



AIR NEW ZEALAND

AIR NEW ZEALAND SUBMISSION

TO THE

**INDUSTRY COMMISSION
INTERNATIONAL AIR SERVICES INQUIRY**

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1. INTRODUCTION

1.1 Air New Zealand wishes to record its appreciation to the Australian Government and to the Industry Commission for the opportunity to make this submission to the Commission in relation to its inquiry into the Commonwealth Policy on International Air Services Agreements (ASAs) and the International Air Services Commission (IASC) allocation process.

1.2 This submission reflects the views of Air New Zealand, being a major operator of both international and domestic air services in New Zealand. Air New Zealand is also a significant international airline serving Australia and a 50 percent shareholder in Ansett Holdings Limited.

1.3 The views expressed here reflect the experience gained by Air New Zealand from operating in a regulatory environment which is closely linked to Australia through the single aviation market, but which is significantly more liberal than Australia in its approach to international Air Services Agreements.

2. OPENING COMMENTS

The important role of international air transport

2.1 International air transport has become an increasingly vital component of the global economy. It is the essential and major driving force in the growth of international tourism, which is the world's largest single industry and, for many countries, including Australia, a major contributor to the national economy.

2.2 In addition to tourism, a country's external air links are important for its international trade, business travel and investment.

Home-based airlines are beneficial to the national economy

2.3 In a country that is pursuing a broadly liberal economic policy, the principal objective in the international air transport sector should be to maximise net social and economic benefits to the nation. Recognition should be given however, to the total contribution made by the participants in its aviation industry, principally airlines but also airports.

2.4 It is generally to a country's advantage to have at least one successful international airline based in its territory. This is particularly so where a country has a significant population base but, as in the case of Australia, is relatively distant from many of its major tourism and commercial markets.

2.5 Home-based airlines have a commitment to their home market in respect of both inbound and outbound travel. They are usually very active

promoters of tourism to their own country, contributing a large percentage of the total international advertising and marketing effort and expenditure.

2.6 Foreign carriers supply additional capacity and route options for travellers and freight, and their operation provides vital competition for home-based airlines. They can however, review their priorities and redeploy their resources to better performing markets. Thus, in recent times several major international airlines based in the northern hemisphere have withdrawn from Australia.

Stronger aviation linkages between Australia and New Zealand

2.7 Since conclusion of the Closer Economic Relations Agreement (CER) between Australia and New Zealand in 1983, integration of the economies of the two countries has steadily increased, with the growth in free trade now also including trade in services.

2.8 Some progress has been made towards free trade in air services with the Single Aviation Market Arrangements, and integration in the aviation industry has been advanced through the Air New Zealand investment in Ansett Australia. Moreover, New Zealand is Australia's second largest inbound tourism market, and Australia is New Zealand's largest.

2.9 These strong and significant linkages between the two countries suggest that mutual recognition of aviation certification and licences should be expedited. Some harmonisation of international air transport policy would also seem appropriate. At least, there is a need for greater recognition of each other's policy position. This point is expanded upon in Section 8.

3. INTERNATIONAL TRENDS

Expansion of air services

3.1 The international regulatory framework of bilateral air services agreements, stemming from the Chicago Convention of 1944, remains in place and the number of agreements continues to expand. Accordingly, access rights continue to be traded in a very mercantile fashion.

3.2 Nevertheless, the growth in bilateral agreements and consequent expansion of airline networks have brought about a number of significant changes in international air transport:

- greater diversity of inbound markets
 - emergence of new markets with initially very high growth rates, e.g., Taiwan and South Korea

- consistent growth in demand, though recent economic conditions have dramatically reversed this trend in some Asian markets, e.g. South Korea, Thailand
- progressively declining fares in real terms.

Greater liberalisation

3.3 Where countries are able to reach agreement, the bilateral framework has also provided a vehicle for the liberalisation of international air services. This trend has been increasing, especially among advanced economies, but the rate of change to more liberal market access has been uneven. Many countries still pursue policies designed primarily to protect their airlines. Others, particularly the United States and, within the Asia-Pacific region, Singapore and New Zealand are actively pursuing open market access.

3.4 The "open skies" arrangements negotiated by the United States with an increasing number of countries in Europe, the Americas and Asia-Pacific are simply liberalised bilaterals. They are marked by unlimited capacity entitlements and open route rights other than cabotage, i.e. access to foreign domestic markets.

