



**TRANSCRIPT
OF PROCEEDINGS**

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PRODUCTIVITY COMMISSION

INQUIRY INTO INTERNATIONAL AIR SERVICES

**PROF R.H. SNAPE, Presiding Commissioner
MRS H. OWENS, Commissioner**

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON TUESDAY, 28 JULY 1998, AT 10.05 AM

Continued from 22/7/98

PROF SNAPE: Welcome to this continuation of the public hearings on the Productivity Commission's draft on international air services. These hearings on the draft report commenced last Wednesday in Melbourne and we're resuming here in Melbourne today and of course we'll continue tomorrow. You'll be aware that this inquiry started as an Industry Commission inquiry but since it started the Industry Commission has been absorbed into a newly created Productivity Commission. The implications of this change, of which there are none I think to cause any concern to participants, are set out in chapter 1 of the draft report.

As you know, the hearings are recorded for a transcript which is available publicly and we ask that if participants are unsure of any facts they provide during the hearings, they get in touch with staff after the hearings to provide an accurate version of those facts. Transcripts will be provided for the relationship participants. If participants would like transcripts of other participants' participation, then they should get in touch with a member of staff, of whom there are several present. I would now like Westralia Airports Corporation, being represented by Ryne Johnson, to identify himself for the recording.

MR JOHNSON: Ryne Johnson, director of business development and marketing, Westralia Airports Corporation.

PROF SNAPE: Thank you, Ryne, and thank you very much for your additional submission, for the submission on the draft report, and I will now ask you to speak to it, if you would like to do so.

MR JOHNSON: Sure. I didn't come here with a written statement beyond that which you've already received. I have a few brief comments to make. I'd like to ask you a couple of questions in terms of how a couple of points in particular in the report were derived or conceptualised. But I guess mostly what I came here to do was to congratulate your organisation on having put together what I think is a very solid and balanced document which clearly reflects a great deal of very diligent and thoughtful work. Having been an author of reports, many reports of this magnitude, on complex issues myself as a management consultant I can tell you that you've - and I'm sure I don't need to tell you this, but you have very clearly taken on what is by any definition a most complex issue and have done admirably at drawing together the salient points for any kind of public debate over the issues involved.

I quite frankly was not expecting a report of this quality, certainly as a draft. That's not because I had doubts about you but because frankly I had just seen the complexity of the issue and felt that there would be more political involvement at the drafting stage. I guess there is a bit of a baited statement there because clearly there are in this matter a fair amount of very strong and to some degree opposing viewpoints. I guess if I were to just comment on the report as a whole and on the work that the commission is undertaking here, I would say that with all of the positive comments that I have given you about the work that you have done today, in my opinion the hard part really begins now and has not really passed behind you.

From what I have seen, I guess the commission, this report and your overall mission, if you will, as stated in this report in terms of your objectives, become both a strength and a bit of a liability. If you read - and I have read as recently as this morning again - what your overall charge is, it appears to be at some point sort of all things to all people. You want to on one hand protect or promote competition, and on the other hand, sort of protect the economy as you complete your studies. I think what's going to happen now is that there will be a - having come out with, as I say, a document that appropriately brings into light many of the issues that many of us within industry have questioned for quite a while, you will now see very subtle - or maybe not very subtle, but rather quiet workings to erode the comments in your report and I would just caution you that probably your biggest job, and that of a sales job, is ahead of you.

It has been interesting to see just in the one public forum that I attended at TAG when Helen was there to present the document that for a group that would appear to be greatly benefited by the majority, if not all the recommendations in this report, there seemed to be a fair amount of scepticism around the room. I found that to be somewhat curious in that if that organisation is really there about increasing the opportunities and the requirements and the fulfilment of transparency at a minimum in the existing process - and I would think hopefully is there to encourage growth in the air servicing and airline industry and certainly with respect to better, cheaper products available to tourism consumers - to look at this document, to have any knowledge of the subject matter in its complexity and to look at this document, as all apparently had to some degree, and not give a great degree of credence was a bit bewildering.

I guess that from that it's not really a knock on the group but it's probably representative of many within the industry as a whole and I guess I'd sum it up as saying that you are in the process of trying to prove the unprovable; that is to say that change will bring about positive effects, is effectively what your report says in its sort of 300 plus pages. Yet there are a lot of people that will say, "The devil we know is better than the devil we don't," and it was just very interesting. There are many that you would expect that statement to come from but ironically those that you wouldn't are also probably in that group of stone throwers. So I would say to you that you really will need to steel yourself going forward, that you should have confidence in the analysis that you've drawn together, the facts that you've drawn together, and to push diligently onward and getting this process not only concluded but your product put into the public spotlight, because it is a very useful document.

The other thing I think is working against you now is that the recent developments in the international air traffic market stemming from the economic crisis throughout Asia has undoubtedly taken the heat off of many of the markets and the capacity requirements in those markets, such that it would appear that the need for sweeping changes has abated. I would tell you that at best and in most of those markets it could only be looked at temporarily and that what you're doing now and what this document stands for is probably even more essential to that, because what will happen as a result of this process is that there will be more consolidation. That is unquestioned for this region, and this region including Australia and throughout Asia.

Smarter, more demanding money will come into the airline industry as a whole. Easy opportunities for negotiations with airlines/countries that were less than economically driven prior to this period will change to airlines in many cases that are driven by international money with trans-border equity that won't really care about what was once internally vested interest at a governmental level and will simply want a return, meaning competition will increase. At the end of the day this is about increasing the competitive capability of Australia's airline industry and travel market, travel industry as a whole.

If we don't take this opportunity to take the positive recommendations that your report brings out, apply them and improve this industry, what I believe you will see is an Australian airline and travel industry in grave jeopardy in approximately 5 years, if not before, and that will coincide with the period when the Asian crises probably sorts itself out. Those economies are back on the march and if our carriers have not sorted out in particular their capital balance sheets, the way in which they have invested their resources, then I think that you will find that the opportunity will have been lost really for us to move forward in this market and we as an industry will be largely on our heels of trying to again justify a decrepit system.

So while it may seem a bitter pill to move forward to many, challenge the system at a time when it is ailing etcetera, etcetera, this is probably the time when we as an industry have to be smartest, most aggressive, not foolish, but most willing to accept the change is inevitable, and that we must embrace it and that the only way that the change is going to occur is what will come from groups such as yours that are putting forward responsible recommendations that will bring about positive change.

So with that having been said, let me just say one other thing and that is, as you read this report, as I say, it is very good and very comprehensive. One general comment is that the salient logic points throughout this, I'll call them, that support your recommendations are not altogether apparent as you read through them. Mind you, they're in there but the logic stream itself, it sort of basically says, "Competition has produced positive change within this country, within this industry, in the past. Here are the results. These are our recommendations." Were those points brought to the front of this document in a concise manner to supporting or juxtaposing the recommendations, I think that you would find the sale process a fair bit easier, because clearly they are there and you read through a fair bit of material to sort of get to some real meaty nuggets and some real good quotes. But it's just sort of hard to draw them out at some points.

That is probably the bulk of what I have to say. I will take exception or - when I say take exception, I'd like to understand better and again, if this is brought out more clearly in the document than I have sort of found it, please direct me and I'll be happy to refer to that again. But you make a recommendation, draft recommendation 5.1, first bullet point, and it again is brought out on page 110, regarding the removal of restrictions on city designations and secondary gateways. The commission has defined secondary gateways as all international airports with the exception of Sydney,

Melbourne, Brisbane and Perth. I'm not altogether clear as to how you came up with that definition as to what was - and it's left to the reader I guess to deduce that the primary gateways are Sydney, Melbourne, Brisbane and Perth.

From our standpoint of course, Westralia Airports Corporation in Perth, this recommendation has probably the most significant potential impact on us out of all of the recommendations, at least in the immediate term. I'd like to just highlight a point that we made in our initial submission and then in our follow-up submission. The game quite simply in this country with respect to air service negotiations, bilateral negotiations, is for one market and one market only and that's Sydney. Anybody that would question that could only be arguing the exception and not the general rule. When you look at the market for Perth there is literally one airline that serves Perth and no other markets here in Australia and that's almost by accident.

Perth accommodates less than 10 per cent of the international traffic. It cannot be reached by either of the two primary markets outside of Asia by any aircraft directly, meaning that it has to go through an intermediate point either in Asia or in the eastern states of Australia. All of that leads you back to the fact that there is a substantial difference between Sydney and the other markets and even if you were to look at it sort of geographically you could say, "Well, Brisbane could be reached directly from North America and therefore it could serve as a primary gateway." Suppose that is an upside scenario for anybody operating Brisbane Airport; but the simple fact is that isn't the way that airlines look at the market.

That isn't the way that the airlines look at this country market as a whole. It isn't the way that airlines are developing their hub and spoke network here and it isn't going to be the way that international airlines view this market in the future. Sydney will continue to be the crown jewel. It is the primary airport and that if you're going to make a secondary airport designation it rightfully should include, from a very, very vested side, Perth. But I would submit to you that frankly Melbourne and Brisbane also fall well below the mark of Sydney - and just for the record, while I know that this was not the primary objective here, if you were trying to relieve the pressure on traffic in and out of Sydney the policy that is here is not going to improve current conditions, whereas were you to put the other, meaning Melbourne, Brisbane and Perth - other airports into this designation of secondary gateway - then I believe you could have a fairly potent tool to at least start providing some positive means of trade-off to the other airlines.

You make the point of cost of entry, of establishing a market etcetera. All of that suggests to you that market forces will still come to bear and there will not be a land rush of airlines leaving Sydney and moving to these other secondary locations. But it's almost a free tool at the disposal of government and at the commission before you get into peak hour prices, before you get in slight controls etcetera to say, "You can have as much of these other markets as you want but let's face it, boys, if you want Sydney the price is higher."

I suppose that's probably the bulk of what I had to say. In going around the country I guess there's one other comment; that coming back to the point of proving the unprovable you no doubt have been met with those who say that deregulation, open skies and the likes, will do nothing but bring on the results seen in the United States and the demise of the airline industry there. Interestingly this is one of those points that your document sort of talks around in terms of saying, "Well, what is the demise of the US airline industry? What are the actual facts with respect to its growth or deterioration etcetera?" But you don't really bring that point out and I understand that it is not a central point to your document.

But there are some facts that aren't brought out in this document that I think speak more to that rebuttal than those that say that if you deregulate, if you open this market out, you will simply get inferior quality airlines that are less viable etcetera, etcetera. The fact is that the US airline in the eighties went through, in addition to the process of market deregulation - went through an unparalleled period of management ineptitude and frankly predatory policy toward its own corporations. The likes of Karl Ikon should not have overlooked that and what he did and what others did to that industry - frankly you could say were allowed to do - but that was not because of airline deregulation per se. It was simply what corporate rating mentality I think has done or has been the result in the airline industry and others.

The airline industry is still there today. Frankly I think that the product in the US market is probably not as good as the product here in Australia domestically. I have argued that within circles of my friends who are Americans who know both markets, however, and they have told me that I'm completely wrong on this and from their perspective the US product is significantly better. Well, you know, maybe I've become Australian since coming down here; I don't know. But I don't think that's really the debate. If it's close enough for there to be two legitimate sides to that argument I think it's fairly apparent to see that the industry hasn't gone away and I don't think anybody would question, if you were to look at the balance sheets of most of the larger airlines in the United States or the largest airlines, which would appear healthier and which would appear more capable of taking on a future shock of competition if both were downsized etcetera and put on equal playing terms.

The Australian airline industry in the way that it is structured - I'm really talking about the two domestic airlines - is just not prepared to take on high-level competition and that is probably the thing which is driving the greatest amount of angst about any change. But without impetus to change, change will not occur and so it is this process of how do you create positive change, responsible change, but change nonetheless? If you look at it, they've been given a break from the airport industry through the regulated price control process, CPI minus X, where I guess when it's all said and done after 5 years we'll see what the net economic benefit has been.

But at least at our airport it stands to be somewhere between 20 and 25 per cent operating cost reductions and I guarantee you I have not seen advertisements in the paper where ticket prices are coming down as a result. In those markets where ticket prices are coming down it's a result of the economic downturn in Asia and the

reduction in passengers. So if things do not push the airline industry to change, if the system is not changed to force the airline industry to change, I don't think it will change, but ironically it's probably in the airlines' best interest to look at these issues and to promote change from within, and I think to a certain extent that is happening.

But this is a process that would encourage that positive change, assuming that the recommendations are responsible and I believe your recommendations by and large are. So with that having been said, I will turn it off now. I would like to find out how you came to the distinction of primary versus secondary gateways. That would be beneficial for me. Maybe I've missed something. But apart from that I'd like to congratulate you on a job very well done. I'd encourage you to go forward boldly I guess with your final report, whatever the aftermath is of issuing that.

PROF SNAPE: Thank you very much for those comments, Ryne, and not just for the compliment, but they're welcome too. The Productivity Commission's role of course is to make a report in light of its terms of reference and in terms of the requirements of our act and that's what we endeavour to do. We don't of course actively try to do a sales job on it. We try to make the best report we can and it's up to government to make the policy. But we do notice of course with our reports, not just this one but in the past, that usually those who support the report are fairly quiet and might in fact pick up one or two points that they don't like and make a noise about that and don't make a great deal of noise about the recommendations with which they are comfortable or with which they may in fact be more than comfortable - and of course, as one would expect, those who don't like the report will be those who make the most noise.

This is the way that it's always biased and so in a sense the sales job is not up to us. We make a report to the government and I suppose it's really up to those who like it. If they want those recommendations adopted then that's up to them. Responding to the question that you had and understanding the secondary gateways question, what we were endeavouring there is to work this into the general framework of where we say we don't see the general unilateral open skies or that general unilateral liberalisation is the way to go, for the reasons that are spelt out, I hope clearly there, and that we're in a negotiating framework internationally and that we can't really unilaterally escape from that.

So then we try to say what is it that we have got negotiating clout with? Some people are telling us that every international designated airport in the country has got some negotiating clout with it and that negotiators don't want to go out without any grain of sand taken out of their negotiating bag. We try to make a judgment as to where there would be gains from in fact making unilateral actions and where there wasn't much negotiating clout and where there was some negotiating clout that would in fact justify holding back the gains that might otherwise occur because of the possibility of greater gains in using that negotiating clout.

Now, you're basically saying we drew the line in the wrong point, that the line should have been drawn under Sydney and not under Sydney, Brisbane, Melbourne

and Perth. You're not the only people to have made that comment, I might say, and not surprisingly it's the states other than New South Wales - from whom we have not heard at all - that are making the point that they would like this opened up more, and we will take account of that. This is a draft report and we are inviting comments like that of course. We may or may not have made the right judgment, but that was the basis on which the point was - - -

MR JOHNSON: I'd just like to reiterate that in our primary submission we pointed out that of the 51 existing ASAs Perth is currently either non-included in or has significant restrictions through 18 of those and I didn't actually look at it with respect to Brisbane or Melbourne, but by and large that compares back to Sydney. Sydney is included in every one of them, at least to my review, and if I missed one there I couldn't have missed more than - I think actually there was one that somehow didn't mention Sydney. But you just look at the evidence as it stacks up.

Right now we, I guess, are at a minimum in this process. We in Perth, Western Australia are seeking equality through this and that in many respects which are documentable and we have documented through this process we are, have been and probably will continue to be if the process is not changed, disadvantaged and it has resulted directly in service reduction or opportunity losses to us, to the state - not just Perth but to other airports in the state - and frankly it is a very bitter pill to have to swallow to be told by Canberra that, "The reason that you didn't get service requested by an airline on commercial grounds was to be able to play you off against some other market," and then only to find out that that market ended up not getting the service as well because the service requested and negotiated for was not commercial. So where is the sense in that?

At the end of the day we have a perfect document and a failed market. So unless I'm missing the point of this process we presumably are all better off as commercial entities with airlines that are hauling passengers striving to make a buck, presumably making a buck, or at least doing their best at making a buck, than to have negotiated documents that sit on a shelf and produce nothing in terms of economic activity except for providing those who negotiate those agreements an opportunity to fly some place and negotiate them.

PROF SNAPE: A number of - or at least one other submission from another state has argued that not to have city designation would in fact disadvantage them, and it's not Sydney obviously. I wonder if you would like to comment on that. I mean, our recommendation is basically not to have city designation other than those four and as I say, we will consider that recommendation in light of yours and other comments. But the point has been made to us that in some other cases not to have city designation for the secondary gateways would in fact disadvantage them.

