and 59 marine reserves. Parks Australia charges entry fees, camping fees and fees for commercial licenses to cover the costs associated with managing these national parks.

In 2013-14, revenue from these fees accounted for about 44 per cent of operating expenses at Uluru–Kata Tjuta National Park, about 16 per cent of expenses at Kakadu National Park, and about 23 per cent of expenses at Booderee National Park.

### International examples

Internationally, some parks agencies have approaches in place to minimise the burden of funding protected areas on governments. For example, Ontario Parks in Canada recovered about 85 per cent of its operating costs from parks' revenue in 2012-13, predominantly through camping fees. In the United States, some parks operations have been outsourced to the private sector (including, in some cases, the operation of the national park itself). For example, in California, governments have outsourced some services to the private sector, such as the operation of camping grounds, parking lot management and the collection of fees. In addition, in 2012 the Californian Government leased several national parks to American Land and Leisure — a private company. The company returns a portion of its operating revenue to the Government, which is invested in park facilities.

*Sources:* California State Parks (2013); Director of National Parks (2014); DPIPWE (Tas) (2014); Office of the Auditor General of Ontario (2013); Parks Victoria (2014).

However, there may be legitimate reasons for the low level of cost recovery in national parks. Parks agencies often have a legislated objective to provide equitable access to

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national parks (Hughes and Carlsen 2011). National parks may also have public good characteristics:

- In national parks with low attendance rates, the marginal cost of providing entry to the park for an additional visitor is likely to be close to zero (Pinkerton, Marsh and Scrimgeour 2009). However, in parks with high visitor numbers there may be congestion effects if the use of the park diminishes other people's enjoyment of it. There may also be external costs associated with visitation, such as the effects of visitation on the environment and park infrastructure. Thus the marginal cost of additional users visiting the park will be greater than zero.
- The cost of excluding people from attending national parks may be excessively high, which may mean that the costs of charging entrants to the park outweighs the revenue brought in by such a mechanism. For example, Hughes and Carlson (2011) noted that one state agency routinely patrolled parks, and issued infringements for non-compliance. This process led to legal costs that were higher than the entry fees not paid by visitors. However, the authors noted that other states have implemented lower-cost approaches.

Any entry charge implemented for cost recovery purposes still needs to be efficient and equitable. In general, recovering the costs of managing national parks through charging for their use is likely to be more suitable in heavily visited national parks, where there may be congestion effects and effects of additional tourism on the environment, and where the costs of collecting the charge (per person) are likely to be lower. Where a charge is applied, it needs to be high enough to recover the cost of collecting the charge and to contribute to the costs of maintaining and developing infrastructure, but not so high as to compromise the social equity objectives of national parks systems (although mechanisms, such as concessions, could be used to aid with meeting social equity objectives). Some governments, such as New South Wales and Tasmania, have entry charges for some national parks.

Another option available to parks agencies is to charge for the use of specific infrastructure within national parks (or allowing a private provider to operate and charge for this infrastructure). For example, Cradle Mountain Huts, a private-sector entity, provides, and charges for the use of, private hut accommodation along the Overland Track in the Cradle Mountain–Lake St Clair National Park. While most states have fees to use campgrounds in national parks, these may not fully recover the costs of providing this service. For example, in 2011-12 the Victorian Government recovered about 35 per cent of the cost of providing camping and roofed accommodation in national parks (fees to use these campsites increased in March 2014) (Victorian DEPI 2013). There is also likely to be scope to examine the cost of these services to ensure that they are being provided in the most efficient way.

A further source of revenue available to parks agencies is via the licencing of commercial operators in national parks, such as tour operators. Most states and territories require a licence for operators to undertake commercial operations on public land, and require both

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annual fees and per capita fees for customers. However, studies have suggested that these fees appear to be low in many cases. The Tourism and Transport Forum (2012a) suggested that these fees have not generally been seen as funding opportunities for parks agencies to improve park amenities or infrastructure. The Victorian Department of Environment and Primary Industries (2014, p. 1) noted that its fees ensure that land managers ‘recover a reasonable proportion of licence administration costs’. Parks Australia also requires, and charges for, permits to undertake commercial tourism activities and notes that ‘the fees are modest and do not reflect the administrative costs involved, and have not increased since ... July 2000’ (Director of National Parks 2013, p. 4).

Operators of tours in protected areas, and other similar commercial operators, are gaining a commercial benefit from the use of the land and any public infrastructure provided on that land. Thus it is reasonable to expect these operators to contribute to the costs of the upkeep of the protected area. In a 2007 Senate inquiry into protected areas, participants generally recognised the need to make a financial contribution to the funding of protected areas (SSCECITA 2007). One example of a charge on commercial operators explicitly designed to fund the upkeep of a protected area is the Environmental Management Charge for commercial activities in the Great Barrier Reef region, including tourism-related commercial activities.

The Commission notes that many of the parks operated by the Australian Government are leased from the traditional owners of the land, with a provision that the Government must pay a proportion of the revenue from the park to the traditional owners. For example, under the terms of the lease of the Uluru–Kata Tjuta National Park, the Government must pay 25 per cent of park revenue to the Uluru–Kata Tjuta Aboriginal Land Trust (Director of National Parks 2010).

In addition, the Commission acknowledges that there are challenges associated with setting an appropriate fee structure within national parks. For example, the appropriate commercial license fee will likely vary across parks, as it will depend on the benefit tourism operators derive from government-provided infrastructure.

