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INQUIRY INTO INTERNATIONAL AIR SERVICES

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OVERVIEW

Australian industry depends heavily on the provision of efficient transport links for transporting people, goods and services between Australia and our major export markets. The development of the Australian tourism industry, in particular, has traditionally been highly dependent on air services. Aviation services must keep pace with the demands placed on industry in the context of the increasing globalisation of markets and a more open economy.

Aviation deregulation in Australia has yielded significant benefits to the Australian economy. This has resulted in a significant expansion in airline capacity and competition on Australia's major routes with increases in air services between Australia and our major markets.

However, the international aviation industry remains subject to a framework of bilateral air services agreements which impedes competition in international air services. International airlines servicing Australia remain constrained by capacity and operational restrictions on many routes.

The economic gains from air services liberalisation, the increasing 'globalisation' of the airline industry and the approach being pursued by other countries highlights the need for Australia to continue to move towards a more competitive aviation environment. The question for policy makers is where, on the continuum of deregulation, is Australia best placed to maximise net national benefit and how quickly should we move there.

In order to maximise net national benefit from aviation services, full account needs to be taken of the impact of current arrangements on all industries including tourism, Australian airlines, as well as consumers and regions.

This Submission recommends an increase in the pace of liberalisation of Australia's air services and, in particular, the adoption of an explicit policy goal of bilateral 'open skies'. Related issues including cabotage, airfares, charters, airport infrastructure and the role of the International Air Services Commission are also considered.

1. INTRODUCTION

Australian industry depends heavily on the provision of efficient transport links for transporting people, goods and services between Australia and our major export markets. International aviation is therefore vital for underpinning the manufacturing and service sectors contribution to Gross Domestic Product and boosting their contribution to employment, investment, import replacement and export earnings.

Australia must ensure that aviation services keep pace with the demands and challenges placed on Australian industry in the context of the increasing globalisation of markets and a more open economy. Among other things, this will require improved market access and competitiveness for both passengers and freight.

The development of the Australian tourism industry, in particular, has traditionally been highly dependent on air services. The tourism industry is a key growth industry for Australia and the development of a competitive and sustainable tourism sector is one of the Government's priorities for industry development. The overwhelming majority of the 4.32 million overseas visitors to Australia during 1997 travelled by air and, given the country's relative geographic isolation from most of its major tourism markets, this dependence will be expected to continue into the foreseeable future.

Since the early 1990s, Australia has pursued a more liberal and expansive approach to the negotiation of aviation entitlements. This approach has resulted in a significant expansion in airline capacity and competition on most of Australia's major routes. In

addition, the establishment of a deregulated aviation market involving Australia and New Zealand has seen the entry of new carriers on the Trans-Tasman route and more price and service options for passengers.

However, the current regulatory environment retains characteristics which continue to hinder the full development of Australian industry including tourism. While competition has increased, international airlines servicing Australia remain subject to capacity and operational restrictions on many routes. Australia's regulatory framework requires further liberalisation in order to maximise the net national benefit.

The Trade Environment

Over the past two decades, a common policy objective of Australian Governments has been Australia's integration into the world economy. As a result, Australia now has a much more internationally competitive economy, with business performing at world's best practice in many sectors.

Globally, goods and services are increasingly being traded on the basis of comparative advantage, bringing higher standards of living across economies. Multilateral initiatives in the GATT/WTO have led to broader and deeper commitments to trade liberalisation. However, despite the importance of competitive transport links to international trade, agreement has not yet been reached on including air transport route rights within the GATT framework and they remain outside the WTO Agreement. International air services remain one of the few traceable products which are relatively insulated from competition.

The industry remains subject to the somewhat dated and generally anti-competitive bilateral air services agreements (ASAs) that have been in force since 1944. Under this framework, international air services between most countries are heavily regulated. ASAs determine, inter alia, capacity, frequency, routing and port of entry for participating national carriers.

These arrangements have essentially been designed to protect national airlines from competition from airlines in other countries. Air service rights are traded between nations on the basis of reciprocity rather than free trade, far removed from the notion of comparative advantage.

'The bilateral system is not consistent with the standard principles used to develop rules for the world trading system ... The allocation of capacity inevitably discriminates between foreign suppliers ... The effects of the regulatory system are not transparent...'

The Importance of Tourism to Australia

While tourism is not the only industry sector affected by the current aviation regulatory framework, it is certainly one of the most dependent on air services.

Alternative transport modes for international tourists are limited. The tourism industry provides a useful guide as to broader industry effects, and is therefore given particular emphasis in this Submission.

In order to ensure the tourism industry's long term development, it is imperative that efficient, reliable and easily accessible air services are established to all our tourism markets, particularly those offering significant growth potential. The adequacy and convenience of air services have an important bearing on the cost of air travel which directly influences the competitiveness of a destination.

Policy directed at developing international air links must give due recognition to the importance of the tourism industry to the Australian economy and its potential to contribute to future economic and employment growth.

A summary of the contribution of tourism to the economy and the outlook for international tourism is at Attachment A.

The link between aviation and tourism

Government Policies

The gross output of world travel and tourism, in total sales, accounts for around 12 per cent of consumer spending, of which at least 25 per cent can be attributed to airline tickets. Spending on international airfares and receipts from international tourism have both increased at twice the rate of world GDP over the past twenty yearsⁱⁱ.

The aviation and tourism sectors are highly interdependent and in a period of change. The tourism industry, like all other industries which are subject to international competition, will increasingly need to look for efficiencies in the transport sector to ensure that it remains internationally competitive.

National carriers have been an important means for many countries, including Australia, to project national image and presence abroad and have served to strengthen trade and cultural links, especially in tourism. Many national airlines have, however, often operated at a significant loss. Increasing pressure on Government budgets is seeing a transition in many countries with moves towards privatisation of Government-owned airlines, deregulation, alliance formation and the emergence of new and aggressive passenger airlines.

"It is quite clear that aviation regulatory systems throughout the world are now undergoing profound changes and that the whole structure of the international airlines industry will be radically different by the end of this decade. At the same time the governments of many countries are reappraising the importance of the contribution which tourism makes to their national economies"ⁱⁱⁱ

Strains between Government policy objectives for the aviation and tourism sectors most often arise when aviation policy is directed at protecting the commercial interest of countries' national carriers at the expense of optimising the economic contribution of traded goods and services, especially sectors such as tourism.

Generally speaking, where the regulatory environment restricts competition, the incentives for airlines to provide sufficient fare discounts, service frequencies and seats to induce demand from the tourist market are reduced.

Supply and Demand

Leisure travellers are particularly price sensitive with the majority travelling on the range of discount fares offered by airlines. The advent of high volume long-haul aircraft and the general availability of discount fares was largely responsible for the increases in international tourism from the 1970s onwards.

Commercial airlines make extensive use of yield management, offering different prices to passengers to maximise their revenues. Airlines make most money from full fare paying passengers (full first, business and economy class) after which they will offer seats at varying discounts to attract leisure travellers. The number of seats made available and the discounts on offer will therefore vary, as well as being influenced by other factors such as aircraft type and seasonality.

The level of airfares affect different tourism markets in varying ways. For example, the price elasticity coefficient for tourist travel to Australia from countries such as Singapore (-1.86) and Indonesia (-1.46) appear to be higher than those for Japan (-0.79), Taiwan (-0.83) or Malaysia (-0.78)^{IV}.