Alliances and code-sharing

3.5 As airlines strive for greater efficiencies, they consider the benefits of consolidation. However, the normal commercial process of acquisition and/or merger is not available due to restrictions contained in bilateral agreements that are designed to ensure that ownership and control of airlines remain with nationals of the countries where they are based. Alliances have become a substitute for acquisitions or mergers that deliver some, but not all, of the benefits.

3.6 Alliances are the principal means by which airlines seek to counter the restrictions on market access imposed by many bilateral agreements. In particular, they enable individual airlines to better meet consumer demand by extending their market reach, leading increasingly to the establishment of global networks.

3.7 This is most commonly effected by airlines code-sharing on each other's services, backed up by such service improvements as single check-ins, closer connections, joint airport lounges and the like. Code-sharing also allows airlines to offer their customers increased flight frequency and, in many instances, to offer new routes where the introduction of services would be otherwise uneconomic.

3.8 The decision by Air New Zealand to invest in Ansett was driven in part by the need to overcome restrictions placed on Air New Zealand services through Australia. The investment and the associated commercial alliance

between Air New Zealand and Ansett will enable both airlines to improve the networks linking Australasia with key offshore markets.

3.9 Travel consumers are increasingly demanding access to global networks, superior levels of service and lower fares. Consequently, international airlines worldwide are being drawn into alliances in order to meet those demands and compete. Ultimately, this global consolidation is likely to result in a relatively fewer number of airline groupings, but each able to offer consumers a cost-effective global network.

Impact of alliances on Australia

3.10 Both of Australia's international carriers, QANTAS and Ansett, have entered into alliance arrangements. The Ansett/Air New Zealand alliance has already assisted these two airlines to expand their networks in a cost-effective manner. This process will continue and further benefits can be expected for airlines and consumers alike. However, the alliance process also has implications for aspects of Australian aviation policy discussed in Section 8.

3.11 The Australian carriers, as with all carriers in global alliances, will continue to operate a network of services to maximise their competitive position. Their association with major foreign airlines could involve a greater emphasis on some foreign hubs, but the principal focus will continue to be on third/fourth freedom traffic between Australasia and its major inbound and outbound markets. The possibility of the airlines becoming merely "feeders to foreign hubs" was more likely to result from their standing aside from alliances and finding it too difficult to compete with the global networks.

3.12 Yield management systems continue to be used within alliances, with benefits to both airlines and consumers. Airlines maximise the use of their capacity, and consumers get access to the lowest market fares.

Australian international aviation policy changes

3.13 The adoption of a multiple designation policy, together with related changes (integration of domestic and international networks, privatisation, etc.), has clearly been successful in stimulating demand and increasing the international market share for the two Australian carriers combined.

3.14 The introduction of competition between the two carriers on international routes has encouraged them to increase efficiency and reduce costs. Increased competition from foreign carriers, provided it is balanced and fair, has the same effect.

4. AUSTRALIA'S AIR SERVICES AGREEMENTS

Capacity

4.1 It is acknowledged that Australia has sought, under its bilateral agreements, to maintain capacity levels ahead of demand, and thereby to secure a degree of flexibility for its carriers. However, the amount of capacity provided by an airline is essentially a commercial decision and, subject to certain conditions, should not be regulated by governments. A traditional concern is the need for protection against capacity dumping, though this is probably not such a hazard now as in former times when many airlines were still government-owned.

4.2 A potentially more serious concern arises from the fact that bilateral arrangements do not necessarily reflect the real markets. This can occur where the bilateral partner is a gateway as well as an origin market. For example, capacity between Australia and Malaysia is used to serve a number of markets, including those beyond Malaysia, such as in UK-Europe and elsewhere in Asia. Consequently, if consideration were to be given to open capacity arrangements on the Australia/Malaysia route, account should be taken of the degree of access Australian carriers have to the principal markets beyond Malaysia. At least there should be liberal capacity entitlements in place with such third countries, thus allowing Australian carriers to compete on an equal basis.

4.3 It follows that it is important that air services negotiators accurately identify the real markets being served under each bilateral agreement and ensure that there is adequate opportunity for the airlines of both sides to compete in these real markets.