Nonetheless, given the persistent funding constraints associated with constructing and maintaining infrastructure within national parks, there would likely be benefits from the Australian, state and territory governments reviewing their fee structures to ensure that charges for activities within national parks are efficient and equitable. This may include the greater use of entry fees, activity fees and/or commercial licencing fees, perhaps coupled with mechanisms to help meet social equity objectives.

### *Governments are seeking to increase private investment in national parks*

A complementary approach to increased application of user charging may be to seek greater private-sector involvement in providing or financing infrastructure in national parks (although where private-sector financing is sought, funding for the project still must come from either user charges, general government revenue, or a combination of the two).

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Facilitating private-sector investment in national parks, if done well, could facilitate innovation, lead to increased efficiency, and ultimately lead to better tourism experiences. However, governments need to consider conservation objectives, as in some cases the costs of development, such as environmental degradation, may not be well captured in prices.

Historically, in some states and territories, there has only been a limited role for private investment in protected areas. For example, until changes to the *National Parks Act 1975* (Vic) in 2013, private-sector investment in national parks was not allowed in Victoria. Similarly, the Queensland Government restricted private development in national parks to semi-permanent infrastructure under 15 year permits until 2013. Other states have allowed private-sector investment. For example, Tasmania allowed a private investor to build huts along the Overland Track in 1987.

The lack of private sector investment in protected areas in some states in part reflects a view that tourism, and thus tourism-related investment, is likely to run counter to conservation objectives. For example, some participants to the Victorian Competition and Efficiency Commission's (VCEC) inquiry into tourism opposed removing restrictions on development in national parks, believing that these controls were necessary to protect the natural environment (VCEC 2011). However, if undertaken appropriately, tourism can aid conservation efforts by providing a source of funding for conservation activities, and promoting understanding of protected areas and their environmental and cultural values.

Most governments are now taking steps to facilitate private investment in protected areas, although there is little basis on which to evaluate the success of these programs thus far:

- The Western Australian Government has established its Naturebank program. Under this program, the Government identifies potential sites for the development of ecotourism accommodation, and undertakes development clearances before the sites are put to tender to the private sector.
- The Victorian Government has undertaken competitive tender processes for some sites. For example, following a tender process, the Government entered into a 50 year lease with a private investor to operate the Point Nepean Quarantine Station, on the condition that they conduct works on the site, such as building a restaurant, café and accommodation.
- The Queensland, Northern Territory and Tasmanian governments have open expression of interest processes for investment in national parks. The Tasmanian Government suggested that it was seeking appropriate private-sector development to encourage visitation and broaden the range of experiences on offer in national parks (Tasmanian Liberals 2014). The Tasmanian Government reported that it received 37 proposals through this process (Groom 2014). An assessment panel recommended that 24 of these projects proceed to the second stage of the expression of interest process (Groom 2015).

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## Government grant programs for tourism investment

The Australian, state and territory governments have offered some direct incentives for investment in tourism-related products, such as accommodation and attractions. These have often been targeted at regional areas. For example:

- in 2013, the Australian Government announced recipients of funding under the Tourism Industry Regional Development Fund. The Fund offered matched grants of between \$50 000 and \$250 000 to private investors to improve the quality of accommodation and attractions in regional areas. The Fund was abolished after the first round and replaced with the Tourism Demand Driver Infrastructure Program, which provides funding to state and territory governments for the provision of tourism-related infrastructure
- in New South Wales, the Regional Visitor Economy Fund provides funding for marketing and product development activities. The Fund has provided matched funding of up to \$500 000 for a variety of activities including accommodation and conference centre upgrades. New South Wales also introduced its \$110 million Regional Tourism Infrastructure Fund in its 2014-15 budget, which provides funding for investment in rail trails, regional airports and cruise ship terminals.

In general, facilities such as accommodation and theme parks are likely to have predominantly private benefits and costs, and thus the decision as to whether to undertake these investments should be a matter for the private sector based on commercial considerations, without government intervention. The Commission does not consider there to be a strong rationale for programs to provide grants for infrastructure that have largely private benefits.

In addition, grants programs often have administrative issues, that reduce their efficiency. In particular, such programs can be prone to lobbying, and it can be difficult for governments to determine whether a project would have proceeded in the absence of the grant.

## 5.2 Regulation of privately provided infrastructure

The private sector is an important investor in tourism-related infrastructure. This includes investment in accommodation — an essential component of the international tourism industry — resorts, and attractions such as casinos and theme parks.

