

SA GOVERNMENT COMMENTS

ON

THE PRODUCTIVITY COMMISSION'S

DRAFT REPORT ON

INTERNATIONAL AIR SERVICES

JULY 1998



1 INTRODUCTION

- 1.1 The Productivity Commission ("the Commission") has invited the South Australian Government to comment on the Commission's Draft Report on International Air Services.
- 1.2 The SA Government made a submission to the Commission (then called the Industry Commission) dated 25 February 1998 on various issues raised by the Commission in its Issues Paper.
- 1.3 Transport SA then made a supplementary submission dated 6 April 1998 to provide further information requested by the Commission following its questioning of Mr John Evans of the South Australian Tourism Commission, who attended the Commission's hearings on 4 March 1998.
- 1.4 The supplementary submission was made on a confidential basis because it contained information obtained from the SA Government's confidential discussions with various airlines. The submission accompanied various reports into the cost to South Australian exporters of the additional transport time to their markets caused by the transshipment of their products by road to interstate gateway airports. The reports were provided on a confidential basis because some of their contents were provided in commercial confidence to Transport SA by exporters.
- 1.5 This submission comments on the issues and recommendations arising from the Commission's Draft Report, particularly as they affect the concerns raised by the SA Government and Transport SA in the previous submissions.
- 1.6 Adelaide Airport Ltd and the South Australian Air Freight Export Council have confirmed that the comments also represent their views on the issues.
- 1.7 The first point of contact for discussion of any of the issues contained in this submission should be:

Mike Milln
Senior Adviser - Aviation
Transport SA
Ph 08-8343-2793
Fx 08-8343-2939
Mb 0419-849-121
Email mike.milln@roads.sa.gov.au

2 OVERVIEW

- 2.1 The SA Government supports the general approach of the Draft Recommendations which advocate a phased program of incremental reform and liberalisation of the present regulatory regime.
- 2.2 There is little doubt that the desired objective of inclusion of trade in air services in the General Agreement on Trade in Services (GATS) will be hard to achieve. The Commission's approach of recommending a series of unilateral and bilateral reforms which can be effected within the existing structure is therefore sensible.
- 2.3 The SA Government believes, however, that rapid implementation of more achievable bilateral 'open skies' reforms poses threats to the objective supported by the Commission of better access to secondary gateways.
- 2.4 The efficacy of the Commission's regional reform package in this context is therefore very important. The package incorporates many of the measures necessary to remove the opportunity cost of operating to secondary gateways identified in the SA Government's first submission. It does not address the crucially important issue of the provision of capacity for use to those gateways.
- 2.5 This submission takes up these issues in greater detail in its comments on the various sections and recommendations of the Draft Report in the next section.

3 COMMENTS ON DRAFT RECOMMENDATIONS

3.1 Australia's aviation policy and processes

The SA Government supports recommendation 4.1.

- 3.1.1 The Commission has made the point that Australia's aviation policy objectives are widely scattered throughout a range of documents. A single recognised document clearly stating the Commonwealth's aviation policy objectives, periodically updated as necessary, would be a useful innovation.
- 3.1.2 It would be a useful interim measure if, as an appendix to its final report, the Commission included a list of the documents relating to aviation policy that it referred to in writing this section of its draft report.
- 3.1.3 The SA Government notes that successive Commonwealth aviation policy statements have, without exception, included

references to the benefit of spreading international air access to regional Australia, but without providing detailed policy as to how that will be accomplished. This sort of policy vagueness has made it possible for various Commonwealth agencies or business enterprises to implement policies of their own which act at total odds with the objective of achieving better international access to secondary ports.

- 3.1.4 Airservices Australia's implementation of location specific charging for terminal navigation and rescue and firefighting services is a case in point (the second phase of which took effect on 1 July 1998). While the need for charges to be related to the costs of their delivery and the need for those costs to be transparent is indisputable, the effect of the policy nevertheless is to make Airservice charges for landing a Boeing 747 at Adelaide double those at Melbourne or Sydney.¹ If the Commonwealth had more concisely stated international aviation policy objectives which continued to include the objective of encouraging international carriers to serve secondary gateways, then the inadvisability of implementing such Airservices charges without corresponding Commonwealth subsidy would be more apparent.

The SA Government supports recommendation 4.2 with the reservation noted below.

- 3.1.5 In its first submission the SA Government indicated that it was satisfied with Commonwealth Department of Transport and Regional Development's (DoTRD) approach to consultation.² The weakness of the present system, to the extent there is one, is in gaining access to the "*timely and informative feedback on the outcomes of the negotiating process*" which the Commission suggests is necessary as part of this recommendation. The SA Government would support a formal approach to the provision of this information.
- 3.1.6 The SA Government would support any consultative mechanism set up to improve stakeholders' opportunities to make their views on air services negotiation known to DoTRD. It questions, however, whether formal consultative meetings of large numbers of stakeholders, many with competing interests, are likely to achieve this.
- 3.1.7 The SA Government also supports the Commission's position that "*there should be a strong presumption in favour of disclosure and*

¹ Airservices International TNC & RFC charge effective 1 July 1998 for B747-400 MTOW 385.555 tonnes: Adelaide \$4,079, Sydney \$2,059 and Melbourne \$1,924

² SA Government Submission, Paragraph 6.8 page 10

transparency of the arrangements"³, in reference to outside parties gaining access to the full text of Air Service Agreements, as part of a consultative process.