These estimates, however, do not provide any indication of the degree of substitution between competing tourism destinations brought about by changes in relative airfares for which estimates of cross-price elasticities would be required. Such measures are particularly important in the case of mature tourism markets. For example, the tourism industry has experienced an increasing degree of price consciousness among Japanese travellers, particularly as the United States has become a more competitive destination in terms of air fares.

Airfares are, of course, only one factor influencing tourists total travel costs. Others include marketing, relative movements in exchange rates and the cost of accommodation in Australia

Marketing is clearly demonstrated as a major factor inducing tourist demand, particularly when combined with the introduction of new services. Australian and foreign airlines join the Australian Tourist Commission (ATC), the States/Territories and the tourism industry in marketing Australia as a destination. The ATC, for example, undertakes significant joint marketing with both Qantas and Singapore Airlines in Europe.

2. THE CURRENT FRAMEWORK

The regulatory system

Aviation Deregulation in Australia

The competitiveness of international air services to and from Australia has improved considerably since 1992. There has been a significant increase in competition on Australia's international routes in recent years and it is likely that this has resulted in lower prices for consumers than would otherwise have been the case.

These improvements have been largely due to significant aviation policy reform. Notable among these reforms have been the introduction of multiple designation on our international routes¹; a more liberal approach to negotiating international air services including a more forward looking approach to negotiating increased capacity; the creation of the single aviation market with New Zealand and more liberal charter guidelines.

Other developments which have improved aviation industry efficiency have been the deregulation of domestic aviation; the merging of Australia's domestic and international aviation markets; privatisation of Qantas; Ansett's entry into the international market and airport privatisation.

The tourism industry has been among the most prominent beneficiaries of a more efficient Australian aviation industry through significant increases in airline capacity between Australia and our key tourism international source markets.

The number of international airlines operating to/from Australia has increased from 40 to over 55 in between 1992 and 1996 and the number of passenger flights has increased from around 430 to over 700 per week. Australian and foreign carriers are able to operate capacity equivalent to around 320 000 seats under the ASAs in each direction each week, of which airlines currently operate around 200 000 seats².

¹The positive results flowing from this measure are well illustrated by the significant increases in capacity which Australia negotiated at the time on some of its more important routes. For example, the June 1992 negotiations with Malaysia resulted in a 50 per cent increase in capacity on the route and those with Indonesia in October 1992 resulted in an increase of almost 40 per cent. This additional capacity was well above the trend to that time and was quickly taken up by the airlines.

²based on DoTRD estimates

Policy Goals

The Australian Government has committed itself to a liberal and flexible approach in the negotiation of Australia's ASAs, including the negotiation of capacity ahead of demand. This policy is based on maximising *net national benefit* to Australia, with balanced consideration being given to Australian airlines interests, tourism and trade issues.

The adoption of net national benefit has been directed at encouraging a shift in Australia's approach to negotiating air services agreements, from an emphasis primarily on Australian airline interests, to a focus which includes wider national economic objectives.

Australian airlines have an immediate interest in the outcome of international air services negotiations. They rigorously pursue outcomes which will maximise their ability to serve markets. From a trade and industry perspective, Australian airline interests are a very important consideration because of their significant contribution to the economy and their commitment to marketing and servicing Australia vis-a-vis other carriers.

The contribution of the tourism industry to the Australian economy, by virtue of its diverse nature, is not always as obvious as that of the major Australian international airlines.

The Air Services Agreement Negotiation Process

The Aviation Policy Division of Department of Transport and Regional Development (DoTRD) has primary responsibility for negotiating and administering Australia's ASAs.

Air services negotiations are initiated by either Australia or another country. Once there is an agreement to hold air services negotiations, DoTRD initiates a process of consultation and research, culminating in the approval of an Australian negotiating position by the Minister for Transport and Regional Development.

Tourism Input to the Negotiating Process

As a full delegate on air services negotiating teams, the Office of National Tourism's (ONT's) task is to ensure the concerns and national interests of the tourism industry are taken into account in the formulation of a negotiating strategy and during the negotiation process.

The key objectives of ONT in the negotiating process are:

- to facilitate the provision of adequate capacity to meet projected growth in inbound tourism, and

- encourage vigorous and sustainable competition in the market for international air services to Australia.

In order to achieve these objectives, it is vital that the tourism perspective is appropriately considered in the negotiation of Australia's air services agreements. To this end, ONT consults both formally and informally with the tourism industry in the development of priorities for negotiations and in the development of negotiating strategies.

Tourism input to the air services negotiating process is coordinated through a Tourism Aviation Group (TAG) chaired and administered by ONT. Details on the consultation phase for formulating a negotiating strategy are at Attachment B.

In addition to providing tourism input on individual negotiations, the ONT also contributes to the formulation of *priorities for air services negotiations*. This list, compiled in consultation with TAG members, is provided to DoTRD for the purpose of assisting DoTRD's prioritisation. DoTRD will then commence efforts to engage those countries in negotiations which it determines as being of high to medium priority. In general, DoTRD prioritisation of countries for negotiations has coincided with tourism needs.

3. THE EFFECTS

Bilateral agreements by their nature constrain the full expression of commercial airline activity in a given market. They are a significant constraint on the development of a competitive aviation sector and hold back the expansion of some of the world's most efficient airlines.

Negotiations have traditionally been conducted on the basis of a *reciprocal exchange of rights* of equal commercial value for national airlines. Generally, many countries only agree to an exchange of a package of rights which their airlines can use in the near future. As well as restricting competition, costs are imposed through the need for frequent renegotiation of rights and a potential loss in passenger traffic if capacity constraints are reached before rights can be re-negotiated.

The extent to which a bilateral ASA affects competition is dependent on the approach taken by different countries. For example, the bilateral air services agreement between Australia and United States is, by any measure, a very liberal one particularly in respect to the carriage of point to point traffic between the two countries. The operation of services under this agreement is effectively a function of demand and market growth. Airlines can respond to demand and other market conditions without the need for renegotiation by governments. By contrast, Australia's air services with Japan have restrictions on capacity that can be operated, flight frequencies and ports served.

One restrictive bilateral agreement can effectively become the lowest common denominator, restricting operations which rely on piecing together ASA rights with different countries to make one route or a wider network. Until February 1998, capacity constraints applying in Thailand, for example, had affected service frequencies to and from European markets and elsewhere in South East Asia. Australian carriers also have no 'beyond rights' from Hong Kong to the United Kingdom or from Japan on to third countries. while other carriers do.

Robust dispute resolution mechanisms are also required, within the ASAs framework, to ensure that trade and tourist flows are not adversely affected while Governments and airlines sort out their differences. The experience of disputes in which Australia has been involved such as with Hong Kong during 1995 (over Qantas fifth freedom rights) and the United States in 1993 (over North West's fifth freedom rights) suggest that the bilateral process is quite volatile and subject to escalation and the threat of sanctions.

Effects on tourism

It is difficult to make a precise assessment as to the effects of the current bilateral air services framework on tourism given the range of other factors which affect tourist travel decisions. However, to the extent that the ASAs are an impediment to a more competitive market in air services, they are likely to be inhibiting market creation i.e. inducing people who would not otherwise have travelled to Australia to travel here.

