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**QANTAS SUBMISSION IN RESPONSE TO THE DRAFT REPORT ON  
INTERNATIONAL AIR SERVICES RELEASED BY THE PRODUCTIVITY  
COMMISSION ON 18 JUNE 1998**

Qantas is pleased to submit the following further comments to assist the Productivity Commission in finalising its report to the Treasurer on International Air Services.

The comments take account of the draft recommendations released by the Commission on 18 June 1998 and respond to the matters identified by the Commission as those on which further comments are invited.

***Overview***

The regulations under review relate to an industry which has experienced substantial reform for more than a decade. This is true not just in Australia but internationally. There is no sign that this process is slackening nor that Australia is in danger of being left behind. Indeed, the reverse is more likely to be true.

Qantas of today, and the policy environment within which it operates, are nothing like they were ten years ago. Globally, the industry is subject to competitive pressures which would have defied imagination in the 1980's. The regulatory framework has adapted to the pressures for change and is continuing to do so.

In its original submission, Qantas demonstrated the efficiency gains it has made over this period and the benefits which have passed to consumers as a result.

Given the significant progress which has been made, it might be reasoned that the Commission has attempted to find solutions for problems which do not exist or for which effective policy responses are already in play. What is more, in doing so, it has come to the wrong conclusions in some quite important respects.

It might also be concluded that the net benefits of further liberalisation are likely to be small.

Generalised open skies solutions or attempts to graft Australian policy and practice onto overseas experiences, tailored to the interests of other countries and which take no account of the extent to which Australia is already ahead of

the game are, on the evidence, unnecessary or impractical or a combination of the two.

### ***Qantas' Position***

The place of liberalisation is not in question. Liberalisation is essential if Qantas is to grow and to have a viable future. It is also essential if other aviation dependent stakeholders are to advance their interests. However, there needs to be close attention paid to the pace, sequence and timing of initiatives if the economy wide benefits to Australia are to be maximised.

Qantas believes very strongly that the process should be evolutionary, implemented progressively and with a consistency of policy purpose, through the bilateral system.

In its original submission, Qantas argued that the current system of bilateral air services agreements is the best and most pragmatic form of competition policy for Australian aviation. This is because it is at least as capable as any of the alternatives of securing competitive outcomes both in the short and long term.

Qantas went on to say that managing the transition to more liberal bilateral outcomes is the key to further gains and that it is important to pursue liberalisation on a case by case basis - with policies tailored to suit the nation's own circumstances, market characteristics, welfare objectives and international relationships.

### ***The Commission's Response***

The Commission has only partially supported such an approach. It has found that unilateral deregulation has nothing to offer Australia and that the bilateral system can still deliver positive outcomes. Nevertheless, it opts for a formulaic response - the universal pursuit of an "Open Skies" model, the formation of a plurilateral "club" of like minded countries and various multilateral initiatives.

This dilutes Australia's ability to maximise the opportunities on offer from the bilateral system and to tailor outcomes in the national interest.

### ***Open Skies - Recommendations 8.1 to 8.3***

Central to the draft recommendations is the pursuit of "Open Skies" initiatives.

It is unfortunate that use of the term open skies, which has no universally accepted meaning, has become so prevalent as to symbolise the debate about

the future direction of aviation policy in Australia. Anyone who opposes open skies is made to appear reluctant to accept change.

Qantas takes a more pragmatic view. Inevitably, under a process of progressive bilateral liberalisation, the point will be reached on occasions when the next practical step will be to agree to open markets in all respects - capacity, routings, service options etc.

Qantas does not hide from this. Indeed, it is possible that airlines seeking to maximise commercial opportunities under bilateral arrangements will see this position reached sooner than might otherwise be the case.

However, for this to occur, it is important that this not be part of an ideologically driven or "designer label" policy but the result of a case by case examination to ensure that Australia is confident of the benefits to be obtained and has positioned itself in such a way that full use can be made of the opportunities on offer.

Qantas believes there is an important distinction to be drawn between this evolutionary approach and the Commission's recommended model whereby "Open Skies" becomes the liberalising mechanism rather than a point to be reached after careful consideration of all of Australia's interests.

### ***The Starting Point***

The Commission recognises that the bilateral system is capable of delivering further liberalisation but overlays this with negative references to its inability to adapt quickly enough.

The Commission takes as its starting point the conclusion that under the bilateral system, capacity remains highly constrained on many important routes. It seeks to do this through an analysis of Australia's top 20 routes which shows that for a small number of these there is little or no unused capacity available. Even if this was the right conclusion to draw, which it is not, the analysis has already been overtaken by events which simply serves to illustrate the speed with which developments occur under the current system.

Qantas does not see that it is possible to reach a conclusion on this evidence or with this level of analysis. In its original submission, Qantas undertook a similar analysis supplemented by commentary on seat factors achieved, the number of carriers operating in a particular market and information on third country carrier operations and opportunities. This concluded that growth is generally not constrained and that the few instances of blockage were due to the attitude of Australia's bilateral partners - an attitude that would carry over whatever the regulatory arrangements.

The Commission appears to have made no allowance for the underlying dynamics in any market - whether the airlines with access to the rights in question have any plans to enter the market or expand their operations, the timing of any such intentions, whether the market has any growth potential left in it, whether current capacity is sustainable, airline seat factors, the ability or willingness of the authorities on either side to respond if airlines sought to introduce new services and so on.