3.2 Regional reform package

The SA Government strongly supports recommendation 5.1, subject to the qualifications below.

- 3.2.1 The Commission has recognised that the opportunity cost of scarce capacity is a disincentive to foreign airlines' use of secondary gateways. Its statement: "*regional economies as a whole are likely to benefit from a more liberalised approach to providing access to secondary gateways than from the preservation or development of more restrictive arrangements, particularly if additional capacity is introduced*"⁴ is key in this regard.
- 3.2.2 The regional reform package outlined in recommendation 5.1 does not, however, make any provision for capacity to be made available specifically for use at secondary gateways. Without it, notwithstanding the unilateral provision of access to the secondary ports, the opportunity cost of using scarce capacity is not reduced at all.
- 3.2.3 For recommendation 5.1 to be effective therefore presupposes that the core package of further liberalisation of capacity suggested in recommendation 8.2, which is to be implemented only on a bilateral basis, will be successful. If capacity in key agreements remains scarce, then recommendation 5.1 will not be effective, at least to the extent that it seeks to influence foreign carriers to implement their own services to secondary gateways. Unrestricted rights to carry own-stopover traffic and freight within Australia are important measures to increase the viability of multiple-stop foreign carrier flights to secondary ports, and are particularly important when capacity is not scarce. However, as long as the opportunity cost of using capacity to secondary gateways remains, they are unlikely in themselves to be effective.
- 3.2.4 The SA Government is also concerned that under conditions of capacity scarcity, the provision of unrestricted rights for foreign airlines to codeshare on Australian airlines to all points in Australia may actually act as an additional *disincentive* for them to implement new flights of their own, or even to maintain existing flights to secondary gateways.

³ Productivity Commission Draft Report pages 68, 69

⁴ Productivity Commission Draft Report, page 110

- 3.2.5 The SA Government recognises that as long as the present bilateral regulatory regime remains in place, it is important that the Commonwealth retains enough leverage to ensure that it is able to negotiate outcomes that are in the national interest. The SA Government does not believe that the unilateral grant of capacity for use at secondary gateways would materially reduce that leverage. However, there may be occasions for a particular secondary gateway and for a particular set of negotiations when this might not be true, and for reasons of national interest the Commonwealth might need to restrict access to that gateway. Under those circumstances, provided the transparency of process already recommended in section 4 of the Draft Report was in place, the South Australian Government would of course support the national interest.
- 3.2.6 It should nevertheless be possible to implement a regional reform package as recommended by the Commission, but with general capacity incentives included. Those may include approaches other than unlimited third and fourth freedom capacity to the secondary gateway itself. For instance, most secondary gateways need to be paired with another larger gateway in order to support services. A regional reform package could include a provision where, under conditions of scarce capacity, a foreign airline operating a unit of capacity to a primary gateway could be considered by the Commonwealth to be using only half a unit if it were operated beyond the primary gateway to a secondary gateway as well. Or, depending on circumstance, it might be discounted altogether.
- 3.2.7 Under certain limited circumstances the Commonwealth might provide access to the primary gateway only if paired with a secondary gateway. This was the case when Malaysia sought access to Australia for a freighter service in 1995. Access and capacity to Adelaide was granted and Malaysia Airlines was permitted to operate the service also to Melbourne, provided service to Adelaide was maintained. Malaysia Airlines has operated a Kuala Lumpur-Melbourne-Adelaide weekly freighter service ever since.
- 3.2.8 Finally, the wording of recommendation 5.1 allows interpretations which the body of the Draft Report suggests are not intended. The SA Government suggests that the first sentence of the first dot point should be worded "*Secondary gateways should be included as nominated points in all air services agreements*". The last dot point should be reworded "*unrestricted rights for foreign airlines to offer freight services on Australian domestic sectors of their flights operated to Australia*".

3.3 International Air Services Commission

The SA Government supports recommendations 6.1 to 6.6 with the exception of 6.3.