MR JOHNSON: I think I'll speak very cautiously here because I wear a hat and a half in this respect. As you know, the company for which I work is involved with more airports than just Perth and in certain of those other airports there are probably agreements which support, if not cause, existing international air service operations to

exist, to continue. I find that at the end of the day very curious from two perspectives. If you're an airline and you're told, "You can't fly in here but you can fly in there," at the end of the day you're not in business just to have the opportunity to fly somewhere. You're in the business to have the opportunity to pull passengers out of a market.

So while there are airlines still in the world that are not, as I indicated before, purely economically involved their numbers will dwindle, or at least the pressure on them will certainly increase with situations like the Asian crisis and I guess I believe that a system that is built around the assumption that non-commercial - and that's really what we're talking about - airlines will continue to survive in this market and go along with the rules as stated is a bit of a risky one because there's really nothing supporting that apart from the belief that the structures behind those non-commercial entities, because they have existed up till now, will continue to exist and behave in that fashion.

But as we've seen time and time again, dating back I suppose to the Soviet Union and beyond, at the end of the day things that are non-commercial have a real hard time standing up without some form of rationale, government or otherwise, benevolent or otherwise. So I think that in the long run this country and probably every other is better off sustaining itself on market terms, on commercial terms. While it may be more difficult in the short term, in the long run you're better off and that therefore the focus should not be on how do we maintain this service for 3 years, 5 years or potentially an eternity, understanding that the odds are probably stacked against us in that respect, but how do we increase our capability from the standpoint of marketing, market development etcetera to ensure through direct means and controllable means that service that exists stays around, because the airlines that are there, interestingly enough, have gone through the sunk cost experience of establishing that market.

You would rightfully say that if they're on less than economic terms then the chance of them being competed with in those markets is even less than highly competitive markets. So if anybody is going to survive with those restrictions taken away, if any service is going to survive, it would be those airlines that have already bitten or taken a bite and are there presently. So in those markets where it is asserted that restrictions have caused and are supporting service I guess what I would be telling those communities, governments, airports, my boss, is to go out and work very hard and acknowledge that if there is a glitch in the efficiency of that market to find a way of shoring that up as opposed to running to Canberra and arguing that non-commercial policy be supported simply for the sake of supporting one or two services. I think you end up in a very difficult position to maintain overall and that's not why we got into that business. I think it's just a hell of a lot more comfortable to argue from a free market standpoint.

MRS OWENS: At the moment you said you've got 18 or so. You're not included or restricted in 18 air service agreements but there's obviously another 33 where you are included. So I suppose - - -

MR JOHNSON: We're included.

MRS OWENS: But you're not necessarily getting the services through?

MR JOHNSON: Well, that's the whole fallacy, that, you know, there are these 42 airlines or whatever that are approved to fly into Western Australia and Perth. But when you look at it, you know, at an absolute maximum you might have six of those airlines that even remotely are operationally capable of actually serving that market and I'm not just talking about, you know, battling through difficult code-sharing relationships. For all intents and purposes those code-sharing relationships, especially when you're talking about part-alliances, are brick walls. You're not going to see an airline breaking from an agreement to run out, break both of its legs, to serve a market as thin as Perth. So, you know, I mean, it's not going to happen.

In the marketing process you've essentially got to foster growth of the carriers that are within that market that have negotiated their position through those code-sharing arrangements. Those that aren't aligned that are looking to expand into this region first of all and into the Perth market secondarily have some connection to it, have the aircraft to fly it, have a schedule that is compatible with it and when it's all said and done, if after all of that you've got three airlines that you really want to work on, then those are the ones that you hold up to the light against the air service agreement and lo and behold, from our standpoint, every single one of those are maxed out.

MRS OWENS: So they're all in the 18 that are - - -

MR JOHNSON: Absolutely. Well, and/or are in the 33 with no additional service, you know, so I'm just talking 18 we were left out of.

PROF SNAPE: So the three that you are talking about, without being specific, you're saying that there are capacity limitations on those.

MR JOHNSON: Absolutely.

PROF SNAPE: And that they are still binding with the recent Asian downturn?

MR JOHNSON: Three binding in the sense - what do you mean by binding?

PROF SNAPE: Well, you said they're maxed out, they're up to capacity, and so that there's no - that they're up against the ceiling still?

MR JOHNSON: One would not be, as a result. But I mean - - -

MRS OWENS: It's still not flying to Perth anyway.

MR JOHNSON: Yes, and I mean, it's almost farcical to think that, you know, if you see - it is expensive to fly to this market, to say the least, from almost any place in the world with the possible exception of Indonesia or Singapore. To think that you could lose your shirt in the biggest markets and all of a sudden take a deliberate market strategy shift and focus your assets in Perth where you've never had a market presence and to start pulling profits out of there - well, I'd like to believe that and I'll do my best to sell that. You know, it's a fairly uphill battle to think that anybody in route and asset management in an airline is going to jump into that position rapidly.

So at the end of the day really what you're looking to are airlines that see at least stable or if not reasonably high prospects of future potential growth and that are committed to the Australian market as a whole by and large and would be looking to move into additional markets. When you start talking in those terms you're talking about a very few carriers, from the passenger standpoint. Freight is a little bit different. In fact freight is quite a bit different, from the standpoint of all cargo freighters, dedicated freighters.

But if you opened it up, if you literally said with the exception of Sydney that there were no restrictions on service growth at any other gateway in Australia for the next 5 years, if you were just to say that, if you really were going to be cautious about it over 3 years, I'd be willing to bet you that you would see very little new service development in most markets, apart from that which is already planned and to the most part those players that would experience the growth know about that growth. There is a fair amount of programmed growth for airlines around. But I don't think you would see, especially in this present day and age, a huge volley of new carriers coming into this market.

MRS OWENS: And that would include Perth.

MR JOHNSON: Sure it would.

MRS OWENS: So I mean, in terms of your concerns about not defining Perth as a secondary airport it probably doesn't make a lot of difference one way or the other.

MR JOHNSON: Well, except to say that it has made a difference in the past. When the growth curve for this continent was different we were incapable of realising at least two services that we would have otherwise had in Perth, for commercial reasons. Now, you're talking about a downturn in most directly relationship markets. You would not see a huge influx simply because the carriers that would be serving this market naturally, or that frankly could serve this market, are just not in abolish growth mode. So I don't know which side of the argument this statement really assists. I think in some ways it assists both. That is, I guess I can't say that right now if you were to increase the capacity of Perth I would see overnight this huge increase in traffic.

I will tell you that I have lost traffic because of the existing system in the past. But because market conditions are different, I can't tell you that that traffic will just

automatically today come back. But that's not inconsistent with the statement, that is, Perth still should have the opportunity, like all other markets frankly, to accommodate growth where it is commercially viable and that's really where this process up to now - for whatever reason, negotiating points, whatever, have undoubtedly and from the standpoint of the government admittedly prevented growth from occurring as it would under unconstrained conditions.

So again I guess it gets back to the bogey man sort of theory, that if you were to make this big change all of a sudden this industry would just collapse. In the next 3 years you can almost be certain that it won't because you won't see much effect. In that 3 years' time you could potentially take a big leap forward in terms of opportunity with the Australian carriers and if in that time the Australian carriers got their houses in order and were more capable of taking stock of that opportunity, maybe you have a different world that's more positive.

PROF SNAPE: I'm interested in your comments there. But a point that has been made to us by the airlines and substantiated is the enormous changes that they have made in recent years and that very great changes in terms of ownership structure, the privatisations of course and other ownership changes, the alliances that they are forming, the cost cutting that they've engaged in which has been very, very substantial and that they would argue that they're doing it. But yet your picture is that they're still fairly sleepy.

MR JOHNSON: I don't know if I'd classify it as being sleepy. I think I'd classify it as they've been selective in taking their cost, as anybody rationally would be. I think that there are still some major and fundamental issues that need to be addressed within the airlines to sort of put the airlines on a more rational footing with other international carriers around the world and particularly in the US. If you look at the way that airlines here are structured, their balance sheets, where their capital is invested, I find it not amazing but given where everybody knows this airline probably will go, at least where the evidence suggests, you would ask any US carrier executive, "Would you prefer to have 20 per cent of your assets, 30 per cent, 40 per cent of your capital assets tied up in ground facilities? Would you do it?" I would be amazed if any of them said that they would.

Yet that continues to be a factor that the domestic carriers hold onto here and there are other ways of doing that, ie lease arrangements etcetera where airports hold the capital for terminal facilities on their books and that's just one example. Now, why do you do that as a carrier? Well, you do it because you've always done it, first of all. You do it because the system is structured for you to have it that way. The domestic terminal leases are basically - I mean they're a remnant of an era and a system gone by. There are undoubtedly advantages I suppose to both sides. I mean, it's a lucrative contract on the one hand from our standpoint in that it certainty is an annuity.

But from the airlines' standpoint I have to believe that the biggest advantage right now, and it was seen in the last 2 years, is that it keeps potential competition

out. You know, that is widely exposed in anything that goes back, certainly to Aussie airlines, and there are articles virtually every day in the paper about how difficult it would be for a new entrant airline to start up in this country, given what it takes to gain entrance into any of the major gateways. That's the game and, you know, that is flaunted by domestic carriers and the system allows that to perpetuate.

MRS OWENS: What's the US model?

MR JOHNSON: The US model is fairly mixed but certainly the modern model is that the asset and the risk for terminal assets to the greatest extent possible is held by the airport operator and that the airlines have, again in the modern model, at a maximum a preferential use arrangement for ticket counters and gates and they pay for those facilities that they use and when they use them. If you look at the new Denver airport that's probably the best possible example of that, where in the terminal ACON course I suppose there is actually - well, it's still preferential use because there is a reversion clause within that lease that if United Airline ceases to operate that terminal it does revert back to the city and county of Denver and that's expressly in there because TWA left the city and county with an enormous liability of about 36 gates at Stapleton Airport on an exclusive use basis that the city and county ultimately just closed because they couldn't break the lease on legal terms and TWA wouldn't give them up.

So there sat an entire concourse at Stapleton Airport un-utilised and maintained by the airport on a mothball basis for years. Now, you don't see that here necessarily but what you do see is you see carriers that will not make available space to new entrant or prospective new entrant airlines and unless the airport operator - and this probably comes up at our airport on a monthly basis now. Unless our facility can accommodate a new entrant at the international side there is no hope of a new entrant really coming in except through a fortunate and successful protracted legal battle with Qantas and Ansett. So that's where they get it.

PROF SNAPE: That's international, we're talking international carriers.

MR JOHNSON: No, I'm talking domestic. But in order for a domestic carrier to come into Perth, without a very, very fortunate outcome of a protracted legal battle that would allow that entrant to come in and use the domestic terminal we would have to accommodate them at the international terminal. It's as simple as that. You start talking about cost of entry. Before you ever get an airplane on the tarmac you're spending millions of dollars in the courts. You know, at some point you've got to pay for that and it's usually right up-front. So you look at that. You look at the way in which - you know, how many new orders of aircraft have you seen for the domestic routes here in Australia with Australian carriers? Very few.

You look at domestic traffic. You know, what's it growing at. In Perth it's something around 2 per cent. Flying in on an airline last night I can tell you that load factors here are an excess generally on these major truck routes. 70, 75 per cent. In the States that would probably be down somewhere in the high sixties. The chapter

out of your book in yield management is basically all about what the airlines are really doing here.

PROF SNAPE: It could be taken to mean that they are very efficient.

MR JOHNSON: But they're not.

PROF SNAPE: In the sense of getting high yields. You know, yield management is very efficient.

MR JOHNSON: In that case a monopoly would be the most efficient because the yields would be the highest. There is nothing to, I think, support the argument that the status quo is an optimum - in fact I can pretty much state that is an optimal state and that it is very clear that when competition has occurred in a meaningful way in the recent past it really is only compassed to draw these conclusions from, that the consumer has benefited and that air service has increased and that new to market travellers were abundant. Where is the problem there? Yes, okay, the carriers - a bite was taken out of them etcetera etcetera.

But, you know, that's where you can't just say, "Ticket prices went down, you all lost money." "Ticket prices went down. You're going to lose money unless you restructure," and you restructure to become more efficient and if the new carrier can't take you on, on that basis - and it's going to be hard enough because the prices will drop immediately without the restructuring etcetera etcetera by the existing domestic airlines. But, you know, you have to say that unless the nest is created there will never be new birds that come out of it, and we just don't have that right now. In fact it's going the other way.

PROF SNAPE: In your written comments you make the point there that the common aviation market with New Zealand would herald significant economic benefits for the country as a whole. Well, we've recommended this but a number of people have come back at us and said that they don't agree with that view. Indeed some have said that all the benefits would go to New Zealand and that in fact there would be some disadvantage to Australia in that. Would you like to elaborate on what you perceive as the significant economic benefits which would come from that? This is at the top of your - well, it's under Recommendation, 8.6, your heading there.

MR JOHNSON: I suppose the benefits are manifold. Beginning I guess at the big picture level, if there is this perspective that change is scary and it's going to bring about crises, catastrophe, then pushing the process forward in a sort of laboratory environment in areas that you know were your furthest along and you can predict to the greatest extent the outcomes and you know to the greatest extent the competitive characteristics or potential, then it seems logical that you would want to start the process in those areas. I think therefore New Zealand is the obvious first choice that you - as a country, Australia could push forward a more liberalised agreement there, that there is effectively one carrier out of New Zealand that is going to be introduced to this market in a greater way that they already are, understanding that even then

there is under the written word greater opportunity than is already being taken up by New Zealand, and that's - the rider as to how the negotiations went down between Australia and New Zealand, where they ended up with, I guess I wasn't there when this happened. I wasn't in the boardrooms of airlines. Therefore I can't really comment as a source.

I have been told by many who are more enlightened than I in this industry in terms of the facts of the day. I guess the perception that I have is that when cabotage was taken off the agreement and then put back on it was put back on for probably more political reasons after an agreement was basically reached with Ansett that was going to prevent it from really being realised. I mean, again I can never support that. That's what I have been told. I don't know if that's true. My view though is that you have a country that is smaller in every sense, but yet more bullish on opening up its borders and its markets and its processes to, if not follow in complete market forces, more open market forces I believe in general in many leading markets than Australia, and yet we are afraid of what they have done.

New Zealand has not perished and if New Zealand can pull off these markets and, yes, okay, they are going through recession now etcetera, but in many respects no-one could say that because of privatisation, liberalisation, deregulation, those things and only those things have resulted in Australia's present day economic woes. New Zealand has been going through economic woes for the last 25 to 40 years from what I can tell. If anything, there has been a significant increase in wealth. So that they are going through problems is not a result of this, but that they went through positive change is probably a result of those things.

So opening the borders up to more aligned, more liberal relationships with New Zealand I think in general would suggest that there are further opportunities in other areas. The next area would probably be Singapore and moving outward and I think that is consistent with what we say. The establishment of a more liberalised arrangement which would allow through traffic beyond those two countries, could very possibly focus airline attention on this market in a new way. Again, this is sort of proving the unknowable, but again, it is not going to make a dramatic change overnight in this market, but airline strategists may all of a sudden say, "There is a niche here to exploit, let's focus resources, let's focus interest etcetera on the Australian New Zealand market" that they wouldn't have otherwise done the day before.

So all of a sudden something relatively small that may not have huge potential for change, you add that with a few other things and people say, "Look, these guys are getting very progressive down here, we have carriers that are changing, they are out in the market looking for new relationships, alliances." We have the travel industry that is out looking for new wholesale relationships etcetera etcetera privatised airports. All of that is a soup of a positive change that may focus the attention of the world industry in ways that haven't happened up till now or the recent past, on Australia again, the Olympics etcetera.

So it provides a foundation for the potential of change. I think that it speaks to those people who say, "Well, if we did this with the world, the effects would be catastrophic." You come back and you say, "We did it with New Zealand, these were the effects." Two-fifths of not much. All of a sudden the foundation for looking elsewhere to make the similar changes I think becomes less radical in practice. So I'm afraid from a micro-economic standpoint I can't tell you the results would be 50 new flights per week into this country or a new airline or whatnot, but I just think that it starts to put feet to general policy in that it suggests that there is the will to make change happen if you just extend what is already there.