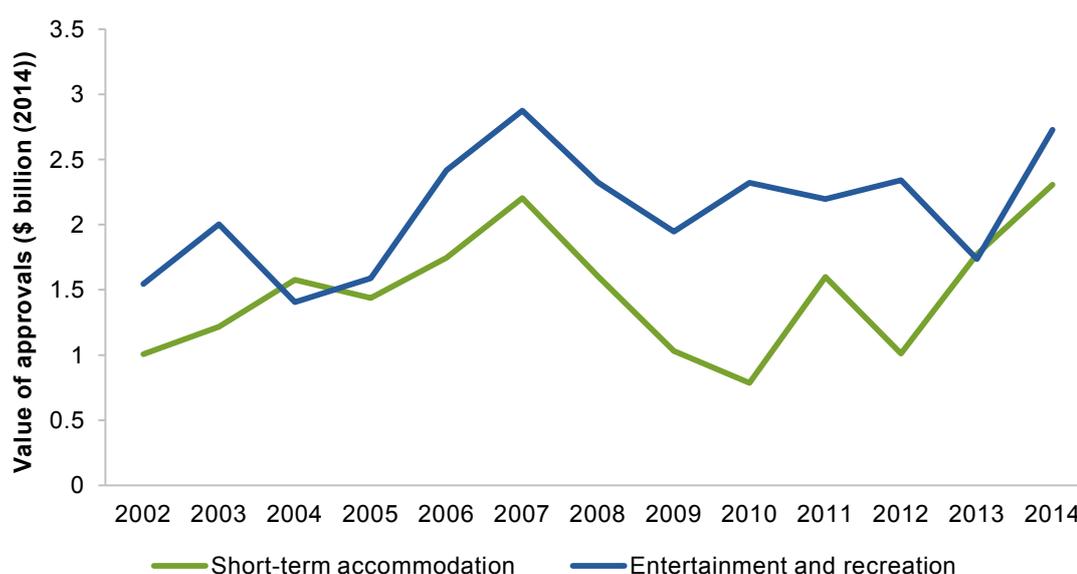
Tourism Research Australia (2014f) has stated that industry sentiment toward investment in the tourism industry is positive, particularly in aviation and accommodation. There was a dip in the value of building approvals in the short-term accommodation sector, and the entertainment and recreation sector beginning in 2008 (coinciding with the global financial crisis), although approvals in both sectors have since rebounded (figure 5.2).

However, participants to this study suggested that development approval processes, and the posture adopted by regulators when administering them, are a barrier to private development in the Australian tourism industry. For example, Tourism Research Australia (2014f) noted that there are issues with projects progressing from planning to completion, in part due to the development approval processes in place in Australia. In addition, Austrade (comm. 19) noted that overly restrictive planning regulations have been identified as one of the barriers to tourism-related investment, and Tourism Australia (comm. 12) suggested that regulatory and planning approvals are the main impediments to tourism-related investment.

### What development assessment and approval processes apply to tourism?

In some cases, the private costs and benefits faced by a developer may not reflect the social costs and benefits of a development. For example, a development may impose costs on the natural environment, impose excessive noise on nearby residents or affect the visual amenity of an area. Without government involvement to manage externalities these considerations would generally not be taken into account by a private developer, as in most cases the developer does not directly bear these costs and benefits (although, in some cases, such as for an ecotourism operator, the value of their project may be directly tied to the environmental and heritage values of the surrounding area).

Figure 5.2 **Value of building approvals in the accommodation, and entertainment and recreation sectors**  
2002–2014



Source: ABS (*Building Approvals, Australia, Nov 2014*, Cat. no. 8731.0).

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Governments use development assessment and approval regulation to balance economic, environmental, social, heritage and aesthetic factors (PC 2013):

- Development assessment and approvals might be required under legislation pertaining to environmental protection, heritage, Indigenous heritage, Native Title, land access and acquisition, marine and coastal, building code, and pollution and waste management. Approvals may also be required under relevant planning and zoning regulations (PC 2013).
- Planning systems set out the overarching framework for the use and/or conservation of land.
- Within planning systems, land is generally divided into zones. These zones set out acceptable uses for land, and are typically based on land uses such as residential, industrial and commercial (PC 2011b).

Approvals can be required under all three levels of government. In general, the Australian Government regulates matters of national environmental significance and developments on Commonwealth land. State and territory governments regulate matters within their jurisdiction, and are generally responsible for setting overarching plans for the state or territory. Local governments process and determine the majority of development applications, and establish planning and zoning systems for their jurisdiction, based on the framework established by the state government.

### **There are concerns with development approval processes for tourism**

Delays in development approval processes impose an undue burden on small tourism operators

Participants to this and other studies have argued that the burdens imposed by development assessment and approval processes, especially the time taken for developments to be approved, are inappropriate for the (often small) scale of proposed tourism-related developments. For example:

- Wyndham Vacation Resorts Asia Pacific (comm. 25) noted that approvals for hotel developments generally take 8–12 months, and that this is a barrier to generating business activity in this sector
- the Queensland Government (comm. 21) stated that tourism-related developments are required to go through the same processes under the *Environmental Protection and Biodiversity Conservation Act 1999* (Cwlth) (EPBC Act) as high-impact uses such as mining
- VCEC (2011) suggested that approvals for high-value tourism projects in 2008-09 took longer than other approvals (on average, tourism-related approvals took 305 days, while the average across all applications was 239 days, which is likely to reflect the increased complexity of tourism-related applications)

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- L.E.K. Consulting (2011) noted that the approval process for the Wolgan Valley Resort & Spa in New South Wales led to additional costs of about \$16 million (about 10–15 per cent of the total cost of the project). These costs were due to delays in the planning process caused by miscommunications between the proponent and authorities, and duplication of regulatory processes.

The burden imposed by approvals is in part because approvals for development can be required across all levels of government, and under numerous regulations. For example, a proposed zipline ecotourism project in Queensland was required to obtain 16 separate approvals under Commonwealth, Queensland, and local government legislation and planning schemes (Department of National Parks, Sport, Recreation and Racing nd). This proposed project has been delayed due to Native Title processes despite the support of the traditional owners of the site (Queensland Government, comm. 21). For larger developments the number of approvals required can number in the hundreds (PC 2013).

