27 July 1998

Ms Delwyn Rance
International Air Services Inquiry
Productivity Commission
Level 28 Collins Tower
35 Collins Street
MELBOURNE VIC 3000

Dear Ms Rance

Ansett welcomes the Productivity Commission's draft report on International Air Services and appreciates the opportunity to comment on it. Ansett makes these comments from the perspective of a very new international airline, in comparison with its major competitors, with services to a small number of single sector regional destinations.

The report is a wide ranging examination of the international aviation industry and its recommendations cover the key issues that emerged through submissions and public hearings. Ansett supports many of the conclusions reached by the Commission although there are some which are of concern to us.

Further Liberalisation of International Air Services

The key matters on which Ansett wishes to comment relate to the Commission's recommendations for further liberalisation of international air services.

The report notes that although Australia has been liberalising its air services agreements (ASAs) to some extent, pressure will continue to mount from the global push for more liberal aviation agreements. As indicated in the Department of Transport and Regional Development's submission to the Commission, Australia has been very responsive to the trend for greater liberalisation. In fact it could be argued Australia has been one of the leading advocates in the Asia Pacific region for greater liberalisation, both on a bilateral basis and in multilateral fora. The major practical constraints for Australia at present arise from the unwillingness of bilateral partners to liberalise rather than from any constraints imposed by Australia.

The report proposes the following six options for liberalisation which are not mutually exclusive:

- unilateral 'open skies';
- liberalise ASAs;
- bilateral 'open skies';

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- plurilateral open club;
- multilateral liberalisation;
- Australia New Zealand common aviation market.

Unilateral 'open skies': Ansett is pleased that the Commission has rejected a unilateral 'open skies' approach, recognising that Australia could be worse off if this were adopted.

Liberalise ASAs: As Ansett has indicated in earlier submissions to the Commission, it supports progressive liberalisation of ASAs, taking into account the costs and benefits to Australia on a case by case basis. This option is consistent with current Government policy. Ansett considers it provides Australia with the greatest opportunity to maximise benefits from liberalisation. As liberalisation continues, inevitably the point will be reached where an 'open skies' agreement is appropriate. The advantage of this option is that Australia has the opportunity to optimise the timing of such agreements and the sequencing.

Bilateral 'open skies': Under this option the Commission proposes that Australia should negotiate bilateral 'open skies' agreements with like-minded countries, incorporating a core package of six elements and two further negotiable rights.

As we have indicated in earlier submissions, Ansett is opposed to this option. Our major concern is that a blanket approach to 'open skies' does not enable Australia to assess whether the benefits of an 'open skies' approach would be negated by restrictions imposed through agreements with third countries. Such restrictions could seriously disadvantage Australian carriers in comparison with those of our bilateral 'open skies' partner. Ansett considers that, particularly in the current difficult economic times, our approach needs to be more discriminating to obtain maximum advantage for Australia.

Notwithstanding our views, if an 'open skies' agreement were to be negotiated, Ansett supports most of the elements of the core package. It has some concerns about the requirement for removal of ownership restrictions for airline designation (Draft recommendation 8.1 also refers) because of the practical difficulty this represents in relation to those ASAs which have traditional ownership requirements. Changes of this nature would be better achieved through multilateral options.

Another element of the core package is the regional reform package outlined in chapter 5 of the Commission's draft report. Ansett supports moves to enhance services to regional Australia and notes that much of the proposed package is already commonly included as part of the package offered by Australia in ASA negotiations eg the ability of foreign carriers to codeshare on domestic airlines between designated points in Australia and behind the gateway points and the ability for foreign airlines to carry their own-stopover traffic. In relation to domestic code sharing arrangements, Ansett assumes, however, that as a pre-condition, foreign airlines would need to reach a satisfactory commercial agreement with an Australian carrier.

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Currently Ansett has agreements in place with four foreign carriers enabling them to code share on Ansett domestic services to some thirteen destinations in Australia. Such arrangements are a very effective means of encouraging foreign tourists to include regional Australia in their itineraries.