PROF SNAPE: Thank you. The peak load pricing and I understand the CPI minus X, but the CPI minus X will apply to an average price, won't it, and so is there a problem of having peak load pricing where it simply increases the differential between peak and off-peak and you have the off-peak going down and the peak going up so the average price stays the same within the CPI minus X find?

MR JOHNSON: It is a price time volume calculation, so with the rebalancing you could end up actually, depending upon what growth occurred, as an airport operator do better or do worse with a change in any of the basket price components. The same thing would occur if you were to transfer or redistribute prices between international and domestic, depending upon where the growth occurred. My view on the peak load pricing is - and I know that the airlines have argued that peak load pricing slot distribution through a commercial process etcetera would not have any effect other than raise costs.

It is a very interesting argument, because in the last 9 months there have been four carriers of our existing group that have requested slot changes to the late afternoon peak, concentrating basically on the 5 o'clock hour for a departure time - these are existing services that were for the most part prior to that time, but several of them after that time - for the simple reason that the 5 o'clock out of Perth allows you to get into your Asian hub before midnight. At approximately midnight up till about 12.30 the wave out to Europe occurs and all of a sudden Perth is more connected to Europe via that change than it was prior to.

From the standpoint of Perth, specially with respect to what has happened in the latest economic turmoil in Asia, Europe is the dominant market in terms of consistent traffic. So it's quite apparent that we would have no trouble getting peak hour utilisation out of additional gates at that airport. So much so I am fairly convinced that if we were to double the number of gates or basically taking the government's policy and applying them to our facilities, provide capacity ahead of demand, that what we would end up with would be three very thin bands of peak hour traffic that would correspond to a hubbing airport maybe in the United States where you just saw waves coming in from the west coast to the central point and then out again to the eastern states,

I guess theoretically there is no problem with that. I mean if you look at it from a social standpoint or a broader financial standpoint, you would like to see better

utilisation out of your assets etcetera. But at the end of the day if our ability to accommodate a carrier at their desired slot time allows them to tap into a more lucrative market wherever and therefore become more viable, that should support growth, it should enhance competition, it should bring down prices, it should bring new travellers into the market. So we don't I guess in principle have a problem with building churches for Sundays, as long as the risk associated with that is understood, acknowledged and that our return as a provider of those facilities - if we are willing to provide them - is commensurate with what we are taking on and providing.

Therein lies the big problem, that we would be providing gates for effectively one turn per day. Now, peak hour pricing is the only way that we could at that sort of logic - because we are not willing to from Perth sort of wag the dog up in London and assume that British Airways and Malaysia and the rest of them are going to change their slots out of London to be 3 o'clock in the afternoon instead of 7.00 in the morning for the business day. That isn't going to happen. But if we can't use peak hour pricing and if the airlines aren't willing to pay for these facilities and acknowledge that in providing facilities for the peak, if for whatever reason that service goes away - now, there is no reason to have that facility there until someone else fills that slot - and therefore the risk associated with the investment on that facility is greater than if you were getting higher utilisation out of a facility at a lower facility or capital asset level. So while you might have a rate of return fixed at X for a more efficient facility it would be X plus something for a peak built facility. If everybody would acknowledge that and say, "Yes, we're happy with that, build an enormous concourse that would just see this volley of aeroplanes coming in three times a day and leaving an hour later and we would all go home."

PROF SNAPE: That is an interesting view on it, because the peak load has been discussed almost entirely in the context of Sydney I think, but rather than peaking at a relatively small airport as compared with Sydney and Melbourne. So that I think is an interesting extra dimension to it.

MR JOHNSON: A professor of economics would sit here and say, "You are going to get a maximum utilisation of this and the other thing and your concessions are going to be better etcetera," and on and on and on and they would be right. But the simple fact is that if we could get greater throughput through our facility and help the airlines into Perth and if Perth became a viable market as a result of that, we would have to consider it. We would just absolutely have to consider it. I would tell you that the empirical evidence suggests that in the next year we stand more chance of growing by being able to grow at our peak than by trying to push airlines into an untenable slot outside of the peak.

MRS OWENS: Nevertheless, if you do what you say and build the churches, you have to have money to do that and you are still constrained through the CPI minus X, so don't you still have an issue in relation to raising the money to actually build the facility?

MR JOHNSON: Sure we do, but that is the whole point I am trying to make is that CPI minus X was sort of thought out in terms of the world in its rather simplistic fashion and through micro-economic theory that said maximisation of facilities and risks put off on concessions activity. You know when you start getting into this discussion you end up with something that leaves you more with the status quo and suffering along as opposed to really being able to look outside the box and saying, "Okay, guys, what is it that you want here?" We are not opposed to providing those facilities. Mind you, I would like to get a steady throughput of passengers because we are going to make more out of parking lot, we are going to make more out of our concessions etcetera etcetera.

But at the same time, if the airlines are jumping up and down and saying we all need to be there or leave there at 5 o'clock, why wouldn't we try to accommodate them? Now, we wouldn't try to accommodate them now because frankly we are going to be constrained by CPI minus X. If it is that important to you, here is what we need and what I just said is it's X plus a risk factor associated with this peak hour service. That gets back to as we said in our submission, peak hour pricing outside of the cap or at least with due consideration to the risk associated with that.

I think there is a fundamental belief - and I believe misunderstanding - of the risk associated with airport ownership and operation, if nothing else, and this period that we are going through right now in Asia proves a lot of things. It certainly proves the airport industry is not without risk. While things have not been great for us, if you want to make that point very clear you can bring up the operators of other eastern states' airports and I think they will bring that point out very, very clearly. It is a risky business, especially with the competitive pricing process that leads to or that allows for ownership. This is not an annuity or a licence to print money by any stretch.

PROF SNAPE: I found that very interesting. Is there anything else that you would like to add in conclusion?

MR JOHNSON: In terms of the time-line now, you will be going through this process of public hearings and that - - -

PROF SNAPE: Today and tomorrow are the public hearings.

MR JOHNSON: Then the final report issued in August?

PROF SNAPE: 13 September, but not issued by us to the public; given by us to the government. Then it is up to the government. There are some statutory provisions as to when they are supposed to table it. I think it is 25 sitting days - that is sitting days of parliament - after it is received, although one must acknowledge that there have been some cases in which the government has not managed to meet that timetable.

MR JOHNSON: Sure. The comment that you have received thus far, are you able to say what the likely potential for a radical shift from the document that you have presently - - -

PROF SNAPE: I don't think I can comment on that. The submissions that we are receiving of course are public and you are able to judge the nature of the comment from that. I think it would be rare for Productivity or in the past, Industry Commission, to revise between the draft and the final, significantly outside the scope of the comments which it has received. That may not help very much.

MR JOHNSON: That is sufficiently clear, okay.

PROF SNAPE: But you will see that there is quite a wide range of comment that we have received upon it. So that may not help very much.

MR JOHNSON: As I say, I think as you have pointed out, it is one of those processes whereby if nothing else, you get the busy people factor playing against you. Those people that are content are too busy to show up and those people that aren't content will find the time to take a shot at you. But I would tell you that having been in this industry for awhile that there are not things in this report that really caused my eyeballs to stick out. You're not off the mark. If anything you could have been bolder but I recognise that, you know, you probably pushed it to the point where you think that you can defend it but I think now it's about defending it and you should go forward in understanding that you've done a good job and I wish you all the best.

PROF SNAPE: Thank you very much for your comments. Thank you. We will now adjourn for morning tea for perhaps 15 minutes and reassemble at 25 to 12 when we'll have Melbourne Airport. Thank you very much.

PROF SNAPE: We resume now and we have with us Melbourne Airport and John Marinopoulos is representing Melbourne Airport this morning. John, I wonder if you would identify yourself for the tape, for the court recorder please.

MR MARINOPOULOS: Thank you. John Marinopoulos, research manager for Melbourne Airport.

PROF SNAPE: I now invite you to speak to your submission. Thank you very much for the submission.

MR MARINOPOULOS: Thank you, Richard and Helen. We've responded with a fairly short reply. We thought that actually the draft was an excellent work, similar to what Ryan said before. It's a very complex issue of an complex environment and we thought that it was an excellent conceptual functional understanding of the area and we welcome the draft report and a lot of the recommendations that were in there. There were a couple of points that we had regarding some of the draft recommendations, most of those appeared to us as being fine in their current form. Two of the ones that we found most difficulty with were draft recommendation 4.2 which was dealing with transparency and process of the current situation of air service negotiations and also the way in which the Department of Transport and various other faculties of the government work. The other one that we had problems with was something to what Perth Airport talked about and that was the regional reform recommendation 5.1.

In general the first part with the transparency and process issues, one of the key ones that we have, as it is at the moment, we find that there is not enough acknowledgment and also reciprocity of work that goes from the government back towards the actual airports, governments and various other institutions and bodies as what we all put into the submissions in terms of air service negotiations. A couple of major points are that the consultation process currently at the moment seems rather unstructured, informal, a number of different organisations or groups have been formed together to be able to talk on this and they seem to be very fragmented. One of the ways in which we would like to see - and is similar to where you were moving to within the draft report, is that we'd like to see a consultation process that's both formal and informal; one that allows people to be able to submit and receive reply regarding how they've submitted, the issues they've brought forward, where they sit within a negotiating framework so that we can be able to understand where we can then go off and maximise our efforts to be able to go and increase the productivity of what we give and the efficiency of what we do, so that we can get the best benefit out for the government to be able to go to the negotiating table.

The second part of that is that we'd like to see some sort of performance measurement though to be able to go off - see how we can go off and measure the performance of the various government organisations that are in the negotiating framework, see where they have succeeded or not succeeded. At the moment all we do is we receive back information saying we were successful or unsuccessful. There are measurements of success and just going back and saying that we were, you know,

increased by two units of capacity can be classed as success or failure by many different people. So we'd like to be able to see on a multifaceted basis of the program of air service negotiations, some sort of measurement so we can be able to understand where we impact on the process, where the government has impacted on process and how truly successful we all were. We, as the privatised airports, go through a fairly rigorous progress within the ACCC of performance measurement on many different facets of our performance and we'd like to be able to go off and start seeing some of that coming back to us, especially in such an important situation as air service negotiations.

The second major point that we had was regarding the regional reform package. Very similar issues were brought up in our submission as with Westralia Airports Corporation regarding where the line in the sand should be drawn regarding the regional airports. The other point about this particular recommendation was that it was almost out of context within the report because it was sitting - it basically came before we actually started talking about liberalisation and various other things like that. If I had a criticism of the report, I would almost want this to be the last chapter of the report, being able to say, "If all these other issues don't occur and we have to go off and sit within the current framework, then let's look as something like this as being a way in which we can then go off and start getting regional development." If there was an open skies policy, then a lot of this wouldn't need to be implemented. The major concern we also had was, as I said before, where that line in the sand was drawn. We saw that there shouldn't have been that distinction between Sydney, Brisbane, Perth and Melbourne as regards to all other airports. We would have seen it as being Sydney and all other airports if there was going to be a line in the sand drawn.

When you class where the second largest international airport with 2,500,000 passengers and Sydney has over 7,000,000 passengers, there is a very large quantum of difference between both airports. So a number of the issues that came out from there, in particular within the regional reform - one of the other things, we want to see is basically a lot of the issues of market demand, working out where we can go within the various issues of Australia. One of the major problems we have with city designation, as we have - and that's one of the issues that we had there - was that it's - Australia is quite different, we have stated this in our regional submission, Australia is quite different to most other countries.

In most countries you have one international airport; we have seven or eight or however many we have. Consequently, what happens is if we go off and say, "Yes, you can go to the three cities," we're going to their one city. Maybe we should think about it in terms of total Australia and consequently say, "Listen, if we get access to your major airport, you can get access to all our airports as well." So whether it goes to Sydney and the rest or all of them, there's another issue there. That was one of the points you brought up earlier regarding whether you would class the cities as - should there be city designation.

Just some of the other points that we had. We'd like to see a formal review of the air services agreements process, similar to this but roughly ever 2 years or so. From the previous time in which there was a review, there's been far too much time in between and a lot of change in between. Consequently, some sort of review of the process and how it's progressing and various other things like that should be made by this commission or some other independent facilitator or commission. We'd like to see some sort of formal review of each agreement over a 2-year period and then a formal review of the whole process, as I said. Lastly, there's a number of points in terms of how do we then implement where we're going to go with a lot of the recommendations that are in here? One of the things was we've stated where we sit, where the current situation is, some ways in which we can move forward but how do we then institute that process so we can be able to go off and have changes within the agreements and various things like this. That's one of the key things we'd like to see within the final version of this report.

PROF SNAPE: Good, thank you very much, John. The independent facilitator and monitor, it would be independent of whom?

MR MARINOPOULOS: Probably within that framework I would say independent of the Department of Transport or Department of Foreign Affairs and Trade - some sort of independent group or body or statutory authority that would be able to then go off and comment, possibly the ACCC or anyone like that.

MRS OWENS: What would they be commenting on? What sort of things would they be looking at, the processes as well as the outcomes?

MR MARINOPOULOS: Yes, and also the measurement of their performance, to be able to see exactly how they perform.

PROF SNAPE: You mention, of course, that Melbourne is a secondary gateway or Melbourne is really a gateway for Tasmania. Have you had any input from Tasmania into your consideration of this? Have you been in touch with them?

MR MARINOPOULOS: Yes, we've been in touch with Tourism Tasmania and we've discussed the issues and we passed forward a draft of what our responses were. Tourism Tasmania sees us as the main gateway towards their international air services and we've made that consideration also. Having purchased Launceston Airport in conjunction with Launceston City Council, we're aware of the regional aspects that we have to cover in terms of understanding where our focus should be. We aren't just a Victorian - or APAC, in terms of the holding company of both airports of Melbourne and Launceston, consider both Tasmania and Victoria within the context of international air services.

MRS OWENS: Can I ask while we're talking about the regional issue, you say that designation of cities isn't really required, so if you drop designation altogether that means dropping designation in relation to Sydney. Would that in some way upset the current balance between Melbourne and Sydney? Would it have any impact?

MR MARINOPOULOS: It's an interesting point. To my knowledge only one air service agreement actually has Melbourne and not Sydney or Melbourne and not any other airport in Australia designated.

MRS OWENS: Which one's that?

MR MARINOPOULOS: That's the one for the United Arab Emirates. So Emirates Airlines, who are a fairly strong airline at the moment. That distinction may last forever or it may terminate quite soon. We've got to see how the next round of air service negotiations move on. But in terms of all the other ones we have Sydney and Melbourne and other airports or Sydney and other airports not including Melbourne. So without the city designation at the moment you would find that Sydney and Melbourne - I don't believe there would be that much change within the actual way in which air services, international air services, are currently operated. Sydney and Melbourne quite often operate triangulated routes towards Europe and you find that there's a large critical mass of roughly around 8 to 10 million people within those two markets and consequently they can work in coherence with each other. However, Sydney does have the bulk of the air transport into Australia.

PROF SNAPE: This might be an unfair question to you, but do you know whether if there were no city designation Emirates would give Melbourne up and go to Sydney instead?

MR MARINOPOULOS: I can't speak for Emirates Airlines, as you will expect. However, I don't believe that they would go off and give up the route totally to go to Sydney. No doubt there was a lot of - well, I can't really say this either, but there was perceived lobbying from various sectors within the Victorian community when the original agreement was signed and a lot of work was put in for them to be able to come through Melbourne. Consequently Emirates Airlines and the United Airlines would have seen great benefit in coming through from Victoria. Consequently I wouldn't expect them to just turn around and pick up and move on to Sydney just because they could. At any time they could go off and ask for negotiations, to be able to say, "Let's put multiple cities on these designations as they currently exist at the moment," and they'd be able to put Sydney within that framework if both parties or both governments, or whichever way, would actually want to go and do that.

MRS OWENS: Out of 51 agreements that we've got how many is Melbourne excluded from?

MR MARINOPOULOS: I'm not sure of the exact number unfortunately. I would dare say it would be roughly in the vicinity of around 10.

MRS OWENS: So fewer than Perth.

MR MARINOPOULOS: Fewer than Perth. I mean, some of those ones - there's a number that always come up. I mean, aside from the Asian financial crisis and various

other things like that, you know - an interesting case in point is Korea where we're excluded. There's a designated third city which used to be Cairns. For it to become Melbourne we have to go through a whole process of air service negotiations again, it seems. Another one is a case in point just recently of Papua New Guinea where there's a south-east Australian route that's classed as Brisbane and Sydney but not Melbourne or Adelaide or any other point there, or Perth in terms of Perth Airport. So there's a number of different countries that we're excluded from.