### Tourism is not adequately considered in planning and zoning processes

Studies have suggested that tourism is often given a low priority in planning and zoning schemes. *The Jackson Report* found that ‘too often, planning regimes do not recognise the importance of tourism and the needs of the industry’ and advised states and territories to ‘review these processes urgently’ (NLTTSSC 2009, p. 6). L.E.K. Consulting (2011, p. 22) also suggested that ‘tourism has a low profile in planning’ and that ‘generally, the planning regime does not fully recognise the scope and role of tourism development’. It suggested that the lack of consideration for tourism in planning schemes leads to unnecessarily high costs for tourism operators, including through increased timelines for approval and compliance requirements.

In addition, concerns have been raised that inflexible zones may have excluded tourism-related activity from occurring in areas where it is otherwise suited. For example, until recent reforms in Victoria it was only possible to provide group accommodation for more than six people (such as self-contained lodgings) in green wedge, rural conservation and farming zones if the accommodation was provided ‘in conjunction with’ other specified uses, such as agriculture, rural industry or a winery (VCEC 2011). The Tourism and Transport Forum (2012b), in a submission to a 2012 review of the New South Wales planning system, also noted that zones in New South Wales exclude short-term accommodation development in areas where it would otherwise be appropriate, such as rural and business park zones.

Parties submitting to VCEC’s 2011 *Inquiry into Victoria’s Tourism Industry* also described some less traditional tourism-related developments that had been inhibited by planning and zoning schemes. These included a sculpture park on a small rural property and a large free fly aviary — which was refused by the local planning office despite having the support of councillors, the local tourism board, the economic development committee and the visitor information centre (VCEC 2011).

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## Requirements for accessible rooms in hotels may be excessive

The Disability (Access to Premises — Buildings) Standards 2010 (Cwlth) prescribe that around 4.5 per cent of available rooms in hotels have to be made accessible and available to people with a disability. In 2010, the Australian Hotels Association and Tourism Accommodation Australia conducted a joint survey into the supply of, and demand for, accessible rooms used for short-term accommodation. They found that average demand for accessible rooms was far outweighed by the legislated supply, and imposed unnecessary costs on the hotels industry (AHA and TAA 2013).

The Commission has previously examined this issue and concluded that the ‘Premises Standards may be excessive and potentially impose an unnecessary burden on the industry’ (PC 2010a, p. 197). However, the Commission considered that it was appropriate to examine the issue as part of a scheduled five yearly review of the Premises Standards (scheduled to commence before 1 May 2015). The Commission also suggested that this review should be informed by an independent assessment of accessible room supply and demand (PC 2010a). The Commission remains of this view.

## **There is a need for ongoing review and reform of development approval processes**

Governments have reformed their approval processes, which may have partially addressed the above concerns. There are reforms at the state and territory level occurring under the *Tourism 2020* plan. All ministers responsible for tourism have undertaken to remove unnecessary barriers to tourism-related investment at both the state and national level, including streamlining the environmental assessment process, removing duplication of regulation and simplifying planning systems (Austrade, comm. 19; box 5.5). For example, Tasmania and Queensland have in place processes that allow for significant tourism projects to be assessed at the state (rather than local) level. Other state governments are in the process of implementing reform in this area (Austrade 2013). In addition, some states, including South Australia and New South Wales, have recently completed reviews of their planning systems.

It is too early to judge the success of the reforms to development assessment processes occurring under *Tourism 2020*. However, in the Commission’s view, it would be appropriate for this reform process to be independently reviewed by 2020.

There is a need for ongoing review and reform of development approval processes to ensure that the investment decisions of tourism-related (and other) businesses are not unnecessarily impeded. In particular, the international tourism industry would benefit from general reforms to regulatory frameworks, such as those recommended by the Commission in previous inquiries and studies into development assessment, including: Major Project Development Assessment Processes; Planning, Zoning and Development Assessments; the Role of Local Government as Regulator; and Regulator Engagement with Small Business

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(box 5.6). While there have been some reforms to development approval systems, many of the reforms recommended by, and leading practices identified by, the Commission have not been adopted, and there remains a need for further reform in this area. For example, while the Commission has identified that allowing tourism developments to be tested against the strategic intent of the planning scheme (rather than using prescriptive land-use zones) would allow developments to be more easily facilitated (PC 2012), this approach does not appear to have been adopted by all jurisdictions. Some areas of particular relevance to the international tourism industry are outlined below.

### **Box 5.5 Priority reforms for state tourism investment**

As part of *Tourism 2020*, the tourism ministers undertook to remove tourism investment barriers at both the state and national level by focusing on six priority reforms:

- That at state level, tourism-based uses are defined in a standardised manner, and that these uses are more commonly included as a permitted use in planning zones.
- Developments that meet transparent and firm criteria for the determination of their significance should be eligible for referral to a single higher decision-making authority in each state.
- That a state-based tourism investment facilitation management agency is established within existing government structures
- That mixed-use precincts and sites are created to encourage short-term accommodation development, with floor-space ratio concessions and other incentives, like increased height allowances, provided for the accommodation part of the development to significantly improve the economics of the development.
- That as a matter of priority, the Australian Government commission a rigorous review by an independent party of the disability-access standards for new buildings.
- That the approval processes for tourism development in national parks and other high natural amenity public land are reviewed with the objective of streamlining them, while retaining their conservation focus.