Fares

4.4 IATA itself has no direct role in setting fares. It only provides a process by which airlines can agree on fares, especially interline fares involving more than one carrier. Many bilateral agreements still require that fares be first agreed by the designated airlines and then approved by the governments. In most countries the process of filing fares and having them approved provides the airlines concerned with immunity from action under normal competition law. While consumer benefits arising from interlining have traditionally been regarded as justifying acceptance of the cooperation necessarily involved, bilateral requirements have also been used to prevent the airlines of one country from offering fares lower than those wanted by the airlines of the other.

4.5 However, with increased competition in recent years, “market” fares, where the fare collected does not match the fare shown on the ticket, have become common in most markets. Similarly, yield management systems have increasingly produced lower fares subject to “special conditions” (e.g. limited booking time, advance payment, restricted time and duration of travel, etc.). Reflecting this trend, in more liberal bilateral agreements, fares cannot be declined unless both governments so decide (“double disapproval”

regimes) or, as under the Australia/New Zealand Single Aviation Market Arrangements, filing fares with governments is no longer required at all.

Fifth and sixth freedom rights

4.6 Fifth freedom rights, the right to carry traffic between the bilateral partner and a third country, are vital to support airline operations on:

- (a) long-haul routes, such as those between Australia/New Zealand and points in UK/Europe, via Singapore, Bangkok and Los Angeles; and
- (b) thin routes (i.e. to serve still developing markets, where traffic is light), such as those between Australia/New Zealand and points in South America, via Tahiti.

4.7 Fifth freedom rights also allow routes to be operated with greater frequency than could be sustained by third/fourth freedom traffic alone - for example, a daily service from Sydney to Jakarta en route to Kuala Lumpur, and four services per week from Auckland to Nadi en route to the US.

4.8 Fifth freedom rights are also required to serve markets where there is a significant degree of consumer preference for dual or multiple destination travel. In response to demand of this kind in a number of Asian countries, Australia and New Zealand are often marketed as a dual destination. For some years Australia has been less willing than New Zealand to acknowledge this situation and to grant fifth freedom rights to New Zealand to balance the sixth freedom opportunities enjoyed by Australian carriers.

4.9 Fifth freedom rights need to be negotiated in order to obtain balanced access to markets where sixth freedom carriers are also operating. For example, Asia-based carriers can carry traffic from countries in Europe through their home base and on to Australia and New Zealand, and vice versa. Such sixth freedom rights are not negotiated and are not normally contained in bilateral agreements. In order for Australasian carriers to have the opportunity to compete, Australia and New Zealand need to obtain beyond rights from the Asian countries concerned.

Seventh freedom and cabotage rights

4.10 Both seventh freedom and cabotage rights are available to European Union carriers within the economically integrated countries of the European Union itself. Cabotage rights (but not seventh freedom) have also been exchanged by Australia and New Zealand under the Single Aviation Market Arrangements. Seventh freedom rights for cargo carriers only have featured in some of the recently negotiated “open skies” agreements, e.g. between New Zealand and Singapore, and between both countries and the United States.

4.11 As these precedents indicate, seventh freedom and/or cabotage rights have been exchanged only as a component of “open skies” agreements or where there is a significant degree of economic integration between the countries concerned. Accordingly, it is appropriate for these rights to be traded only in the context of a liberalised agreement, on a reciprocal basis, where a balance of opportunity results, and there is a demonstrable benefit to the national economy, including the interests of the carriers involved.

4.12 The usual strategy adopted by airlines to partly circumvent, if not to overcome, cabotage protection is to enter into alliances that provide for reciprocal code-sharing on each other’s domestic services. This has been a particular feature of “open skies” agreements negotiated by the United States, with anti-trust immunity being granted to associated airline alliances that incorporate code-sharing on US domestic sectors.

Restrictions on foreign ownership of airlines

4.13 Although “substantial ownership and effective control” provisions continue to be retained in the great majority of bilateral agreements, within those restrictions there has been a global trend towards more flexibility in the degree of foreign ownership permitted. Both Australia and New Zealand have

moved to allowing up to 49% foreign equity in their airlines, though with equity by a single foreign carrier limited to 25%.

4.14 More recently, New Zealand has negotiated “open skies” agreements that remove the requirement for majority national ownership of airlines, but retain the control requirement. They also stipulate that an airline must have its principal place of business in the territory of the government that has designated it. For the time being, airlines that complied only with these liberalised criteria would be unable to exercise traffic rights under bilateral agreements containing traditional ownership requirements. However, the intention of New Zealand and the bilateral partners with which it has negotiated these arrangements is to establish precedents that might increasingly be followed.

