

AUSTRALIAN TOURIST COMMISSION

**SUBMISSION TO THE
INDUSTRY COMMISSION**

**INQUIRY INTO
INTERNATIONAL AIR SERVICES**

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1. THE CURRENT REGULATORY ENVIRONMENT

1.1 Changed market for international air services

The market for international air services to and from Australia has undergone significant changes in recent years. Over the past decade, inbound tourism to Australia has recorded spectacular growth. In 1987 international visitor arrivals into Australia totalled 1.8 million. Ten years later this had risen to 4.3 million international visitors in 1997.

At the same time the top ten countries from which Australia draws its international visitors has changed significantly as the following table indicates:

1987	1997	2001*
1. New Zealand 427,289	1. Japan 813,892	1. Japan 1,241,000
2. USA 310,602	2. New Zealand 685,655	2. New Zealand 756,000
3. Japan 215,562	3. UK 410,620	3. UK 537,000
4. UK 198,942	4. USA 329,586	4. USA 433,000
5. Singapore 56,958	5. Singapore 239,306	5. Korea 417,000
6. Germany 53,260	6. Korea 233,815	6. Indonesia 347,000
7. Canada 52,733	7. Indonesia 160,366	7. Singapore 331,000
8. Malaysia 47,110	8. Taiwan 153,247	8. Hong Kong 255,000
9. Hong Kong 42,689	9. Malaysia 143,683	9. Taiwan 250,000
10. PNG 32,839	10. Germany 128,874	10. Malaysia 223,000

The next few years is expected to see continuing growth in international visitor arrivals. According to the Tourism Forecasting Council (TFC) June 1997 forecasts, the outlook will remain positive. The TFC has forecast that international visitor arrivals will reach 6.2 million by 2001 and that there will be some variation in the top ten source markets as indicated in the last column of this table. Given the recent changes in the economic situation in Asia, the forecasts from some source markets will be subject to revision. Updated forecasts will be released in June 1998.

The number of carriers flying into Australia over the last 10 years has increased from 35 in 1988-89 to 53 in 1996-97. New carriers are primarily from the

* Tourism Forecasting Council forecasts June 1997

Asian region, whilst some carriers from the more traditional source markets such as the USA and Europe have stopped services into Australia during this time. The number of codesharing arrangements has also increased during this time period, most particularly in the last 2-3 years.

1.2 The Bilateral system of Air Service Agreements (ASAs)

Similarly to most countries, Australia operates a number of bilateral ASAs to regulate air services into and out of the country.

Australia's current system of ASAs specify a range of issues much greater than simply allowing a country the rights to fly into Australia.

By specifying designated city pairs, ASAs limit the ability of airlines to fly into all areas of Australia or indeed to alter their plans should they desire to do so. This limits their ability to respond to changes in market conditions.

In terms of operational efficiencies, it would seem logical that less restrictive agreements would be more operationally efficient as they provide the airlines with ability to respond to consumer and market changes without the need for the renegotiation of a bilateral ASA.

Thus the ATC favours ASAs being negotiated with less prescriptive/restrictive components to the agreement.

1.3 Australia's approach to negotiating entitlements – consultation arrangements

The key consultation mechanism between tourism and transport interests in relation to ASAs is the Tourism Advisory Group (TAG).

TAG was established in 1992 by the then Department of Tourism and Department of Transport to facilitate communication between the two departments. It provides a mechanism for updates from the Department of Transport to tourism officials, and for tourism input and perspective on aviation issues to transport officials.

TAG comprises officers from States/Territory Tourism Authorities, the ATC as well as industry representatives, and meets on a quarterly basis. Officers from the Department of Transport and Regional Development (DoTRD) attend these meetings and provide updates on previous and upcoming aviation negotiations as well as any policy issues.

TAG members are invited to provide input to all ASA negotiations. The Office of National Tourism perform a co-ordinating role in bringing together all TAG members input and submitting a tourism perspective to DoTRD.