The only element of the regional package which we strongly oppose is the proposal to include unrestricted rights for foreign airlines to offer freight services within Australia. The granting of unrestricted freight cabotage rights anywhere within Australia is an enormous concession to foreign carriers and it is most unlikely that bilateral partners will reciprocate. Australian carriers provide a very effective domestic freight distribution network and the carriage of freight makes an important financial contribution to domestic passenger routes, particularly to regional ports. If situations exist where Australian carriers are not able to meet adequately the demand for carriage of freight within Australia, Ansett suggests that more liberal use be made of the temporary exemptions from freight cabotage restrictions granted by the Department of Transport and Regional Development.

Our only other comment relates to the proposal to offer the regional package on a unilateral basis for incorporation into all Australia's ASAs. From Ansett's perspective, each bilateral negotiation should be treated separately with the overall benefits to Australia being assessed before agreement is reached. Although we accept that some elements will normally form part of the package offered by Australia, we do not agree that they should be automatically incorporated into an ASA, particularly if the package offered by our bilateral partner is grossly inadequate. In these circumstances, it would be in Australia's interests to continue negotiations until a more balanced outcome had been agreed.

In relation to the negotiable rights included in the Commission's 'open skies' package, Ansett continues to oppose the granting of cabotage rights to foreign airlines, other than those agreed as part of the single aviation market with New Zealand. At this stage, cabotage is not a right which is likely to be agreed on a reciprocal basis by our major bilateral partners. Giving foreign airlines the right to carry domestic passengers within Australia could significantly destabilise the domestic market.

Because foreign carriers will have no interest in maintaining a network of domestic services, they are likely to engage in 'cherry picking' and expose the incumbent domestic carriers to unfair price competition, by offering fares as low as the marginal cost of carrying passengers in otherwise empty seats. Domestic airlines would need to respond if route profitability were affected e.g. by reducing the number of services on these routes or by reducing or withdrawing services from less profitable routes. Ansett considers the proposals contained in the regional reform package relating to own-stopover traffic and domestic codeshare (and which are already included in many ASAs) provide international airlines with important opportunities to participate in the domestic market without the detrimental effects of unrestricted access.

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Plurilateral open club: Our concerns about this proposal were expressed in our letter to the Commission of 1 May 1998.

Multilateral liberalisation: Ansett notes the Commission's comments that other approaches may be preferable in the short to medium term but nevertheless supports this proposal.

Australia New Zealand common aviation market: Ansett notes some of the advantages the Commission has outlined from a common Australia-New Zealand aviation market. However, we believe the practical difficulties, including the time and costs involved, of renegotiating all the ASAs of both countries have been significantly underestimated and the outcomes, at least in relation to some bilateral partners, are uncertain. There is a further possibility that the renegotiated ASAs will not be acceptable to third countries. The Commission has also referred to the different policy approaches of the two Governments. This is likely to be a continuing problem e.g. the concerns an Australian government may have about access to services for regional Australia and the special arrangements that it may wish to put in place may not have the same priority for the New Zealand government. The advantages of a common market are also likely to reduce with the increased liberalisation of air services globally.

Capacity Allocation and the International Air Services Commission

Ansett supports the general thrust of the recommendations in this chapter of the report but would like to make comment on some aspects of the recommendations.

Draft recommendation 6.1: Ansett agrees that contested capacity should continue to be allocated by the IASC using a public benefit test.

Draft recommendation 6.2: This recommendation concerns amendments to the objectives of the *International Air Services Commission Act 1992.* Ansett considers that the current objectives have worked well and has reservations about the proposed change. In particular, it would like objective (d) maintained.

This concerns enhancement of international air services by fostering maintenance of Australian carriers capable of competing effectively with airlines of foreign countries. The airline industry is a significant employer in Australia (Ansett alone employs some 17,000 staff) and given Australia's size and geographic location, it is an industry of strategic national importance. This objective is consistent with subsections 8(1)(c) and (f) of the *Productivity Commission Act 1998.* These subsections require the Productivity Commission to have regard to the need to encourage the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovative and internationally competitive and to increase employment, including in regional areas. Ansett notes that the translation of these general policy guidelines in Box 1.1 (p.3) of the Commission's draft report appears to have some inaccuracies. In particular the word 'Australian' has been omitted from (c) and the words 'including in regional areas' from (f).

