"Aviation Liberalisation:

The Need for Decisive Action"

A Submission to the Industry Commission

Inquiry into Air Service Agreements

by

The Australian Chamber of Commerce and Industry

March 1998

Executive Summary

International aviation is crucial to the growth and development of trade and commerce, both for Australia as well as globally. It is essential to the fast-growing global tourism industry, and becoming increasingly important to commerce and industry as the globalisation of business dictates greater reliance on air freight movements to win and hold export markets.

More liberal trade, commerce and investment must be reinforced by comparable reforms in international aviation, covering both passenger and air freight services.

Air freight is an essential element of Australia's domestic and international aviation services industry. Official figures suggest air freight accounted for more than one dollar in every five of Australia's export income - or some $A 14 billion - in 1994/95.

Nearly all Australia's exports of non-monetary gold, and computer and office equipment depart our shores by air freight, as does around 80 per cent of our exports of pharmaceutical products. For electrical machinery and appliances, non-metal manufactures, and transport equipment (excluding made-up vehicles), the shares using air freight for export are between 50 and 60 per cent.

The supply of air freight services for exporters is tightly linked to that for out-bound passenger traffic. In many respects, air freight is a close companion of the international passenger travel market.

The Federal Department of Transport and Regional Development (DTRD) has estimated around 90 per cent of air freight movements into and out of Australia on scheduled air services travel in the belly hold of passenger services.

As such, the terms and conditions of access for these passengers services to international aviation routes and systems will have important implications for the supply and configuration of air freight services for Australian exporters.

At the same time, while dedicated air freighters are an option, commercial reality is that relatively few routes to and from Australia could support such services, given current general aviation costs/export product prices. As such, the belly hold carriage in scheduled passenger services will remain for the foreseeable future the overwhelming source of capacity for air freight into and out of this country.

Australia's air freight services, like those for passenger services, are regulated through the many - currently more than 50 - Air Services Agreements (ASAs) we have with other countries. Around half of these Agreements have been translated into actual services.

These ASAs, by intention and outcome, have a profound impact on the market place, in aggregate supply and its configuration, for aviation services, both passenger and freight.

The ASA's generally deal with named routes to be served by the participating countries, which freedoms (air service rights) are to be granted, the frequency of flights, the size of aircraft, and even the method for determining prices.

In effect, the ASA-based system for determining aviation market access are little better than government-determined non-tariff barriers to trade and commerce. They are as distorting and corrupting of, and detrimental to, competition and efficiency as their namesakes in other areas of international business.

The general perception of commerce and industry remains ASA negotiations, including their configuration, are predominantly driven by passenger interests, with air freight an ancillary and second round issue.

Liberalisation of the international aviation industry is already on the broader trade policy agenda.

Indeed, aviation liberalisation is essential to the further freeing-up of the global trading system. It is wholly unrealistic to expect the world trading system to liberalise the trade in goods, services and the movement of people and capital without commensurate deregulation of the means for achieving these outcomes.

Put simply, freer trade in goods and services requires freer trade in transport services.

At the multilateral level, primarily through the World Trade Organisation (WTO), there have already been attempts to include aviation reform within the scope of the landmark General Agreement on the Trade in Services (GATS).

While these efforts, taken in the context of the long-running Uruguay Round, where initially unsuccessful, the WTO has an obligation to undertake a review of, and potentially negotiations on, the international aviation industry.

Closer to home, aviation liberalisation in the Asia Pacific region has been progressing more on a bilateral rather than a regional basis, and then a very slow pace.

APEC transport ministers and officials appear to have regrettably agreed to: do very little on aviation liberalisation; with anything at all maybe under the bilateral system; and almost certainly nothing at all under the regional umbrella of the APEC initiative.

On a bilateral basis, the Australian and New Zealand Governments operate what amounts to an ‘open skies’ approach to international aviation across the Tasman Sea.

Under this arrangement, there are no limits on the number and type of services which airlines from the two countries can operate across the Tasman, and carriers from both countries have unrestricted access to the other’s domestic markets. However, ‘beyond rights’ remain problematic in the bilateral relationship.

Australia could usefully replicate this model with some of the other nations of the Asia-Pacific region, although the aviation policy of the Australian (Howard) Government for the foreseeable future appears to be limited to greater reliance on bilateralism in air market access negotiations, eschewing regional or multilateral strategies.

The United States' Government has become active in recent years in pressing an 'open skies' framework, albeit on a bilateral rather than multilateral basis. Some 22 such agreements have already reached, with a number in Asia and in Europe, although the Australian Government has shown scant interest, to date.

Important benefits of the 'open skies' agreements for the bilateral parties derive from greater competition, and more specifically include: for both passengers and freight users, more frequent services and lower fares; and, for operators, increased destinations and the opportunity to fly to third - 'beyond' - countries.

Given the likelihood of the United States Government securing agreement from an increasing number of countries, and reflecting past practice by that nation, there is the very real prospect such agreements could become the foundation for the wider negotiation of what could be called a Multilateral Agreement on Aviation (MAA).

The negotiation of a MAA within the World Trade Organisation (WTO) General Agreement on the Trade in Services (GATS) would merely bring the international aviation system into line with other aspects of the global trade in goods and services.