Attachment A outlines the essential characteristics of a constrained market - by looking at seat factors, growth characteristics, market share, price and airline yields - and applies these to the markets which the Commission identifies as constrained. The Qantas analysis leads to the conclusion that there are no binding capacity constraints in key markets.

### ***Competitive Outcomes***

If the existence of capacity constraints in some markets is overstated, perhaps more significant still, is that hardly any recognition is given to the effects of the pro competitive policy stance Australia has taken for the best part of a decade.

Australia's policy of negotiating capacity ahead of demand is dismissed as inherently arbitrary, time consuming and costly. These criticisms are cosmetic and focus on inputs rather than outcomes which, by any reckoning, have seen Australia make accelerated progress towards liberal market access in all key markets.

### ***Carrier Efficiency***

Little positive commentary is provided in support of the efficiency gains of Australian industry, particularly Qantas which has been at the cutting edge of this process in the international arena. This oversight is important because it withholds from the reader the efforts being made to increase consumer welfare and the benefits likely to accrue as a consequence to aviation dependent industries. It also creates misplaced emphasis on what the Commission regards as regulatory costs to airlines from the bilateral system.

### ***Airline Alliances***

The increasing trend towards alliances is an important element of many airlines' efforts to remain efficient through the reduction of costs and the generation of revenue and service benefits. This is regarded by the Commission as a response by airlines to the inefficiencies forced upon them by the existing regulatory regime and their inability to merge operations under bilateral ownership and control rules, rather than an efficiency initiative in its own right.

Equally, this might be regarded as a response to increased competition which is changing the face of the global industry.

There are many reasons, quite unrelated to regulatory issues, why airlines enter into commercial arrangements with other carriers. Just as likely to provide the impetus are the marketing and operational efficiencies which can be obtained and the revenue enhancement and cost reductions which go with it.

It is Qantas' experience that carrier alliances are likely to be a major factor in urging governments to conclude more liberal bilateral arrangements. Airlines recognise that competition authorities will wish to see a liberal regulatory environment in place to offset any perceived anti competitive detriment and the airlines themselves will very often see the potential for more liberal arrangements to be of mutual benefit in extracting value from their relationship.

### ***Mixed Menu***

The Commission rightly concludes that unilateral open skies will not enhance Australian welfare. It would be likely to make Australia worse off.

It goes on to recommend continuing to work within the bilateral system under a package of reforms including a common market with New Zealand, an open skies policy with other countries based on the New Zealand model, and under a combination of plurilateral and multilateral arrangements.

Like the Commission, Qantas recognises that multilateral, and to an extent plurilateral approaches have their place. But they are not really the main game. More significant from Qantas' perspective are the Commission's proposed unilateral and bilateral initiatives, including application of the New Zealand "Open Skies " model.

### ***New Zealand Open Skies Formula - Recommendation 8.7***

Qantas believes strongly that Australia will be best served when it sets its own priorities based on Australian interests. Adoption of the New Zealand "Open Skies" model is not synonymous with this approach - in many respects it is the antithesis.

A closer examination of New Zealand's aviation policy and performance is illuminating for what it reveals about how far New Zealand is behind Australia in creating a competitive international aviation environment.

New Zealand has thirty three bilateral agreements, six of which meet the open skies definition - United States, Brunei, Luxembourg, Malaysia, Singapore and

United Arab Emirates. New agreements are pending with Belgium and Ireland. Rights are exercised under only three of these - US, Malaysia and Singapore - and, in each case, by only one carrier.

Conventional agreements remain for most of New Zealand's major markets - including UK, Canada, Germany and Hong Kong.

Ten of New Zealand's agreements are with Pacific Island states where the market can barely support one carrier let alone two.

Despite its professed multiple designation policy, New Zealand does not have a mechanism to allocate traffic rights or capacity. Under 1947 legislation, the Minister of Transport approves and issues licence applications. There is only one international airline of any consequence (Air New Zealand) which routinely applies for all capacity.

There are no provisions to review or renew capacity allocations, thus Air New Zealand holds all the capacity regardless of whether or not it is used. The only other New Zealand international airline, Freedom Air, is a wholly owned subsidiary of Air New Zealand.

Currently, twenty one airlines operate to/from New Zealand. A further nine operate only as code share marketing carriers mainly with Air New Zealand. These include carriers from the major markets of Japan, UK, and Germany which code share on Air New Zealand (with the exception of British Airways which code shares with Qantas).

Between them, Air New Zealand and Qantas probably generate 85% or more of all international aircraft movements into and out of New Zealand.

A significant number of foreign carriers have withdrawn from the market in their own right - British Airways, Japan Airlines, Lan Chile, American Airlines, Air France, Continental, and Hawaiian Airlines. The "new" arrangements have enabled Air New Zealand and Singapore Airlines to reduce frequency and capacity through code sharing. The only offsetting development has been Canadian Airlines' re-entry of the New Zealand market with a weekly B767 service following termination of its commercial agreement with Air New Zealand.

Compare this with the recent Australian experience of multiple designation, a competitive process of capacity determination aimed at encouraging new entrants, the designation of Ansett International and a number of niche international carriers, at last count, fifty seven airlines offering services to Australia under fifty one ASA's and a far more significant uptake of carrier entitlements.



### ***Common Market with New Zealand - Recommendation 8.6***

In addition to advocating the New Zealand "Open Skies" model, the draft recommendations include extending the single aviation market (SAM) with New Zealand to the point where it would become a common market for aviation purposes. This would require Australia and New Zealand to reach agreement on a common external aviation policy, the designation of "Australasian" carriers under common bilateral agreements with other countries and a single capacity allocation process to apply in both countries.