But even so, I mean, there's cases in point in which you may be included in some but the rationale of the airlines that operate on those particular routes actually preclude them from coming through to Melbourne because of the way that they're operating.

PROF SNAPE: Yes. Korean Airlines may or may not come to Melbourne I suppose. But do you know why Melbourne was excluded?

MR MARINOPOULOS: From the history of the agreement I believe it was originally one city as Sydney and then it was two cities as Sydney and Brisbane. I would dare say that they would have seen that as either the Korean government or the Australian government or various governments within Australia quite often lobbied for that particular designation, and then there was a third city that was left as a city of designation where there was no particular case and Cairns was nominated by the airlines as being that particular city.

MRS OWENS: The ones that were not included, apart from Korea and PNG, if city designation was to be lifted would there be any of those other countries where you think there would be a chance of them coming into Melbourne?

MR MARINOPOULOS: It wouldn't happen overnight - sounds terrible this one - but it would happen. A case in point is South Africa where air service negotiations were undertaken in May of this year in which there were unsuccessful outcomes in that there was no change to the bilateral agreement. Yet in that agreement there is only Sydney and Perth. Consequently where Qantas had a Johannesburg service out of Melbourne which they withdrew for a number of different reasons in about March this year, if there was no city designation then South African Airways may have been enticed or may have been asked to come in through Melbourne and they might have undertaken that route. Because they can't actually utilise Melbourne as a point within Australia that couldn't happen and consequently we lost our South African service out of that. Now, there is transit through to Perth and then on from there to Johannesburg.

PROF SNAPE: Do you see Melbourne as being adversely affected by the restrictions on freedom rights out of New Zealand? What I've got specifically in mind here is of course that aircraft, current aircraft, can fly from Sydney to Los Angeles and from Los Angeles to Sydney non-stop. But as I understand it, at least on a commercial basis, they wouldn't be able to fly from Los Angeles to Melbourne non-stop or vice versa and so they have to stop somewhere. One of the principles

that many people adopt in flying out of Australia is, "Avoid Sydney wherever possible." But the number of opportunities to fly Melbourne-Auckland and then on are limited, that is, if you're going to pick up traffic in New Zealand, and so that route is therefore constrained.

Now, I realise that Australian airlines aren't using all their fifth freedom opportunities out of New Zealand, which I think are 12 a week equivalence. But nevertheless they may be constrained because they want to have a regular schedule and if they were to have a regular schedule then they would go over the 12. Do you see any problems of that nature caused to Melbourne Airport because of that cap on fifth freedoms out of New Zealand?

MR MARINOPOULOS: Primarily from an aspect in terms of South America, in terms of where the various aspects - for instance Argentina, we've discussed how there would be access from New Zealand through to Argentina from Australian ports. But there's also what happens if Brazil comes into the equation and various other countries within South America. If Brazil suddenly comes into the equation and say, "Look, we want daily services to Brazil," and you've got daily services by United Airlines and you've got daily services, let's say, by Qantas and various things like this, then suddenly you're starting to get into a fairly large mass in terms of capacity on that route. So we could be losing out in that case.

If there was unlimited fifth freedom then that would be a hop that could be done, a port that could be used, to be able to go there. Now, in terms of what you were saying with commercial rights, it's stated from a number of airlines that it would be very beneficial to be able to fly Melbourne-Los Angeles directly and unfortunately I think they fall about 300 miles too short, literally.

PROF SNAPE: Particularly coming back I think.

MR MARINOPOULOS: Yes.

MRS OWENS: Technology changes.

MR MARINOPOULOS: Yes, but video screens on planes don't change. They get heavier and heavier. That's where the problem is.

MRS OWENS: I was going to ask you a little bit about the consultation process. In the Financial Review yesterday there was an article about Alitalia abandoning its thrice-weekly Melbourne to Rome operation and hiring - I gather via code-sharing, I'm not quite sure - KLM to fly on its behalf to Sydney. I was wondering how that decision is made and whether Melbourne Airport gets some say in that process, in that decision, or whether you did have some involvement, whether you were able to have the ability to put the case for Melbourne Airport and for Melbourne in the context of that decision.

MR MARINOPOULOS: I would say that that would be just like any airline. It would be Alitalia's choice as to how they operate their services into Australia. It's something that we don't want to see happen. It's a commercial decision that we would have to make in conjunction with Alitalia and I would say that the correspondence that we would have with them - the point that we'd like to make is that this has probably been a fairly long time coming, if it does actually eventuate given, however, at the last year there have been - the Italian government has actually rejected advances to be able to go and discuss their air service negotiations with the Australian government.

Consequently due to the sort of number of advances being rejected and stated by the Department of Transport to us, it's probably something that we're - some sort of mechanism should almost be there to say that this country or carriers of this country should be placed on alert as a service by the Department of Transport. Given if there's a country that says no continually, "We don't want to discuss, we don't want to discuss, we don't want to discuss," for unsure reasons or various other things like that, there may be other components in terms of their political stability and various other things like that, that as a service the Department of Transport could be able to undertake to - in our case, various airports operators and things like this. In terms of Alitalia and Melbourne Airport, the Victorian government, whichever Victorian representative authority we talk about, it would have to be something that we would have to discuss directly with them on a commercial basis.

MRS OWENS: So you haven't been involved in - - -

MR MARINOPOULOS: Not with that particular discussion with Alitalia at the moment. We have had discussions with Alitalia on other matters, but that particular article within the Financial Review in terms of there, I think they were doing a wet lease with KML on a thrice-weekly service and they were eventually talking about going Sydney, Singapore, Milan. So that will be the new airport in Milan, roughly around 2001.

MRS OWENS: So that doesn't necessarily have to go anywhere near government I presume, if it's a wet lease.

MR MARINOPOULOS: There's a number of issues there in terms of no doubt where the ISC would sit and where the Department of Transport would sit and various things like this. But then that becomes an Australia-wide basis.

PROF SNAPE: That would be a bit of a blow for Melbourne, wouldn't it, to lose Alitalia?

MR MARINOPOULOS: It's a blow to lose any carrier. Alitalia has been a carrier that has worked in Melbourne I think continuously for 28 years.

PROF SNAPE: And that route actually from Australia to Rome is a route which is currently just about at the capacity too.

MR MARINOPOULOS: Very much so.

PROF SNAPE: Which makes it even perhaps more surprising that direct competition is being shut out by a capacity limitation. I mean, you'd have thought that might have had some effect upon prices and- - -

MR MARINOPOULOS: Well, it's interesting. Alitalia have got three services and it hasn't been expanded past its three services. Qantas have got three services Bangkok-Rome and the loads on those aircraft are very good. If you ever go down on Friday afternoon at 5 o'clock at Melbourne Airport you'll see many people going through onto that flight.

PROF SNAPE: I caught it myself coming back a few weeks ago.

MR MARINOPOULOS: Yes, it's quite busy, isn't it?

PROF SNAPE: Yes.

MR MARINOPOULOS: However, a number of political pressures and various other things like that within the Italian government, the - I shouldn't say insolvency but the financial situation of Alitalia in Europe and the European Union in terms of where they want to be able to see subsidies to governments, have direct impact on those particular airlines. In a similar vein we could be looking at a number of different carriers from Europe who were suffering various similar cases. One that doesn't fly to us is Iberia who have a similar or worse financial situation than Alitalia.

But in terms of the capacity there's an interesting point there in that what happens now in terms of if Alitalia decide to drop out of that route? There is now three units capacity but it's sitting on - let's call it the other side. Now, Qantas, who have available aircraft, various other things - well, they probably don't have available aircraft, but Qantas who are currently running that route, why wouldn't they be able to undertake those three extra services to be able to say, "We will offer that capacity to be able to go off and give a similar service standard and service level to what is currently being achieved at the moment." There are a number of different points in there regarding how quickly we can respond to bilateral agreements, how quickly we can respond to capacity changes. We have seen that with the Philippines now where Qantas supplied and received 1140 seats, I believe, to be able to go off and operate roughly what was going out by Philippine Airlines but not wholly, and in a different way in which it was done before. So there are a number of the different issues in how we could see how that operates.

MRS OWENS: Thank you. Is there a potential that we could lose other direct flights from other airlines in the same way at this has happened? When I say "we" I mean Melbourne because I live in Melbourne.

MR MARINOPOULOS: There is always a case in which that happens. Well, another one was Philippine Airlines. There was a rumour about Merpati pulling out but now they have just changed the aircraft they were leasing and I think they stopped one service on one day and now they're back in with a larger aircraft so they have got more capacity. There is always the case in chance that an airline will be able to terminate its services. We saw out of Brisbane and Perth from February where there were a number of services pulled out by Qantas over time and Qantas have probably pulled out of Brisbane probably 10 services. If you think that Alitalia has got three services a week, that's equivalent to three Alitalias going out. So it's not whether the carrier goes out. It's also whether the capacity and the seats go out which is the key issue.

With alliances and various other changes within the aviation industry and the airline industry we're finding that there's less of a reliance in terms of, "Do you know the tale of the plane that you're flying out on? Is it the same as the ticket?" Code-sharing is a similar sort of situation. You could buy a Virgin Airlines ticket to go out of Melbourne but you would be on a Malaysian aircraft and when you get to Kuala Lumpur you get onto Virgin Airlines. The same with Canadian Pacific.

MRS OWENS: So doesn't it make it very difficult for an airport operator to actually plan and to make investment decisions in what is a fairly uncertain environment?

MR MARINOPOULOS: Overall there is a perceived growth factor that will be eventuated on an average basis of, say, 5 years. You find that forecasts in general in terms of passengers and aircraft movements are always much more conservative than the actuality. Consequently what you can do is plan on a modular basis to be able to go and expand incrementally various other things such as capacity of terminals, runways, taxiways, ground transport infrastructure, various other things like that, so that you can be able to increase the viability of your terminal. For instance, you have seen that there is the new carpark that was built about just under - or was finalised just under a year ago yet there are plans in check to be able to expand that carpark.

As you can see in terms of our master plan over the next 20 years there are cases in point where that capacity of that carpark could then be extended out further back and across and past the roads that it's at, and even extending out the long-term carpark. Overall there is an expectation that the growth will occur. The minor changes in terms of services and various other things like that, quite often you find that if there's a market there and it's market-driven, that those markets will be able to sustain it by other carriers coming in. The problem is when there is capacity constraints, and also when you can't see where the airlines are coming from, but overall you find that those particular cases were changed.

For instances, Emirates Airlines we were talking about, Emirates, their major market is not the United Arab Emirates. It's the UK, Greece and Italy. Say with a Greek marketplace, 5 years ago you only had pretty much Olympic and - yes, Olympic and that was about it, and Singapore Airlines and Thai going on there, but now you

have also got Gulf Air, you have got Emirates, and you have got other airlines that can go out there, and Qantas through their British Airways code-share through from London. So capacity usually will come up and try and meet the demand. The problem is when you have constraints in terms of negotiated agreements and various other things like that that don't allow market factors to be able to go and influence how those particular airlines can come on board.

MRS OWENS: Going back to the consultation process again, you do say in your submission, and you mentioned in your opening comments you had some concerns about the current process, and you in the submission said that segmenting the consultation process as per current forums, that is, TAG and AWSCOT, is both counterproductive and inefficient. You also mentioned that you think there's room for both formal and informal processes. Have you got any suggestions as to how the formal side of the process could work better?

MR MARINOPOULOS: I have, but just going back onto that previous point where you were saying with the number of different forums, just to give you a idea of why I stated that there it's been counterproductive and inefficient. A number of colleagues within the sort of government and the tourism industry - actually, I remember when I was at the TAG meeting where you presented the draft report here and there were about five people in there just basically saying, "I've heard all this before. I've done all this, I've done all that," and I said, "Where have you heard all this before?" They said, "We were at a meeting last week and we were at a meeting the week before and we were doing this and we've heard it there and all that sort of thing."

Consequently, I'm thinking to myself, where does the influence lie? Are we just basically separating out the influence in terms of how we can go off and give a defined and unified judgment or value of information towards the government to be able to go on and take into these negotiations? If we're going from different forums, then what we're doing is possibly segmenting our information and making ourselves basically inefficient in the terms of the way we're operating. If we have to go to five forums to say the same thing, then it's not a waste of time, it never is, but it's an inefficient use of time. In terms of the formal process, what I'd probably like to do is see some sort of mechanism in which we can go off and have - a way in which we can put forward our case and then have it. It's probably almost a case of acknowledgment that's not there prior or in this current form at the moment.

It's something that we'd like to see in terms of, as we have in this case, a public forum where we can state our particular key issues in terms of where we see our growth markets and various other things like that, have an acknowledgment, public hearings and consequently, some sort of information that returns to us on a formal basis that says, "We acknowledge that and it's been taken into account in terms of this way or that way."

MRS OWENS: What about this airport consultative committee that is to be set up - it may have already been set up, I'm not sure - is that going to help?

MR MARINOPOULOS: It helps once again, but if it just becomes the airports on their own then it's a bit more of the same as we've got now.

MRS OWENS: More segmentation possibly?

MR MARINOPOULOS: Yes. For instance, the Tourism Advisory Group was essentially the tourism operators in the government and then they led in the airport operators. But within that group prior to the last meeting the Department of Transport was not included, they only came there on an informal matter to present and then to leave. So you had a group talking about air services, but the people who were actually meant to take this information away, the actual primary beneficiaries weren't there. Now that they are there, they get a different impact and understanding and have that interaction. But beforehand the Department of Transport in Canberra would take this information away, work it all together and pass it on to the Department of Transport - the Department of Tourism would pass it on to the Department of Transport.

If it becomes that airports again - and we have the Department of Transport interacting directly there, you know, would then we still have to be on TAG? Would we have to be on other committees? Would we have to do that? I mean, there must be a better consultative process than what there is currently with this segmentation so that we can be able to organise one group that meets on a regular basis, where you can be able to go off and voice your opinions and you can be able to say where we go.

MRS OWENS: Thank you.

PROF SNAPE: Well, I think I've asked my questions and Helen has asked hers. You heard the discussion earlier in the day as well. Is there any comment that you would want to make in relation to that? I mean, a number of the points were very similar, of course.

MR MARINOPOULOS: We've discussed a number of the points there. Just lastly I'd like to thank you for the work that you've done within this report. I think it has been excellent in terms of how you've brought it together and it would be great to be able to see the time-lines that you've stated in here as being satisfied and we can see an agreeable outcome in the future.

PROF SNAPE: Thank you very much, John.

MR MARINOPOULOS: Thank you.

PROF SNAPE: We will now adjourn for lunch and we shall be resuming at 1.30 when Qantas will be making their presentation and then later in the afternoon we will have the Australian and International Pilots Association. So we have got a full afternoon and one might say some different views this afternoon from those of this morning. So we now adjourn and if we resume at 1.30. Thank you.

(Luncheon adjournment)

PROF SNAPE: Welcome back to this hearing and the draft report on International Air Services and this afternoon we are kicking off with Qantas and we would ask the Qantas representatives, James Strong, David Hawes and John Kerr, if they would identify themselves.

MR STRONG: Thank you very much. James Strong, chief executive of Qantas.

MR HAWES: David Hawes, group general manager, government and international relations.

MR KERR: John Kerr, general manager, international relations, Qantas.

PROF SNAPE: Thank you very much and thank you very much for your submission and comments on our draft report. Not quite as enthusiastic as we might have liked, but then we can hardly expect this morning's performance to be repeated in all sessions. Thank you very much for that and for the extra information which you provided there and up-to-date information on capacity utilisation etcetera which will be very helpful to us. I should also say that Qantas wish to make some comments also on a confidential basis later and that what we plan to do there is to run through the non-confidential part first and then we will have to ask other people to leave and take an early afternoon tea next door and we will go through the in-camera after, which we do also record for the transcript, but of course that doesn't go on the web site and it stays as confidential. Then after afternoon tea we will come back and have the Australian and International Pilots Association at that stage. So as I say, thank you very much for coming and for the comments and I would ask first of all, James Strong, if you would like to add to your written comments or whether your companions would also.