*Source:* Austrade (2013).

## **Development assessment and approval regulation should be risk based**

Effective regulation should be risk based and only impose burdens that are proportionate to the risk of the proposed project. This means that tourism-related development assessment and approval processes should only be as thorough as is necessary to ensure that regulatory objectives are met.

Some approval processes seek to incorporate approaches analogous to risk-based assessment by adopting measures to scale project assessment requirements. For example, projects requiring assessment under the EPBC Act, and not all do, can be assessed under five different tracks ranging from an assessment based solely on the information provided

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in the referral form to an assessment by public inquiry. Other processes can exempt low-risk activities from assessment requirements altogether (PC 2013).

### **Box 5.6      Leading practices in development assessment and approval**

#### **Major project development assessment processes**

The Commission's inquiry into major project development assessment processes included a range of recommendations designed to improve decision making, reduce regulatory duplication, increase certainty and improve assessment timeframes. Some of these include that:

- governments should ensure that regulatory objectives in major project development assessment and approval processes are clear, consistent and coherent
- governments should continue to strengthen bilateral assessment agreements (which accredit state and territory regimes under the *Environmental Protection and Biodiversity Conservation Act 1999* (Cwlth), so that development applications do not need to be assessed under both state and Commonwealth assessment regimes)
- governments should provide clear guidance on development assessment and approval pathways that apply to major projects
- regulators should establish measures that scale aspects of assessment requirements based on the risk and significance of expected impacts
- governments should establish a maximum time that may elapse between a proponent's assessment documentation being lodged and the assessment agency providing its report.

#### **Role of local government as regulator**

The Commission's study into the role of local government as regulator identified leading practices in the areas of planning, zoning and development assessment. Some of these included that:

- decision-making processes can be made more reflective of relevant risks through pre-lodgment meetings and advice, use of a standard approval format, timely assessment and electronic submission of applications, and the adoption of track-based assessment
- making information on decisions relating to planning applications publicly available increases transparency for businesses and the community
- the implementation of broad land-use zones in local planning schemes that apply across the state or territory has the potential to increase competition, increase flexibility for business and reduce costs for businesses that operate in more than one jurisdiction
- tourism developments can be more easily facilitated by testing them against the strategic intent of the local planning scheme.

*Sources:* PC (2012, 2013).

The Commission supports risk-based assessment where possible. However, it also notes that in practice it can be difficult to design and administer efficient risk-based assessment processes. The complex and variable characteristics (such as size) of tourism-related developments means that the 'optimal' level, scope and type of assessment can vary across projects, locations and time, and it may be difficult for a regulator to obtain sufficient

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information to assess these matters upfront. Thus, regulators must balance the need for a rigorous assessment based on the external risks involved in a development project, against the costs that an assessment imposes (PC 2013).

While efficient risk-based approaches are difficult to implement in practice, governments should continue to examine these approaches and incorporate them into assessments where feasible. In principle, this should minimise the possibility that low-risk tourism projects are subjected to unduly onerous assessment processes, and would have benefits for smaller tourism operators. In its 2013 study into major project assessment requirements, the Commission recommended that governments continue to establish measures to scale project requirements — although it is unclear how widely this recommendation has been, or will be, adopted.

### Guidance and resourcing for local governments is important

The majority of development assessments occur at the local government level and are relatively small and low-impact. As a result, it is important that local governments are able to implement development approval processes in a timely manner.

This issue is not unique to tourism, although it can be exacerbated by the fact that:

- tourism is not generally considered a primary land use (discussed above)
- tourism-related developments often do not require approval from other levels of government (as is the case for mining)
- local governments may not be used to managing, or have the expertise and resourcing to manage, tourism-related development issues. VCEC (2011) has noted that, in Victoria, local government planners have generally perceived tourism-related development applications to be more complex than other applications.

In response to the difficulties for local governments involved with tourism-related development issues, some state and territory governments have issued guidelines on the management of tourism within the planning system. For example, the Queensland and Western Australian governments have released guidance which is designed to assist planners when considering tourism proposals. The Queensland Government (comm. 21) stated that it had received positive feedback from planners, developers and the tourism industry on this guidance. In addition, the Australian Government has funded the development of the National Tourism Planning Guide, which was released in 2011 (TTF 2011a).

There would be benefits in state and territory governments engaging with local governments (particularly local governments in regions with high visitation), and ensuring that they are adequately equipped to manage tourism-related development issues. This may include the development of guidelines for the consideration of tourism in planning schemes, where this guidance has not already been established.

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## Planning and zoning systems need to be flexible

Where land-use zones are not sufficiently flexible, this can have a substantial effect on tourism. The need for flexibility in planning systems is compounded by the dynamic nature of the international tourism industry — the industry is constantly changing due to product innovation and changing patterns of demand (chapter 2).

Zoning systems should be sufficiently flexible to allow for tourism-related activities and developments where they are suited and where they provide net benefits to the community, regardless of whether tourism is explicitly recognised in state and territory planning and zoning frameworks. These frameworks also need to be flexible enough so as not to impede innovation or prevent tourism businesses responding to new technologies and changes in demand. The Commission has previously noted that allowing tourism-related developments to be tested against the strategic intent of the planning scheme, irrespective of the land-use zone (such as in Queensland's Integrated Development Assessment System), allows easier facilitation of tourism-related developments where appropriate (PC 2012).