Regulatory constraints and lack of competition resulting from ASAs, combined with continued tourism growth³, suggest that if travellers are not prepared to pay higher fares or take indirect and less convenient services they will increasingly opt for holidays elsewhere. To the extent that such constraints apply unequally on Australia, as compared to other countries, it is highly probable that Australia is continuing to lose market share to competing destinations. This, in turn, would be affecting the industry's employment levels.

While the extent to which recent reforms have resulted in additional arrivals (over and above what would have been experienced anyway) is difficult to quantify, there is evidence that deregulated air services can grow the market.

The price and market creation effects of a deregulated aviation environment, for example, are underlined by developments over recent years on the trans-Tasman route. The commencement of the New Zealand airline Kiwi International (which has since gone into liquidation) and its Air New Zealand subsidiary competitor Freedom Air, around August 1995, was accompanied by a significant recovery of the market in growth terms. Over a 12 month period visitor arrivals increased by around 25 per cent. This followed an extended period of stagnation in what is characterised as a mature tourism market.

Much of this market creation was due to a significant discounting on published fares. ABS data indicates a significant fall-off in growth rates following the withdrawal of Kiwi Air from the route. The market creation occurred despite the small size of the new airline, as the incumbent larger carriers engaged in price competition with the new comer. A growth rates graphic is at Attachment C.

The deregulation of domestic aviation in Australia also provides a useful illustration of the level of benefits that can flow from a more liberalised aviation environment. The Australian Competition and Consumer Commission, for example, has estimated that average domestic air fares decreased by 21.8 per cent in real terms between the September quarter 1990 and the March quarter 1996, following domestic deregulation of these services in late 1990. Domestic traffic growth has averaged 12.6 per cent between 1990

³ This can be reflected in lack of seat availability and high aircraft load factors

and 1995 compared with average growth of just 4.7 per cent for a similar period prior to deregulation⁴.

Effects on airlines

Given that the bilateral ASAs were historically designed to protect the interests of national airlines, it is hardly surprising that many airlines, particularly the incumbent airlines, have benefited from the arrangements.

Due to the bilateral process, Australian airlines may not have operated as efficiently as they might otherwise have. This is evidenced by, for example, the cost savings achieved by Qantas in recent years. As the airline has moved from a highly protected environment, to one in which it has been faced with growing competition, it has had to adopt an increasing number of efficiencies in order to compete effectively in the market place.

However, it is interesting to note that while capacity has been restricted and fares higher than would prevail in free trading environments, airline profits, in general, have not been particularly high.

Effects on Industry, Consumers and the Regions

While Australian airlines have generally benefited from ASAs, this has arguably been at a cost to the community. The provisions of these agreements act like import quotas allocated to particular firms^V. As with all industry specific assistance measures, the assistance provided to the airlines is likely to have resulted in the transfer of income to this sector from a range of other areas.

For industry, this has resulted in an increased cost of both travelling overseas and of transporting their exports (or for that matter their imported components). Although the freight industry is typically one of the less regulated aspects of air services, it is difficult to separate the freight component of the industry from passenger services because a large proportion of air freight is carried on passenger services. It is not always efficient or indeed viable to operate a purely freight service on a route and any inefficiencies in passenger services therefore have a significant impact on freight costs. Such costs could have affected the level of industry investment.

The effect on consumers is closely aligned to that of the tourism industry. To the extent that protection afforded to the aviation industry impacts on the cost and convenience of travel, consumers are either paying more for their travel or are changing their purchasing patterns to buy other, perhaps less desirable, goods. They also lack the purchasing power they would typically have in a more efficient economy, without a protected aviation industry.

⁴ Australian Competition and Consumer Commission and DoTRD data.

Restrictions placed on the number of services on a route can lead to added concerns for regions. This is because the limited rights airlines receive are a valuable resource which they tend to use to serve the larger, more prospective markets rather than the potentially less profitable regional centres. When overall capacity is limited only the most profitable ports will be served.

Regional centres have also suffered from the general tendency in the past for each of our agreements to provide access to a limited number of specific ports in Australia. While this trend has generally been reversed in recent years, most of our agreements still limit the number of ports that any foreign carrier can service⁵. The availability of points is frequently used as a negotiating chip. In this sense, the benefits regional Australia would receive from a more liberal and flexible regime are often seen as a secondary consideration.

Airlines should be free to choose which gateways they serve on the basis of commercial judgement. The non-specification of gateways also implies the negotiation of sufficient additional capacity to reduce the opportunity cost to carriers of serving smaller or more distant gateways. As mentioned earlier, where capacity entitlements are finite, airlines may only choose to service the highest yielding routes.

Of course tourism authorities have a role to play in promoting different gateways and influencing airlines' choices. Once there is agreement between governments on the expansion of access rights, it is the responsibility of the tourism industry and the States/Territories to encourage airlines to take up these rights. The newly privatised airports are already proving very active in this regard.

Current Constraints on Air Services

Capacity and operational restrictions

While total negotiated capacity runs well ahead of capacity utilised by Australian and foreign carriers (see Graphic at Attachment D) this aggregate data tends to mask capacity shortages on particular routes and the limits on competition in many markets⁶.

In fact, capacity constraints apply across a range of countries. For example, Australian and foreign carriers are, or near to, fully utilising available capacity in important tourism markets such as Japan and Germany (Australian airlines only), Italy, Taiwan and Hong Kong. Important developing markets for inbound tourism, such as South Africa and Vietnam are also capacity constrained. Not all carriers, however, would necessarily be seeking further increases in capacity.

⁵ This sometimes reflects the preference of other countries for the 'security' of Sydney being specified as a gateway for their carriers.

⁶ It is also not clear how routes with unlimited capacity (such as that with New Zealand) are taken into account for the purposes of the DoTRD capacity estimates above.

On the Japan route, Australian carriers currently operate 94 per cent of capacity available to them. This does not allow Australian carriers to respond to increasing demand in the medium term. They are also constrained by the lack of available slots into Japan's congested airports. Further capacity and slots will be required to develop the market and to assist in creating a more competitive environment. This would also be of assistance in helping generate more attractive fares on this route - an issue considered in more detail in Section 5 of this Submission.

Attachment E summarises the capacity position on Australia's major tourism routes.

Over the last three years significant increases in capacity have been negotiated with many of our important tourism markets such as the United Kingdom, Singapore and China. Ample capacity is now also available on the Middle East⁷ and South America routes. Results over the last twelve months, however, have been mixed with only two markets with reasonable tourism potential (Austria and the Netherlands) gaining significant capacity increases. However, the most recent increase in capacity agreed with Thailand is a significant breakthrough.

Airlines might choose to increase the level of services/seats operated were it not for *operational restrictions* such as, for example, restrictions on beyond rights and limits on routes that can be served. Such restrictions on airline operations are often more

anticompetitive than the constraint of insufficient capacity. In fact they can limit airline flexibility even where capacity is well ahead of demand.

The TAG list of priority tourism markets for negotiations, which identifies current capacity and operational restrictions is at Attachment F.