- 3.3.1 Recommendation 6.3 is that “*The IASC should not be involved in assessing the viability of airlines, or anticipating approvals by other government agencies*”. The SA Government does not support this recommendation as it applies to applications for contested capacity.
- 3.3.2 If contested capacity is awarded to an airline according to public benefit criteria, then the public should have a reasonable expectation that the airline is capable of operating it. It should not be left to events to prove otherwise so that the public is denied the benefit of another airline operating the capacity in the interim.
- 3.3.3 In supporting recommendation 6.1 “*Contested capacity should continue to be allocated by the IASC using a public benefit test*”, the SA Government reiterates the statement in its first submission⁵ to the effect that when an airline is awarded capacity according to the public benefit it will generate by operating a specific city-pair or series of city-pairs, then the capacity should be awarded with the proviso that the airline operates on that basis.
- 3.3.4 The SA Government does not have a strong view about whether the start-up provisions of the IASC’s policy statement should be retained or not. However, there seems to be little evidence that they constitute the market distortion that Qantas claims in its submission⁶, or that, if properly applied, they might result in Qantas or other incumbent carrier failing to win capacity contested by a start-up carrier “*even if it could demonstrate a greater level of benefit from its service proposals*”⁷. The requirement for the IASC to award capacity to the start-up carrier only if the “*approval would not result in a decrease in inbound tourism to Australia, Australian consumer benefits or trade*”⁸ should be sufficient safeguard against that. The SA Government’s view is that the requirement for the IASC to judge a start-up carrier’s ability to operate any allocated capacity is particularly important if the start-up provisions of the Policy Statement are retained.

⁵ SA Government Submission paragraph 10.7 page 16

⁶ Qantas Submission page 61

⁷ Qantas Submission page 60

⁸ IASC Policy Statement paragraph 7.1c

- 3.3.5 The SA Government cautiously supports the Commission's view that allocation of capacity should be made in perpetuity and the principle that new entrants' access to capacity should be by "*expanding available capacity, rather than the redistribution of constrained capacity.*"⁹ This presupposes that the IASC must enforce its "use it or lose it" powers to ensure that an incumbent carrier cannot block access to a route while failing to operate it itself, and that available capacity can be negotiated to meet demand.

3.4 Access to Airports

- 3.4.1 The Commission asked for comments on its proposed recommendations that greater use should be made of peak load pricing at congested airports in Australia and that a market for trading in landing and take-off slots should be investigated.
- 3.4.2 In regard to the former, the SA Government draws the Commission's attention again to its comments in paragraph 3.1.4 of this submission, about the effect of the implementation of location specific charging by Commonwealth service providers such as Airservices Australia and the Australian Protective Service. The effect is that charges for services delivered by these agencies decrease at large airports and increase at small airports. While it is not always the case that the larger airports are congested and the smaller ones are not, that is generally the case and the policy is likely to exacerbate rather than relieve this condition.
- 3.4.3 The sale of landing slots was suggested in the SA Government's initial submission as a possible redistributive mechanism to encourage use of secondary gateways. The submission suggested that this would not be useful unless capacity was freely available.¹⁰

3.5 Further liberalisation

The SA Government supports recommendations 8.1 through 8.7 in principle, subject to the comments below.

- 3.5.1 This submission has already suggested that the free availability of capacity for third and fourth freedom traffic included in recommendation 8.2 should be applied at secondary gateways as part of the regional reform package. Recommendation 8.2 suggests that it should be negotiated as part of a bilateral 'open skies' agreement prior to inclusion in the regional reform package. The SA Government's position is that it should be granted

⁹ Productivity Commission Draft Report page 147

¹⁰ SA Government submission Page 19

unilaterally at secondary gateways unless there are pressing reasons relating to the wider national interest not to do so.

- 3.5.2 It is not clear why, since all the provisions of recommendation 8.2 are subject to bilateral negotiation, the issues of seventh freedom traffic rights and lifting of passenger cabotage are designated separately as “negotiable rights”.
- 3.5.3 The SA Government does not oppose the part of recommendation 8.7 which relates to completion of the common aviation market with New Zealand, but has yet to be convinced that doing so will be of net benefit to either the State or the country as a whole. There is no doubt that the benefits of a common aviation market would heavily favour the airlines of New Zealand, and the extent to which that would benefit Australia depends on factors which are not yet clear.
- 3.5.4 The SA Government supports the Commission's incremental approach to bilateral, pluralistic then eventual multilateral reform demonstrated in these recommendations. It believes the program is realistic and achievable, notwithstanding the Bureau of Transport and Communications Economics' 1994 warning *“A note of caution for the future is not to see calls for a more liberal approach to international aviation as new, nor is it any more likely to achieve greater success than similar calls in previous times have achieved”*¹¹
- 3.5.5 The South Australian Government adds the additional caution that quick achievement of even bilateral liberalisation could result in further concentration of international air services at primary gateways, and reduce the efficacy of a regional reform package.
- 3.5.6 The maintenance of scarcity of capacity and restrictions on operations to primary gateways are incompatible with the reforms recommended in this section. They are nevertheless - in the short term - the best chance regional economies have to develop their fragile markets to the point where they can compete for services in their own right in an ‘open skies’ environment.
- 3.5.7 It is that fact, and the importance of a regional reform package incorporating the additional dimension of free availability of capacity, that the SA Government wishes to emphasise most.

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Transport SA
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¹¹ BTCE Report 86 1994