Some state and territory governments have made changes to their planning systems to allow for tourism-related developments in areas where they were previously prohibited. For example:

- the Victorian Government reduced and/or removed restrictions in some zones as a result of VCEC's 2011 inquiry into tourism. This included removing a restriction on group accommodation in the farming zone
- since changes to the Northern Territory Pastoral Land Act came into effect at the beginning of 2014, the Territory Government may issue permits (for a term of up to 30 years) that allow the use of land held under a pastoral lease for non-pastoral purposes such as tourism. This type of permit is being used to offer extended walking tours on the salt flats at Kings Creek Station.

State and territory governments should ensure that prohibition of tourism-related developments is limited to a small number of planning zones, and only where such developments are demonstrably unsuitable — such as for health reasons.

## Strategic approaches to resolving land-use conflicts

Tourism in Australia often occurs in areas of high natural amenity that appeal to visitors. The use of these areas is often subject to conflicts, particularly when other high-value uses like agriculture and mining also occur in the same location. There have been concerns that the value that visitors and tourism-related businesses derive from environmental and cultural assets is often not adequately taken into account in making decisions about land-use conflicts. Particular concerns have been raised about the effects of developments in the Great Barrier Reef region (box 5.7). For example, the Queensland Tourism Industry Council (comm. 17, p. 10) stated that: '... changing policies and the use of the [Great

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Barrier Reef] for incompatible activity, as well as other factors such as climate change, are having a significant effect on the health of the [Great Barrier Reef]’.

### **Box 5.7 Competing land uses in the Great Barrier Reef region**

The Great Barrier Reef (GBR) is a multiple use area that supports a range of activities and industries including tourism, fishing, boating and shipping. Deloitte Access Economics (2013a) estimates the tourism, recreation, commercial fishing and scientific research and management activity occurring in the GBR in 2011-12 as contributing about \$6 billion to gross value add, of which \$5 billion was contributed by tourism activity. Ports adjacent to the reef also support a significant amount of economic activity. For example, in 2012-13, about 83 per cent of the output from the Queensland coal industry — which was estimated by Campbell (2014) to have a total gross value add of about \$20 billion in that year — was exported through ports adjacent to the GBR.

Conflicts around the use of the GBR are acute. For example, a port expansion for coal terminals was approved at Abbot Point in 2013. Concerns have been expressed about the effect of the dredging being conducted in the GBR region to construct the port, and the disposal of the dredge spoil, on the water quality and environment of the GBR. In 2015 the Australian Government announced its intention to ban the dumping of dredge spoil in the GBR Marine Park.

There are also concerns about the effect of broad-scale land use on the GBR, including the discharge of nutrients caused by agricultural practices (such as the use of fertilisers and pesticides), and the effect of land clearing on GBR ecosystems. The GBR Marine Park Authority estimated that around 90 per cent of the sediments, nutrients and toxic chemicals entering the Reef are due to agricultural practices.

There are policies and regulations in place to manage these land-use conflicts, including the Queensland Ports Strategy, various environmental management plans administered by the GBR Marine Park Authority, and federal and state development assessment and approval legislation. In addition, the Australian and Queensland Governments completed a strategic assessment of the GBR region in 2014 that is intended to inform the management of the area for the next 25 years. The strategic assessment included a range of recommendations designed to improve the management of the GBR, including to:

- provide clearer guidance on how the cumulative effects of activities should be assessed
- streamline assessment processes to reduce duplication
- improve alignment between protected area and tourism management arrangements
- support research on ecosystem thresholds.

In combination with the strategic assessment, the GBR Marine Park Authority released a 25-year management plan, outlining the future management direction of the Authority.

*Sources:* Australian and Queensland Governments (2014); Australian Institute of Marine Science (2014); Campbell (2014); Deloitte Access Economics (2013a); DNRM (2014); DSDIP (Qld) (2012); Hunt (2015); Queensland Treasury and Trade (2014); Senate Environment and Communications Committee (2014); UNESCO (2012).

While development assessment approaches generally aim to promote safe and orderly development, and to minimise the effects of development on the environment, there may be scope to improve the ability of regulatory frameworks to manage conflicts around the

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use of environmental and cultural assets. Resolving these conflicts requires competing interests to be balanced to determine what activities would provide the greatest net benefits to Australia.

The principle of ecologically sustainable development, enshrined in most Australian environmental statutes (for example, section 3A of the EPBC Act), should be applied to address these issues. However, in practice development approval processes may not adequately resolve competing uses or deal with the cumulative effects of multiple projects on the environment. Rather, development approval processes generally evaluate the effect of one project proposal at a time on the environment.

Governments are beginning to make greater use of strategic assessments, which may have greater capacity to consider the cumulative effects of development than traditional development assessments. Strategic assessments have been carried out, or are in progress for, developments in regions including the Great Barrier Reef (box 5.7), the Lower Hunter in New South Wales, and the Pilbara region in Western Australia. These assessments can be used to focus on the overall effects of development, and to inform and streamline individual development assessment processes. For example, the Commission (PC 2013, p. 323) has noted that:

... a strategic assessment of a groundwater resource might determine that a certain quantity of water can be extracted sustainably, but that above this threshold the ecological health of wetlands will begin to deteriorate. Such an assessment can lead to the setting of an overall extraction limit that strikes a balance between the benefits from extraction and the benefits from conserving groundwater.