There has also been some consolidation of services on a number of routes including the trans-Pacific route (US carrier pull-outs in the early 1990s) and the Australia-Japan route (most recently a function of Qantas/JAL codeshare arrangements). Where there are only a few major carriers on a route, and demand is buoyant, this can act to reduce competition and increase fares. Where bilateral agreements are liberal, any fare impact is likely to be more moderate. However, this will not necessarily be the case if entry of new carriers, particularly from third countries, is restricted. For example, United States' carriers are restricted in serving Australia via Japan under the Australia/United States ASA.

⁷ Australian airlines for instance have 19 units of capacity across the Gulf States of Dubai, Bahrain and Kuwait but choose not to operate in their own right. The Gulf carriers are currently operating 46 per cent of their available capacity.

Time frame for securing outcomes

The pursuit of Australian objectives at negotiations often requires a considerable period of time to elapse before agreement acceptable to both sides is reached. This can, on occasion, require several sets of talks, depending on a range of factors including the relative bargaining power of each side. Other Governments can sometimes prove to be very reluctant to 'do a deal'.

While we acknowledge that this situation is sometimes unavoidable, we have some concerns over the pace at which some negotiations proceed, particularly where foreign carriers have been eager to commence or increase the level of their services. This has, at times, hindered the provision of adequate capacity to meet projected tourism demand.

An example is provided by negotiations held with Singapore. During 1996 Singapore Airlines had been operating to the limit of its capacity entitlements and indicated an intention to increase services. While a substantial increase in the overall capacity was negotiated with Singapore in February 1997 this followed unsuccessful negotiations in November 1996. In aggregate this contributed to a delay of around nine months from dates originally proposed for talks⁸.

On the other hand, negotiations have proceeded relatively quickly where there have been Australian airline imperatives. These have included the need to facilitate multiple designation to allow additional Australian carriers to commence international operations or underpin their operations on major routes such as Qantas' operations on the Kangaroo route. Specific examples include significant increases in negotiated

capacity, particularly with Asian countries, immediately following the introduction of the multiple designation policy in 1992 and, more recently, the negotiation of an expansive package of entitlements with the United Kingdom.

The Department is concerned that, in the absence of similar aviation imperatives in the future, there could be delays in securing outcomes which have the potential to benefit Australian tourism and economic development.

⁸ The airlines of both sides were enjoying healthy load factors and the route was experiencing large seasonal seat shortages during this period. Australian airlines were operating below their capacity allocation. ONT's assessment at the time was the market's growth potential would be constrained if additional capacity was not forthcoming, with a significant loss of benefits for the tourism industry and the economy more generally.

Fifth Freedom Rights

Fifth freedom rights have become an important issue for Australia. They have clearly been increasingly difficult rights to negotiate, particularly among countries seeking to protect national airlines' interests.

While Australia attempts to secure such rights for our own carriers, through granting greater market access for foreign carriers to Australia, it continues to question and constrain the ability of foreign carriers to carry such traffic to Australia via third countries. This constraint, while not necessarily specified in an ASA, can be achieved by limiting the capacity granted for the exercise of third and fourth freedom rights.

The granting of fifth freedom rights to foreign carriers can impose an essential competitive discipline on Australian carriers. For instance, the competition provided by third country airlines⁹ provides the primary competitive counter weight to the Qantas/BA alliance operations on the Kangaroo route.

The shielding of Australian airlines from competition, particularly from third country carriers, is based on the premise that origin - destination carriers (for instance between the United Kingdom and Australia) have a primary right to these passengers. This is regarded as a 'national right' by some countries under the current system of bilateral agreements. It does not recognise the substantial national benefit from more frequent competitively priced services on these routes. Given the less direct routing on such services, tourists are generally only attracted by cheaper fares.

Also, by virtue of their geographic location some countries are often natural hubs for third country traffic, such as those in the Middle-East. To deny carriers from these countries access to this traffic would be contrary to the needs of travellers.

Moreover, such an approach is inherently anti-competitive and it is contrary to the increasing acceptance, both in Australia and overseas, of the benefits of a more

competitive industry structure. It can also be counterproductive to the efforts of Australian carriers such as Qantas in developing hub operations such as in London and Frankfurt to serve Europe, and the airline's 'golden triangle' services between Bangkok, Singapore and Hong Kong. Many of the passengers Qantas serves in this way originate in or are destined to travel to third countries.

The reluctance to grant beyond rights to overseas carriers, from Australia, seems to be built on similar notions of 'ownership' of origin-destination traffic.

⁹ particularly 'sixth freedom' carriers which carry traffic between two countries with a stop-over in their own

An example of how Australia's conservative attitude to beyond rights can adversely impact on the net national benefit is provided by air services from Korea. The Koreans have argued that their nationals are primarily interested in multiple country overseas holidays. In this context, they have previously requested the right to carry their own passengers on to New Zealand (after they have stopped off in Australia) to fully serve this market. There is evidence to support this view from the International Visitor Survey, which shows that over half of all Korean visitors to Australia also visit New Zealand on the same trip.

However, Australia has not assented to the Korean request, despite the healthy growth that has been achieved on the Australia-Korea route (until the current economic crisis). The Koreans claim that the failure to grant Korean carriers beyond rights to New Zealand would have held back further growth on this route.

The question of beyond rights has also been an issue in talks with Argentina. Aerolineas Argentinas had been seeking beyond rights into Asia, with a view to enhancing the commercial viability of their existing services and making them more attractive to potential travellers. Australia has not granted these rights. In taking this position, Australia has discounted the benefits that would flow to the economy from the additional tourists that services of this nature could attract through increased competition and convenience for travellers.

Under the existing agreement between Australia and New Zealand, Air New Zealand has established a Brisbane hub with services operating to several Asian destinations and the USA from Sydney. Australia has rejected calls from New Zealand for an expansion of beyond rights on the basis that, inter alia, these rights are generally more valuable to New Zealand carriers because of New Zealand's location and because of the larger size of Australia's inbound and outbound markets. However, the Department feels that such rights stimulate further competition on major inbound routes and offer a greater choice of services for tourists. There are also wider regional economic benefits of such operations in Queensland.

The Tourism Aviation Group Recommendations

As part of the recent review of the bilateral air services process undertaken in 1998, the Tourism Aviation Group, identified a number of areas, discussed in this chapter, where implementation could be improved. These are:

- as is current policy, capacity should continue to be negotiated ahead of demand; this is particularly important in the lead-up to the Olympics and entitlements negotiated now should be sufficient to cater for traffic up to and during the year 2000;
- unless sought by bilateral partners, points to be served in Australia by foreign carriers should not be specified to allow airlines greater flexibility in choosing cities to be served;
- own stop-over rights could be provided to foreign carriers where appropriate to assist in achieving the Government's objective of spreading tourism benefits; this could also be expanded to allow trans-Tasman rights to foreign carriers;
- support for the negotiation of codeshare rights. Noting that such arrangements should be carefully scrutinised in instances where they might result in significant lessening of competition;
- sixth freedom traffic should be accepted as a legitimate statistic in the negotiation of capacity.

New Route Development

There have been occasions where Australia's negotiating position appears to have held back the development of new routes, denying Australia potential benefits of such developments. Australia has not generally encouraged the development of new routes unless an Australian airline has expressed a firm interest in providing services. A number of examples of this issue occurred during the early to mid-1990s when Australia was negotiating possible new routes with a range of countries in the Middle East, South America and European countries such as Austria.