MR STRONG: Thank you, Mr Chairman. The Qantas submission to the draft report has been supplied to the commission and I don't intend to go through that in detail, because I think it speaks for itself. What I would merely propose to do is to make some comments in formerly tendering that to the commission. I suppose that overall our reaction to the draft report or the phrase that I used when asked by that ever-present group called the media, what our reaction to the report was, I used the word that I thought it was a thoughtful report and that was a very deliberate choice of words.

We have to say and I am sure the commission would not be surprised in saying that particularly in the way in which some aspects of the draft report were highlighted in the media release, that it did tend to trot out some of what we had referred to previously as the myths and legends of aviation for the usual rubber hose treatment and I realise that this is an economic study and that a great deal of it is based on what some people would call supply side economics. But we do think it is important that there is emphasis on what is the reality of the situation today and I think one of the great myths of the aviation industry in Australia of course is that there is a shortage of capacity, available capacity, which is restricting competition and of course that was

picked up by a number of papers, particularly the Australian Financial Review seems to have been taking steroids recently about this aspect.

But any close examination and of course that is one which we have tried to respond to in detail, shows that there is no actual case of shortage of capacity, other than a couple of cases where they already were under consideration or in progress, reviews of that capacity in the normal course of events, or certainly in one classic case, the obstruction is at the other end of the pipeline, not this end, which I think is a very important consideration. So I think that is one of the things the Financial Review in particular tended to trot this out with great vehemence. But the reality shows that this is not the case.

The other thing that we have tried to bring forward to the members of the commission is that if this was an industry which had restricted competition, then you would see that there would be either above average returns consistently in this industry, or else there would be squandering of profitability in the industry. The reason why we have asked to make some confidential submissions on the area of income in the industry is to present some factual material before the commission about that, which you have already mentioned, Mr Chairman.

The other thing is that the reality is that as we have set out on page 15 of our written response today, we have set out what would be the characteristics that one would expect from a constrained market in relation to seat factor, origin and destination market growth, market share and pricing and yield and the reality is that no matter which part of the industry you take, the characteristics are the reverse in practice. I think either at the previous hearing or in background material that we presented to the commission, we did show that the international industry and indeed the domestic industry has been characterised in recent years by continuous decline in yield, which is the exact opposite of a constrained market. That is being driven by over-capacity and competition and of course at the moment is being very much exacerbated by the fallout from the Asian crisis in a number of markets and spreading beyond those markets to every major market in the world.

The other thing that I think we have discussed and I would just refer to it again in passing is that one of the great ways of assessing the reality is to look at the market assessment and the stock market assessments of airlines is very clear and that is that it places them below railroads. Now, I am sure railroad companies wouldn't like me to use that as a pejorative phrase, but it is and on the US stock exchange for example, even in times as at the moment, the strongest economic growth the US has experienced for a long time, the PE ratio which is the classic assessment of the future profitability of any stock of the airline industry remains demonstrably below railroads. It is typically in the region of 10. If a PE ratio is 10 you are doing well; if it is 12 you are doing extremely well. Whereas railroads tend to be in the range from 12 to 20 and communications and high tech stocks above that.

So I think the market has given a continuous and very clear assessment of the profitability of airlines and that I think is a very demonstrable evaluation of just what

the profitability has been. It's certainly not one which you would see flowing from a constrained market. In terms of the issues that have been brought forward by the commission, I think that they are all issues that have been assessed before and I am not saying that by way of criticism, it is merely a comment and you could say why is that? I think there are two reasons. One is that there have been abundant inquiries into this industry and reviews. But also you could say, secondly, that it is a vindication that the approach being followed is reasonable logical and reasonably well placed. In other words they are all issues that have been weighed and evaluated in the current policy settings. I think to a large extent that was borne out by the Department of Transport submission yesterday.

I think you will notice that we have made a very specific comment on New Zealand policy which is often paraded around on the end of a stick to show how things can be done. But this is a case of not, "Look at what we have done," but, "Look at the results." I think there is a big difference between what benefits that policy has brought to New Zealand in terms of competition and the consumers of the industry, compared to what it professes to have produced. I think that one other thing I would just like to mention to the members of the commission is that I know that this may be something that is artificially constrained for you in terms of your role and in terms of the inquiry, but we do believe that an important issue is what kind of Australian aviation industry do we want?

Surely we believe this is an important issue from a national policy perspective. The first thing I would do is to rush in and say that I would never suggest that any of us want to protect an inefficient industry and in that sense we agree with the thrust of the commission's report. But the clear evidence is that reform is driving the industry in Australia to become much more efficient and much more competitive than it ever has been before and that is because the pace of reform in Australia in reality has been as rapid as virtually any other country in the world.

The other thing that we think should never be lost sight of is the reality of Australia's geographic position and its market size, plus the history of the status quo which means that unless care is taken then Australia will certainly end up with a non-competitive industry. So we get back to the same issue that no-one is arguing against the fact that there needs to be continuing competitive forces, but that it is important how those forces occur and the rate at which the forces are applied. We believe that the reality is in Australia that competitive pressures, particularly in the last 5 years, have already made this industry one where it is very difficult to earn a reasonable return on investment and it has forced the airlines - and I can certainly speak from Qantas's point of view - to achieve efficiencies far beyond any ever achieved before, both in terms of utilisation of assets and in terms of the labour force and despite that, as we gave particular evidence to the commission, despite the enormous progress being made in cost control, cost reduction and cost avoidance, the (indistinct) in other words the operating profit of the business is absolutely flat and it is only the cost reduction which is keeping the financial performance at acceptable levels.

The reason for that comes back to the factor I mentioned earlier and that is that yield is continually falling and cost reductions and efficiencies are being consumed by the fall off in revenue. In reality we would say to the commission that this is a world class industry in Australia now, measures of efficiency and so on are demonstrating that. It has been driven by very substantial economic and competitive forces in the last 5 years in particular. We know that often a body such as this is called upon to look at industries which are manifestly inefficient or moribund or poorly performing and we would say that is clearly not the case in the case of aviation. It is not a declining industry but rather the reverse, that tourism has been the fastest growing industry in Australia and one with the greatest potential and there is no clear evidence to say that aviation policy has retarded or restricted that growth. It has been the fastest growing industry in Australia.

With those general comments to the members of the commission, we are quite happy to answer questions or to pursue any of these further. Perhaps if I just chance my arm once more on something which I know is a difficulty for you in terms of - again the terms of reference. But we would say that when we look at driving Qantas forward, just speaking in relation to our business, that one of the biggest constraints on our business is Sydney's Kingsford-Smith Airport and I know that is a difficulty for you. But if one wants to talk about inefficiencies and constraints and so on which are attempted to be solved by artificially restricting the demand, then that is probably the biggest issue of all.

PROF SNAPE: Thank you very much. Do either of your companions wish to speak at this stage?

MR STRONG: We are all happy to respond to any further points.

PROF SNAPE: Thank you very much for that, Mr Strong. We take the point about Sydney airport and you identify the problems as far as we are concerned correctly. Nevertheless we note that point. We also note the point you have made and which the department also made in their submission, that you did not think that we gave sufficient acknowledgment to the changes which have occurred in the last few years and the efforts that have been made to adjust to the changing scenario, the changing pressures. We did endeavour to give some of that flavour and particularly at the beginning of chapter 4 there are two or three pages which go into the very substantial changes that have occurred in the last few years and the responses which have been made to them.

We didn't in fact go into the cost savings Qantas and Ansett have been undertaking and much of that of course was given to us confidentially, so we couldn't do it, even if we had wished to. We take the point, however, that perhaps an acknowledgment of the changes has not permeated the report in the way that you would obviously have liked it, and we note that point. It was not, however, that we didn't attempt to acknowledge it. Of course, different people read things differently. In turn we thought that there would be rather more that you liked in the report than are perhaps reflected in your comments, but this is perceptions from different points

of view. Maybe I could ask then, to start off, if we could look at what is the key recommendation, I suppose, it's recommendation 8.2 in the overview, which in the draft recommendations is on page 40, and then going on to 8.3 - XL.

Of course that was - just to recapitulate there - that Australia should seek to negotiate bilateral open skies agreements with like-minded countries incorporating the following elements: there was a core package of unlimited capacity on third, fourth and fifth freedom traffic and code shares, no route restrictions, removal of ownership restrictions for airline designation. Then there was the regional reform package which was referred to in an earlier chapter, no price regulation and restrictions on government subsidies. Then we had negotiable rights, seventh freedom traffic rights and passenger cabotage. I think it's probably right to say that we perceived that this set of recommendations is very much following the sort of path that had been going on in the past, I mean, very much a liberalisation and we could have characterised it perhaps rather more than we did as a continuation, an extension of the thrust of past policy.

I think the department took the view in fact that to a significant extent that's what it was. In your comments on our report you've said that you are in favour of the direction of the policy and of an extension of it. So when you look at things from that perspective, at least the intentions are fairly similar. So what I would like to ask is what parts - recognising that sequencing is very important which we do and we state that, perhaps we could highlight it rather more, that is the sequencing of the negotiations with bilateral partners, who comes first - and also noting recommendation 8.3 which is if the whole thing can't be achieved then we go ahead with as much as we can. Then noting those two points, could I ask you to say where specifically do you then disagree with our key recommendation?

MR STRONG: I might get my colleagues to comment on this as well, but we did respond on page 2 and the top of page 3 to those points 8.1 to 8.3. I don't disagree with the sort of broad summary of what you put forward, but what we are saying is that we still do believe that even if it is the same objective that you're going through that we would prefer that the evolutionary approach continues. One of the examples of that is what I refer to - and I think I did speak to the commission about this before - the ABC countries. You know, Qantas is a C country at the end of the line and B is a hub country and A is somebody in one of the major markets of the world - in other words, Europe or northern Asia or United States. What a C country like Qantas does with a B country may not help us much unless we have an equivalent deal with the C country. So that is one of the big considerations.

Now, I don't know whether you meant to pick that up by your sequencing statement but I'm just hoping that that was inherent in what you were saying. Because if one sat down and did a catalogue at the moment of where we believe we're subject to unfair restrictions, certainly it is in predominant areas in relation to what you might call the third country access over which a deal with a B country may not give us any relief whatsoever. So that certainly is one example of there's no use doing an open skies with a B country if we don't have the back-to-back rights with a C

country. Sorry to use that terminology but it's my own shorthand for that. But basically and you made the comment before that perhaps we could have been a little bit more supportive of some aspects of the report. We are trying to say that we do think that there are many positive aspects in this report and the biggest one of all, I think, which we acknowledge - obviously a lot of thought was given to - was to move away from the unilateral approach.

I think that is a significant issue that obviously you wish to have debated and hopefully it was properly debated and that we recognise that that was a major issue and by and large I think our reaction to points 8.1, 8.2 and 8.3 or 8.2 and 8.3 in particular was meant to say, yes, we do agree that this is the direction but we still have inhibitions about blanket solutions and that we would rather that you keep moving in that direction carefully analysing every aspect of every deal that you do, rather than to move quickly to that being a blanket approach. I think the best example of that that we've seen recently - and I'm just very much aware of this because I've been in this part of the world recently - that we've just seen some of the Latin American countries strike out, lash out in very emotional terms at the United States in terms of imbalance of benefits that has come out of this lovely phrase "open skies" between those two countries in terms of the way in which it's able to be used by the airlines of the two parties to that agreement. I'm not sure whether my colleagues would like to make a comment.

MR HAWES: There is one further point I think we should probably seek to emphasise here towards the end of that section that James Strong has referred to, and that is that we sought to distinguish between the means by which you travel and the point at which you arrive. In other words, that the negotiation of bilateral open skies arrangements following a formula in one depiction in your draft report seemed to us to be the mechanism by which you go forward, the means by which you travel going forward. Whereas we don't deny that the ultimate end point of the process which is being followed might bring you to the same outcome, but it would lose in it or lose as part of that process the ability to carefully distinguish, to weigh and to apply those elements and the sequencing to which you refer - and we're pleased to see you really do acknowledge - which are important in going forward.

So that if one looks around and identifies what you call like-minded countries, that maybe the fact that country X is like-minded, that country could be of little value or the wrong country at this time. But if you get the sequence right, you might eventually arrive at that point with country X. But that's not the way to go in the first instance. What is also very important, therefore, is to ensure that as you move forward you have the arrangements with third countries which will bring the real value through from the particular bilateral deals that you are doing. So that was a point we thought worth distinguishing between, as I say, the means of travel and the point of arrival.

PROF SNAPE: Yes, I think the negotiating sequence is a very complicated question and there's probably no perfect answer to it, particularly as you don't know what the response of other parties is going to be and it may be that sometimes one

goes into an agreement which may in fact have nothing opening up at the other end of it, but it in fact may put pressure on the opening up of it at the other end. So what appears to be nothing much gained in the short term may be something different in the long term. I think that what we are suggesting here is that it be a declared policy that this is what we should be aiming for. Now, I think perhaps your emphasis is something different there and that one shouldn't hang this out on the line as the declared policy. Nevertheless, the department has said that the policy would be liberalising as much as possible and that they are going out to try and liberalise.

They tell us that the problems are nearly always at the other end, that they're going out these days and that's been the thrust of policy and it seemed to us that a logical extension of that was to say, "Here is what we want," and declare it openly and that is our negotiating position which is the sort of things that we've got here. It doesn't seem to me that there's a huge amount of difference unless you think that advertising it as such is in fact disadvantaging.

MR STRONG: I wonder if I could sort of answer that with a rhetorical question - that's not exactly - but if I could just pose something then. What if by hanging that out somebody arrives at the gate with a deal which is demonstrably going to be more beneficial to the operators in that country than to anyone in the Australian industry and which, by some combination of other rights which are not related to the deal between those countries, is going to give a disproportionate advantage to that other operator? So that there is a danger in hanging things out - I mean, you can state a general - we prefer the position of making a general statement which is a true commitment to liberalisation but then always retaining the right to treat each case on its merits.

I suppose in a way I'm getting back to this point which I touched on before and I think we did discuss this more by way of background, that if the pace of change or the consequences of change is not properly considered in each case, then Australia is going to end up - rather than go through a transition and being able to be forced to change in a way which will make it reasonably competitive as quickly as possible - you could end up with an industry in Australia which will be but a mere shadow of what it is today. Now, you could say, well, if public policy issues outweigh that, well, that's justified and I can see that argument. But not in a case where there is quite a rate of change already occurring in terms of efficiency and cost reduction and obviously your more attractive pricing being forced by market conditions.

What I'm referring to here is that this industry is going through from almost a feudal stage - that's probably a bad term to use - but where there were so many airlines and everybody did everything for themselves and it was sort of judged to be in the national interest to have full infrastructure in every country which I think most people today acknowledge is not sustainable. But globalisation which is what is driving trade change today is going to mean that there certainly will not be the same structure in this industry in 10 years' time and possibly even 5 years' time that there is today. That certainly has consequences in terms of the wider effects in the industry

which are the subject that I've mentioned in my opening remarks, which I realise is not fully within the terms of reference.

For example, I think we did discuss this in some background discussions that obviously the industry is going to have to continue to drive for further cost reduction and efficiency gains and this may mean the rationalisation of all sorts of infrastructure in individual airlines, with greater amortisation of investment over a bigger investment base. This may have great significance in terms of the development of alliances and indeed, as you've mentioned in your report from time to time, the fact that if restrictions on ownership are removed or certainly made less onerous, then one would expect that economic forces are going to drive continuing change in that area as well.

All of that, I think, does have potential major implications. I'm not saying that in any way those forces shouldn't be inhibited, but it's a question of creating a situation to be able to best handle that and weighing that off against whether a satisfactory rate of change is occurring in any case without artificially stimulating it so that you may actually get a worse result by over-stimulating that rate of change. I don't know whether I'm making the point clearly.

PROF SNAPE: I think probably one shouldn't answer rhetorical questions, but I shall - not least to comment on it. I think that as you set it up you said what if the gain to another party was going to be much greater than the gain to Australians, and I think to that I would say that the test is not how much the other party is gaining but whether it is a gain to Australians. Certainly if they're getting more out of it than we are but we're still getting a positive gain, then one should go ahead with it. Of course, you might then say that if we did something else we might get more of the gain. That's another question as to maximising our own gains. But I think that I would not be wanting to hold something back simply because it benefited someone else more.

MR STRONG: No, I understand.