4.15 Other ownership requirements occur within integrated economic groupings. Thus the aviation regime in the European Union provides for ownership to be vested anywhere within the EU, and under the Australasian Single Aviation Market Arrangements (SAM), ownership may be vested in either Australian or New Zealand nationals or both. However, these more liberal arrangements are only applicable within the EU or SAM as appropriate.

4.16 Ownership restrictions preclude airlines from seeking greater efficiency and viability through acquisition or merger. The restrictions are more onerous in less populous countries such as New Zealand (and, to a degree, Australia) where there is a relatively small equity market and, in consequence, there are limits to the local capital available for investment in

airlines. The effect can restrict the growth of such airlines and depress their market capitalisation, as indicated by the difference in the market value between Air New Zealand's A and B shares. The former, which are limited to New Zealand nationals, have consistently traded at a lower value than B shares, which may be held by either New Zealand or foreign nationals.

5. ECONOMIC EFFECTS OF THE CURRENT ARRANGEMENTS

5.1 To the extent that the policy changes of recent years underlay the current arrangements, there have been benefits to consumers, the tourism industry, the airlines and the economy generally. Australia's carriers have improved their efficiency and level of service, and access by foreign airlines provides further competition and travel options.

5.2 A vital element of policy is to ensure that capacity, including fifth freedom capacity, increases in accordance with projected demand. In practice this means that available capacity should, wherever possible, expand ahead of current demand.

5.3 Further adjustments in the aviation relationship with New Zealand that could have both general and sectoral economic benefits are discussed in Section 8.

6. APPLICATION OF COMPETITION POLICY TO AIR SERVICES

6.1 The consolidation of the international aviation industry through the establishment of airline alliances has brought forward the need for new thinking by those responsible for formulating and implementing competition policy. The notion that more participants in a market will in itself increase competition does not necessarily hold true. The level and intensity of competition depends on the economic strength of the participants.

6.2 A scenario where a relatively large number of individual carriers operate in a market that generates low profit margins may lead to some withdrawals; and it will likely provide a less competitive environment than a scenario where a smaller number of carriers, perhaps members of global alliances, are achieving reasonable profit margins and are able to compete with each other vigorously. Thus, the implementation of competition policy must not prevent the industry from offering its consumers the best possible value, i.e. highly competitive fare levels combined with superior levels of service and convenience.

6.3 Serious problems will occur if an alliance agreement is unacceptable in the jurisdiction of one of the parties but is approved in others. In that event, the effectiveness of the alliance would be undermined and the benefits would not flow to consumers in those countries where the arrangements were not approved.

6.4 Alliances can thus be threatened by differing competition policies in various countries. As an example, the Ansett/Air New Zealand/Singapore Airlines alliance has required these carriers to structure their agreement so as to comply with three different policies and three different regulatory approval processes. As a consequence, the alliance agreement has been approved by the New Zealand and Singapore authorities, but the application to the Australian Competition and Consumer Commission is still under consideration.

6.5 There is no simple answer to this potentially serious problem. However, it does call for some attention by regulatory authorities who need to focus on the global nature of the airline business, which means it is not well served by domestic competition considerations.

7. APPROACHES TO LIBERALISATION

Unilateral approach

7.1 Most steps taken to liberalise aspects of the Australian aviation industry on a unilateral basis - e.g. privatisation of airlines, relaxation of restrictions on equity investment in airlines, allowing airlines to integrate domestic and international networks – have not affected the rights exchanged under bilateral agreements, and have not therefore required negotiation with Australia's bilateral partners. However, with respect to the multiple designation of airlines, while the initiative was taken by Australia the principle could be given effect only by way of negotiated amendments to the various bilateral agreements. The relative ease with which agreement was reached reflected the already widespread acceptance of multiple designation.

7.2 It is altogether a different proposition to remove restrictions from bilateral arrangements on a unilateral, that is non-reciprocal, basis. The purpose of governments in negotiating bilateral agreements is to create opportunities for their respective airlines. It is then up to the commercial decisions of the airlines as to how, and to what extent, they avail themselves of those opportunities. The underlying principle is that the opportunities should be fair and equal to both sides, whether or not, or to whatever extent, they are taken up. The unilateral granting of rights to foreign airlines without securing comparable rights would seriously disadvantage Australian carriers, undermining their ability to compete. Given the commitment and priority accorded by home-based airlines to their home market, referred to earlier, the result would be seriously detrimental to the national interest.