Such a common external policy would go well beyond the free trade arrangements applicable in other areas of goods and services trade with New Zealand under CER. This is at odds with the Commission's statement that in the context of goods and services trade, "a different system for international air services is increasingly difficult to justify".

Notwithstanding this, it is difficult to see what, if any, benefits would accrue to Australia from the Commission's recommended approach. The Commission is, no doubt, motivated by the expectation that this would put pressure on Australia to accept the New Zealand "Open Skies" model for external application. But this option is open to Australia anyway.

The Commission also suggests that such an approach would make fifth freedom rights more accessible. But these can be exchanged at any time under the current arrangements.

It seems also to be motivated by the view that Ansett and Air New Zealand have been forced into company structures which are less than optimum and that they (and Qantas) should have the opportunity to merge their operations that a common market would create. From Qantas' perspective, it is arguable in the extreme as to whether any of the players in the Australasian market would want to lose their independence in this way.

Australia proposed a common aviation market of the type envisaged during the negotiations which led up to the current SAM agreement. The New Zealand Government was not interested citing, at the time, the loss of independence which would result.

It is very easy to underestimate the difficulties associated with implementing this proposal. To be successful, it would require the cooperation of all of Australia's bilateral partners and all of New Zealand's. As the Commission has itself pointed out in its consideration of the ownership and control rules, unless third parties universally accept the bases on which Australasian carriers are designated, any changes to the current arrangements would leave Australian and New Zealand carriers open to international discrimination.

Qantas does not believe the proposals are workable in the current climate - until a sea change occurs internationally with regard to designation and a relaxation of bilateral ownership and control obligations.

#### ***Plurilateral "Club" - Recommendation 8.4***

The third approach favoured by the Commission is the suggestion that like minded countries might be encouraged to sign an "Open Skies" agreement on a plurilateral basis. Club members would offer an open set of rights to each other but not to non members. Non members would be free to join at any time on the same basis as the existing members. The Commission sees this as a stepping stone to global liberalisation based on the notion that, somehow, Australia will be left behind if it does not pursue such an approach.

As with bilateral open skies, this assumes that Australia is ready to enter into open access arrangements without critical evaluation of the national interests in each case. If Australia could choose the members, it would be possible to ensure that only those countries with whom Australia had all the interlocking rights in place were admitted - but the proposal would allow anyone to join whether we were comfortable that we had all the rights in place or not.

Experience suggests that an "Open Skies" club has very limited support within Australia's geographic region.

#### ***Multilateral Liberalisation - Recommendation 8.5***

Some elements of the regulatory framework lend themselves to consideration in a broader, multilateral framework - ownership and control, government subsidies, and fair trading provisions for example.

Qantas is not opposed to close examination of the idea that aviation hard rights might be brought within the processes of GATS/WTO but notes that this will not of itself guarantee market liberalisation. In any case, like other contributors, Qantas believes that progress will be slow in multilateral forums.

#### ***Regional Package - Recommendation 5.1***

The Commission identifies a package of access opportunities for use by foreign carriers, aimed at encouraging the distribution of aviation services throughout regional Australia and at secondary international gateways. The Commission effectively steps outside the bilateral system by proposing that these be offered by Australia on an unreciprocated basis as "there appears to be little negotiating coin in retaining some of these features".

The package includes unreciprocated access to all international gateways, codeshare and own stopover rights between all points in Australia and the opportunity to carry cabotage freight.

With the exception of freight cabotage, which by virtue of its special nature should not be offered, there will be times when this is true. However, there will also be many when it isn't. Recent Government policy has become considerably more relaxed in relation to domestic access rights to the point that these are rarely, if ever, denied foreign carriers with a genuine interest in using them even when reciprocity is not obtainable.

It should not be concluded that they therefore have no value as negotiating coin. In the newly emerging markets of India, China, South Africa and Latin America, for instance, multi-point itineraries, code shares and stopovers are likely to be very valuable to Australian carriers in establishing the viability of their services and contributing directly to their ability to generate visitor traffic to Australia.

Qantas believes that the Government has correctly positioned Australia on these issues. It is important to encourage the development of secondary gateways and regional trade and tourism, and whenever genuine service proposals present themselves every effort should be made to facilitate them.

This can best be done on a case by case basis with an eye to the spread of national and regional interests. At times, it will be possible to extend the benefits to Australia by obtaining useable equivalent rights in foreign countries. This opportunity will be lost with the Commission's approach.

### ***Airfreight - Recommendation 5.1***

In its original submission, Qantas pointed to factors other than the regulatory regime which impact on the availability of dedicated freight services into and out of Australia - in particular, the inability of exporters to cover the costs of providing dedicated air freight capacity.

The Commission acknowledges some of these but, nevertheless, concludes that restrictions on the operations of dedicated freighters in many of Australia's ASA's increase the costs and inconvenience of doing business in Australia for little, if any, gain to Australia's airlines.

The Commission seeks views on whether Australia should retain restrictions on fifth and seventh freedom rights for dedicated freight services and recommends the unilateral grant of cabotage rights to foreign carriers in the Australian domestic market.

Qantas believes the principles which should guide Australia's position on passenger rights and entitlements should equally be applied to airfreight. This means that decisions to move to more liberal or open market access arrangements in air freight should only be taken after case by case analysis of all of the sectoral and other interests involved rather than on the basis of a "one off" decision to remove all existing restrictions.