Key elements of any MAA negotiations should include: ensuring liberal market access, with no restrictions (bar genuine safety considerations) on capacity or frequency of services; charges, prices and fares should be set by the market, subject only to bona fide competition policy issues; both passenger and freight movements; and, transparent and welcoming accession arrangements for countries which wish to join during or after the negotiation processes.

Summary of Recommendations

The Australian Chamber of Commerce and Industry recommends

(1) on the issue of the negotiation of Air Services Agreements the Australian Government, including the Industry Commission in its current reference, take fully into account when developing policy for the negotiation of air service arrangements:

. the commercial reality belly hold carriage in scheduled passenger services will remain for the foreseeable future the overwhelming source of capacity for air freight into and out of Australia; and,

. this dependency be given greater weighting in the strategic and tactical approaches taken in the negotiation of such agreements.

(2) on the issue of broader aviation liberalisation the Australian Government:

. take a leadership role within the APEC initiative in aviation liberalisation issues, most notably the development of an integrated region-wide program of aviation liberalisation in the Asia Pacific within the context of the Bogor Declaration of 'free and open trade and investment'; and,

. take a leadership role within the General Agreement on the Trade in Services (GATS) negotiations under the World Trade Organisation (WTO) for negotiations on multilateral aviation liberalisation, or failing this participate actively in any negotiations for a Multilateral Agreement on Aviation which may progress under the auspices of the Organisation for Economic Co-operation and Development (OECD).

The Air Freight Dimension

International aviation is crucial to the growth and development of trade and commerce, both for Australia as well as globally. It is essential to the fast-growing global tourism industry, and becoming increasingly important to industry as the globalisation of business dictates greater reliance on air freight movements to win and hold export markets.

More liberal trade, commerce and investment must be reinforced by comparable reforms in international aviation, covering both passenger and air freight services.

. Overview

Air freight is an essential element of Australia's domestic and international aviation services industry. It should not be portrayed, let alone accepted, as the poor cousin to the higher profile passenger services component.

As Australian commerce and industry becomes more closely integrated into the Asia Pacific region, air freight will become increasingly important in realising new export opportunities for higher value added commodities and manufactures.

The Australian Department of Foreign Affairs and Trade (DFAT) estimate as much as one-third of world trade by value is moved by air, which is all the more remarkable given the significance of bulk commodities (such as oil) in global commerce.

The DFAT also expect the future pattern of world trade to favour air freight, with the fastest growing export categories being delivered to their destination markets by air freight rather than sea freight. Efficient and effective air freight services are likely to be integral to Australia's competitiveness, both winning and holding market share, in the Asian market place.

Official figures suggest air freight accounted for more than one dollar in every five of Australia's export income - or some $A 14 billion - in 1994/95. The Chamber expects both figures, the nominal dollar amount and the proportion, to have grown since then.

. Demand for Air Freight Services

Australia's exports by air freight are primarily non-monetary gold, higher value/lower volume manufactures, and perishable goods.

By value (in 1994 dollars), as a nation we exported by air freight: nearly $A 4.5 billion in non-monetary gold; $A 1 billion in computer and office equipment; $A 1 billion in perishables (half of which was seafood); and $A 500 million each of electrical machinery and appliances, non-metal manufactures, and pharmaceuticals.

Looked at another way, nearly all Australia's exports of non-monetary gold, and computer and office equipment depart our shores by air freight, as does around 80 per cent of our exports of pharmaceutical products. For electrical machinery and appliances, non-metal manufactures, and transport equipment (excluding made-up vehicles), the shares using air freight for export are between 50 and 60 per cent.

The export of perishable foodstuffs has been identified as a strong growth sector. Food demand in the Asian region is expected to grow strongly over coming years, reflecting continued economic and income growth (notwithstanding recent instability in some markets) and the inability of local producers to meet the (changing) needs of expanding populations.

According to estimates by the DFAT, Australia's shares of the imported food markets were generally less than 10 per cent in most north, east and south-east Asia countries, with substantial prospects for expansion.

Changing attitudes and operating practices within manufacturing are likely to drive much greater use by this sector of air freight.

Prominent drivers will include: the increasing globalisation of secondary industry, in particular the more specialised nature of production and distribution; considerably greater time-sensitivity in production processes (including the use of just-in-time supply); and, the accelerating growth in exports of high-value goods.

Either way, whether exports of perishable foods or time-sensitive manufactures, air freight is becoming increasingly important for our capacity, as a nation, to earn foreign income.

As the DFAT told the Vaile Inquiry into Australia's air freight exports: "The demand for air freight services is likely to continue to rise rapidly, underpinned by the strong general growth in Australia's export volumes in recent years."

"Four product categories are most prominent amongst the growth in all commodities travelling by air world-wide: car and motor-cycle parts, pharmaceuticals, textiles and electronics. Many companies are beginning to use air freight as the primary conduit for just-in-time inventory management, rather than resorting to the expense of more traditional distribution and inventory management systems."