Multilateral approach

7.3 Regionally, liberalisation of international air transport has been successful within the economically integrated European Union and, sometimes elsewhere, where free trade arrangements exist between neighbours, such as Australia and New Zealand, and the United States and Canada.

7.4 Liberalisation within the wider APEC grouping is more problematic, and certainly a longer term process owing to the great diversity of APEC's membership. Although the members have jointly committed themselves to eventual free trade in goods and services, there are very differing views concerning the priority that should be given to the liberalisation of international air transport.

7.5 However, multilateral agreements can be advanced only so far as all of their participants wish to go, and this is emphasised in the APEC reference to "more competitive air services *with fair and equitable opportunity for all APEC economies*" (our emphasis). Consequently, were APEC to try to put together a multilateral agreement on international air transport at this point, it would not be very liberal at all. In other words, the principle of the lowest common denominator applies. It therefore seems unlikely that there will be a comprehensive APEC multilateral agreement until all its members are willing to accept an open regime. It is too soon to assess the likely impact that the current Asian financial and economic crisis will have on the aviation policies of the countries most affected.

7.6 This leaves two lesser, multilateral possibilities in which Australia could be involved at a more or less regional level. A smaller, perhaps sub-regional grouping of like-minded economies could forge a liberal multilateral agreement. New Zealand negotiators have had preliminary discussion with their "open skies" partners on adopting a plurilateral approach to this objective, which would provide for further economies to join as and when they were ready. Another approach, which might attract a wider grouping, would be to formulate an APEC accord limited to certain aspects on which all could agree to adopt a liberal position, with a view to adding others over time. A similar approach has been taken through the General Agreement on Trade in Services (GATS), but global agreement is intrinsically more difficult to reach.

8. IMPROVING AUSTRALIA'S INTERNATIONAL AIR SERVICES ARRANGEMENTS

Options under the bilateral system

8.1 In view of the difficult course faced by multilateral agreements, it is likely that the bilateral system will remain in place for the medium term at least. Given Australia's relative affluence, high ratio of outbound travel relative to its population, attractiveness as a tourist destination, and proximity to Asian

markets which, despite current problems, have huge future potential, Australia has significant leverage with its bilateral partners and is well placed to achieve the outcomes it seeks within the bilateral system.

Fair and equal opportunity for the airlines

8.2 Each bilateral agreement should be treated individually and subjected to individual market analysis, including identification of the real markets to be served under the agreement, and what is required to achieve a reasonable balance of opportunity for the airlines of each side to access those markets.

8.3 "Open skies" agreements along the lines of the United States model are simply very liberal bilaterals – though, as noted earlier, not totally liberal in their continued protection of cabotage and seventh freedom. In assessing "open skies" options and proposals, the same criteria should be applied as in the case of other, lesser changes to bilateral arrangements.

Benefits of liberalisation

8.4 Subject to these considerations, there are clear benefits to both the airlines and the national economy in freeing international air transport from detailed economic regulation. **Given fair and equal opportunity**, the airlines themselves are best placed to make the essentially commercial decisions of how often they should operate, with what aircraft, and on what routes. Their efficiency and profitability will be largely determined by the success with which they meet consumer preferences and requirements in terms of service options and price. In general, there are potential benefits all round: efficient airlines, more consumer choice, competitive pricing, increased traffic, expanded tourism.

8.5 There are clear opportunities for Australia to pursue liberalisation with a number of its existing bilateral partners. Within the Asia-Pacific region, for example, Singapore and Malaysia, each of which has entered into "open skies" arrangements with the United States and New Zealand, are the most obvious candidates. So is New Zealand insofar as the Single Aviation Market Arrangements, though providing for full domestic access falls short in fifth freedom rights.

Alliances and "open skies"

8.6 The participation of the Australian international carriers in alliances could also have a bearing on liberalisation. Especially where alliance arrangements result in the virtual integration of the services offered by the airlines involved, there is a strong case for introducing an "open skies" regime to ensure that market access remains available to other carriers. This eases the concerns of competition authorities because it eliminates regulatory barriers to entry for new carriers. This is a "win-win" situation – a pro-competitive environment is maintained while airlines can enter into

arrangements that promote their own efficiency and give consumers global access.