ATC believes that this process works reasonably well. It could be improved by greater notice of when ASAs are taking place, as often it is difficult to meet tight time restrictions imposed on providing input. This situation has however improved in more recent times, where a general indication of upcoming talks is provided 3-6 months in advance.

The way in which the consultation process takes place does however focus on tourism input being provided to transport officials. It could perhaps be improved if a clearer understanding of Australia's overall position on the air talks was provided. By providing such a framework, more relevant information would perhaps be forthcoming. For example, there may be occasions where it would be beneficial to be aware of Australia's foreign policy and economic imperatives in developing the overall negotiating position. Awareness of such issues would assist in developing the tourism input and ensure that the tourism perspective was consistent with the Government's other policy objectives.

The ATC has an excellent working relationship with DoTRD. On some occasions prior to the commencement of ASA negotiations, the negotiator will seek the views of the ATC on tourism issues relating to the talks and seek ATC input on a specific aspect of those talks.

The ATC also provides regular briefings to the DoTRD on tourism priority markets and ATC's strategic plan. In mid-1997 ATC presented its five year strategic plan to DoTRD and in February 1998 DoTRD were consulted on the development of ATC's Corporate Plan.

1.4 Representation in ASAs

The ATC has in the past been directly involved in ASAs as a member of the ASA negotiating team on two occasions. These were the Australia-Japan and the Australia-Taiwan negotiations during the early 1990s. The ATC is of the view that it should be able to participate directly in those negotiations where tourism is a major component of airline business from an international market.

The ATC is the Federal Government's statutory authority with responsibility for marketing Australia internationally as a tourist destination. With offices around the world, the ATC is in the unique position of being able to offer direct in-depth market knowledge and expertise.

As the ATC works with many foreign carriers, there is an added advantage of ATC involvement in ASA discussions. Many of the foreign carriers who are involved in the negotiations recognise the ATC's role and expertise particularly in the market so this agency's involvement would help to strengthen the credibility of Australia's position in negotiations for ASAs.

2. RECENT CHANGES TO AUSTRALIA'S INTERNATIONAL AVIATION POLICY

Recent reforms have resulted in Australia's aviation policy changing greatly over the last five years. Overall these changes have resulted in greater liberalisation of Australia's air services, with changes such as multiple designation, whereby more than one Australian carrier can operate on an international route, as well as the privatisation of airlines and airports. These changes have resulted in greater levels of competition in Australia's air services and thus translate into consumer and economic benefits.

As the International Air Services Commission (IASC) is now tasked with allocating negotiated services, a very different situation exists from the time when all negotiated capacity was available to *Qantas*. From a consumer perspective, there has been an increase in the range of services available and a greater choice of carriers and destinations.

2.1 International Trends

In recent years, Japan has pursued a policy of greater liberalisation in respect to the negotiation of its air services. For many Japanese carriers that operate at relatively high cost structures, it is understood that this is a welcome development because the pre-existing regime of over regulation exacerbated costs.

In January 1998 Japan and the USA announced a new civil aviation agreement that liberalises all previous arrangements. The alliance will result in increased services between the two countries as well as enabling carriers to code share on the route without restriction.

The likely code sharing alliances are *Northwest/Continental/Japan Air Systems*, *JAL/American Airlines* and *ANA/United Airlines*.

From the USA perspective, the new agreement has moved towards achievement of full “open skies” with Japan. According to press reports, Japan does not share that view and has stated that they do not agree with the USA approach to “open skies”. Both countries have however stated that the agreement will facilitate competition and result in better services at lower prices to consumers.

The Japan/USA agreement has already impacted on air services to Australia. *All Nippon Airways (ANA)* are shortly expected to officially announce that they are planning to halve their current services to Australia, and will be cancelling six weekly services between Tokyo, Brisbane and Sydney effective 1 July 1998.

It appears that *ANA* have taken this decision in order to free up slots at Narita Airport for additional services to the USA, as a result of the recent agreement between Japan and the USA.

The European Union entered into an “Open Skies” arrangement within Europe from 1st April 1997. This policy allows all European based carriers to fly within Europe and point to point in one European country. For example, *British Airways* is able to provide services on the Paris-Nice route as often as it desires. While it is still too early to determine the full impact of these changes, it would seem likely that the combination of market forces and consumer choice would result in an overall net benefit.