"Perishable exports will be one element of this growing demand for freight capacity... Australian exports of food are likely to grow, given Australia's already strong reputation as a supplier of 'clean and green' produce. High value fresh food items such as fresh seafood will continue to do well in markets like Japan." (Volume of Submissions, page 248).

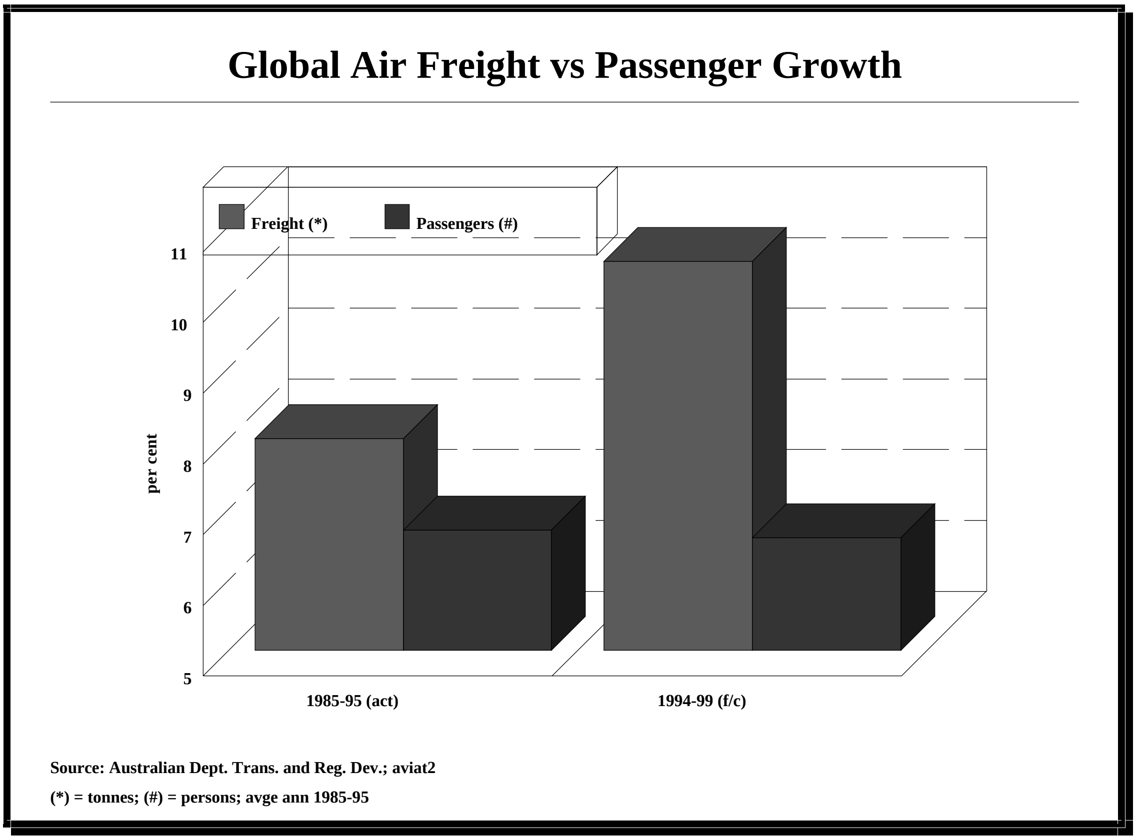
. Supply of Air Freight Services

The supply of air freight services for exporters is tightly linked to that for out-bound passenger traffic. In many respects, air freight is a close companion of the international passenger travel market.

The Federal Department of Transport and Regional Development (DTRD) has estimated around 90 per cent of air freight movements into and out of Australia on scheduled air services travel in the belly hold of passenger services.

As such, the terms and conditions of access for these passengers services to international aviation routes and systems will have important implications for the supply and configuration of air freight services for Australian exporters.

Interestingly, international air freight volumes have grown faster than comparable passenger numbers over the past decade or so, and are expected to do so for the remainder of this decade, trends the DTRD sees being replicated for this country; as the following chart shows:



In the decade to 1995, global freight movements (on a tonnage basis) rose at an annual average rate of 8 per cent, while passenger numbers increased by 6.7 per cent on the same basis. The World Tourism Organisation has calculated between 1985 and 1992 air freight grew at an annual average rate of 7 per cent, ahead of tourism (5.5 per cent) and trade (5 per cent).

Forecasts by the International Air Transport Association, which represents the interests of the airlines, for the five years to 1999 are for the margin to widen, with freight volumes growing by 10.5 per cent and passenger numbers by 6.6 per cent per annum, on an annual average basis.

Official figures indicate some 55 Australian and international carriers operate around 700 services per week to and from Australia. The freight carried on these scheduled passenger services is augmented by 24 weekly dedicated air freighter services.

As a broad rule of thumb, scheduled international passenger services are capable of uplifting an average of around 10 tonnes of airfreight, although this can vary with distance, terrain (flying over land or sea) and weather: for Sydney-Singapore, the uplift can be as much as 14 tonnes, while for Sydney-Los Angeles it can be as little as 2 tonnes (largely reflecting the extra fuel load and more problematic weather).

Successive Australian Governments over the past decade have implemented progressively liberal approaches to charter services, for both passenger and (especially) air freight, which adds further to this supply of capacity.