While strategic assessments can be complex and time consuming, they can be a valuable tool for improving development assessment and approval processes (PC 2013), and may improve decision making in regards to the effect of developments on the tourism industry. The use of strategic assessments by governments has increased in Australia. However, there may be scope to further increase the use of these assessments where consideration of the cumulative effects of development on the environment are likely to deliver superior environmental and regulatory outcomes to those achieved under other processes (PC 2013).

Where strategic assessments are not in place for whatever reason, it is important that effects on tourism activity as a result of other land uses are more rigorously and transparently assessed than may have been the case previously. Evaluating the best use of an environmental or cultural asset requires a range of data, including information on both market values (such as the costs and benefits to a company of a new port terminal) and non-market values (such as 'existence' benefits to the community of knowing that an environmental asset exists). Approaches to value non-market costs and benefits (such as stated preference methods, whereby community members are asked how much they value the asset) are complex, and have not been routinely used in Australian policy (Baker and Ruting 2014). Regardless of whether such approaches are used, governments should ensure that, where there are conflicts regarding the use of an asset, extensive community and

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business consultation is undertaken, to ensure that decisions about the use of the asset are well informed.

### **There is confusion about the legality of short-term residential letting**

Short-term letting of houses and apartments in residential zones has led to policy and regulatory issues for the tourism industry and local governments. This is partly because of the advent of peer-to-peer accommodation sharing websites, such as Airbnb and Stayz (chapter 2), which have led to more short-term letting in areas where it was previously not common. Proponents of short-term residential letting have argued that it provides competition in the accommodation market, and supports the tourism industry by encouraging additional visitors. However, short-term letting has also drawn complaints from permanent residents reacting to the noise and antisocial behaviour of some temporary occupants (GPSC (NSW) 2014). Additionally, concerns have been raised by the short-term accommodation industry that short-term letting does not include the additional costs imposed on regulated accommodation providers (like hotels) such as food safety licensing, fire and safety regulations, and higher council rates (QTIC 2014b).

Regulatory approaches to short-term letting vary across local government areas. In some regions it has been prohibited, while in others there is considerable uncertainty for providers of short-term letting as to whether it is allowed, especially where they do not meet the requirements normally expected of bed-and-breakfast accommodation (box 5.8). Some states have implemented approaches to manage issues around short-term residential letting. For example, in August 2014, the Queensland Government passed an amendment to the *Sustainable Planning Act 2009* (Qld) to allow a flexible response to issues associated with short term letting. The amendment gives local councils the power to require that ‘party houses’ — private residences that are let for a period of less than 10 days and regularly used for parties — obtain a development permit to operate lawfully. The power is available to local councils on an opt-in basis and allow councils to give certainty to residents by designating ‘party house restriction areas’ where the power may be used (Seeney 2014).

Regulation of private property markets may be warranted when markets fail, for example where the use of land imposes costs (such as excessive noise) on others. State and territory governments have in place frameworks to regulate these costs. For example, the Environment Protection (Residential Noise) Regulations 2008 (Vic) prohibit certain noise in residential areas after specific times. However, regulations to address any external costs should be sufficiently flexible to accommodate alternative models of product delivery so as not to stifle innovation within the tourism industry. It is important that governments monitor trends and innovations in the tourism industry, such as short-term letting, and ensure that their regulatory processes keep pace with technological advances and consumer trends, and are able to adequately manage any relevant issues. This broader issue of regulatory adaptation to technological and business model change will be dealt with in more detail in the Commission’s inquiry into Business Setup, Transfer and Closure.

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## Box 5.8 Regulation of short-term letting of residential property

### New South Wales

In New South Wales, local councils have the power to set rules pertaining to short-term letting of houses and apartments, subject to compliance with state planning policy. Some councils in New South Wales, such as Shoalhaven, Eurobodalla and Kiama, specifically permit short-term letting (Blackburn and Adraskelas 2014; Wallace and Bibby 2013).

Randwick Council threatened legal action against a resident engaged in short-term letting through Airbnb, claiming that the resident was running an 'unauthorised' bed-and-breakfast. The council later determined that it was feasible for a resident to let part of their home for short-term rentals if the principal use of the property was a 'dwelling' (McKenny 2014).

Byron Shire Council has sought prohibitions on short-term rentals in residential areas. It proposed a licence system and designated holiday-let precincts under its draft local environment plan, but these proposals were refused by the NSW Planning and Infrastructure Department (Papadakis and Harley 2012). The Council has since threatened to take property owners to court for short-term letting in residential areas where there are noise disturbances (Wallace and Bibby 2013).

The City of Sydney has warned that individuals could face a fine of up to \$750 for renting out their property without council approval as it 'does not permit mixing permanent residential use with tourist and visitor accommodation in the same building' (McKenny 2013).

### Victoria

Regulations under the Building Code of Australia have also been raised as an impediment to short-term letting. However, following a dispute between Melbourne City Council and an apartment owner engaging in short-term letting, a decision of the Victorian Supreme Court in May 2013 made clear that existing building regulations cannot restrict short-term letting in residential apartment buildings (Danckert 2014; NSW Government 2014).