It is also understood that certain European based carriers such as *Lufthansa* have an arrangement with the USA based carrier *United Airlines* which allows these airlines some form of “open skies” with European based carriers being able to fly to any points in North America.

2.2 Alliances and Codesharing

A significant increase in the prevalence of alliances and codesharing has been evident by airlines in recent years. The primary factor leading to such arrangements relates to the economic realities of operating in a competitive, high cost environment. Airlines will choose to enter alliance and other arrangements such as codesharing when and where they consider it economically viable to do so.

The ATC supports alliances where there is a demonstrable benefit to potential and actual visitors to Australia. It does not support such alliances where services into Australia are decreased as a result of the combining of services and thus where the consumer has reduced choice and access.

Recent experience would suggest that alliances have been of benefit to Australia. The relatively recent alliance between *Qantas* and *British Airways* has resulted in an increase to the number of sales outlets across Europe for air services to Australia given the strength of the *British Airways* network across Europe.

The *British Airways/Qantas* alliance is also resulting in a wider range of choices for the consumer in terms of how they travel to Australia. As these alliance partners operate a strong yield management focus on the UK-Australia route, passengers are given a range of options in terms of how they access Australia.

For example, a *British Airways* reservations clerk is able to assess whether flights to Australia via the traditional routes of Bangkok or Singapore are full, and whether routing a passenger through South Africa or Japan is an option as well as whether this will deliver a cost saving to the consumer. These options are available as a result of the alliance which has created a number of different routes to and from Australia and often provide the consumer with a lower fare than the more traditional routes.

The ATC is also supportive of the proposed alliance between *Singapore Airlines*, *Air New Zealand* and *Ansett Airways*. This alliance, if approved, will enable *Singapore Airlines* to more effectively market and promote Australian holidays to the European consumer since it will have a dedicated airline partner offering a comprehensive domestic service to all points in Australia. Currently, and despite their strong commitment to the Australian market, *Singapore Airlines* is operating at a disadvantage in this regard.

Code-sharing can of course be one component of an airline alliance, with potentially quite different impacts to alliances. Recent experience in the UK suggests that passengers departing from the UK for Australia are flying *Qantas* even though they had originally made reservation with *British Airways*. Although the ATC does not have any direct evidence of consumer dissatisfaction with this situation, it does seem possible that some passengers will express dissatisfaction with such a change particularly given the length of this flight and the lack of notice of the change. This may not be a factor on shorter haul sectors such as the Australia-New Zealand route where code sharing is prevalent.

Another potential impact of codesharing is the decrease in number of Australian ports served. It can also lead to reduced capacity on certain routes. If carriers choose to rationalise their services through codesharing arrangements, less ports of entry may be serviced than when two airlines, with access to a number of entry points were operating on the route. Ultimately, these issues are determined by the financial imperatives the carriers operate within.

3. THE NATURE OF AUSTRALIA'S AIR SERVICE AGREEMENTS

3.1 Restrictions on capacity, aircraft and routes

The ATC believes that ASAs should be negotiated so that potential capacity is greater than actual demand. As markets can develop rapidly associated with strong economic development, it is important that negotiating capacity is ahead of demand.

In recent times, there has been rapid market development and consumer demand for air services in countries such as Korea and Taiwan. In the case of Korea, this coincided with the lifting of outbound travel restrictions and the realisation of a massive pent up demand to travel. Visitor arrivals from Korea increased from 28,930 in 1991-92 to 250,400 in 1996-97.

China is an interesting case where capacity has been successfully negotiated well ahead of actual demand on the route. This has assisted tremendously in the development of the market, whereby the ATC has been able to develop the market knowing that the air capacity was there to do so.