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It is interesting to note that the Australian Competition and Consumer Commission, in its final determination approving the alliance between Ansett Australia, Ansett International, Air New Zealand and Singapore Airlines said that the Alliance has the potential to strengthen Ansett International's position and that there is a public benefit in having a strong, second international carrier designated by Australia (p74 of determination).

Draft recommendation 6.3: Ansett does not support this recommendation. It is difficult to see how the IASC can assess adequately the merits of contested applications if it cannot form a view as to whether the carriers' plans are likely to be viable or the necessary approvals are likely to be forthcoming.

Draft recommendation 6.4: Although Ansett does not oppose this recommendation it is concerned that the involvement of two agencies in the allocation process may result in confusion. An alternative is to allow the IASC Secretariat, under delegation, to approve uncontested applications.

Draft recommendation 6.5: Ansett opposes this recommendation. It considers that submissions should be permitted even if the application is uncontested, as other carriers may wish to express a view on certain aspects of a determination. An example is where one carrier applies for all the available capacity, including capacity which is not available immediately but comes on stream in future years. If all this capacity were granted, it would leave other carriers with no opportunity to commence services in subsequent years.

Draft recommendation 6.6: Ansett does not object to a revision of the criteria used by the IASC to allocate contested capacity, but it would like an opportunity to comment on the revised criteria before they are finalised.

Start-up provisions: Ansett does not support the Commission's proposal that the start-up provisions be removed from the policy statement of the Minister for Transport and Regional Development.

The arrangements put in place in 1992 were developed in such a way as to achieve a balance between the interests of the incumbent carrier and potential new entrants. All the incumbent's existing rights were grandfathered which has given it a continuing advantage, particularly in some markets such as Hong Kong and Japan. Additionally the start-up provisions are only applied once the incumbent Australian carrier has a level of capacity available and in prospect to support the development of efficient, commercially sustainable operations. If determinations are to be made in perpetuity, as recommended by the Commission, this already reduces the opportunities for the start-up provisions to be applied. The key feature of the start-up criteria is that they are 'route' specific and allow a new entrant over time to build up critical mass in separate country markets. Although it is true that liberal capacity outcomes will largely negate the need for the start-up provisions, they are still important in markets where our bilateral partners continue to prefer conservative outcomes.

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Other proposals: Ansett supports proposals to introduce a maximum period of two years for the commencement of operations, to make determinations in perpetuity and to limit the IASC's consideration of code sharing to contested applications.

Access to Airports

The Commission proposes to recommend greater use of peak load pricing at congested airports in Australia. Ansett does not oppose peak period pricing provided all steps possible are taken to maximise physical capacity and there is no other equitable method of allocating capacity. The pricing regime used in such circumstances should be designed to discourage inefficient use of the runways. The KSA pricing regime discussed in the report satisfied this requirement but has been discontinued, presumably because of the introduction of the slots system.

In relation to the Commission's proposal to recommend a market for trading in landing and take-off slots, Ansett notes that the use of pricing tools or economic instruments as the basis of a slot management regime at Sydney Airport was canvassed with the aviation industry but ultimately rejected by the Government because of industry opposition and legal concerns with regard to property rights (the Regulatory Impact Statement for the Sydney Airport Demand Management Bill 1997 refers). The slot system for Sydney is only now being bedded down. The grandfathering of peak period slots reflects the operation of peak period pricing and the Government's policies with regard to ring-fencing of regional airline slots. Ansett considers that it is important for the Government to continue its commitment to the slot regime at this critical stage.

The report also discusses the access regime in Sec 192 of the Airports Act. It will be important that the Sec 192 regime not operate in a reverse direction than intended i.e. to discourage rather than encourage the provision of facilities in response to demand.

There are some significant differences between the Airports Act access regime and the full Trade Practices Act Part III A regime. These raise questions not just of the value of precedents with respect to one regime for the other but also whether any useful purpose is served by having two separate regimes.

If you have further queries please feel free to contact me (tel.03-96233883) or Anne Buttsworth (tel. 02-62166540).

Yours sincerely

Craig Wallace
General Manager International

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