The Commission appears to have decided that fifth and seventh freedom rights are of little value to Australian carriers because they do not operate dedicated freighter services. However, just as the Commission argues that the award of additional rights (such as cabotage) might tip the commercial balance for foreign freight operators in favour of commencing or maintaining services, so might this apply to Australian carriers.

Qantas opposes the proposed unilateral grant of freight cabotage rights to foreign carriers. Not only would this undermine Qantas' revenue base, but there would be a strong possibility that some domestic services particularly to regional gateways (passenger services included) would be put at risk leading to their suspension and a worsening of overall capacity availability. The Perth - East Coast route, which is currently served by leased freighter capacity, is a prime example.

Qantas took the view in its original submission that cabotage was a matter for consideration once certain conditions precedent had been met - as the process of investment liberalisation adds to the opportunities for offshore establishment and as the trading of other rights, including seventh freedom rights progresses.

Even if the Commission's open skies proposals were to meet with success, it is unlikely that these conditions will have been met, and certainly not before the proposal to offer freight cabotage on an unreciprocated basis takes effect.

Qantas continues to believe that until these pre-conditions are met, it would be ill advised for Australia to consider the exchange, let alone grant, of cabotage rights.

### ***Airport Access***

Qantas believes it to be essential that the Government complement its policy objectives in relation to airline capacity with policies in relation to airport capacity designed to meet the same objectives - to encourage and facilitate capacity growth according to demand, at the lowest possible cost, and consistent with the needs of users.

It is disappointing, therefore, that the Commission has felt constrained by its mandate about giving more weight in its findings to the link between Australia's

competitiveness in world markets for tourism, travel and freight and the availability of capacity at Australia's airports, particularly its key Sydney gateway.

It might be noted how Australia's competitors in the Asian region - Hong Kong, Singapore and Malaysia in particular - are investing significant resources in a major expansion of airport capacity to meet future demand and market growth as well as to provide increased opportunities for their own carriers to operate more efficiently at these hubs.

Detailed comments on the two airport access issues raised by the Commission, which Qantas believes will not add to efficiency of operations but will add to costs to the consumer, appear at Attachment B.

### ***Capacity Allocation and the IASC - Recommendations 6.1 to 6.6***

The Commission has identified a number of areas in which IASC policies and practices are in need of attention. Qantas is in broad agreement with the Commission's findings although it would take a different view on some points of detail. These are identified at Attachment C which focuses on the recommendations at chapter 6 of the draft report and the matters on which the Commission has sought further comments.

### ***Statement of Aviation Policy - Recommendation 4.1***

Although there is currently no one document which parallels the US DOT's Statement of International Air Transportation Policy, or the NZ Statement of Policy, **Australian policy has been subjected to thoroughgoing review and analysis in the period during which those statements were prepared. Indeed, the NZ Policy Statement** updated in 1998 a policy which had been last addressed in 1985.

Policy consistency and its articulation are important elements in the development of an efficient and competitive airline industry. Qantas anticipates that the Government's response to the Commission's final report will meet many of the recommendations underpinning draft recommendation 4.1.

### ***Consultation and Transparency - Recommendation 4.2***

The pursuit of an economy wide approach necessitates that all interested parties have an opportunity to present their views to DTRD before negotiations take place and to receive feedback after the event. Like other stakeholders, Qantas is keen to see that the most effective consultative processes are in place.

Qantas relies on its direct contacts with Government agencies and Departments in advising on positions for air services negotiations and in the majority of cases is a member of Australian Government negotiating teams. This recognises both the technical skills which Qantas possess and the commercial insights which Qantas can provide to Australian negotiators. It also recognises that Qantas is the single most directly affected party by the outcomes of air services negotiations.

In the main, this has been a satisfactory arrangement for Qantas. However, it does not ensure that Qantas' objectives are necessarily met nor that Qantas is always aware of developments.

Qantas does not have first hand experience of all of the consultative processes employed by DTRD and is not a participant in the Tourism Aviation Group (TAG) chaired by DIST.

### ***Public Access to Air Services Agreements***

The release of documents relating to air services arrangements is a matter for the Australian Government. If asked, Qantas would raise no objections, provided no commercial in confidence material was included.

## ATTACHMENT A

### CONSTRAINTS ON CAPACITY

The Commission contends that capacity "remains highly constrained on many important routes". Based on an examination (Figure 4.2) of capacity use as a proportion of available capacity on Australia's top twenty routes, it goes on to note a series of concerns including the restricted ability of carriers to increase the overall number of services and to respond to rising traffic demand in those markets.

Qantas believes the Commission has exaggerated the significance of capacity constraints - which exist in relatively few markets - and has accorded insufficient weight to other factors which reflect the circumstances of particular markets or otherwise influence the willingness or ability of carriers to provide additional services.

#### ***Markets Identified by the Commission as Capacity Constrained***

The Commission identifies twelve markets as under some form of capacity constraint because:

- there is no capacity remaining for Australian carriers (Germany, Italy, Vietnam, Zimbabwe) or very little left (Hong Kong and Thailand); or,
- there is none available for foreign carriers (Italy, Korea, Lebanon, Mauritius, Taiwan and Zimbabwe) or very little (China and Singapore).

The situation has changed markedly since February 1998 when the data used in the Commission's table was compiled. Subsequent air services negotiations and/or carrier withdrawals from some markets mean that only in the Hong Kong and Italy markets is all of the negotiated capacity being used. In both of these, negotiations are likely to be held soon. In a third, Kansai, nearly all capacity is in use but this market is in substantial decline and carriers are struggling to use viably the capacity they have.