Australia was granted Approved Destination Status by the Chinese Government in December 1997. Whilst a number of factors contributed to this decision, the fact that air service capacity existed on the China-Australia route, and that five airlines (2 Australian and 3 Chinese) are operating on the route, would have been viewed very positively by the Chinese officials considering Australia's case for Approved Destination Status. Thus China is an example of where the importance and benefit of the supply of air capacity being ahead of current demand has been demonstrated.

In the situation where capacity is tight, and load factors are high, there are potential impacts on all aspects of the travel distribution system. If wholesalers and travel agents (retailers) experience difficulty in obtaining seats to Australia, they are likely to "cross sell" the potential Australian traveller to other more easily obtainable destinations. Thus the potential traveller to Australia who walks into a travel agency looking to travel to Australia, could be persuaded to

visit another destination, eg Hawaii or the USA if the travel agent has trouble in securing a seat to Australia.

The ATC is also aware that there have been recent capacity constraints in relation to air services between Thailand and Australia. This has impacted on the carriage of passengers from Europe to Australia, trying to access seats on flights through Thailand. This is an example of where an ASA with one country can constrain growth from a third country.

3.2 Fifth and sixth freedom rights

The ATC is aware that most of Australia's current ASAs allow Australian carriers to operate air services between two foreign countries, as long as the flight originates or terminates in the carriers home country.

Australia's current policy in this regard appears to maximise opportunities for Australian carriers to operate fifth and thus sixth freedom rights, and constrain opportunities for foreign carriers to do likewise.

Current arrangements vary significantly depending on the ASA that has been negotiated and also on the interests of the foreign country. For instance, the Australia-Thailand ASA provides for fifth freedom rights to Australian and European based carriers to carry passengers through Thailand and onto Australia. While it is open for Thai carriers to have fifth freedom rights to carry passengers via Australia and onto New Zealand, these rights have not been sought by Thailand, presumably because it is considered not commercially viable for their airlines.

For Australian carriers, fifth freedom rights are a significant financial factor to their advantage. The recently negotiated Australia-Singapore ASA grants fifth freedom rights to Australian based carriers to carry passengers from Australia-Singapore-India. It is understood that for Australian carriers servicing this route, the substantial demand on the Singapore-India-Singapore leg of this route was a factor in seeking these rights.

On the other hand, Australian carriers have consistently opposed the granting of these rights to foreign carriers who wish to operate a service through Australia. During recent negotiations, Korea attempted to negotiate fifth freedom rights for their airlines to carry passengers through Australia and then onto New Zealand.

Clearly, Australian based carriers are keen to have fifth and thus sixth freedom rights when it is in their commercial interests to have these rights. At the same time, Australian based carriers are understandably interested in ensuring that these rights are not extended to foreign based carriers.

However, the ATC is of the view that consideration should be given to granting fifth and sixth freedom rights to foreign carriers if these rights are held by Australian based carriers. Apart from the argument of equity, to do so would encourage greater levels of competition as well as providing an additional level of competitive discipline on Australian carriers. The ATC is also of the view that increased international tourism would be generated as a result of the additional level of service and convenience being offered.

3.3 Own carriage restrictions

Currently, international carriers flying into Australia are not automatically able to uplift their passengers between domestic destinations within Australia. The ATC disagrees with this policy and is strongly of the view that it inhibits the travel of international visitors across the country.

Given Australia's geographic dimensions, air travel is in many cases the most convenient way for international visitors to travel between destinations within Australia. The current restrictions are very likely to act as a major disincentive for the international traveller who wishes to book all their domestic travel with one carrier at the time of booking their international flight.

From the perspective of a visitor who has never travelled to Australia previously, being advised that they will either have to make their own arrangements when they arrive in Australia, or that arrangements can be made when booking their trip but that they will need to fly on another airline, is a situation likely to adversely affect their decision to undertake additional travel across Australia. Current arrangements do not enable foreign based airlines to offer competitive package holidays featuring Australian domestic flights to consumers.

Combined with the very high relative domestic airfares, the current regulations act as a disincentive for international travellers to visit a variety of locations across Australia. The ATC believes that greater competition is needed on Australia's domestic airlines routes to provide more consumer choice in terms of routes as well as pricing.