These Governments have also actively pursued, and largely delivered, aviation policies which have sought to ensure capacity is negotiated well above and ahead of actual need.

Indeed, in the four years to June 1996 Australian Governments have negotiated a doubling (excluding freight-only) of capacity, which in turn has delivered a comparable rise in air freight capacity in the belly holds of passenger aircraft.

This supply of air freight capacity - both in the belly hold of passenger aircraft and in dedicated air freighters - has produced a situation where: there is substantial unutilised capacity on many international routes into and out of Australia; and, as a result, Australia’s outbound freight rates are amongst the lowest in the world, and lower than in-bound freight rates.

Taken as a whole, according to the DTRD, in evidence to the Vaile Inquiry:

“The current level of scheduled passenger services per week means that there is a well developed and sophisticated transport system which provides freight capacity to a wide range of gateways and destinations.”

“Importantly, the level of scheduled passenger services means that freight space is often available at much lower rates than would otherwise be available if freight capacity was only provided on dedicated freight services.”

“In fact, on many routes out of Australia characterised by low but constant demand, provision of air freight capacity in the belly hold of passenger aircraft is the only economically viable option as there would be an inadequate return to an airline from operating a freight only service.”

“However, the use of passenger services has disadvantages for exporters including flight departure times serving passenger needs rather than freight needs and passengers and their baggage receiving priority over freight shipments. These must be balanced by exporters against the relatively low rates on offer.” (Volume of Submissions, page 758)

While moving air freight in the belly-hold of passenger aircraft delivers a substantial net benefit for exporters of relevant products, the essential message from the DTRD submission, and the large number from users (especially exporters of perishable products) is air freight is generally in competition with passenger baggage for uplift space.

The Vaile Inquiry/Report spent a considerable part its time and space addressing user concerns about ‘freight being kicked off passenger planes to make way for baggage’. While these matters are outside the scope of this submission, we note Qantas’ view, no doubt borne of the commercial reality of the competitive international aviation industry:

"(F)reight as a whole also must compete against the demands of the passenger sector, including baggage, and fuel. Invariably freight cannot compete against passenger revenue returns on the same aircraft." (Volume of Submissions, page 165).

Looked at another way, one pallet of air freight represents a relatively sizeable share of capacity - according to Qantas, as much as the equivalent of 50 passenger seats. Given the out-bound air freight rates, the net yield to the carrier of 50 passengers would generally exceed that of a pallet of air freight, other than for very high value products for which premium charges can be sought.

. Dedicated Air Freighter Services

As noted earlier, the overwhelming majority, by value, of Australia's air freight exports and imports travel in the belly hold of scheduled passenger services, a situation which is unlikely to change in the foreseeable future. The remaining 10 per cent is carried by dedicated air freighter services, or in the belly holds of charter passenger services.

The genesis of the Vaile Inquiry, and subsequent Report, included calls by exporters of perishable products for greater awareness and remedial action on the perceived problem of inadequate air freight services: at peak seasons; and for producers without close access to the main Sydney/Melbourne/Brisbane international aviation hubs which account for 55 per cent, 23 per cent and 9 per cent, respectively, or 85 per cent collectively, of Australian air freight capacity.

Leaving aside the issues of the quality of air freight services in these situations (issues addressed in the dedicated Vaile Inquiry/Report), an essential hurdle in the supply of dedicated air freighter services is cost of provision for the air freight carrier.

In simple, yet easily understandable, terms the air freight service operator will not provide a commercial service unless it is profitable for them to do so.

In general terms, assuming the use of a dedicated B747 aircraft, this means ensuring an uplift around of 100 tonnes of product at an average transport cost of, at very least, $A 2 per kg.

Qantas has estimated the average cost of operating a B747-200F aircraft was around $A 13,000 per block hour - $US 10,000 per hour at $A/$US 0.763 - in the 1995/96 financial year; Singapore Airlines has estimated $A 20,000 per block hour for a B 747- 400 F service. (A block hour is the time taken from push-back from terminal of departure to arrival at terminal at destination, and includes taxiing and waiting time.)

The airtime alone for a Sydney-Los Angeles-Sydney trip can amount 28 hours, while a Sydney-Singapore-Sydney trip can be as much as 14 hours: hence the need for the airlines to ensure maximum load factors against which to apportion substantial operating costs.