MRS OWENS: You could possibly get the similar situation right now with the current system. You could ask the same rhetorical question about the current negotiating position. I was going to just point to what happens in New Zealand, and I'm loath to talk about New Zealand because I don't know if our department likes to set New Zealand up as being something we should be moving towards, but they, as I understand it, when they're negotiating open skies agreements, look at these agreements on a case-by-case basis on their merit. For example, I think they took a totally different approach when they were negotiating the open skies agreement with the US to when they were negotiating the open skies with Singapore.

With Singapore there was quite a lot of resistance from Air New Zealand because of the very point you made about the A country. It's one thing to negotiate something with Singapore but that's not where the main game is. The main game was with the UK. But by virtue of thinking about an open skies agreement with Singapore, it directed their attention to trying to free things up at the UK end. So they went slow on Singapore for a while while they were negotiating with the UK. I

think overall they ended up with, probably for them, a better solution between the three countries. So there is potential within open skies arrangements to actually be very strategic and think about the sequencing.

MR STRONG: Yes. I don't have any disagreement with that at all, but I just think there's an over-emphasis that if you're wearing a sheriff's badge which says "open skies" somehow this is better than liberalisation. We could say we're getting into semantics here, but that is the approach that the Australian government takes in its dealings with Singapore and the UK as well - and I'm saying that I don't think there's any difference except that New Zealand runs around wearing a sheriff's badge which says "open skies" - as long as what the Australian government is doing in judging the pace of change in its dealings with Singapore and the UK cannot be demonstrated to actually be artificially constraining competition on that route, and I'll defy anyone on earth to prove that. It's a cutthroat market, as being demonstrated at the moment by everyone and his cousin flying on it and offering every deal under the sun.

I know this can be said as semantics, but this is what we're getting at; that we think too much is being placed just on this tag of open skies. It does mean different things to different people in different markets. I'm sure that commissions have seen that from the examination that they've done. So I don't wish to dwell on the New Zealand situation either, although we probably can because we did win the last game of football. But doing an open skies deal with Brunei really hasn't done much for the New Zealand consumer and yet that's sort of a badge that's shown as a success for this policy. That's why I think that we realise that the commission has to go and look at principles, and that is very important, but we do think that the practical reality is always very important to relate it to, "Well, what did this produce," and, "Where are the best benefits going to be achieved," and concentrate on those sort of, what I might call the realities, the practicalities of it.

MRS OWENS: Maybe it's too soon to see what's being produced by what New Zealand is doing, but I think they're also being driven by their understanding of what has come out of APEC and the Bogor declaration, which they are arguing does in fact have implications for liberalisation of air services.

MR STRONG: We made a comment on APEC here somewhere I think. The latest attempt in APEC to really do something substantive about airlines was an absolute bellyflop, and I'm sure the commission is aware of that.

PROF SNAPE: I take that point, though I understand that what New Zealand is - and again I'm reluctant to speak about New Zealand too much; it does seem to raise the hackles in some quarters - that they're attempting to follow in a path of negotiating open skies agreements around APEC countries, and that while Brunei in itself may be unimportant and Chile may be unimportant and the foreshadowed one with Peru may be unimportant in themselves, as one works around the APEC countries one gets them all in.

MR STRONG: But then if I could just go back, at the risk of raking over old territory. It's the combination of the policies in that country. In a particular country you couldn't care if you had all sorts of open arrangements, putting on an airline hat, if the internal policy of that country was that you were the sole flag carrier. The reality in New Zealand is that there isn't even an authority equivalent to our authority which allocates capacity. Once given, it's permanent and no-one is using any authorities allocation of capacity in New Zealand other than Air New Zealand, and there's nothing at risk.

Perhaps that's a little overstatement but everyone's view of these things is obviously predicated on what is at risk. In the case for New Zealand there is very little downside. Why? Because it's a 3,000,000 market, definitely in the C category, and the risk of them being swamped by three US airlines or two UK airlines coming there is zero. What is the upside is obviously access to much larger markets.

PROF SNAPE: Yes. While there are 3,000,000, which is about the same size of Singapore but they don't quite have the same favourable location, it's a question of whether Australia's bargaining power, with New Zealand in it as well, would be stronger than it is at the moment. Also, when you mentioned in your introductory amounts what kind of Australian aviation system do we want, the question is whether that should be Australian or Australasian.

MR STRONG: My comments are only of condition by, I suppose, personal discussions and statements that I've heard. I think it's very clear that New Zealand has not the slightest interest in relinquishing any control over the allocation of rights to fly into and out of New Zealand. I mean, they've made that abundantly clear. They see it as a sovereignty issue. I think that - I may be mistaken - is the current policy of the current government, based on some recent discussions that I had in New Zealand.

MR HAWES: Can I just mention - I think you touched there onto another one of your recommendations as well, or observations, about the forming of an Australasian common aviation market. I think we have two points there. One is that we wouldn't expect that the adding of New Zealand's weight to ours would substantially increase Australia's leverage or Australasia's leverage in third country negotiations, but I think the second and more important point that we'd like to leave you with here, and I think the department may have done this already, is that it would be very impractical. It's very unlikely that the bilateral partners of Australia and New Zealand would be receptive to receiving us jointly for the purposes of renegotiating all of those bilaterals. So a lot of effort for questionable gain would be our assessment of that recommendation.

MRS OWENS: David, I think the New Zealanders actually turn that first point around the other way and say adding Australia to New Zealand doesn't do much for their position. So you can see it both ways.

PROF SNAPE: Is there resistance from the partners, other than the United States perhaps, of the EU countries to negotiating with the European Commission? Of course the European Commission has not yet succeeded in exercising its authority over the 15 countries, but they're attempting to. Would there be or is there resistance from other parties to negotiating with the EC rather than the 15 countries - except perhaps the United States who was trying to pick them off one at a time?

MR STRONG: I was trying to think of some very colourful phrase. There's enormous resistance. It is a very big issue.

PROF SNAPE: In the concerns that one is talking about and the capacity and as to whether it's being fully used or not, I think there are possibly two points there. One is, of course, the short term versus the long term. Lots of things have popped up in the short term with the Asian crisis, and what might have been approaching constraints before suddenly left a big hole between what is being done and what the capacity is. So it might be an idea if we could sort of throw our minds forward a little bit and see whether there would be developing constraints with the capacity once things get back on to a normal path.

The other point is that I think there are probably some negotiated capacity constraints into some Australian cities. We had Perth with us this morning, Perth Airport, saying that they had been running up against some negotiated capacity constraints that those who wished to fly more into Perth were not able to.

MR STRONG: On the first point, I suppose my principal reply would be that I think that the government has made it very plain, probably with more vigour and enthusiasm than we would prefer from a self-interest point of view, that their policy is to negotiate capacity ahead of demand. I would put to you that covers the position whether there's sort of some temporary slow down or then if there's some resumed rate of growth.

That has been the policy they've been following. The only exception has been those of a type that we've referred to before where there has been some temporary hold-up or there has been resistance at the other end of the pipeline. So it has only been a timing issue or a lack of willingness, mutual willingness. On the second one I might ask David if he would comment on that. My impression is that what you might call location specific restrictions have gradually been eased, but perhaps David might be able to comment.

MR HAWES: I mean, we do touch on that in our own submission, that the government's actual policy is - I'm interested in why these days very rarely, if sought, are specific points not achieved, not often.

MR KERR: I think that's the key to it. Our experience is that often some of the service offerings that carriers present to the states are illusory and very often, even when rights are made available to specific secondary gateways, if you like, given a choice they will put those rights onto more profitable gateways, generally in the

Australian context the eastern coast gateways. You might therefore say, "Well, why not just give them those rights and open up access to those points, such that they don't have to make that choice?" But I think in reality they will still make that choice. At the end of the day these things boil down to the commercial prospects of operating services to one point or another rather than the rights availability question.

MR STRONG: But it does raise the question of whether there is a demonstrable demand waiting there at the moment or whether it's a perception of it. As an Australia-wide carrier we have to try to be very diplomatic about what we say about this, but I'm sure the commission has seen evidence that tourism in every part of Australia is just waiting to take off with remarkable growth, restrained only by forces beyond the control of the local area and I think the one thing that I'd like to say is that it's fairly obvious that what determines where airlines will fly is their anticipated financial outcome.

One will not fly to a destination because rights are available or any other reason unless you expect that you will get enough traffic on a regular basis to give you a seat load factor and a yield which will make a profit, otherwise you're going to go broke. Unfortunately there still are a number of airlines who aren't as religiously committed to those beliefs as we would like every airline to be and there are some airlines that still aren't run by financial criteria and there are still airlines that are now choking with aircraft orders that they made years ago on the assumption that there would be perennial growth and prosperity and they're now unable to defer those orders so they're being forced to do flying which is absolutely illogical.

But in the end I think it is absolutely clear that the primary objective should be, and is, whether you will make a profit in flying to that destination and the size of the assets employed in airlines means that if you have one aircraft costing you \$240,000,000 then you have to be very, very careful about the allocation of that investment and the return that you're going to get on it.

PROF SNAPE: Yes, I take the point and while I take your point that some parties would seem to assume that supply will generate its own demand, nevertheless the capacity is negotiated ahead of actual demand and there can always be potential demand that one is not aware of until one tries the product. Of course the department may or may not be the best judge of whether there is that potential late demand out there, but nevertheless of course it's negotiating in advance of actual demand and cannot of course negotiate in advance of actual demand.

MR KERR: But the current policy is one which is very responsive to any indication that there might be demand. I mean, you talk about latent demand but if somebody has a service proposal then it will be accommodated. I mean, that's - -

PROF SNAPE: It takes quite a while to negotiate a new ASA.

MR KERR: Well, you don't need to negotiate a new ASA. In the great majority of cases something like a service to a regional centre is fairly easily negotiated and I

think that it is easy to overestimate the administrative slowness, if you like, of the system. I think in many ways it's not as administratively cumbersome as it appears to the outside.

MR HAWES: I think there's another point, just to I guess supplement James' answer to your question 1. If you cast your mind back 5 years and see the amount of liberalisation and development which has occurred in that period and then say, "Well, where with the continuation of current policy would we be in 5 years' time?" I think - and bearing in mind that we see no loss of momentum in the liberalisation of process either from the Australian government's point of view or what's occurring internationally, but I think the sort of concern that you may have been expressing, that if there is not significant constraint today, there may be in the future, I don't think we see that as real, quite frankly.

MRS OWENS: I think a lot of the focus has been on sort of the constraints at this end in terms of our capacity or regional markets and whatever. Are there any markets in other countries, international markets, cities that you would like to be going into that you can't because of the current system?

MR STRONG: There's two major routes that we're unable to fly at the moment which are fairly well-known and that is Hong Kong-London and Los Angeles-London, major routes.

MRS OWENS: Is that a function of the current system? Is there potential for that to be resolved through more liberalised arrangements?

MR STRONG: Well, there's potential but I wouldn't like to be hanging by my fingertips because of the attitude of intervening parties. It's the old ABC situation.

MR KERR: The potential is really the same to resolve those, whatever the regulatory arrangements, because they depend on government attitude at the other end, so whatever the regulations in place. To pick up your question at a lower level in terms of whether there are points within countries - because if you're focusing on points within Australia, and there is still some leverage left - I grant you not that much, but there is at times some leverage left in some of the issues which are part of the regional package which the commission is tending to discount I think. The markets where those issues are the strongest are the ones that are the newly emerging markets for us, Latin America, South Africa and other points in Africa, China, India.

Those are big countries, big markets, where it is likely that they will be able to sustain more than one gateway point of access and where we will be able to profit by domestic code-share rights, exchange of stopover rights, additional access points in those markets and so on. One of the concerns I think that we have is that part of the leverage that we can bring to the table in those things are those issues in the Australian context, maybe not the point question of whether somebody can access Darwin or not or Townsville or Alice Springs, but the question of stopover rights, the

question of domestic code shares. Indeed the cabotage issue is much more fundamental in those markets than otherwise it might appear.

PROF SNAPE: I suppose it's a question there of saying, "Well, there may be a little bit of negotiating power in holding Hobart back." But - - -

MR KERR: I'm not suggesting that you - I mean, I wanted to distinguish between holding back access to a point and some of those other domestic carriage and on-carriage rights that you've identified.

PROF SNAPE: Yes. But it is, I guess, a question of balance. If there are going to be gains from opening them up then how much are you losing by holding it back as a potential negotiation point.

MR KERR: We would just like to see those dealt with reciprocally I think, if possible.

MR STRONG: Could I just make a comment?

PROF SNAPE: Yes.

MR STRONG: And this is rather obvious I know, but if I could just make it, that one of the very distinctive features of the Australian market is the relative spread of the population and thinness of it, which produces a lot of very marginal markets. I'm sure the commission is aware that scale of operation is a significant factor in a business such as this with a capital intensity, whether you're talking about airports or aircraft or all of the accoutrements that go with it, and I can only say that when one goes to the United States and looks at the number of cities with more than 1,000,000 population or even indeed more than 250,000 it's a mouth-watering prospect. Australia per head of population has more international gateways than any other nation in the world, which has its own problems for somebody such as us trying to operate a national network.

PROF SNAPE: On that gateways question I wonder if you have formed a view on the recent UK initiative announced a few weeks ago of, "We have decided that open access to all UK airports except Heathrow and Gatwick should be offered to all of our bilateral air service partners as long as UK airlines are also allowed to operate on the same routes." Is that something which you would think Australia might offer with respect to all except perhaps Sydney?

MR STRONG: One should always hesitate to use the word "never" but it is of no immediate interest to us whatsoever. The big issue is the efficiency of Heathrow as far as we're concerned. That is where the traffic wants to go to. It's the hub. It's the distribution network. I mean, this is the same issue as Sydney.

PROF SNAPE: Yes. Well, I mean, it brings us back to the point that every other country wants to fly to Sydney apparently. So how much negotiating advantage is there associated with even Melbourne, let alone Broome?

MR STRONG: Coming back to the previous point that we were discussing I think all that John was trying to say is that he believes that there is still some bit of leverage left in there. I don't think we were trying to overplay it.

MR HAWES: I think our concern goes to the unilateral aspect, unilateral offering aspect of that element of the regional package with which you associated access to points and that we wouldn't wish to see squandered or undervalued the importance of leverage in some senses in terms of our aspirations elsewhere. I take it the UK policy you described there was based on reciprocity also?

PROF SNAPE: Yes, it was, on routes to it.

MR HAWES: Yes.

MR KERR: Can I just make a couple of points in relation to that? The UK policy is actually the policy which the US adopted about 5 years ago, so there are two examples of that.

PROF SNAPE: What are the exceptions in the US?

MR KERR: They define their secondary gateway as - there are more exceptions than there would be in most countries, as you'd appreciate. I just can't recall now how they defined their secondary gateways but they do. The other issue I just wanted to draw to your attention was that the current policy in terms of secondary gateways in Australia has brought its rewards at times in terms of dedicated services to dedicated points and if the regime was opened up so that there wasn't that support for some dedicated gateways or some dedicated rights to particular gateways, I suspect that some states would see themselves feeling to be the poorer rather than the richer and I think in terms of a national policy that Commonwealth-state dimension would be something which you'd have to consider.

PROF SNAPE: Yes, that point has been made in a submission from one state, though I must say from Westralia Airports this morning it might have been thought that Perth was another one that might have been interested.

MR KERR: I could probably - I won't, but I could probably tell you which states would see it which way.

PROF SNAPE: Well, we've only had it stated from one state so far.

MR STRONG: If I could just - at risk of labouring this a little bit, in terms of if you take the United States from the Qantas perspective, our biggest problem with the United States is access to Los Angeles Airport and facilities and that's bearing in mind

that there's another major airport not very far up the coast called San Francisco. But the issue for us is access to Los Angeles and the same in the UK our biggest issue is access to Heathrow and so on.

PROF SNAPE: Just on this nominated cities or gateways, there was a point in which we may not have explained ourselves as well as we might have and I think you might have misinterpreted, or it's slightly ambiguous as to whether you might have or not, but certainly another party misinterpreted it, and that was on the top of your page 8 where you're saying we effectively step outside the bilateral system but proposing the secondary gateways be offered on an unreciprocated basis.

Of course, that was within the existing capacity negotiations. It wasn't saying that anyone could come in who wanted to. It was, in fact, within the negotiated capacity generally that there should be free access to those other cities. I think perhaps we didn't explain that as well as we might. So it was not in fact going as far as the UK one, which was to say open.