Australia-New Zealand aviation relations

8.7 As outlined in Section 2, the linkages between Australia and New Zealand have brought about a substantially integrated aviation market and industry. Yet significant policy differences remain and these are reflected in Australian restrictions affecting New Zealand carriers. It is probably unrealistic to expect a full harmonisation of the international air transport policies pursued by the two countries, but there is a need for greater recognition of the linkages in the manner in which each applies its policy.

8.8 Australia and New Zealand are perceived in most major Northern Hemisphere markets as being a single tourism destination. This is due to our relative remoteness and the perception that the two countries offer a complementary tourism experience. It is common, for example, to hear in the United States comments such as, "My wife and I have just visited Australia and New Zealand and it was fantastic." Most foreign carriers who serve New Zealand are authorised to fly via, or on to, Australia and can therefore satisfy this dual destination market. It seems logical therefore that airlines based in both Australia and New Zealand should also be able to serve this market.

8.9 It is becoming apparent that within the Australasian region there is evolving two home-based airline systems, each of which are developing alliances which will enable them to offer truly global networks. In a practical sense therefore the outside world will increasingly see Australia and New Zealand as a single entity in regard to travel and tourism, and will regard QANTAS and Ansett/Air New Zealand as Australasian carriers. It seems logical that the policy frameworks in Australia and New Zealand should recognise this drawing together of the industry in the two countries. Certainly, the two home-based airline systems should have free access not only between and within Australia and New Zealand, but beyond each country as well. Only in this way will each be able to deliver their full potential in the context of their alliances and be able to compete effectively with foreign carriers and alliances.

8.10 A related and specific issue relates to code-share on third-country carriers. New Zealand does not make this distinction. Its position is that code-sharing is a means by which traffic rights are exercised and is acceptable provided that both code-share partners have the appropriate rights. Australia may have good reason not to adopt such a policy for general application. However, given the degree to which the aviation market and industry of the two countries are integrated, it would be appropriate for Australia not to regard New Zealand as a third country in the context of negotiating code-share arrangements with its other bilateral partners, and for it to seek their acceptance of this position.

Multilateral agreements through ICAO or WTO

8.11 Until the liberalisation process advances to the point where most countries are prepared to accept open access, the bilateral system is likely to remain in place, though in co-existence with regional arrangements should these continue to come into effect. Following on from the International Civil Aviation Organization (ICAO) Special Conference of 1994 on the future of international air transport, the Organization's Council has issued some general and very cautious recommendations on liberalisation. The GATS made very limited progress on international air services towards the end of the Uruguay Round – relating only to some “soft rights” (e.g. ground handling) – but steered well away from “hard rights”, which include the full range of market access issues.

8.12 The World Trade Organisation (WTO), which has taken over from GATS, has been mandated to undertake a review of international air transport issues by the year 2000. Some progress may eventually be made through that forum, but the possibility of aviation becoming involved in inter-sectoral bargaining would not seem likely to enhance that progress.

8.13 Liberalisation can usefully be pursued through various international fora – ICAO, WTO, OECD and APEC – in order to influence the international aviation environment. But for some years to come concrete progress will best be made through the continuing process of bilateral negotiations.

9. SUMMARY AND CONCLUSION

Policy objectives to include recognition of home-based airlines

9.1 The principal objective for the international air transport sector should be to maximise net economic and social benefits to the nation, but due recognition should also be given to the contribution made by the airlines.

9.2 Home-based airlines are to the national benefit. They have a strong commitment to their home market, contribute most of the international advertising and marketing effort, and both directly and indirectly are major employers. Foreign airlines provide additional capacity, travel options and competition, but may give priority to closer and more populous markets.

Capacity a commercial decision, but real markets need to be identified

9.3 Australia has sought to maintain capacity levels ahead of demand, but the amount of capacity provided by an airline is essentially a commercial decision. Subject to certain conditions, it should not be regulated by governments. However, a major responsibility of negotiators is to identify real markets, especially in the bilateral arrangements with gateway countries. Liberal capacity entitlements with the third countries concerned are needed so there is adequate opportunity for the airlines of both sides to compete in these real markets.

Trend towards minimising government involvement with fares

9.4 With the increase in competition, the importance of IATA co-ordinated fares and government approved fares has been substantially modified by the growing incidence of “market” fares, and special fares that are the product of yield management systems. Liberal bilateral agreements have minimised government involvement with fares or dropped such provisions altogether.