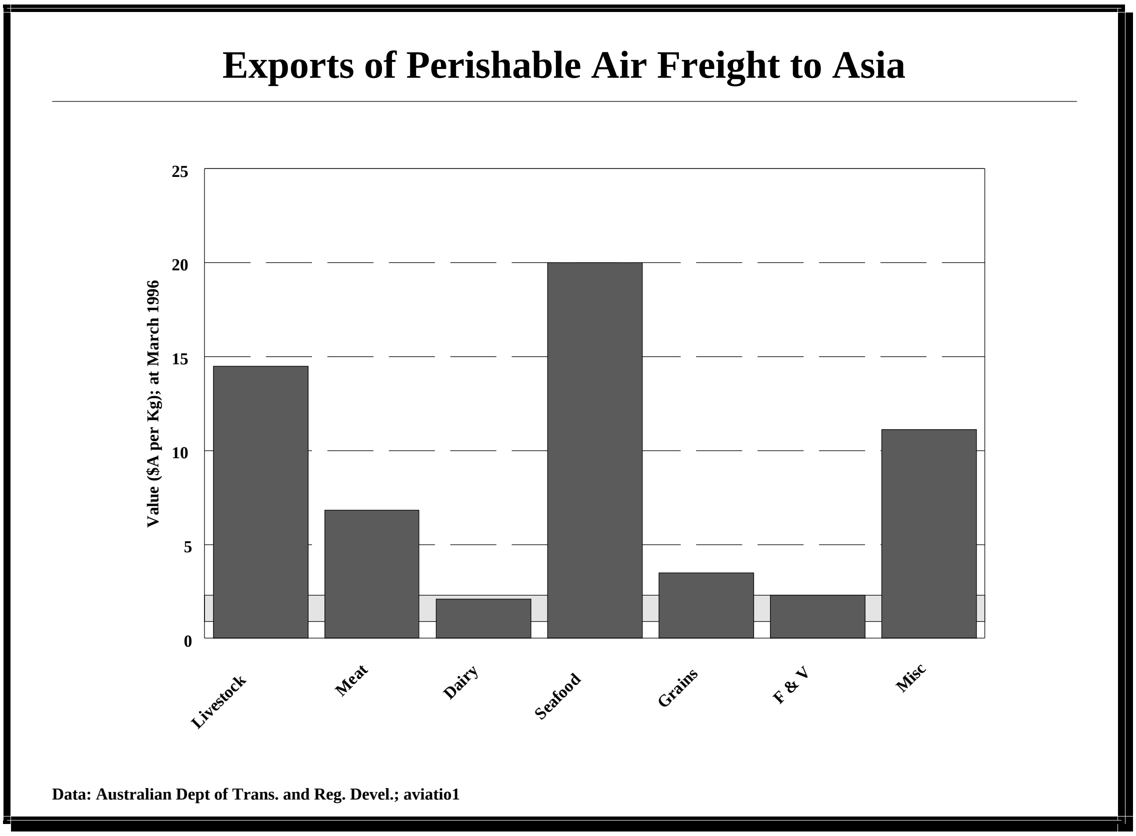
Qantas told the Vaile Inquiry a trip by a dedicated air freighter Melbourne-Hong Kong-Melbourne would take around 17 hours and 40 minutes flying time, with an operating cost (at mid 1996 prices) of $US10,000 per hour, or more than $A 235,000 for the round trip (at $A/$US = 0.75)

On a full pay load, both directions, the average cost per kilogram of air freight uplifted would be $A 2.14; at a more realistic load factor of 85 per cent, the cost would rise to $A 2.52 per kg.

These figures do not include profit margin for the carrier, while consistent load factors of 85 per cent (the minimum considered viable to sustain a dedicated air freighter) are available for only short periods - peak season for perishables - each year. They are also well ahead of what Qantas calculated were the $A 0.80 to 0.95 per kg actual rates for carriage in passenger belly-holds.

Research by the Bureau of Transport and Communications Economics on the value of perishable exports to Asia found over half the goods were relatively low value fruit and vegetables, with an average value of $2.31 per kg.

As the following chart shows, only a small number of groups of perishable products would be viable to export by dedicated air freighter to Asia:



As the graph indicates, only livestock, meat, seafood and miscellaneous perishable (such as flowers) would generally be viable for export by air-lift on a dedicated air freighter service, with dairy, grains, and fruit and vegetable probably unviable.

Looked at another way, the lowest average cost of a dedicated air freighter service would be more than one-third the average value of most perishable goods, and almost equal to their full value in some cases.

Indeed, given the airline's costings are very much lower bounds (given they do not include ground or handling costs of, let alone a margin for profit for, the air freight operator), the fractions are likely to be higher again.

The hard reality is international dedicated air freight services are geared towards, and generally more viable on, high value/heavy volume routes (such as the North Atlantic, and to a lesser degree northern Pacific), and not to the lower value/volume routes typified by Australian connections.

The implications of this picture is relatively clear: relatively few routes to and from Australia could support dedicated air freighter services, given current general aviation costs/export product prices; and, belly hold carriage in scheduled passenger services will remain for the foreseeable future the overwhelming source of capacity for air freight into and out of Australia.

According to Qantas, in its submission to the Vaile Inquiry, the supply of air freight services, either in the belly-holds of passenger aircraft or on dedicated air freighters is likely to remain focused on the Sydney and Melbourne hubs for straightforward commercial reasons:

“The primary capacity flows into and out of Australia are concentrated in Sydney and Melbourne (on both passenger and freight services) because they are comparatively the only strong sources of inbound demand for high value imports. Consequently, the lion’s share of capacity available for export is also concentrated on these two cities.”

“Freighter (and other) operators have no incentive to add to their costs by diverting capacity via the smaller Australian gateways when demand in those markets is almost entirely driven by low-value cargo which fetches low freight rates.” (Volume of Submissions, page 156)

. The regulatory framework for air freight services

Australia's air freight services, like those for passenger services, are regulated through the many - currently more than 50 - Air Services Agreements (ASAs) we have with other countries. Around half of these Agreements have been translated into actual services.