In the predominantly outbound Mauritian market, there is no capacity available on the Mauritian side. This is capable of being addressed readily should there be any commercial interest on the part of airlines or any other reason for the negotiation of additional capacity. Qantas would not regard the Mauritian example as sufficient evidence on which to base the conclusion reached.

Table A1 below outlines the capacity in use and available for take-up in all of these markets as at July 1998.



**Table A1**

**Bilateral "Capacity Constraints" as at 24/7/98**

Country	Aust Capacity	Used	Spare	Foreign Capaty	Used	
China	now - 2520 seats pwNov 98 -2740 seats pw	QF - 916AN - 630	974 seats +240 seats	same as Aust	CA- 825MU- 861CZ - nil	834
Germany	now - 14 pwOct 99- 18 pwOct 02- 21 pwOct 04- 25 pw	QF- 7 pw	7 services+ 4 + 3 + 4	same as Aust	NIL	AL
Hong Kong	28 freq pw/ 9000 seats + 200 tn/2 freq convert. frtrs	QF 24 pw/ 6807 seats+ 1 B747F.AN 5 pw/2070 seats	NILfreq	same as Aust	CX 28 pw/ 8372 sts + 2 B747F	NIL
Italy	3 x B747	QF-3 x B747	NIL	3 x B747	3 x B747	NIL
Japan (KIX)	21.2 B762 eq. units/14 frequencies pw	QF -6.6 units/ 6 pwAN -14 units / 7 pwk	0.6 units/1 freq. pw	same as Aust	JL-14 unitsNH-7.2 units	NIL
Korea	10 x B747 eq units	NIL	ALL	same as Aust	OZ-2.4 unitsKE- 3.2 units	4.4
Lebanon	2 x B767 eqv	NIL	ALL	2 x B767 eqv	NIL	AL
Mauritius	1x B747 or2x B767	NIL	ALL	1x A340or 2x B767	1 x A340	NIL
Singapore	now - 20,800 seats pwApr 99 - 23,200 seats pw	QF - 52 flts/14318 seatspw +/- BA code share seats	6482 +2400	now - 15200 sts pwApr 99 - 17600 sts pw	50 flts/ 14974 seats pw	220
Thailand	now - 25 x B747 unitsMar '99-30 B747Mar '00-35 B747	QF - 19.4 B747 units	5.6 units+ 5+ 5	same as Aust	14.2 B747 units	10.
Taiwan	now- 2400 seats pwNov 98- 2800Nov 99- 3600	QF- 912 stsAN- 828 sts	660 seats+ 400 + 800	same as Aust	BR - 1270 stsAE - 897 sts	230
Vietnam	3 x B767	2 x B767- susp Aug '98	1 x B767	3 x B767	2 x B767	1 x
Zimbabwe	now- 1200 seats pwApr 99- 1600 seats pw	2 x B747	400 seats + 400	same as Aust	2 x B747(QF C/Shre)	400

**Notes:**

<b>China:</b>	<b>CZ</b> (China Southern) suspended its Australian services in April 1998.
<b>Hong Kong:</b>	<b>QF</b> has converted one freighter frequency for use as a passenger frequency.
<b>Italy:</b>	Bilateral discussions between Italy and Australia are proposed for Sept. 1998.
<b>Japan (Kansai):</b>	<b>QF</b> now code shares on 3 JL services weekly, and operates three direct services.
<b>Lebanon:</b>	<b>MEA</b> suspended service to Australia in February 1998.
<b>Mauritius:</b>	<b>MK</b> has regularly operated above the base entitlement, under bilateral provisions supporting seasonal supplementaries. Qantas is not aware of any approach to seek additional base capacity.
<b>Vietnam:</b>	<b>QF</b> will withdraw direct services from mid August '98
<b>Zimbabwe:</b>	It is misleading to show that Air Zimbabwe is constrained by lack of capacity. They do not have any plans or suitable aircraft to serve Australia in their own right.

***Other Factors***

Although touched on in passing, Qantas believes the Commission has not given due weight to such things as seat factors achieved by the airlines participating in a specific market, the rate of growth in origin/destination passenger traffic, relative market concentration and participation by third country carriers, and the prevailing trends in prices and carrier yields. Also relevant is the anticipated ease with which adjustments to the capacity balance would be possible on a bilateral basis.

Qantas contends that the characteristics of a constrained market are likely to be:

- seat factors - high and increasing;
- O/D market growth - low;

- market share - concentrated in small number of third/fourth freedom carriers;
- prices and yields - increasing.

An examination of the relevant characteristics in the most "constrained" of the above markets (in the Commission's terms) leads to the conclusions at table A2 below:

**Table A2**

	<b>SEAT FACTOR</b>	<b>O/D MARKET</b>	<b>MARKET SHARE</b>	<b>PRICE/ YIELD</b>
Characteristics for a constrained market	High and increasing	Small growth	Concentrated in small number of 3rd/4th carriers	Increasing
Japan (Kansai)	Low and falling	Negative growth	5 carriers offered non stop service - now reduced to 4 x 3rd/4th operators	Falling
Italy	Falling	Strong growth	50% carried by 5th/6th freedom carriers and increasing	Small fall
China	Low and falling	Very strong growth	4 carriers non stop. 5th/6th carriers hold 27% market share	Falling
Hong Kong	Small fall	Negative	3 carriers non stop. 10% held by 5th/6th freedom	Large fall

On none of these routes are all of the characteristics of a constrained market evident. In all cases, the indicators most relevant to carrier performance and sustainability (seat factors, prices and yields) are the reverse of those which would typically be expected in constrained markets.