The difficulty in accepting requests from these countries was based, inter alia, on the principle that the level of origin-destination traffic was insufficient to provide commercially viable services or that carriers would be carrying through traffic from our existing markets, especially Europe (with negative effects on Australian carriers on these routes).

In our view, assessments of the commercial viability of air routes are best left to the airlines, and regulators should not try to second guess the market.

Flexibility of response to rapid changes in market conditions

A more liberal regulatory environment for air services usually means lower airfares and more flexibility for airlines to respond to market needs.

Many ASAs build in a facility for the approval of supplementary flights in periods of peak demand. While this is useful for airlines, it does not necessarily allow much flexibility for travel agents and tour wholesalers who will generally need to sell tickets well in advance of travel dates. Moreover, in view of the large capital investment and lags involved in deploying new equipment, airlines cannot always react to changing market circumstances by instantly providing new services.

Travel agents currently complain of a lack of seasonal seat availability on a range of routes including in markets such as Italy, Germany and Hong Kong.

Where demand is increasing rapidly airlines are limited in their response beyond the capacity limits prescribed in the relevant air services agreement. However, in an environment where Australia has negotiated sufficiently liberal ASAs with third countries increasing volumes can be catered for by less direct services.

In some countries even where capacity may currently be adequate, the potential for rapid increases in tourism demand will require further substantial increases in capacity ahead of demand. This is especially the case for China where Australia has been granted 'Approved Destination' status.

Net National Benefit

In order to maximise net national benefit from aviation services, full account needs to be taken of the impact of a particular outcome on Australian airlines, other industries including tourism, consumers and government revenue.

As the previous sections points out, Australia's approach to air service negotiations does not appear to take sufficient account of the potentially substantial benefits that would flow to Australia from the introduction of more frequent, more competitively priced services. A true net national benefits approach to the negotiations would recognise these wider net benefits of liberalisation.

Some specific examples of benefits include foreign exchange earnings from airlines and travellers (less import leakage by Australian airlines - aircraft are expensive to import and maintain); tax revenue (including landing fees paid); employment effects (Air New Zealand for instance provides a significant regional contribution to employment through its Brisbane hub); lower business costs and improvements in the terms of trade. Policy makers and negotiators need such information to ensure that Australia is achieving ASA outcomes closely aligned to the net national benefit, with aviation concerns being fully weighed up against the interests of other sectors.

The International Civil Aviation Authority (ICAO) has commenced work on the development of an analytical model for evaluating the net national benefit of international air transport.¹⁰

It is noteworthy that, outside the wider economic benefits of liberalisation, foreign exchange leakage is higher for airline operations than for tourism and that net receipts are larger for tourism. Moreover, tourism has greater employment generation effects than aviation^{vi}.

¹⁰ Tasks identified for the Air Transport Regulation Panel, February 1997

4. A WAY FORWARD

International trends

The international airline industry is continuing to evolve in response to greater privatisation, foreign investment, alliances among carriers and the liberalisation of regulatory arrangements. This 'globalisation' of the international airline industry is tending to draw more and more attention to the shortcomings of negotiating agreements on a bilateral basis which currently dominates the regulation of air services.

The economies of scope conferred on airlines by large size and cross equity investment is likely to result in the emergence of fully global multinational airlines. The trend towards globalisation of airline services will make the current system increasingly clumsy and will pose difficult issues for regulatory bodies.

Indeed, the notion that Governments negotiate ASAs for airlines which are 'substantially owned and effectively controlled' by nationals is likely to become increasingly blurred as ownership patterns change and alliances develop. ICAO is currently examining issues in relation to broadening these ownership and control criteria; a formula under examination would require 'principal place of business/permanent residence' status.

The development of single aviation markets or regional aviation blocs in a number of parts of the world (the European Community and the Single Aviation Market with New Zealand being two examples), also points to the need to move away from a protectionist bilateral approach.

The current Asian crisis presents an important opportunity for Australia to progress liberalisation regionally and bilaterally. Following massive currency devaluations, many Asian countries have become much cheaper tourism destinations. The foreign exchange benefits of this trend are not lost on Government policy makers in the region. This situation should therefore provide useful negotiation leverage for liberalisation (ensuring better access to third markets) and place Australia in a better position to

benefit from economic recovery in these markets in the medium term. The success of the negotiated outcome with Thailand, in February 1998, underlines this point.

Moreover, financially pressed Asian airlines are also forging a range of short term alliances in the region and pressing for lifting regional restrictions on discount airfares. Overall, there appears to be an increased willingness to consider faster regional liberalisation, particularly to facilitate capacity redeployment and fuller fleet utilisation.

Airline alliances

Airline alliances have become an increasingly common feature of the international airline industry. In Australia, both Qantas and Ansett International have alliance arrangements with a number of international carriers

The rapid growth in alliances reflects the benefits that airlines can achieve through closer co-operation, including opportunities to increase their own efficiency and the marketability of their services. They are a response to low profitability in the industry, foreign ownership restrictions and airport constraints.

Alliances are also a response by airlines to regulatory restrictions created by ASAs. In fact, liberalisation of air services could result in the emergence of true global airlines rather than alliances which can be inherently fragile.

Alliances, however, may represent the beginning of a trend towards a world aviation market dominated by a few, large airline groups competing for the travel and trade dollar^{vii}. Under this scenario, while there will still be a place for the smaller regional airlines such as those operating out of Australia, it would generally be expected that these will primarily serve niche or regional markets and aligned themselves to major groups to ensure access to feeder traffic and world wide booking systems.

Alliances formed on routes where there are only a few major competitors can work to reduce competition, allowing capacity to be restricted to force fares up. It could only be countered by allowing members of alternative alliance groups open access to the route.

However, the alliance trend should not reduce the level of competition in the market, provided there is a sufficient number of groups serving any market and as long as the barriers to entry are minimised.

Codesharing

We have generally been supportive of the negotiation of codeshare rights (to be taken up at airlines' discretion) within ASAs. This has been on the basis of the greater commercial flexibility that such arrangements can provide airlines in serving particular markets. This can translate into greater choice of services, improved service quality

and consequent growth in inbound tourism. It should be noted that the tourism effect of each codeshare arrangement depends on the characteristics of the particular arrangement and the tourism markets/segments served.

Analysis suggests that code sharing, under alliance arrangements' on Australian international routes may have led to around 10 per cent reduction in economy air fares over the past few years^{viii}. However, the potential impact of this reduction on tourism is unclear as code sharing did not have a significant impact on discount fares. It should be noted that a large proportion of travellers to Australia, and virtually all passengers on inclusive tours, utilise discount fares. The reduction in economy fares may, however, stimulate travel to Australia by higher yielding tourists who are likely to be attracted to this fare category. This in turn would have a positive impact on inbound tourism.

On the other hand, travellers are often resistant to travel on different airlines if the quality/safety records of the carriers is inconsistent. Airline loyalty can also influence tourists' decision making. There may be legal implications where passengers expect to be flying their favourite airline and, without sufficient notice, end up on an unknown carrier or miss connections.

Moreover, tourism benefits may also be offset by related service rationalisation. Such arrangements therefore require monitoring to ensure that they do not result in a significant lessening of competition and/or product quality, particularly where the number of competitors on a route are limited.