These ASAs, by intention and outcome, have a profound impact on the market place, in aggregate supply and its configuration, for aviation services, both passenger and freight.

- national carrier interests

These Agreements are negotiated bilaterally, reflecting the interests of the two participating governments, which can and do operate as agents for their respective national carriers (whether or not they are publicly or privately owned).

The ASA's generally deal with named routes to be served by the participating countries, which freedoms (air service rights) are to be granted, the frequency of flights, the size of aircraft, and even the method for determining prices.

In effect, the ASA-based system for determining aviation market access are little better than government-determined non-tariff barriers to trade and commerce. They are as distorting and corrupting of, and detrimental to, competition and efficiency as their namesakes in other areas of international business.

The DFAT outlined fairly clearly the 'balance of interests' approach adopted by the Australian Government in negotiating ASAs when it told the Vaile Inquiry:

"In recent years, the assessment of the balance of interests has shifted to some extent away from a position of simple congruence with Qantas (when it was the sole national carrier) although the views and interests of our designated carriers are still important considerations."

"Due regard to gaining access for Australia's designated carriers is still a vital consideration because this access to foreign destinations, and therefore our designated carriers' competitiveness, is totally dependent upon the results of government-to-government negotiations." (Volume of Submissions, page 265)

The DFAT also told the Vaile Inquiry the emphasis given to the access entitlements for national carriers in ASA negotiations may not necessarily always maximise the opportunities for the Australian trading community, with the 'fine judgements' in these trade-offs being matters for responsible governments.

- passengers vs freight

The general perception of commerce and industry remains ASA negotiations, including their configuration, are predominantly driven by passenger interests, with air freight an ancillary and second round issue.

While Australian Governments may no longer see the terms and conditions of ASA negotiations as closely linked to the direct interest of a publicly-owned national carrier (with both Australian international carriers being privately owned), the same cannot be said for the counter-parties in some of the negotiations (although the global trend towards airline privatisation is encouraging in this regard).

Indeed, international experience suggests the nature and extent of regulatory intervention in bilateral ASAs rises in proportion with the degree of government ownership, protection or subsidy of national carriers. In some ASA negotiations, this can lead to quite different approaches and objectives for the respective national governments.

Contrary to some perceptions, capacity provisions vary between agreements and tend to be set against maximum rather than minimum performance indicators. Quite a few agreements are either actioned by one side only, or not actioned at all (that is, zero utilisation for either passengers or freight).

Indeed, the bilateral ASAs provide the designated airlines (being single or multiple carriers from the respective countries) with a high degree of flexibility in apportioning capacity between passengers, freight and/or mail.

Most ASAs to which Australia is a party allow multiple designation, meaning more than one carrier from either party (eg Qantas and Ansett, of Australia; Garuda and Sempati, of Indonesia, on that bilateral).

As a general rule, these ASAs deal with aviation services in a generic sense and do not differentiate between passenger and freight capacity, leaving the airlines to allocate this capacity at their own discretion and on commercial grounds (for example, profitability and creating shareholder value).

Not surprisingly, the overwhelming majority of the negotiated capacity on most routes into and out of Australia is allocated by the airlines on commercial grounds to passenger services, reinforcing the general tendency for air freight to be moved in the belly holds of (and as a adjunct to) scheduled passenger services.

The Howard Government, in June 1996, announced Australian would seek to negotiate specific dedicated freight entitlements in our bilateral ASAs. However, the agenda of such negotiations are likely to remain dominated by the higher yielding passenger services dimension, with dedicated air freight being a ‘second round’ issue.

As the DTRD told the Vaile Inquiry: “While this policy approach removes any policy impediments to air freight carriage it will not necessarily change the structures of the freight market between two countries if the commercial reality is that higher returns are available for carriers in carrying passengers or in other markets; or if exporter demand is insufficient in price or co-ordination of supply to support dedicated freight." (Volume of Submissions, page 774)

- capacity utilisation

According to the DTRD, capacity is generally not an absolute constraint on air freight use by Australian exporters, although there can be excess demand (over supply) on some direct routes at certain times (eg peak seasons) for specific products (eg perishables). These bottlenecks tend to be exceptional, rather than general and regular.

The DTRD told the Vaile Inquiry at that time (July 1996) there were the equivalent of 52 x B 747s per week (or more than 7 such aircraft per day) in spare capacity available between Australia and ASEAN countries to meet additional passenger/freight demand, with an additional 8 x B 747s available for dedicated air freight movements.

For the rest of Asia (including India, and the high traffic routes of Hong Kong and Japan), there were just over the equivalent of 41 x B 747s per week (or nearly 6 such aircraft per day) in available capacity.

Where there are particular bottlenecks, such as the lack of sufficient available capacity on certain direct routes (such as Australia to North Asian destinations at peak exporting seasons for perishable goods - October to December), air freight charters are permitted within a very liberal regulatory environment.

Indeed, the number of air freight charters has almost doubled in recent years, from 375 in 1992 to 720 in 1995, according to official statistics.