Importance of liberally exchanging fifth freedom rights

9.5 Fifth freedom rights are vital to support both long-haul and “thin” routes, to provide greater frequency, and to balance sixth freedom rights. They are also required to serve markets where there is significant consumer preference for dual or multiple destination travel. In a number of Asian countries this occurs in respect of Australia and New Zealand. Australia has been less willing than New Zealand to acknowledge this and has restricted fifth freedom rights for New Zealand carriers, presumably to protect its own carrier operating on those routes.

Growth of alliances calls for new thinking about competition policy

9.6 The growing incidence and importance of airline alliances has brought the need for new thinking about competition policy. A proliferation of individual airlines operating in a market that generates low profit margins may lead to some withdrawals, and will likely provide a less competitive environment than a smaller number of global alliance members that achieve reasonable profit margins while also competing vigorously with one another. Serious problems can occur, however, where alliances have to meet differing competition policies pursued by the countries of their constituent carriers. Airlines must not be prevented from offering their consumers highly competitive fare levels, plus superior levels of service and convenience.

Liberalisation needs to be reciprocal

9.7 Granting rights to foreign airlines without securing comparable rights would seriously disadvantage Australian carriers, undermining their ability to compete. Given the commitment and priority accorded by home-based airlines to their home market, the result would be detrimental to the national interest.

Multilateral liberalisation a longer-term goal

9.8 Multilateral agreements can be advanced only so far as all their participants wish to go, as has been demonstrated in APEC's aviation discussions. Two lesser multilateral possibilities in which Australia could be involved at regional level would be: (a) a smaller grouping of like-minded economies forging a liberal joint agreement, adopting a plurilateral approach that provided for others to join when ready; and (b) a wider APEC accord limited to certain aspects on which all could agree to liberalise, with a view to adding others over time.

Australia well-placed to achieve goals within bilateral system

9.9 Given Australia's relative affluence, high ratio of outbound travel relative to its population, attractiveness as a tourist destination, and proximity to Asian markets which, despite current problems, have huge future potential, Australia has significant leverage with its bilateral partners and is well placed to achieve the outcomes it seeks within the bilateral system.

Fair and equal opportunity for the airlines

9.10 Each bilateral agreement should be treated individually and subjected to individual market analysis, including identification of the real markets to be served under the agreement, and the requirements to achieve a reasonable balance of opportunity for the airlines of each side to access those markets. "Open skies" agreements along the lines of the United States model are simply very liberal bilaterals, and the same criteria should be applied.

Benefits of liberalisation

9.11 Subject to these considerations, there are clear benefits to both airlines and national economy in freeing international air transport from detailed economic regulation. **Given fair and equal opportunity**, the airlines themselves are best placed to make the essentially commercial decisions of how and where they should operate. With airlines acting on their own assessment of the market, there are potential benefits all round: efficient airlines, more consumer choice, competitive pricing, increased traffic, expanded tourism.

Opportunities for Australia to pursue liberalisation

9.12 There are clear opportunities for Australia to pursue liberalisation with a number of its existing bilateral partners. In the Asia-Pacific region, for example, Singapore and Malaysia, each of which has entered into "open skies" arrangements with the United States, are obvious candidates. So is New Zealand insofar as the Single Aviation Market arrangements, though providing for full domestic access, falls short in fifth freedom rights.

Alliances and “open skies”

9.13 Where alliance arrangements result in the virtual integration of the services offered by the airlines involved, there is a strong case for introducing an “open skies” agreement. This eases the concerns of competition authorities because it eliminates regulatory barriers to entry by new carriers.

Australia and New Zealand aviation relations

9.14 The linkages between Australia and New Zealand have brought about a substantially integrated aviation market and industry, and this is consistent with developments in Northern Hemisphere markets where the two countries are perceived as a single tourist destination. Although most foreign carriers who operate into Australasia can serve this dual destination market, home-based carriers are restricted by the limitation on fifth freedom rights which is a feature of the present Air Services Agreement between Australia and New Zealand. The moves by QANTAS and Ansett/Air New Zealand towards membership of global alliances reinforces the perception that Australasia is a single aviation and tourism market in global terms and policy development needs to reflect this reality.

Pursuit of liberalisation through international organisations

9.15 Liberalisation can usefully be pursued through various international fora – ICAO, WTO, OECD and APEC – in order to influence the international aviation environment. However, for some years to come concrete progress will best be made through the continuing process of bilateral negotiations.