Codesharing will ameliorate the effects of current service rationalisation by carriers in the Asia-Pacific, following sharp falls in demand, by allowing airlines to at least maintain market presence until markets recover. Moreover, where a market is flat, airlines can be assisted in redeploying aircraft to more profitable routes elsewhere.

Apart from codesharing, there is no evidence that alliances inherently lead to cheaper air fares. However, increasing competition between alliance groupings holds out the prospect of price competition provided it is not hindered by increased industry concentration.

An Australian Approach

In our view, Australia would currently fall in the middle of the range of countries in terms of its general stance on liberalisation and the account taken of national airline interests when negotiating ASAs.

The question for policy makers is where, on the continuum of deregulation, is Australia best placed to maximise net national benefit and how quickly should we move there.

Overall, the economic costs of the current framework make it clear that Australia needs to continue to move towards increased liberalisation of its air service arrangements. The move forward on air services liberalisation could be achieved in a number of ways, including through both multilateral and bilateral options.

Multilateralism

A multilateral approach would seem to be the preferred option, since in recognising that there is little difference between aviation services and other traded goods, it could potentially bring trade in these services in line with the general trend in the trade in services (such as is occurring under the jurisdiction of the WTO). It would also provide a mechanism for pulling more conservative nations along the deregulation path.

While there are a number of alternative international organisations that could be used to achieve this goal, including the WTO, APEC and the various international transport based organisations, we understand Australia already takes a relatively liberal approach in these fore. It appears progress is being held back by the attitude of countries that wish to continue protecting their aviation industry.

Although the potential gains from a multilateral approach to aviation regulation justify continuing effort in this area, given the limited gains to date, there is also a need to review the options available under the alternative bilateral mechanism.

Bilateralism

The bilateral approach to deregulating air services, while more cumbersome and unwieldy, offers similar gains, if broadly applied, to those that can be achieved through the multilateral approach.

While success in this area requires the goodwill of the parties negotiating agreements, if all parties to the agreement were to take a pro-competitive approach to negotiations it would effectively represent a similar outcome to that available under the multilateral approach.

Policy Options

Given that the current bilateral framework is likely to be with us for some time, it is important to identify practical measures to ensure further progress in air services liberalisation inside the existing framework.

The Department therefore recommends that Australia concurrently:

- increases the pace of liberalisation; and
- sets an explicit policy objective of 'bilateral open skies'

These options would require careful assessment as to their appropriateness, on a case-by-case basis. They are mutually inclusive, and may lend themselves to regional solutions among groups of like-minded countries.

Particular aspects of adopting such an approach to negotiating air service arrangements are discussed below.

Capacity Determination

The optimum approach, inside ASAs, would be 'free determination' of capacity whereby airlines would be free to choose what capacity they want to offer and on what routes. This would allow for timely introduction of capacity in line with the growing needs of markets at competitive fares.

An alternative approach is that applied under the US ASA. It allows for automatic increases in capacity, provided certain conditions are met such as growth in traffic and load factors (a 'trigger' mechanism). There would seem to be valid reasons to apply this approach to new and renegotiated agreements as it would allow airlines greater flexibility to respond to changing market trends with potential benefits for users, including tourists.

Open Skies

The term 'open skies' generally refers to the full liberalisation of trade in international air transport, including cabotage, between all countries. In its purest form it would bring the current system of bilateral aviation agreements to an end.

In recent years, the United States has offered its own form of bilateral 'open skies', including open entry on all routes, unrestricted capacity, frequency, route and traffic rights (but not extending to cabotage rights). Countries which have already agreed to these arrangements with the United States include Germany, Switzerland and the Nordic countries and, in our own region, New Zealand, Singapore, Thailand and most recently Japan.

New Zealand is pursuing bilateral 'open skies' agreements as a matter of priority, with a particular focus on the APEC economies. Apart from the United States it has negotiated these agreements with Singapore, Malaysia and the United Arab Emirates.^{ix} Singapore is also seeking to develop 'open skies' arrangements with other countries of the region.

However, Australia's aviation policy does not yet extend to negotiating 'open skies' arrangements. The Department considers that there is a strong case for Australia seeking out countries with a view to negotiating agreements of this nature given the potential economy-wide benefits of such a regime.

Australia's experience of the single aviation market with New Zealand suggests that 'open skies' type arrangements can lead to lower airfares and greater consumer choice through increased competition between carriers.

While some will argue that the pace of liberalisation should reflect the ability of Australian airlines to adjust to competitive pressures, these airlines have already demonstrated their ability to increase efficiency and competitiveness on international routes. Further liberalisation would provide an additional impetus to increased productivity.

It also needs to be recognised that more liberal arrangements can bring significant new opportunities for these airlines which can potentially enhance their profitability, including through the development of new alliances. The development of these alliances can only give further impetus to increasing the pace of liberalisation. The increasing globalisation of airlines will ultimately make it increasingly difficult for airlines operating under protective regulatory arrangements to remain viable in the longer term.

The substantial public and foreign ownership of Australian airlines (including by foreign airlines) makes it more difficult to argue in support of constraining competition to assist 'national airlines'. Like other global industries, airlines may also increasingly locate ground-based operations in several countries.

It is important that Australia not be left behind in regional developments towards liberalisation and 'open skies' arrangements. Such arrangements lend themselves to the emergence of more efficient and competitive airlines and overall reform of the regulatory framework.

Cabotage

Cabotage could be considered as being at the furthest end of the continuum of liberalisation in air services.

While domestic market deregulation has not resulted in sustained competition to-date by new entrants, competition between Qantas and Ansett is more vigorous than in the past. As a result these carriers have become more flexible and responsive to consumer needs, providing the industry with greater access to cheaper fares, increased frequencies and passenger services. However, the tourism industry considers that, as the cost of domestic air travel is high when compared with fares to Pacific and Asian tourism destinations, this has affected the relative competitiveness of an Australian tourism experience.^x

Increased competition by foreign carriers, through cabotage, could further assist domestic tourism development and the spread of inbound tourism around Australia.

The possibility of domestic carriers being 'picked off' in the competitive environment that may be created by cabotage has been raised as one reason for maintaining the status quo on this issue. While there might be changes in industry structure resulting from such an initiative, the economy-wide benefits could be significant.

In this regard, as the experience of full liberalisation in Europe unfolds there may be some important lessons for Australia (See Attachment G). On the other hand, foreign international airlines may not have much enthusiasm to undertake cabotage given high start up costs, thin routes and the strength of incumbents. They already have the capacity to tap the domestic market through cross equity initiatives with domestic airlines and through alliances.

A limited form of cabotage could be an appropriate step in this direction. International airlines are sometimes hesitant to extend their services to ports beyond their primary international gateways because of a lack of, or limited, rights to carry passengers between points in Australia. This has been softened in some Agreements which permit 'own carriage'. The spread of tourism benefits would be assisted if international airlines were able to improve operational efficiencies and carry domestic passengers on particular routes

This would be particularly beneficial on routes not as well served by Australian domestic carriers and gateways which might not otherwise be served by scheduled international carriers e.g. Townsville, Broome.