Figures produced by the DTRD indicate outbound utilisation rates (usage as a per centage of capacity) on scheduled freight services average about 60 to 70 per cent for much of the year, except for the months of October through to December inclusive when demand is up to 120 per cent of capacity.

Qantas echoed this situation in its submission to the Vaile Inquiry arguing, inter alia: capacity provided by scheduled airlines, including air freighters, throughout most of the year is excess to demand by around 30 to 40 per cent; in peak seasons supplementary/charter passenger flights can uplift the increased demand for capacity from exporters of perishables; and, Australian Government policy has been to negotiate increases in capacity well ahead of expected demand.

- recommendation(s)

Against this background, the Australian Chamber of Commerce and Industry recommends the Australian Government, including the Industry Commission in its current reference, take fully into account when developing policy for the negotiation of air service arrangements the commercial reality:

. the belly hold carriage in scheduled passenger services will remain for the foreseeable future the overwhelming source of capacity for air freight into and out of Australia; and,

. this dependency be given greater weighting in the strategic and tactical approaches taken to the negotiation of such agreements.

Aviation Liberalisation - 'Opening the Skies"

Liberalisation of the international aviation industry is already on the broader trade policy agenda.

Indeed, aviation liberalisation is essential to the further freeing-up of the global trading system. It is wholly unrealistic to expect the world trading system to liberalise the trade in goods, services and the movement of people and capital without commensurate deregulation of the means for achieving these outcomes.

Put simply, freer trade in goods and services requires freer trade in transport services. The most obvious winners from such reforms would be the travel, tourism and freight industries, and those who use or rely upon them for commerce, income and/or employment.

. Multilateral - World Trade Organisation

The idea of a uniform multilateral framework governing a largely deregulated, very liberal international aviation system is not new. In fact, it was mooted more than half a century ago, at the Chicago Conference of 1944 which laid the foundations for the current international air transport system.

The United States pressed hard the case for a system under which capacities, frequencies and charges/prices would be set by international market forces, not government/ regulatory fiat, but met stiff resistance from countries such as the United Kingdom which feared American domination of the post-war aviation system.

The still-existing system of bilateral air service agreements (the focus of the current Industry Commission review) was born out of the compromise between the pro-liberalisation and the pro-regulatory groups at and following the Chicago Conference.

More recently at the multilateral level, primarily through the World Trade Organisation (WTO), there have already been attempts to include aviation reform within the scope of the landmark General Agreement on the Trade in Services (GATS).

While these efforts, taken in the context of the long-running Uruguay Round, where initially unsuccessful, the WTO has an obligation to undertake a review of, and potentially negotiations on, the international aviation industry.

At the same time, it is ironic that international law has already established a 'free seas' policy, while there have been commendable efforts to deliver maritime transport liberalisation under the WTO and multilateral sectoral organisations.

. **Regional: Asia Pacific Economic Co-operation (APEC)**

Aviation liberalisation in the Asia Pacific region has been progressing more on a bilateral rather than a regional basis.

While Leaders of the then 18 APEC Member Economies committed themselves in the landmark Bogor Declaration to ‘free and open trade and investment around the region’ by 2010 for developed countries (such as Australia) and 2020 for developing countries, their transport ministers and officials have not shown the same degree of enthusiasm or commitment to this laudable objective.

At most, transport ministers and officials have given weakly worded ‘support’ to an options paper on “More Competitive Air Services with Fair and Equitable Opportunity”.

Indeed, two of the Options amount to a clear lack of ambition for, if not outright retreat from, regional aviation liberalisation:

. Option 7 says “for the foreseeable future, the bilateral system offers the best prospects for further development of more competitive air services”;

. while Option 8 (h) says “APEC economies might like to consider whether there is any merit in a progressive, staged approach to more open market access under the bilateral system, on the basis of fair and equitable opportunity.”

Converting the diplomatic code of Option 8 (h) to plain English indicates APEC transport ministers and officials appear to have agreed to: do very little on aviation liberalisation; with anything at all maybe under the bilateral system; and almost certainly nothing at all under the regional umbrella of the APEC initiative.

The slow pace of movement on the issue, and the apparent desire by a number of APEC countries to at least marginalise the issue of aviation liberalisation, if not delete it from the agenda altogether, suggests APEC is unlikely to become a useful vehicle for achieving meaningful aviation liberalisation, with this sector falling short of the ‘free and open’ tests at the respective deadlines.

. Bilateralism - Australia and New Zealand

On a bilateral basis, the Australian and New Zealand Governments operate what amounts to an ‘open skies’ approach to international aviation across the Tasman Sea.

Under this arrangement, there are no limits on the number and type of services which airlines from the two countries can operate across the Tasman, and carriers from both countries have unrestricted access to the other’s domestic markets. However, ‘beyond rights’ remain problematic in the bilateral relationship.

In effect, the Australia- New Zealand arrangement is a limited (that is, bilateral) form of ‘open skies’, indicating the Australian Government has no objection in principle to the model.

Australia could usefully replicate this model with some of the other nations of the Asia-Pacific region, especially the island States of the south and central Pacific, as an initial step in a broader program of aviation liberalisation.