Market growth characteristics show mixed results with negative growth in Japan and Hong Kong and strong growth in Italy and China. Any reasonable analysis would see the performances of the Japan and Hong Kong markets as influenced heavily in recent times by broader factors not related to airline capacity.

Market share analysis shows a strong competitive influence from third country carriers in all markets other than Kansai. Capacity under the Japan agreement is determined largely by the attitudes of the Japanese authorities. These would prevail whatever regulatory arrangements were adopted.

## **ATTACHMENT B**

### **AIRPORT ACCESS**

In chapter 7 of its draft report, the Commission comments on a number of matters concerning access to airports in Australia and indicates its intention to make two recommendations in respect of pricing and slot management.

Before addressing these specific issues, Qantas wishes to make some general comments concerning airport capacity which, like other users, it holds to be the most important issue in airport policy and deserving of greater consideration in the context of chapter 7.

Airport congestion is most acute at Sydney Kingsford-Smith Airport (KSA), Australia's primary gateway and hub. Forecasts endorsed by the industry and Government indicate that passenger and freight demand for capacity at KSA will continue to grow. Unless growth capacity is made available to users according to the pace of demand, and at the lowest possible cost, the needs of the economy will not be met, inevitably with unacceptable consequences.

The priority requirement - which has not been addressed in the draft report - is to ensure the application of appropriate public policy to encourage and facilitate the growth of airport capacity at KSA, consistent with the needs of users. The report would be enhanced by some detailed analysis of these objectives and how they may be achieved, so that prices can fall and service quality increase.

Qantas contends that the policy objective in relation to airport capacity should have the same outcome as the policy objectives in relation to airline capacity, so that the users of airport services can equally enjoy public benefit.

It should also be noted that the Commission's proposals appear to have been overtaken by events, including:

- Approval by the ACCC of a new charges regime for Sydney Airport which specifically excludes peak period pricing;
- Enactment of new legislation (Demand Management Act) which provides for slot allocation;
- Endorsement by the Minister for Transport of a decision by the Sydney Airport operator to further reduce the minimum landing charge at KSA, which especially benefits operators of comparatively less efficient regional aircraft.

#### ***Peak Period Pricing***

The Commission has noted that airline scheduling is subject to a "Window of Opportunity" but has failed to observe the nature of that window.

Airports globally are constrained in peak periods and some airports are constrained virtually the entire operating day - examples are Narita, Heathrow, Kansai, and Frankfurt. Carriers operating to and through these airports have few opportunities to change schedule times and this limits flexibility at the origin or destination point of flights and at intermediate points.

Peak period congestion is further complicated by curfews and movement constraints at different airports so that global flexibility is increasingly limited. Further, commercial aviation services must pay due regard to customer travel preferences and the need to connect into and out of hub peak periods in order to create viable schedules.

Hub operations facilitate the connection of passengers and freight between the services of one airline or to and from the services of multiple airlines. Hubs typically operate in three or four "waves" of services being an early morning 0600 - 0800, a mid day 1100 - 1300, an early evening 1700 - 1900 and a late evening typically 2200 - 0100.

A typical hub for Qantas involves its services via Singapore whereby timings of outbound services destined to UK and Europe are controlled by an arrival slot and curfew in Europe typically around 0530-0630, which drives services through Singapore between 2130 - 2300. Connecting flights from Australia must arrive in Singapore in the 1900 - 2000 period in order to connect and this in turn drives departure time from Australia into a mid afternoon departure pattern from the Eastern states and late afternoon departure from Perth/Darwin.

Inbound to Australia services are controlled by curfews in Europe, Sydney and Adelaide and this, combined with the need for passengers to connect to domestic points within Australia and to New Zealand, dictates arrival just after curfew, typically in the 0600 - 0700 period. Services must depart Heathrow prior to the 2300 curfew therefore the QF services depart at 2230 from Heathrow to arrive in Sydney at 0600 with no scheduling flexibility, given curfews at both ends of the route.

In turn, up to 8 Qantas services from Singapore must depart in the early evening between 1930 and 2100 to meet the hub connections in Singapore. In other words, a typical international service drives through

three hubs (the evening hub at Heathrow, the evening hub at Singapore and into a morning hub in Sydney).

Qantas operations are paralleled by numerous other airlines operating over Singapore or other Asian ports - Hong Kong, Kuala Lumpur and Bangkok services all follow essentially the same timing profiles, which creates a morning peak in Australian East Coast gateways.

In Sydney, domestic flights are timed to meet the needs of business travellers who seek to arrive in time to commence work for the day. This typically results in departures from most cities into Sydney around 0600 and drives an arrival peak around 0730 - 0830 and departures from Sydney typically occur in the early morning hours to arrive at Eastern States cities in the same business timings. In the evening, departures and arrivals from major gateways face the same peak demand periods.

Regional services experience identical demand with the consequence that movements at airports are clustered into peak periods and relatively little demand exists in mid morning or mid afternoon. During periods of low demand, airlines typically schedule flights to and from predominantly leisure focused destinations, eg Coolangatta and Cairns, and drive discretionary travel into East Coast points through the availability of lower airfares.

Because of passenger demand and hub needs, coupled with curfews and related infrastructure constraints, pricing mechanisms are not capable of spreading demand. Pricing would have no impact on improving the efficiency of the use of airport resources or on spreading services. Economic recovery of airport facilities is achieved through the landing fees and pricing mechanisms currently imposed.