The ATC recommends that the current regulations regarding "own carriage" be changed in order to allow international carriers to carry their own passengers to destinations in Australia.

3.4 Charters

The ATC believes there are both potential positive and negative impacts of charter services operating into Australia.

In terms of positives, charter services can offer reduced prices and increase the overall number of seats available on a route. Recent experience in the UK is that both Britannia and Airtours have contributed significantly to the increase in visitors to Australia from the UK. By offering fares at a lower price than the scheduled carriers, a new segment of the market, who has previously wanted to visit Australia, but has been constrained by the cost of doing so, is now able to travel.

Both charter services have also increased the visibility of Australia in the market as they actively promote Australia whilst promoting their service to Australia. Airtours, with a strong retail outlet presence throughout the UK, have increased exposure of Australia in the market by brochuring of their packages to Australia. Britannia, as the first UK charter to fly into Australia have also played an important role in developing the market between the UK and Australia.

The recent charter activity from New Zealand to Australia also illustrates the impact that charters can have on the market. With the introduction of charter operators *Kiwi International* and *Freedom Air* in 1996, visitor arrivals from New Zealand into Australia increased from 538,377 in 1995 to 671,869 in 1996. This annual percentage growth of 25% contrasts with the historic annual average growth rate (1990-1995) of 5.2% and is directly attributable to the commencement of charter services on the route.

We believe that the introduction of the charter services, with price offers at an all time low, enticed many first time visitors to Australia as well as many repeat visitors. Many of these repeat visitors, familiar with Australia as a destination, decided to return to experience a particular event (sport, theatre) which was now a realisable option given the reduced air fares available in the market. Significantly, the scheduled carriers also reacted to the charter fare initiatives, by reducing their fares on the route as well.

The ATC is also supportive of charter initiatives from countries where there are no direct scheduled air services, such as the recent Canada 3000 charters from Canada. These services have provided direct access to Australia for Canadian visitors at a more competitive price than the current codesharing airlines. The ATC is hopeful that these charter services will assist in growing the overall market from Canada into Australia selected alternative holiday destinations.

Charter services can also disperse visitors across Australia and service new ports in a range of locations across the country which scheduled carriers may have no interest in operating services to. Charters from Singapore have in

recent years for example, operated services to a range of destinations including Hobart and Broome.

In short haul markets, charters can impact negatively on a tourist destination if in fact, by offering cheaper airfares, they lower the perceived value of the destination. This has been evident in places such as Florida and Majorca and has contributed to these destinations being “cheapened” in the eyes of the consumer. Given Australia is a long haul destination, we have no reason to believe that this would apply to Australia.

The ATC understands that current charter policy is quite liberal in terms of allowing charter services to operate on routes where there are existing scheduled carriers. However, the approval of charter services on routes where scheduled services operate, is subject to discretionary approval. Whilst approval of charters on these routes (eg Airtours, Britannia UK-Australia) has been granted, the ATC does not believe that such approval should be subject to discretion, and that in fact the policy should stipulate that subject to certain guidelines, charters can operate on scheduled routes.

The ATC is also aware that the length of time from application to approval of a charter service in some instances has been quite lengthy. This has impacted on the timeframe available to potential charter operators to start promoting the services. Whilst it is understood that a number of checks need to be made by DoTRD officials before approval can be granted, the ATC would like to see these checks streamlined wherever possible to ensure that the charter operator has a reasonable time period in which to promote the service.

Overall, the ATC is supportive of charter operations into Australia and would like to see greater facilitation of applications by foreign charters to access the Australian market. The ATC favours a clearly defined pro-active air charter policy that leads to the greater facilitation of charter operations into Australia.

4. ECONOMIC EFFECTS OF CURRENT ARRANGEMENTS

The economic effects of the current way in which ASAs are negotiated is an extremely complex issue with many influencing factors.

Overall, the ATC believes that the supply of air services should always exceed demand in order to ensure that rapid shifts in demand can be catered for without the need to immediately renegotiate additional capacity.