The international aviation policy of the Australian (Howard) Government for the foreseeable future appears to be limited to greater reliance on bilateralism in air market access negotiations, eschewing regional or multilateral strategies:

“Most of our major aviation partners continue to embrace a bilateral approach and we will continue to negotiate with them using the increased flexibility that is achievable under the bilateral system.”

“Our focus will rightly be on our major markets and those bilateral partners who have in the past and continue to deliver increases in passengers and freight.” (Minister for Transport and Regional Development, The Hon Mark Vaile MP, to an aviation industry forum, 28 October 1997, Sydney).

. The United States' 'Open Skies' Model

The United States' Government has become active in recent years in pressing an 'open skies' framework, albeit on a bilateral rather than multilateral basis.

Some 22 such agreements have already reached. Signatories include Asia Pacific countries such New Zealand, Singapore, Taiwan, as well as 12 European and 6 South American nations with negotiations continuing with a number of other significant players in international aviation, not least of which are Britain, France and Japan.

Despite continuing overtures from the United States Government, the Australian (Howard) Government has expressed disinterest in entering into an 'open skies' style of agreement, with Transport Minister, the Hon Mark Vaile telling an aviation law forum "our policy is not 'open skies'" (Sydney, 28 October 1997).

Key elements of the US 'open skies' model, and the agreements already reached, include: open entry on all routes; unrestricted capacity and frequency on all routes; flexibility in setting fares; liberal cargo and charter arrangements; and, open code sharing (which enables airlines to on-book passengers and cargo) and non-discriminatory access to computer reservation systems.

Important benefits of the 'open skies' agreements for the bilateral parties derive from greater competition, and more specifically include: for both passengers and freight users, more frequent services and lower fares; and, for operators, increased destinations and the opportunity to fly to third - 'beyond' - countries (although only for cargo, not passengers, in a number of cases).

Emphasising the latter point, the US model amounts to substantial liberalisation in international aviation in many cases, but does not meet the test of being genuinely 'open skies' - and will not until such 'beyond rights' include not only freight but more significantly passenger movements.

Given the likelihood of the United States Government securing agreement from an increasing number of countries, and reflecting past practice by that nation, there is the very real prospect the US-negotiated ‘open skies’ agreements could well become the foundation for the wider negotiation of what could be called a Multilateral Agreement on Aviation (MAA).

Indeed, a major review commissioned by United States President Bill Clinton (the Baliles Commission) recommended just such as strategy: the United States should lead the way in negotiating bilateral and/or regional ‘open skies’ agreements as platforms for a global, or multilateral, ‘open skies’ arrangement.

. A Multilateral Agreement on Aviation (MAA)

The negotiation of a Multilateral Agreement on Aviation (MAA) within the WTO GATS would merely bring the international aviation system into line with other aspects of the global trade in goods and services. In reality, it would mean a modest widening of an existing generic practice.

Any MAA under the WTO GATS would essentially have to build on the three key principles which are the foundation stones of the global trading system.

They are: most favoured nation - where any privileges or the like granted to one trading partner must be extended equally to all other WTO member countries; national treatment - where foreigners are treated no less favourably than domestic players; and, non-discrimination - ensuring there is no discrimination between nationality of foreigners.

Key elements of any MAA negotiations should include: ensuring liberal market access, with no restrictions (bar genuine safety considerations) on capacity or frequency of services; charges, prices and fares should be set by the market, subject only to bona fide competition policy issues; passenger and freight movements; and, transparent and welcoming accession arrangements for countries which wish to join during or after the negotiation processes.

Clearly, this short listing highlights only a small number of the more important elements of any MAA, and is far from exhaustive of the many issues which could be included in any such formal negotiations.

- recommendation(s)

Against this background, the Australian Chamber of Commerce and Industry recommends the Australian Government:

. take a leadership role within the APEC initiative in aviation liberalisation issues, most notably the development of an integrated region-wide program of aviation liberalisation in the Asia Pacific within the context of the Bogor Declaration of 'free and open trade and investment'; and,

. take a leadership role within the General Agreement on the Trade in Services (GATS) negotiations under the World Trade Organisation (WTO) for negotiations on multilateral aviation liberalisation, or failing this participate actively in any negotiations for a Multilateral Agreement on Aviation which may progress under the auspices of the Organisation for Economic Co-operation and Development (OECD).

Summary and Conclusion

Air transport is a critical issue for an island nation like Australia. Around one-quarter of our export income comes from the airlift of higher value/lower volume commodities and manufactures. Tourism is already our single largest source of foreign exchange.

At the same time, successive Australian Governments have quite properly embraced the cause of domestic, regional and multilateral liberalisation of the exchange of goods, services, investments and people through arrangements such as APEC and the WTO. Yet, ironically, they have been notably reticent in pursuing the same degree of liberalisation in the means for realising the benefits of these liberalisations - the transport systems, especially air transport.

The current Industry Commission reference on the regulatory impact of the ASA system will not solve all of the problems arising from the distortions caused by these non-tariff barriers to trade. However, a pro-competition outcome, augmented by efforts at regional (through APEC) and multilateral (through the WTO) aviation liberalisation are necessary first steps.