

Section 3 The Nature of Australia's air service agreements

Fares

“ASAs generally include provisions relating to fares and other financial matters such as taxation, airport charges and arrangements for selling air services. Traditionally air fares were negotiated at International Air Transport Association (IATA) conferences and subsequently approved by governments. However, the importance of these IATA agreed fares has declined over recent years.

What is the role of IATA in influencing the entitlements established under ASAs? How has this role changed? What factors have influenced this?

Do existing ASAs restrict the ability of airlines to offer lower prices or better availability, frequency and quality of passenger and air freight services or implement yield management systems?”

Commentary

Bilateral Provisions

Many Air Service Agreements (ASAs), including those of Australia specify the application of passenger fares and cargo rates developed under the auspices of the IATA Traffic Conferences machinery. At the outset, it should be pointed out that IATA has always served only as an “immunised” forum where airlines could meet to discuss fares, rates and associated conditions without breaching US ant-trust and other nations’ competition laws. (The Australian Trade Practices Commission last reviewed IATA’s Traffic Conference system - and other activities of the organisation - in 1985.)

As a typical case, the Australia-Japan ASA includes a tariff-fixing provision as Article X.

Article X (1) - Tariffs or air fares are expected to be established at reasonable levels. All relevant factors are to be taken into account. These include costs of operation, reasonable profit, characteristics of service and the tariffs of other airlines for any part of the specified routes.

Article X (2) - Tariffs shall be determined and agreed by the designated airlines through the rate-fixing machinery of the International Air Transport Association (IATA). Where this is not possible, the two carriers themselves will seek to agree on tariffs, which are subject to approval by the aeronautical authorities of both Contracting Parties.

Article X (3) - Where the two airlines cannot agree on tariffs, or if the two governments do not approve of the tariffs proposed by the two airlines, then the aeronautical authorities shall endeavour to reach agreement on the appropriate tariffs.

As noted above, the execution of fares agreements was controlled by the carriers involved in a particular set of routes, usually determined by geographic region, or sub-region. They, in turn, reported to their governments.

Many years ago, there were sound commercial reasons for airlines to agree on a comprehensive package of interlocking interlinable fares. One was simply the relatively low level, by today's standards, of service. Very few airlines flew to all five continents, let alone all the most important destinations, in the 1950s and 1960s. To take Sydney-London as an example: Qantas flew the route three days a week, BOAC three more and Air-India, the seventh day. By way of contrast, almost all of the airlines flying to Australia offer on-line services today, the two flag carriers have a direct service at least twice a day each and others offer connections at intermediate points ranging from Johannesburg to Hong Kong, Narita and Los Angeles. In addition, there are numerous interlining possibilities, using more than one airline.

Furthermore, by interlining, other carriers that do not themselves fly to Australia can offer services that compete with the other carriers on price and service from their home base. Examples of this include Swissair and Lufthansa. At the same time, Australians have a range of possibilities available to them beyond the major carriers that fly to Australia. This competition circumvents the issues of ASA entitlements generally.

Today, there are about 1,100 airports at which some form of international airline service is offered - and an even larger number of airports receiving only domestic service (around 4,000, we believe, although a reliable figure seems difficult to establish) and it plainly is impossible for one airline, or even an alliance of airlines to cover them all. It is to meet this need that interlining has been developed, whereby a passenger can purchase transportation to as many destinations and on as many airlines as they like in one single transaction - and in one single currency. This is administered by IATA through the Multilateral Interline Transport Agreement (MITA).

Changed Environment

There have been considerable changes in the commercial environment, in technology development, and in the regulatory scene. The commercial environment has evolved considerably - one important trend over the past decade has been to market-driven fares.

In simple terms, an airline's costs on a specific route no longer drive the levels of fares put into the market. The driver is the competing carriers and in some markets this can include charter airlines. This has placed the emphasis on revenue management, maximising revenue per flight through the use of sophisticated computer systems. It has not stopped airlines working hard to reduce costs but there are limits to what can be achieved if reasonable levels of customer service are to be offered.

The function of the IATA Tariff Conferences has been modified in response to these changes to focus on "reference fares" (usually fully-flexible economy or business-class fares and basic cargo rates). Their main functions are to facilitate interlining and pro-rata, the division of revenue between carriers when interlining is practised. Many airlines have two full economy fares, one for interlining - developed through IATA Tariff

Conferences - and the other (sometimes several percent lower) for on-line transfers - set unilaterally by the airline.

In other words, IATA's role was always passive - chiefly consisting of providing an "immunised" forum for airlines to discuss fares and rates together without threat from the US Justice Department, (more recently for intra-European tariffs) the European Commission's Competition Directorate, and a number of other governments around the world, including Australia - and did not impinge on entitlements established under ASAs. It now provides a basis for interline traffic.

As the industry has liberalised, the ability to offer lower prices and better availability has been expanded. However, in IATA's estimation well over 20% of journeys in the world involve some form of interlining. (A recent study for the European Commission showed that 27% of all tickets purchased within the European Union involved "effective interlining", with more than one carrier specified at the time of booking.) Without interline fares which depend on an agreed rate of pro-rata to ensure revenue return (but which in no way dictates the actual fare charged), smaller airlines and carriers with fewer services to a particular destination would not be able to compete. Interlining also increases the degree of consumer choice.

IATA's rate-setting function is continuing to evolve. The basic strategy proposed for the future is to transform the Association's tariff work to enable multilateral tariff consultations to continue but with a change of focus to enhancing the airline business process, further facilitating interline transportation and improving the effectiveness of revenue management systems. This will allow greater competition and be to the benefit of the consumer.