## 5.3 Summing up

The availability of tourism-related infrastructure is important to the health of Australia's international tourism industry. However, there are concerns about the adequacy of infrastructure in some regions. As a result, there is a need to reform the frameworks for government involvement in tourism-related infrastructure, including adopting reforms previously recommended by the Commission in these areas:

- In some cases governments are directly involved in the provision of tourism-related infrastructure, such as infrastructure that is provided on public land (including national parks). In these cases, there is a need to consider reform of project selection and funding arrangements.
- In other cases, governments regulate the private provision of infrastructure. In these cases there is a need for reform of the frameworks for assessing private-sector investment.

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Some potential reforms in these areas include:

- ensuring that the selection of tourism-related infrastructure projects is informed by rigorous cost–benefit analysis that considers trends in the tourism industry
- considering the greater use of user charges and private-sector investment for infrastructure projects in national parks
- ensuring that development approval frameworks are risk based where feasible
- reviewing planning and zoning frameworks, and removing unnecessary restrictions on tourism-related developments in land use zones, so that tourism-related businesses are not unnecessarily impeded from innovating and adapting to changes in tourism demand
- improving the resourcing and guidance available to local governments so that they can implement development approval processes in a timely manner
- increasing the use of strategic assessments to resolve conflicts around the use of environmental and cultural assets.



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# A Conduct of the project

In preparing this report, the Commission consulted with a range of organisations, individuals, industry bodies, and government departments and agencies. The Commission also circulated letters regarding the research project to people and organisations likely to have an interest in the project. This appendix lists parties the Commission consulted with through:

- participants' comments received (table A.1). The Commission received a total of 33 written comments from participants
- consultations (table A.2)
- a roundtable on investment in tourism-related infrastructure held in Brisbane on 2 December 2014 (table A.3).

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**Table A.1 Participants' comments**

<i>Individual or organisation</i>	<i>Comment number</i>
Association of Australian Convention Bureaux	4
Austrade	19
Australian Airports Association	26
Board of Airline Representatives of Australia (BARA)	5
Brisbane Airport Corporation	30
Caravan Industry Association of Australia (CIAA)	29
Crown Resorts	28
Decisive Consulting	14
Department of Immigration and Border Protection (DIBP)	32
Department of Infrastructure and Regional Development (DIRD)	22
Forsyth, Peter	10
Forte Hospitality	2
Koo, Tae-Ryang	11*
Melbourne Airport	24
National Tourism Alliance (NTA)	23
North Queensland Airports Group	15
NSW Trade and Investment	18
Perth Airport	31
Porter, Allan Lowther	1
Qantas	33
Queensland Government	21
Queensland Tourism Industry Council (QTIC)	17
Regional Cities Victoria	9
Regional Development Australia — South West	3
Service Skills Australia	13
South Australian Tourism Commission (SATC)	7
Sydney Airport	27
Tourism and Transport Forum (TTF)	20
Tourism Australia	12
Tourism NT	6
Tourism Western Australia	8
Virgin Australia	16
Wyndham Vacation Resorts Asia Pacific	25

An asterisk indicates that the comment contains confidential material not available to the public.

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## Table A.2 Consultations

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### *Organisation*

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#### ***Australian Capital Territory***

Australian Airports Association  
Australian Customs and Border Protection Service  
Department of Economic Development (ACT)  
Department of Infrastructure and Regional Development (Cwth)  
Department of the Environment (Cwth)  
Tourism Research Australia  
VisitCanberra

#### ***New South Wales***

Austrade  
Board of Airline Representatives of Australia  
CAPA Centre for Aviation  
Destination NSW  
National Tourism Alliance  
Sydney Airport  
NSW Trade and Investment  
Tourism and Transport Forum  
Tourism Australia

#### ***Queensland***

Brisbane Airport Corporation  
Department of Tourism, Major Events, Small Business and the Commonwealth Games  
Tourism and Events Queensland

#### ***Northern Territory***

Tourism NT

#### ***Victoria***

Department of State Development, Business and Innovation  
Melbourne Airport  
Peter Forsyth  
Tourism Victoria  
Victorian Competition and Efficiency Commission

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(Continued next page)

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Table A.2 (continued)

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*Organisation*

**South Australia**

South Australian Tourism Commission

**Tasmania**

Tourism Tasmania

**Western Australia**

Department of Regional Development

Perth Airport

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Table A.3 **Roundtable participants — Brisbane, 2 December**

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*Organisation*

*Participants*

**Brisbane — 2 December 2014**

Ardent Leisure Group

Craig Davidson

Austrade

Spiro Kavadias  
Emma McDonald

Australian Regional Tourism Network

David Sheldon  
Tracey Valenzisi

Department of State Development, Infrastructure and Planning (Queensland Government)

Sue McCafferty

Department of Tourism, Major Events, Small Business and Commonwealth Games (Queensland Government)

Paul Martyn  
Dominic Ward  
John Hoare

Ecotourism Australia

Rod Hillman

HOSTPLUS

Jordan Kraiten

Local Government Association of Queensland

Roland McMillan

Parks Australia

Sally Barnes

Queensland Tourism Industry Council

Daniel Gschwind  
Barry Robinson

South Bank Corporation

Jeff Weigh

Starhill Hotels

John van der Wallen

Tourism Tropical North Queensland

Sharyn Brydon

Tourism Accommodation Australia

Carol Giuseppi

Tourism Australia

Tim Mahony

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