MR KERR: I think the use of the word "effectively" was actually probably not as clearly explained either, but that was our attempt to say you don't do this but it has the same effect as doing it.

PROF SNAPE: Okay.

MRS OWENS: There's another issue that I don't think has been raised in your submission. It's the question of government subsidies to airlines. It's really the question of what's happening in other countries and whether that potentially has an impact on Qantas, and what your views are on governments directly or indirectly subsidising airlines.

MR STRONG: I think we did raise this in our first submission. There are a number of comments I'll just make about it briefly. Firstly, it's often very hard to prove or to quantify the degree of assistance and it can take many forms, from that of the most glaring recent examples, which attracted enormous emotional reaction and so on, were Air France and Alitalia, who have both had over billion dollar capital injections from their governments, allowed as the last, last, last opportunity by the EU commission. Obviously there are other forms, such as policies which very much favour and encourage the development of the domestic airline through to even the classic case of Singapore, where you have a government policy which is obviously so pro-active about the development of facilities that you have probably the most outstanding airport in the world, which is actually planned and developed ahead of demand, which is something which had never been thought about in Australia obviously.

Even in the handling of passengers, if you compare the government policies in relation to immigration and customs and the way they're administered in Singapore compared to Los Angeles, for example, the whole thing is designed that the government policy is "bring as many people through here" and even encouraging the

transit passengers rather than discriminating between transit and get-off passengers, which is the case in the US, through to other things which obviously have to do with policies on taxation, to do with the financing of aircraft, the actual rates of taxation in the country - - -

PROF SNAPE: Is this Singapore or generally?

MR STRONG: Generally, but certainly it is conducive in Singapore also. Then also the rules which may govern ancillary parts of the industry, such as whether there are monopolies at airports in handling agencies and catering operations and so on. That is still the case in quite a number of areas as to who can own and operate a lot of the ground facilities. We still operate in airports around the world where we are unable to provide our own facilities. So obviously we think that it is a problem. It's not so much the physical assistance it's given but the resultant attitude and behaviour, where people will go on doing unsustainable things in the expectation that there won't be some final outcome from that. There is nothing which will greater benefit the airline industry than continuing attention towards proper financial discipline. Anything that cuts away from that I think is very damaging to the industry.

PROF SNAPE: Thank you. The members of the commission would be aware that we had a slight barking session about some of the capacity dumping that's going on in the Australian market, clearly on uneconomic terms recently. I'm not sure whether you're referring to that or not.

MRS OWENS: You could talk about that if you'd like.

MR STRONG: All we were remarking is that there is clearly a whole array of operations in and out of Australia which are sub-economic in terms of the pricing. It raises its own set of issues in terms of government policy. I just think it is important to understand that - I get into all these hackneyed phrases - but there is no perfect market anywhere. There's no level playing field. People do things for short-term reasons.

MRS OWENS: Yes, and I think that your so-called dumping is probably a short-term response to market conditions elsewhere.

MR STRONG: It's certainly exacerbated a great deal by the current situation, yes, in other markets, but there always will be somebody. I don't want to get into specific cases but when you go to Sydney airport and see an aircraft sitting there for 24 hours which has come from some other part of the world and will turn round and go back the next day, how anyone could run a business with an aircraft worth a couple of hundred million dollars sitting on the ground for 24 hours, it's just obviously being done for reasons that have got nothing to do with return on investment.

MR HAWES: Perhaps capturing some of those range of thoughts also is the observation that, unlike in some other areas of trade - trading goods and services - there are no equivalents of, what you could say, fair trade provisions, or some of the

doing business issues which James referred to are not covered by multilateral disciplines. So whether the capacity is being dumped by an airline which is subsidised is one element, and perhaps it can continue to be dumped because the airline is subsidised. There's not that sort of underlying set of fair trade provisions or points that bring people back to a basically level playing field.

MR KERR: If I could just pick up on that point as well. In our earlier submission we said that getting those sorts of broader competition policy like that in place was really a condition precedent to open skies, and we probably would like to see some reflection of that, or at least the commission's thoughts on that idea.

PROF SNAPE: You might have noticed that in our plurilateral that we did have open club. We did have that as a condition in, even though I am fairly nervous about introducing constraints on subsidies into, say, the general agreement and trading in services under the GATT and under the WTO because I think the definition of subsidies when the services are concerned is so open-ended that anything could be included. But, nevertheless, I could see that it could be an important thing in air services.

Could I move to the slot question at Sydney, at the market in slots, or I should say slot question in general. You mention there that with the question of selling slots at Sydney or the means by which slots would be allocated at Sydney was in fact gone into very thoroughly by the department a couple of years ago - a year or two ago - and that they in fact had a number of submissions on the way to handle it. I'm not sure if we've seen those submissions or not. But a view which is around, which I might put to you, is that in a constrained situation like Sydney or Heathrow or wherever, it's not a question of whether there will be a market in slots or not, but rather there will be a market in slots and the question is whether it's above the table or under the table.

You know, there is no overt acknowledgment, as I understood it, of the market in slots at Heathrow. But there is such a market, we've been told, that if you want a good slot at Heathrow then you acquire a slot at an impossible time and then do a trade with someone else with a very substantial payment of money under the table. I'm not suggesting that Qantas has been in this at all, but we've been told by other airlines who have been in it. So, therefore, when you get into this constraint situation it's not a question of whether there'll be a market or not. It's simply whether the market will be above the table or under the table. So then that is the question. Would you like to comment? The point then of course is that if there's going to be a market, let's make it an efficient market and get it above the table.

MR STRONG: Perhaps two comments; firstly, we have no knowledge of that. I'm not just saying that we're goody-good-two-shoes, but we're not even aware of that occurring. I'm aware of sometimes people buying another airline, a smaller airline, that may have some access. But that's a - - -

PROF SNAPE: That was a different question.

MR STRONG: But even if we follow through and take it on the basis that does occur, then the two points that we made back to the commission are on page 18 and 19, and the first is that if you do it then what you're going to do is actually play into the hands of the bigger, more successful airlines and force up the cost of operating to the airport. The only ones who will be able to afford the price will be the bigger and more successful airlines, and they will pay and more and that will force up the cost of operation, which will eventually be passed on to the consumer. I sort of have a dilemma about the efficiency outcome of that. We've mentioned that on page 18, just above the heading Slot Trading, in terms of pricing.

But in terms of slot trading, on page 19, we do say, and we believe that this is the case, that there is no viable market for the sale of slots at any airport worldwide. So then we draw the conclusion that, as no market exists for slots in non-peak periods, charging for slots in peak periods would represent a barrier to entry or retention of services, and again the same point here as in relation to the earlier one in relation to the pricing. It really hasn't been shown to work anywhere in the world, we believe.

PROF SNAPE: It has been suppressed fairly generally. As I understand it, with respect to domestic slots in the United States, there are four airports at which it does occur, and they're big airports. So far as we could discover, we have been told that it was operating efficiently and as one would expect it to operate with respect to those domestic slots. It's true that they had put a ring around it and it wasn't applying to international slots. One or two of those airports were only domestic, one of whom was National at Washington, but then also I think it was JFK and Chicago and La Guardia. So there does seem to be some experience on it, and bringing in the peak pricing also because they're associated with it, and I get the points that you've made on peak pricing, but it would seem to me that with all the constraints that you've got on your schedules, which you talk about in an attachment here, and I accept all of that, that means that you've got times at which you have to fly.

If you want to expand, obviously you'll want more times at around those times - more slots around those times. It seems to me that you get those by pushing other people off. It would seem that having peak load pricing does precisely that. So it opens up the opportunities for you that would not be there without peak load pricing. So it would seem that the peak pricing should in fact favour those airlines that, because of their connections internally and the various constraints that you've got, that you'd be able to get those times because you would pay for them, you'd be prepared to pay for them, whereas someone else who doesn't have perhaps a domestic airline or perhaps some of your own domestic operations or perhaps a regional airline, would in fact be pushed out because they don't value them so highly. It would be to your advantage.

MR STRONG: Yes, but it may not be to the consumer's advantage though in terms of the cost and the array of services. I have a philosophical problem that all of this is - there seems to be an inherent assumption that rather than provide what is

demand driven you live with the restriction and jack up the price which seems to be the history of airports, other than some very notable exceptions around the world where governments have seen that one of the biggest constraints on the industry growing is the facilities. Look at the amounts of money spent with varying results in the short-term in Hong Kong, Kuala Lumpur and again, Singapore in recent times. I'm not saying this negates the issue that you're raising but I do find this curious that more time tends to be spent on managing a problem created by shortage than doing something about the shortage. But other countries who have a very distinguished record in terms of using this as a tool of economic growth have followed an entirely different policy.

To come back to your specific point, I still have a worry that in the end what you're doing is you're favouring the strong and you're penalising the weak and you're forcing the price up.

PROF SNAPE: Well, you may be favouring those who have the strongest demand.

MR STRONG: Yes.

PROF SNAPE: But just on the facilities point, it was put to us this morning by Westralia that they have now got a very heavy demand at various narrow points during the day and that if they were able to have peak-load pricing that in fact they would be able to build additional capacity to meet that. So in that case it's not just - and I'm referring to international gateways - a question of jacking up a price for an existing supply but in fact increasing the supply if they're able to price that.

MR STRONG: It's not a surprising submission from an airport owner though, is it?

PROF SNAPE: No, but your complaint has been about airports not expanding and here is one who is saying, "We would want to expand that facility if we were able to, if we're able to charge for it."

MR STRONG: Again, isn't it ironic that you have somebody saying, "Sanction us charging an artificially high price so we can invest in facilities"? I mean, this is economic rent we're talking about.

MRS OWENS: They're building to meet potential demand or actual demand.

MR STRONG: But why shouldn't it meet the normal test?

PROF SNAPE: Well, the normal test there is not exactly applicable as I understand it because they're subject to CPI minus X, so they've got a constraint on what they can charge. So it's not an open market from that perspective and they are arguing- - -

MR STRONG: I understand the point you're making, but the reason that there is a CPI test on it is that it's not a normal market.

PROF SNAPE: Yes. Helen, how are you going?

MRS OWENS: I suppose with peak-load pricing what you would normally find in other markets like electricity markets is that it's - you impose a peak load price so that you can spread the peak of electricity consumption over a wider range of times and what you're saying is that you're less able to do that in this market for particular airlines if you rely on coming in from other hubs or whatever.

MR STRONG: Yes.

MRS OWENS: But I suppose it could actually work in the other direction. It can either work on the supply side where there's the incentive for the airport operator or owner to build more supply to meet the demand or it can operate the other way to try and reduce the demand overall so that you can - I think airports aren't infinitely expandable for other reasons like environmental reasons and so- - -

MR STRONG: Yes, noise and - - -

MRS OWENS: And noise and all those other things that we were avoiding by not looking at Sydney Airport in our report. But there is that other set of arguments as well which I think are also, I think, very valid arguments.

MR STRONG: Yes, I mean, I'm sort of hesitant to go further on this because I don't want to get into airport owner bashing but, I mean, the question is whether further investment is justified on the known conditions at the time that a price was paid for the airport or whether now, after the event, some artificial means is sought to stimulate the pricing. This is a contentious area, I know, but it's one about which we have quite some feeling because of what has happened and the prices paid for the airports.

MRS OWENS: I suppose that they're still having to abide by a CPI minus X overall cap overall.

MR STRONG: Which was known at the time the price was paid.

MRS OWENS: It would be working within that cap.

MR STRONG: Yes, but the cap was put, as I mentioned just previously, as a acknowledgment that this is potentially a monopoly market and that was known at the time that the price was paid.

PROF SNAPE: If I could shift to a point which you make on the bottom of page 4 and it's to do with alliances. I think we understand that there are many things that are driving the alliances and we also see that they are a factor that are relevant in the pushing for more liberal bilateral arrangements too. I think that we are saying - well, what we're saying is if the restrictions on ownership were eased, that is on national ownership were eased, then there would be another option. We're not just saying that

alliances are prompted by these restrictions. We recognise there many things that are pushing these alliances, choice of alliances.

MR STRONG: Yes.

PROF SNAPE: But if the ownership restrictions were to be eased, airlines would still be able to choose alliances if they wished but they would have another option as well, and that was our point.

MR STRONG: Yes. I appreciate the points being made. I think the biggest issue about the question of controls over ownership is the other end of the equation, if I can put it that way, that is the attitude of other countries and other governments. I mean, on our own experience of talking about this in various parts of the world it is a non-rational issue. I think the commission would be aware of that.

PROF SNAPE: With the turmoil in Asia and the difficulties of so many of the Asian airlines to which you were alluding before, and the fact that there's likely to be different sources of money coming into many of those airlines - governments can't prop them up for ever - do you see that that is going to shake up the ownership question?

MR STRONG: Potentially, yes, but we've yet to see the outcome. There are enormous forces against it which you might call vested interests and those are numerous. So at the moment there are a number of statements of good intention out there and you couldn't take it any further than that. If there weren't these artificial restrictions to which you have referred in your report, then I think it would be an overwhelming certainty that that would be one of the outcomes. I think we've all seem - pardon me for making an obvious point but the most change in any industry or in any country is driven by economic upheaval. More occurs through what you might call catastrophic forces than it does through any evolutionary change, and if there weren't restrictions, then certainly this would have the capacity to drive very dramatic change. But I've got a very reserved view about how much will actually eventuate.

It's like the old, old story, it's like the Australian sort of international trading situation. It never gets quite bad enough for the drastic solution to be forced. So the question will be if there is some recovery in the short term then there will be less force to propel dramatic change. But on the other hand, if it is drastic for some time, then certainly you're more likely to see more change. But it is important and I just repeat that from practical experience that this is not driven by logical forces or irrational forces.

PROF SNAPE: Once that dam gets a crack in it it's likely to collapse to a wide- - -

MR STRONG: It's an interesting point that the commission has raised because it will have more to do with that sort of broad point that I was making before that how different the industry will look in 10 years, but it could be 5 years and whether it's going to be rapid or not has a lot to do with, as you say, do certain dams break and

then what is the reaction to that. But all we're talking about is opening the aviation industry up - normalising would be a better phrase, like most other industries you'd be actually normalising the aviation industry but it would have potentially very significant repercussions.

PROF SNAPE: Would the relationship that Qantas is being encouraged to take with Air Niugini have implications for the bilateral arrangements that Papua New Guinea has negotiated with other countries?

MR STRONG: I don't know that Qantas is being encouraged to. We have actually just said to the New Guinea government that if they require assistance that we'd be prepared to be involved in a number of ways. But obviously any ownership questions is likely to attract some interest from competition authorities.

PROF SNAPE: I was not just meaning the competition authorities, I was thinking - - -

MR STRONG: And bilateral - yes, I'm sorry, I was including them under that as they've been wont to do in recent times to include themselves under the same heading.

PROF SNAPE: I'm sure there's a lot in that statement.

MRS OWENS: On page 10 you have a few paragraphs talking about consultation and transparency and you note there about being a member of the Australian government negotiating teams and Qantas relying on direct contacts with government agencies and departments in providing advice. We, throughout this inquiry, have been talking to a whole range of other groups and other interested parties that see that perhaps the airlines and Qantas in particular, have undue or too much power it may be - - -

MR STRONG: Influence.

MRS OWENS: Influence in these negotiations and you say here that the position at the moment recognised the fact that you're single most directly affected party in the outcomes. But I suppose the states, the tourism operators, the consumers, the business travellers and so on, also all have an interest in the outcome of the negotiation. I presume that this is a fairly common practice in most other countries.

MR STRONG: Yes.

MRS OWENS: Have you got any suggestions as to how you appease the concerns of these other groups?

MR STRONG: No, because I really think it's a perception issue. I mean, we wish they were accurate in what they were saying. We only wish that we did have undue influence, but our influence has diminished substantially. I think that there was some merit in what was said if you went back in the previous decade, and generally Qantas'

attitude in that time was to run up the national flag at every possible opportunity on any subject.

MRS OWENS: And you don't do this?

MR STRONG: Well, we don't do this because to us, you know, we don't act like a national flag carrier any more in that if we have to make a commercial decision whether to fly to X or Y, we will make that decision, because we're driven by economic forces. If we don't we won't be here and we're driven by return to our shareholders. Now, we do try to pay as much regard as possible to other issues, including all the things that we've talking about before, about state and regional interests and all that sort of thing. But, no, I think it's a perception issue and if we were seen to be within 50 metres of anyone who's negotiating then somebody will immediately cry out, "Undue influence."