Extension of peak period pricing would have no effect on efficiency but would impose a cost increase on airlines who have virtually no options available to change schedule peak times. Ultimately, cost increases would flow through to passengers and in turn become an increased cost of business, to the detriment of the community at large.

### ***Slot Trading***

In 1997, the Government decided to introduce a management regime at Sydney Airport with the intention of managing scheduled movements in order to impose a cap of a limit of 80 movements in any one hour period during the operating hours of the airport - 0600 - 2300 daily. Two primary alternatives were investigated:

The trading of slots whereby a price based mechanism would be utilised with airlines purchasing slots or obtaining them via a slot auction, slot lottery or slot trade with economic values attached.

A system of allocating slots within the cap coupled with a process whereby airlines would lose slots if they did not use them and where airlines could be fined for operating "off slot" ie, not at the times allocated.

The DTARD sought views from the industry and other interested parties on the two alternatives and developed study papers for each alternative process.

The study on the sale or auction of slots concluded that it would be inefficient in that little or no market would exist for slots in shoulder and off peak periods and that demand for slots in peak periods would be undiminished. Within the peak periods it concluded that the sale of slots would impose significant additional costs on both incumbent and new entry airlines with the probability that the stronger and larger carriers would retain existing, and gain new, slots whereas new entrants and financially weaker carriers plus regional and commuter operators would find barriers to retention of peak period slots or entry into peak periods unachievable.

The alternative approach involving the establishment of a slot allocation mechanism based broadly on the principals in use at around 200 airports worldwide was considered the most efficient and fair for incumbent and new entrant airlines regardless of size.

The Government determined that all costs for the management of slot allocations would be met by the airlines which evaluated mechanisms and recommended that a neutral company should be established purely for the allocation, use monitoring and compliance management of slots.

The Government accepted the industry recommendations, established legislation imposing a slot limit of 80 movements per hour, a ring fencing of 30% of movements for regional airlines and establishment of the management structure proposed by the industry, including the Airport Operator.

That Company has been established and has allocated the Northern Summer and Northern Winter 1998 slots for all movements in Sydney. New entrants have been catered for, existing entrants have been required to move services to facilitate the cap and regional airlines have been accommodated within a ring fenced 30% pool of slots.

This process has allowed some degree of certainty to airlines through the grandfathering of slots and has demonstrably improved the efficiency of Sydney Airport.



Peak periods remain peak periods and will always remain so, given scheduling constraints described previously in relation to the Commission's statements on peak period pricing.

No viable market for the sale of slots has emerged at any airport worldwide. Trough periods remain at Sydney and are likely to remain even as peak periods become totally congested. It can be argued that no market exists for slots in non peak periods and that charging for slots in peak periods would represent a barrier to entry or retention of services.

Further cost escalation on the industry through the sale of slots would be passed to consumers with the effect of adding costs to business and therefore the community at large.

## **ATTACHMENT C**

### **CAPACITY ALLOCATION AND THE IASC**

Qantas agrees with the Commission that for so long as capacity limits remain in ASA's, the public benefit test approach to allocation in contested situations is the most appropriate and that the IASC allocation system should continue. It agrees also with the suggestion that when capacity limits are removed, the need for the IASC allocation process disappears.

Qantas believes that it is not necessary to move comprehensively to open skies for the IASC allocation process to become unnecessary. The point is valid more generally and should be applied incrementally whenever open capacity arrangements apply.

This would remove the IASC from any decision making with respect to NZ, for example, and any freight determinations required under the recently concluded air freight agreement with Singapore. Capacity allocated to Australian carriers under these arrangements is currently required to undergo a public benefit test under Clause 4 of the Minister's Policy Statement.

Qantas also agrees with the Commission's finding that various issues regarding the operation of the IASC need to be addressed. In summary, the Commission has recommended that:

- the objectives of the IASC Act should be amended;
- the IASC should have power to allocate fifth freedom rights;
- the IASC should not be involved in anticipating the approval of other government agencies or assessing the viability of airlines;
- where an application for capacity is uncontested, or capacity is unconstrained DTRD should allocate this automatically without referral to the IASC;
- submissions should not be called for unless a contested allocation is referred to the IASC and then the criteria should be simplified; and,
- the criteria used by the IASC to allocate contested capacity should be simplified.
- Qantas would like to offer a number of comments on these recommendations.

### ***Objectives of the IASC Act***

Qantas agrees that the objectives of the Act could be made less confusing by an amendment to sub section 3(c) of the Act but otherwise believes that the current text should be retained over the proposed text which:

- introduces the idea that "greater" competition must be promoted, thereby giving this overriding importance amongst any other criteria employed by the Commission to determine benefit to the public; and,
- by removing the existing references to Australian carriers, fails to capture the essence of the current provisions, which are not protective of Australian carrier interests as suggested but recognise that the IASC's purpose for being is the award of capacity to Australian carriers.

Qantas would favour amending Para 3 (c) to read "increased responsiveness by airlines to Australian tourism and trade interests".

### ***Fifth Freedom Rights***

Qantas interprets the Commission's comment at page 129 of the draft report that all capacity rights available under Australia's ASA's, including fifth freedoms, should be allocated by the IASC, to be conditioned by draft recommendation 6.4.

This would ensure that when capacity is unconstrained, as is the case with the great majority of fifth freedom rights, the capacity in question would be approved without reference to the IASC.

This is consistent with the views expressed by Qantas in its previous submission and is supported. Qantas believes that, in these circumstances, the Bill currently before the Parliament is too open ended in the authority it gives to the IASC to determine the allocation of fifth freedom rights. This would need to be amended if the Commission's draft recommendation is adopted by the Government.