If formal negotiations were required to increase the supply of available capacity, there would be an economic cost in terms of the opportunity cost of the carriers not being able to provide a service to the number of people who demanded the service. Thus a potential loss in terms of visitors who would have come to Australia and spent money, but who were unable to secure a airline seat to do so.

In terms of recent changes in the multiple designation rules, the ATC is supportive of these changes. We believe that by having to compete to receive the right to service a particular sector, Australian carriers have a competitive incentive to perform well on the sector. The ATC believes that this has led to a heightened interest in marketing the service and thus working with this agency on promotion of Australia in international markets. The ATC is thus supportive of the retention of multiple designation for Australian carriers.

Many of the other comments made in this submission also relate to these issues.

5. ACCESS TO AIRPORT INFRASTRUCTURE

The access issue in an Australian context relates primarily to Sydney's Kingsford-Smith airport where the majority of visitors to Australia arrive.

It is difficult to determine whether or not access to Sydney's Kingsford-Smith airport is a key issue in relation to the way that Air Service Agreements are negotiated, however it would seem that in the agreements where city pairs are nominated, access to Sydney would be highly regarded by carriers. How such access is allocated and related to slot availability at a high demand airport such as Sydney's Kingsford-Smith is not clear.

The ATC is aware that internationally, access to airports is an issue. This is particularly so at Tokyo, Hong Kong and UK (Heathrow). It is likely that in each of these instances, access is heavily regulated by respective aviation authorities. The inter-relationship between decisions concerning access and decisions concerning overall rights is not clear.

6. IMPROVING AUSTRALIA'S INTERNATIONAL AIR SERVICE ARRANGEMENTS

Open Skies – an option

This is a concept implying total deregulation of international air travel between all countries. Under a totally open skies arrangement, there would be no need for bilateral Air Service Arrangements between countries.

The USA has led the way in negotiating these type of arrangements with other nations in Europe and in the Asia-Pacific region. New Zealand, Singapore, Thailand and recently, Japan, have all negotiated some form of an open skies arrangement with the USA.

The ATC is of the view that some consideration should be given to Australia adopting a more liberalised approach to its international ASAs, which could ultimately take the form of an open skies arrangement with other countries particularly within the APEC. This would be consistent with Australia's policy approach within the WTO, APEC and in relation to deregulation benchmarks set in agricultural and industrial trade.

In recent years, Australia's financial and telecommunication sectors have both been deregulated and liberalised in the interests of increased competition and delivering greater efficiency and benefits to the consumer. It might be difficult to sustain a case for continuing to maintain a regulated aviation sector when other sectors in the Australian economy have been liberalised.

Nevertheless, the ATC is of the view that a move towards a more deregulated and liberalised aviation sector should only be entered into if it can be clearly established that this would increase economic efficiency and growth as well as delivering a range of additional service benefits to the consumer. In other words, open skies arrangements should not be entered into unless this is the only option for reducing regulatory restrictions to deliver overall consumer benefits.

In particular, the relative size of the Australian aviation market is a factor that would need to be considered in determining whether or not moves towards open skies arrangements would deliver an overall net national benefit to Australia. The recent experience in which ANA moved to increase services to the USA at the expense of services to Australia indicates that the large aviation markets such as the USA may in fact have potentially more to gain from open skies arrangements than Australia.

7. CONCLUSION

The ATC considers that there is room for reform within the current system used by Australia in negotiating ASAs.

A range of present restrictions relating to capacity and designated city pairs can mean reduced efficiency for airline operators and ultimately airline passengers. The ATC also believes that all ASAs should be negotiated to allow foreign carriers to carry their own passengers on domestic routes within Australia.

The ATC considers that if the current system of bilateral ASAs remains in place, efforts need to be made to allow for greater flexibility within bilateral ASAs. It is also critical that air capacity exceeds demand to ensure that airlines have the flexibility to respond to changes in market conditions.

In relation to other improvements on current arrangements, the ATC is of the view that careful consideration should be given to adopting a more liberalised approach, with perhaps the adoption of “open skies” arrangements with selected countries where there is a net national benefit for Australia in doing so.