A unilateral approach to liberalisation

A fundamental feature of adopting a bilateral approach to air services agreements is that bilateral partners determine the extent of liberalisation. Unilateralism would suspend the principle of reciprocity which underpins the trading of international aviation rights.

Australia could choose to unilaterally liberalise, but if other countries are not willing to act similarly, Australia would run the risk of its airlines being denied or restricted access to foreign markets. However, there might be cases where providing unreciprocated rights to foreign carriers to induce them to service ports could assist in increasing tourism and trade without detriment to Australian airlines. For example carriers could be granted free access to small gateways, that would not otherwise be served. Garuda conducted services to Townsville after being granted such rights some years ago.

Changes in Administrative Responsibility and Consultation

The consultative process leading to the formulation of Australia's strategy for negotiations works reasonably well. However, as this submission suggests, the relative balance given to Australian airline and tourism/trade interests in the formulation of

negotiating strategies is not yet considered optimum for maximising net national benefit.

While recognising the prerogative of DoTRD in developing strategies and leading negotiations, the achievement of further liberalisation by Australia would suggest a need to review the administrative responsibilities for this area. This might include consideration of joint approval of the negotiating strategy by relevant Ministers.

5. OTHER ISSUES

The Role of the International Air Services Commission

Since 1992, a policy of multi-designation has applied which provides the opportunity for competition between Australian carriers on international air services to and from Australia. As a consequence of the bilateral system, a mechanism was required to allocate available capacity and route entitlements to competing Australian carriers. In July 1992, an independent statutory authority, the IASC, was established for this purpose.

The IASC's primary consideration when allocating capacity is to introduce competition on routes, an objective strongly supported by the Department. In accessing the merits of claims by applicants the IASC is required to take into account specified public benefit criteria, including tourism benefits, consumer benefits, trade benefits, competition benefits and the industry structure.

It is the view of the Department that the independence of the IASC is crucial to the allocation process. The Department has open lines of communication with the IASC and regularly provides information on tourism trends to the Commission. In addition, officers of the IASC are formally briefed on tourism issues by the Department at least once a year.

While a number of new carriers have been granted capacity by the IASC, only two passenger carriers, Ansett International and National Jet Systems have actually started operations. Other start up carriers, such as Australia Air which was initially granted capacity rights on the China route, were unable to satisfy the IASC of their financial capability of implementing their proposals and their entitlements were rescinded.

The Department considers that while some form of financial surety might need to be imposed by the IASC on start-up carriers this should not be such as to unduly restrict competition. A trade off is required between promoting competition and protecting consumers. This requires an appropriate balance being struck between these issues.

That said, where capacity has been granted to new entrants subject to funding requirements, it is the opinion of the Department that the IASC has been lenient in granting extensions in order to allow applicants time to put the necessary funding in place. In the case of Australia Air, tourism flows from China to Australia may have

been restricted by the granting of a number of extensions to the principals of Australia Air.

In general, the ONT is satisfied that the processes undertaken by IASC in allocating capacity has been broadly appropriate. It is important that capacity and other rights are decided by an independent agency.

The IASC is increasingly required to decide on the merits of joint services arrangements, especially codesharing. Such arrangements potentially impact on the competitiveness of routes. On 23 April 1997, the Minister for Transport and Regional Development issued a revised policy statement for the IASC which aimed to provide the Commission with guidance on factors effecting competition. In respect to commercial arrangements between carriers, the policy statement weighs the competition criteria in favour of applicants who propose to use their own aircraft to operate capacity as opposed to those who wish to codeshare, as this is likely to result in more competitive outcomes. While this is an important principle, the criteria for assessment of the merits of a codeshare application would seem to require further clarification.

The Department believes that the respective roles of the IASC and the Australian Competition and Consumer Commission (ACCC) need further delineation in assessing the effect on competition of joint services arrangements. It is not clear as to what stage a competition issue is significant enough for the ACCC to become involved. It appears possible, for example, that the IASC could make a decision on a codeshare proposal which could be overturned by the ACCC.

Indeed, the explanatory notes relating to the policy statement cast doubt on the authority of the IASC to make determinations regarding codeshare. According to the explanatory notes "the IASC is to assess a commercial agreement between an applicant and another airline affecting services on a route only to the extent of determining comparative competitive benefit between competing proposals". It appears that the role of the IASC may only be to rank proposals on the basis of their competitive benefits, rather than adjudicate on their competitive merits. The explanatory notes go on to state that the "wider responsibility relating to possible anti-competitive effects of commercial arrangements is the responsibility of the ACCC".

The ONT also notes that carriers appear to be able to gain easier approval for codeshare arrangements, by not initially linking an application to service rationalisation, made possible by the arrangement. An airline could subsequently notify the IASC of the service cuts, unlinked to the codeshare. Stand-alone service cuts are usually granted without detailed assessment.

Air Fares

The tourism industry has identified airfares as one of the more important issues affecting tourism growth. For example, a recent survey of travel executives conducted

by the Centre for Asia Pacific Aviation^{xi}, identified airfares as the second most prominent constraint on tourism growth, after airport congestion. According to the survey, 60% of tourism organisations rated airfares to be a major issue and considered that lower air fares are needed to achieve fully the tourism potential of the region.

The policy of the Australian Government is to allow airfares to be freely determined in the marketplace. However, it is worth noting that free airfare determination is occurring within a somewhat constrained bilateral system, which in turn acts to dampen the level of airfare competition on any one route.

A 1994 study by the then Bureau of Industry Economics^{xii} found Australia's airfares were lower than in many other regions and that airfares into and within Australia were only matched by fares on some of the routes in Asia. However, the study also found that air fares ex Japan are among the highest observed.

The regulatory environment governing international air services would certainly appear to have an important bearing on this issue.

Airfares are obviously a very significant factor affecting the level of Japanese tourism demand to Australia. The relative cost of airfares from Japan to competing destinations, such as the United States and Europe, has undermined the attractiveness of Australia as a competitive tourist destination. The new 'open skies' agreement negotiated between Japan and the United States is likely to place further downward pressure on airfares to the United States and increase its competitiveness as a tourist destination.

It has been argued that the regulatory environment on the Japan-Australia route has encouraged a virtual duopoly between Qantas and Japan Airlines, with other carriers on the route such as Ansett being limited by, inter alia, the availability of airport slots and capacity restrictions. This suggests that airlines may have been able to maintain fares higher than otherwise would be the case.

While ASAs have been progressively liberalised in relation to airfares this is not the case with the Japan/Australia ASA, which would appear to allow airlines to cooperate quite closely on price and formalises Japanese government involvement in approving air fares. This appears to be directed at protecting the major Japanese carriers.

Not all tourist destinations are affected equally by such requirements in ASAs. For example, Japan can exercise more control over airfares to Australia than on the more highly competitive US routes. This is also likely to reflect the increased trade leverage which can be applied by the United States.

It may well be that Australia's competitiveness is also being more broadly affected by the nature of the distribution system in Japan. Constraints on minimum tour prices, charged by Japanese travel wholesalers, have previously been held responsible for higher prices than would otherwise prevail in the market place.

However, airfare and travel discount initiatives undertaken by airlines and travel wholesalers in Japan over the past year, and particularly in the recent past, are part of a welcome effort to help rejuvenate this market.