### ***General Capacity Allocation Criteria***

The Commission has recommended that the IASC not be involved in assessing the viability of airlines or anticipating approvals by other government agencies. Qantas believes the discretion which the Commission currently exercises in this regard is appropriate and should

be retained. It is in step with international practice, efficient, and enables Australia to uphold its international aviation reputation.

A mechanism for screening first time applicants is necessary to avoid triggering unnecessarily the contested application processes of the Commission. This would appear to be all the more appropriate given the distinction between the handling of contested and uncontested applications which the Commission has recommended.

Qantas is also mindful of the need to avoid the "locking up" of capacity by awarding it to carriers which ultimately fail to accumulate the capital and other resources needed to commence operations or to obtain operational approvals. Experience shows that the award of capacity to airlines which have not met minimum standards can be damaging to Australia's international aviation reputation.

Qantas believes the current general criteria should be retained and applied before first time applicants are able to participate in contested applications.

***Administrative Distinction between Contested and Uncontested Applications and where Capacity is Unconstrained***

Qantas agrees with the thinking behind Draft Recommendations 6.4 and 6.5 and is inclined to support the "separation of powers" between the handling of contested and uncontested applications.

Irrespective of whether the IASC or DTRD has administrative responsibility, automatic approval in uncontested cases will remove many of the difficulties Qantas has experienced with the current process. It will expedite the process.

There will be a need to make clear what constitutes a "contested" application. Qantas does not believe that the receipt of comments on an application - adverse or otherwise - should amount to a contested application if there is only one applicant for the capacity in question.

***Criteria to be used for Contested Applications***

The Commission has suggested that these should be amended to reflect economic efficiency and competition benefits as the major factors to be taken into account in determining the allocation of capacity on contested routes.

Qantas believes that economic efficiency and competition are captured in the existing criteria and would not want to see these narrowed down in a way which gave the Commission and applicants any less guidance than is provided currently. Further emphasis is given to these concepts in the proposed redrafted Objectives of the Act.

Qantas agrees that some clarification is needed under the Competition Benefits heading, particularly in the consideration of code share proposals and the respective roles of the IASC and ACCC. These matters were addressed in Qantas' previous submission (pps 56-57). Qantas is seeking as much certainty as possible in these areas.

The draft recommendation that all uncontested applications be approved automatically will see very great improvement in the manner in which most code share applications are assessed. In practice, Qantas expects that this will see the majority of code share proposals being left to the ACCC to assess in accordance with the provisions of the Trade Practices Act.

Under these proposals, only contested code share applications would be for the IASC to determine. In these circumstances, the current criteria in relation to code share proposals and commercial agreements take on a clarity which is absent when the IASC has the option of applying them to uncontested situations.

### ***Other Matters on which Views have been sought***

The Commission has sought views on four other IASC related matters:

- that start up provisions should be removed from the Minister's Policy Statement;
- that there should be a maximum "use it or lose it" period of two years;
- that determinations be made in perpetuity; and;
- the IASC and ACCC should be required to take each others' views into account when decisions are made.

On these, Qantas offers the following comments:

### ***Start up Provisions***

For the reasons spelt out in Qantas' previous submission, and for the further reasons advanced by the Commission, Qantas agrees that the start up provisions in the existing Policy Statement are unwarranted.

### ***"Use it or lose it"***

The Commission has indicated its disposition towards a maximum period of two years for the commencement of operations involving allocated capacity (rather than the three suggested as the maximum in the current Policy Statement).

Qantas has not seen this as a major issue as the Commission is free to exercise its discretion on a case by case basis and has generally done so without "locking up" useable capacity.

Perhaps more relevant in current industry circumstances, has been the need for the Commission to consider case by case whether capacity which carriers have been using but is now in suspension against the possibility that the market will pick up should be handed back or kept by carriers in reserve. In these circumstances, Qantas has generally sought some flexibility under the "use it or lose it" formula on the understanding that if another carrier had a use for the capacity it would be returned.

This suggests to Qantas that, overall, this is an area where flexibility rather than a more prescriptive approach is needed.

### ***Period of Determinations***

Qantas suggested in its previous submission that the Commission consider 10 year rather than 5 year determinations and is pleased to see it inclined towards allocations in perpetuity. Qantas agrees that there are sufficient policy and procedural safeguards in place, as well as protections in the IASC Act, to prevent entrenched monopolisation.

### **Overlap between the IASC and ACCC**

Qantas is pleased to see the Commission focus on this as an issue in need of further attention.

As discussed above, Qantas believes that the proposed package of recommendations will have a substantial and beneficial effect in removing from the IASC's jurisdiction many of the applications of a type (uncontested code shares) which have given rise to concerns in this area.

However, the suggestion that the MOU between the IASC and the ACCC should ensure that appropriate consideration of each organisation's views is taken into account when decisions are made strikes Qantas as more of an expression of the status quo than a solution.

If the Government adopts the Commission's recommendations in this area, Qantas would prefer to see the MOU make it clear that the ACCC is the primary body responsible for assessing the competition policy effects of service proposals and that the IASC has a responsibility to assess comparative competition benefits (rather than effects) only when it is relevant to decisions on competing applications.

Qantas suggests that it should be the responsibility of the Ministers responsible for the ACCC and IASC to authorise the MOU and that the opportunity might be provided for public comment before it is authorised as part of the transparency of process which lies behind many of the Commission's recommendations.