It is notable that the airlines on the route have recently been undertaking a significant degree of service rationalisation in response to market conditions. Qantas's Japan route operations recorded losses in the year ended 30 June 1997, impacted by price cutting, competitive pressures and market conditions.¹¹

Overall, the negative effect of the Japan route's restrictive regulatory environment and relative competitiveness as a tourism destination are best addressed by continuing to press Japan to liberalise bilaterally and in the regional and multilateral context. Australia must continue to press for further capacity increases and less restrictions to allow an expansion in operations by airlines and the possibility for new entrants. Concurrently, Australia can improve access by negotiation of more liberal agreements with third countries, such as Korea and the United States, to facilitate travel by carriers from these countries.

Charters

Charter services are non scheduled air services that are usually patronised by a particular group or niche of travellers looking to fly to holiday destinations, particularly during periods of peak demand. Charter services offer such travellers the advantages of air travel without the flying scheduled services at times, and through ports, which may be inconsistent with their holiday plans.

Charters have an important role to play in developing new markets, servicing countries where scheduled services are limited and helping to develop smaller gateways and regional destinations. They can often tap new budget conscious markets while at the same time providing greater choice for consumers. A number of charter airlines already operate to Australia. Among the more well known of these airlines are Britannia Airways, Air Tours. Freedom Air International and Canada 3000.

Charter travel accounts for some 10 per cent of air transport activity world wide, and nearly 50 per cent of all international travellers in Europe. The distinction between the two types of services in such regions is increasingly blurred. Indeed the legal and licensing distinction between the two has been removed in Europe.

¹¹ Qantas Annual Report 1997

In this sense, it is worthwhile considering the effect of the ASA framework on this small but growing air transport sector.

DoTRD assesses applications for charter services under its 'Guidelines for International Passenger Charter Flights' (April 1996). The Guidelines are intended to encourage competition among carriers to regional areas and the establishment of new markets and to discourage charters operating in direct competition with scheduled services.

An important factor that needs to be taken into account, in assessing the merit of charters, is the extent of inbound market growth. In this respect it is notable that charter operators to Australia have demonstrated their ability to grow the market from Europe i.e. a large proportion of people on such flights may not otherwise have visited Australia^{xiii}

They also appear to cater largely for different markets than those serviced by scheduled carriers. To the extent that there is competition for the same market segment, this can assist in the generation of more competitive fares.

'For the customer the existence of both charter and scheduled flights on holiday routes is an advantage as it offers a greater choice and encourages competition between the carriers in price and efficiency of service.'^{xiv}

The current regulatory framework inherently provides competitive advantage to scheduled carriers over charter operators, which could act to limit charter flights in developing markets for Australia. For instance, many ASAs permit scheduled carriers to mount supplementary services in periods of peak demand and can allow them to commence services on a route which had been developed by charter operators. Competition moving in the other direction, however, is limited. The IASC may also choose to involve itself when charter operations could impinge on scheduled carriers use of allocated capacity.

The time taken for approval of charters through the various regulatory processes has been considered an issue by some charter operators.

It is recognised that, while increased competition from charters may be of assistance in generating more positive market outcomes, this must be balanced against the need for primary emphasis being placed on encouraging more competitive scheduled services by further liberalisation of ASAs.

In a related issue, the tourism industry has expressed reservations over amendments to the *Air Navigation Act 1920* passed in 1997. These changes require charter proponents to be owners or operators of charter aircraft and introduce other consumer protection requirements. While useful for boosting consumer confidence, these requirements do limit the entry of smaller charter operators in the market.

Inadequate funding of Customs, Immigration and Quarantine charter passenger processing at non-international airports has impeded charter development charter development to regional gateways in the past. It is important that arrangements be put

in place to ensure that charters are not impeded by the provision of insufficient CIQ resources which should be provided on an equitable cost-recovery basis.

Airport Infrastructure

The availability of suitable airport infrastructure is critical for maintaining and developing export markets. This is particularly important for industries such as agri-food, and other perishables where a quick turnaround and frequent flights are needed. The availability of infrastructure is also important to potential investors particularly in the import of intermediary inputs and export of finished goods.

Tourism growth is also dependent on the provision of airport infrastructure keeping pace with demand. Airports are not only a key component of transport infrastructure for tourists, but also the first and last point of contact with Australia for the majority of overseas visitors and can therefore influence significantly their perceptions of Australia as a destination.

Sydney is Australia's preferred port of entry for the majority of international tourists. It is therefore set to remain Australia's leading international gateway for the foreseeable future. Aircraft capacity at Sydney airport is constrained due to land availability, heavy usage during peak periods and environmental considerations. The airport is, however, expected to be fully capable of handling the expected increase in traffic up to and during the Olympic period, within existing curfew and hourly aircraft movement limits.

Some estimates suggest that, under the existing curfew and the aircraft movement cap, a second airport must be fully operational by 2002 - 2003 to avoid chronic congestion at Sydney Airport which would constrain inbound tourism¹².

In the meantime, the new slot control system at the Sydney Airport should ease traffic congestion and improve the airport's general efficiency particularly in peak periods. As air services increase, access to Sydney will be largely determined by the availability of slots, as it already is many other congested airports in our region such as Narita in Japan.

¹² TCA, ONT and FAC estimates 1997

In anticipation of these constraints, Australia has been encouraging some airlines to serve other ports or imposing constraints on how Sydney is served e.g. to be served only once in one direction. The choice of carriers on which constraints have been applied in serving Sydney can appear to be somewhat arbitrary in nature. That is not to say that negotiating policy will not need to reflect the growing scarcity of slots.

When combined with the emergence of the newly privatised airports this situation reinforces the need for non-specification of gateways and negotiation of sufficient

capacity to allow carriers to serve a range of other ports if they are unable to obtain suitable slots at Sydney.

END NOTES

ⁱ 'The role of regional trading arrangements in regulatory reform: the international air transport industry' Christopher Findlay, Peter Forsyth and Bijit Bora. P4. Prepared as a chapter of Bora and Findlay (eds) of *Regional Integration in the Asia-Pacific*. 1995

ⁱⁱ 'Aviation and Tourism Policies: Balancing the Benefits World Tourism Organisation Publication Routledge 1994, page I to 8

ⁱⁱⁱ *ibid* ii, preface

^{iv} BTCE Working Paper No.20 'Demand Elasticities for Air Travel to and from Australia'

^v *ibid* i

^{vi} *ibid* ii, Chapter 4

^{vii} See for example Bureau of Transport and Communications Economics, *International Aviation*, Report 86, pages 251-252.

^{viii} *The Economic Impact of International Airline Alliances*. Productivity Commission 1997

^{ix} 'International Air Transport Policy of New Zealand' Issued by the Hon. Maurice Williamson, Minister of Transport. February 1998

^x 'Tourism: Getting It Right For The Millennium' John Hutchinson, October 1997

^{xi} The Asia Pacific Aviation & Tourism Study 1997, Centre for Asia Pacific Aviation

^{xii} 'International Performance Indicators Aviation' Research Report 59 BE August 1994

^{xiii} Britannia Airways Surveys 1989-April 1990 and Nov 1990-March 1991; Department of Transport and Communications AVSTATS/International Aviation Division

^{xiv} 'Tourism: the state of the art' ed by A.V. Seaton Chichester: John Wiley & Sons 1994