But I think you can see that the results don't suit us at all if we were merely taking a self-interest point of view, but what I meant by saying we don't run up the national flag all the time is, I hope illustrated by our very attitude to this inquiry, that we recognise that there is an inexorable movement towards liberalisation and that it's silly for us to sit there and say that it shouldn't occur. That sort of very narrow self-interest is just sustainable. If you're not realistic about the interests of other parties and so on then, you know, I think that detracts from the value of what you say and the respect which your attitude will get.

MR HAWES: Perhaps we should that we go so far as to say that we recognise that it is in our interests but the debate is over the "how".

MR KERR: Can I just make a point as well? In terms of the comments you get from other parties about Qantas's influence, whenever Qantas is out there expanding and developing new routes, then those other parties will say Qantas's influence is appropriate, because it suits them. If we're out there blocking something which - I think as a position of the past, where we might have been able to be influential at times in blocking things, I don't think that happens any more, but that's where the perception still holds.

MR STRONG: We could get sworn evidence of times when John's ignored Qantas's interests in negotiations in the past, chairman, but I don't think that's necessary.

MR KERR: No, I was around when Qantas - - -

MR HAWES: Never mind. Actually, I was going to say that we are not the architects of current policy, but then I should have withheld my remarks, for historical reasons.

MRS OWENS: I think we could obviously explore that one for about another hour but - - -

PROF SNAPE: Yes, I'm resisting temptation. You provided a very helpful table on capacity which is in table A1. There were a number of markets which had been in our capacity which had been excluded from yours. I think we can work out why probably but I just might note them. We sort of in our table of capacity utilisation had I think what was the top 20, and amongst those that were in ours and not in yours are the UK, Indonesia, Malaysia, Canada, Philippines, South Africa, Netherlands, Fiji, France, Papua New Guinea and India. Now, I'm not sure whether you know - what was the basis for inclusion in your table A1 and not including these others?

MR KERR: The markets that we've included in our table are those that are in your commentary on page 71 of your draft report.

MR STRONG: Where you refer to the constrained - - -

MR KERR: You talk about, "capacity remains highly constrained on many important routes," and then you say, "Germany, Italy, Vietnam or Zimbabwe and very little capacity left Hong Kong and Thailand," and so on. So that's the paragraph that we based our table on.

PROF SNAPE: Yes, I see.

MR STRONG: We were seeking to dispute the comment.

PROF SNAPE: Yes, I could understand. I take the point. Thank you for that. UK of course you'd say at Heathrow is the capacity constraint. Heathrow is probably apart from that the most competitive route of all the sixth freedoms.

MR STRONG: Yes, which is something we've commented on elsewhere. We think that perhaps insufficient regard has been paid to the extent of sixth freedom competition, was the comment in passing.

PROF SNAPE: Yes, I take that and that's a point the department made fairly fully to us and we've asked them for more details. That has been very, very helpful. I thank you very much. I think it's probably the time where we go in to close the session, if we may, so for non-Productivity Commission and for non-Qantas people we'd say that afternoon tea is now served next door and that we would invite you to go there and we shall continue in camera for a little while. Anyway, to the public we thank Qantas very much and you for being with us and we'd ask you to go to afternoon tea. We are not sure how long we will be, but perhaps we could say that we will resume at 20 to 4. Does that suit the pilots? Yes, so we'll resume at 3.40, 20 to 4, in open session. Thank you.

Continued in Transcript-in-Confidence

Continued from Transcript-in-Confidence

PROF SNAPE: We will resume our hearings and welcome the Australian and International Pilots Association and we have Mr Rod Cork and Dr Matthew Cumberworth from there. We welcome you and thank you for your submission and would ask if each of you would identify yourselves.

MR CORK: Rod Cork, assistant secretary, Australian and International Pilots Association.

MR CUMBERWORTH: Matthew Cumberworth, research officer, Australian and International Pilots Association.

PROF SNAPE: Thank you very much and as I say, thank you very much for the submission, the additional submission which you have given to us and your comments. Thank you for those comments where you endorsed what we are saying and thank you also for your comments where you are seeking to enlighten us and also for the references to the articles which you made. Would you like to speak to it, Rod?

MR CORK: Yes, basically we would both like to speak to it. Matthew has only been with us a short while and this is the first time we have appointed anybody into our organisation from his background, so Matthew's approach is very different to mine. I would like to cover my approach first and then Matthew will address the paper as well. The commissioners will by now have read our submission on the draft report into international aviation. The commissioners will realise that AIPA rejects many of the draft recommendations. This rejection is not a knee-jerk reaction by a militant employee association, it's the result of a team effort over the last 6 months to arrive at well researched position on the matters of international and domestic deregulation.

The AIPA approach to this report has been to educate ourselves as much as possible to the status of worldwide aviation deregulation. AIPA already had accumulated a large body of knowledge on the subject as a result of participating in earlier inquiries and the ongoing reallocation process. For our initial submission to the Industry Commission we commissioned the largest pilot organisation in the world US AIPA, to write the answers to questions on US deregulation. This was followed by an attendance at the Royal Pilot Body of AIPA's general meeting in Montreal, Canada, where information was sought from both the FALCA secretariat and from (indistinct) resident in Montreal.

We then spent a week in Washington DC working with the research staff of US AIPA. Finally AIPA recently employed Matthew Cumberworth as a research officer. His primary role will be in the area of international relations, deregulation, code-sharing and economic matters. While AIPA has taken the approach of answering all the Productivity Commission's questions on which we have information,

the commission must take note that our area of expertise is that of operational matters. As such, the ASU and AIPA are the only organisations making submissions that contain the realistic operational concerns of airline industry staff. Our position therefore may be different to the major airlines' position.

AIPA members are concerned that in addressing deregulation the effect on safety is all but ignored in the draft report. Our members all know from experience that the subject of safety and product cost are linked. Our pilot members that were formerly employed in what is a totally deregulated environment, general aviation, will testify to a direct link between profitability, production costs and safety. Economic research more generally supports the link between airline financial performance and airline safety. In the eyes of our members, any inquiry that could consider one subject without the other has adopted an untenable stance.

AIPA is concerned that at best the inquiry was incorrectly named, or at worst delved outside its terms of reference, because an analysis of the draft recommendations reveals that the major impact on the recommendations would be on domestic services. For example, the recommendations on removal of passenger on carriage restrictions could severely impact on our members operating Boeing 737 and 767 aircraft. Having considered changes to domestic aviation, the inquiry failed to seek the opinion of the small but growing domestic operators and by that I mean the domestic freight operators.

AIPA is also concerned with the failure of the commission to clearly identify the total product range of the Australian airline industry. Instead the commission has concentrated on the tourism content of the airline package. However, all products are really connected and changes that result in the loss of premium class travel, freight products or government services will have a severe effect on Australian as a trading entity. AIPA is concerned that in considering changes to the route allocation process there is a general failure to realise the vital importance of the IASC in maintaining a transparency of allocation process. This transparency will only continue if all parties with valid interests in the allocation process continue to have access to a review panel,

Airline employees, their rights and the benefits that they accumulate for the Australian community seem to be neglected. By Australian standards the industry is a large employer of skilled staff and their wages flow with a multiplier effect into the Australian economy. There is little recognition in the draft report of this fact or the recognition that changes have the potential to move most of the work offshore. A full consideration of the impact of loss of Australian aviation jobs or a cross-benefit analysis does not appear to have been carried out.

An area that seems to have also been neglected by the report is that of encouraging new Australian operators. Indeed, at least one major impediment to starting new Australian operations, that of taxation law and specifically section 23G has not been addressed in the draft recommendations. Again, the thrust of the recommendations appear to have been captured by the tourism interests. However, the tourism industry is only one of many industries which benefit from air services.

Finally, AIPA does agree that aviation policy in Australia is extremely hard to determine. This is a particular problem for new entrants. We agree with the recommendations that the policy should be in one document. Thank you, Matthew.

MR CUMBERWORTH: Thank you, Rod. Thank you, commissioners. I am going to start off by looking at what we believe were some items that weren't actually included in the report and should have been and also to stress that some items that were considered weren't given due weight. So I guess to summarise it, what we are saying is that we have a problem not so much with some of the content, but what was left out.

I will begin by looking at the effects of deregulation on airline safety performance. AIPA argues that the commission should have addressed airline safety performance on three particular grounds. Firstly, safety performance is an important aspect or dimension of product quality. Secondly, the safety investment actions by an airline constitute a problem or hazard and their actions are hidden and cannot easily be observed. Thirdly, and perhaps most pressing, is the experience of the US aviation services market with deregulation. We suggest that experience suggests that we should proceed with caution and we should be rather wary of some of the outcomes that we may see.

I am just going to touch briefly on the first two and then I will go into more detail in the third point there and I think we tried to spell things out in some detail in the report and I don't want to labour them. So with regard to the first point, in considering the economic effects of air services on users, the commission paid considerable attention to various aspects related to international air services from the consumer's perspective. This was set out in section 5.5 of the report. Amongst others, the report addressed price competition, non-price effects including frequency and convenience of service and the quality of in-flight service.

The reports focus on non-price effects excluding airline safety is puzzling, since airline safety is an aspect of product quality with substantial merit. The absence of any discussion of the likely effects on airline safety represents a serious omission. Secondly, as I mentioned, an airline safety investment - constitutes a mild hazard problem and that is because the airline's actions are hidden and secondly, the airline has incentive not to divulge information which harms their reputation in the marketplace. Consumers in the market for air services cannot easily observe or evaluate airline product characteristics, and there is a reason to suspect that the market may supply less safety than consumers would demand if fully informed.

While it is true that consumers may be able to observe airline accident rates, they cannot easily observe airline incident rates, which we argue and which is generally perceived is a more meaningful measure of airline safety performance. Consequently, the commission ought to identify and assess what it sees as the likely effects on airline safety that will follow from its recommendations. Further, standard measures or welfare gains will overstate the true benefits provided by deregulation,

whether less observable dimensions of product quality such as safety are declined post-deregulation.

The third point relates to the US experience with post-deregulation. The report states that the commission has seen no evidence that deregulation may lead to lower safety standards. AIPA finds this declaration somewhat surprising given the established literature which has addressed the issue from an economic perspective. Economic research has analysed a broad range of issues relating to airline safety. Has airline safety declined since deregulation? What factors account for differences in safety performance across carriers? AIPA notes that aggregate measures by and large suggest that the long-term trend towards increased airline safety has continued since deregulation of the US airline industry in 1978.

However, a study by Barnette and Higgins in 1989 provides a more insightful assessment by differentiating between established carriers, trunk and local service airlines existing as of 1978, and new entrants; those carriers that have been birthed out of deregulation. For 1979 to 1986, fatality risk for passengers on established carriers averaged one per 11.8 million, whereas new entrants had an aggregate fatality risk of one per 870,000 flights. This finding is skewed however, by the fact that new entrants carried relatively few passengers and only three of the 19 new carriers had domestic fatalities during the 7-year period.

In addition, attention needs to be paid to airline accident causes, since operating conditions are outside the airline's influence. As noted in the report, airline safety performance is the function of its investment in safety and also the operating conditions under which the airline operates. Nevertheless, an operating condition such as increased congestion may result from deregulation, because increased traffic demand is not met with appropriate new supply infrastructure. We are aware that the commission has looked at this aspect.

However, if deregulation induces carriers to cut maintenance activities or compromise safety standards by hiring less experienced pilots, accidents due to equipment failure and pilot error will become more common. A breakdown of the primary cause factors of US commercial Jet Fleet hull loss accidents provided by Boeing Corporation in 1996 reveals that accidents due to maintenance have actually increased as a percentage of total accidents in the last 10 years by a factor of 3.3. However, for the world commercial fleet, accidents due to maintenance have increased only by a factor of 1.8. Further, accidents due to cockpit crew have not declined markedly, despite the fact that there have been significant advances in crew training technology. Hence, evidence from the US is not inconsistent with a view that the deregulation experience has featured more equipment failure and pilot error-type accidents as a proportion of total US accidents.

In the analysis of factors which account for differences in accident rates across carriers, Rose in a study in 1990 and also in 92 cites airline financial performance effects on airline safety. Rose's 1990 study analyses the determinants of airline accidents over 1981 to 1986 period for 26 carriers and finds that profitability is

negatively correlated with incident data. Further, low operating margins are strongly correlated with higher reported accident rates for small and medium-size carriers. Rose suggests that the strength of the profitability link for small and medium carriers may reflect a greater degree of freedom for these carriers in choosing their safety investment levels.

Over a larger time period Rose's analysis of airline safety performance finds that higher operating profits were associated with lower accidents in the following year. According to Rose a 5 percentage point increase in the operating margin - for example from 5 per cent to 10 per cent - implies about a 5 per cent reduction in the total accident rate and more than a 15 per cent reduction in the fatal accident rate, other things equal.

PROF SNAPE: For which airline?

MR CUMBERWORTH: This was US.

PROF SNAPE: Yes, but which sized airlines in the US?

MR CUMBERWORTH: 121 carriers which are RPT. So there weren't charters in this group and there weren't freight carriers, so it's all RPT: In view of the US experience in safety performance post deregulation AIPA believes that this research has a direct bearing on the Productivity Commission's recommendations. The likely new entrants into the Australian market will be small to medium-sized carriers and increased competition is likely to lower profits post-deregulation affecting airline safety performance. Hence the danger here is that standard measures of welfare gain, as incorporated into the Productivity Commission's model of air services will overstate the true benefits provided by deregulation where airline safety deteriorates post-deregulation.

Now I'm going to move on and talk about perhaps the general thrust of the report and we contend that the focus of any approach to regulation must be on outcomes rather than means. Integral to an approach that focuses on outcomes is that the proposed new regulation is subject to a cross-benefit analysis, having regard to the changes in observable and less observable aspects of air services quality. The Productivity Commission's report focuses to a large degree on the means of increasing competition in the domestic and international airline services market but provides little discussion on what outcomes the commission would like to see emerge post-deregulation.

For example, does the commission believe that the three-firm concentration ratio for the domestic services market will rise or fall based on deregulation? If the concentration ratio were to rise, similar to the US experience, what are the implications firstly for air fare prices and secondly for consumer welfare? AIPA argues that a greater focus on outcomes in contrast to means and processes is warranted and would serve to clarify for the participants in these hearings what the

commission conceives as the benefits flowing from further deregulation of the air services market.

AIPA contends that the international air services policy must be consistent with Australian international trade policy. If Australia is to pursue the formation of a regional open skies club then this should be consistent with Australia's overall trade policy. If the government does not advocate regional (indistinct) formation or membership then it will be two-faced to pursue a regional open skies club. A Department of Foreign Affairs and Trade report on regional trade agreements in 1993 concluded that Australia's interests are best served by promoting the continuation and expansion of open multilateral trading system. The wise course appears to be to press ahead with non-discriminatory trade facilitation on bilateral, plurilateral and multilateral fronts while keeping preferential options open.

AIPA poses the question with regards to the US and New Zealand bilateral open skies cases as to whether they amount to a hub and spoke system. While the commission upholds the US and New Zealand cases as leaders in the realm of air services liberalisation the report does not acknowledge some of the inherent dangers in a hub and spoke system. These include firstly that the hub and spoke system could resist multilateral liberalisation as noted by a report, or a study, on bilateral initiatives by Snape in 1992. Further, liberalisation as confined to being - -

PROF SNAPE: Could I interrupt just there. You will find a sentence in the report which obviously you missed, which in fact specifies precisely the dangers consistent with that earlier report arising from the United States hub and spoke system, that it in fact may make United States airlines resistant to a multilateral system. That's explicit in the report but obviously you missed it.

MR CUMBERWORTH: Yes.

PROF SNAPE: I may be accused of inconsistency validly but not on that point.

MR CUMBERWORTH: Well, I wouldn't say I was - was that a low punch? But anyway I'll continue on about the inherent dangers in a hub and spoke system. Liberalisation as confined to being only between the hub and spoke does not delineate all the possible gains from non-discriminatory multilateral liberalisation. AIPA therefore welcomes a multilateral approach in the form of recommendation 8.5. The second point that we cite with the hub and spokes type arrangements that can emerge is meshing problems, in particular when attempting to combine hub and spoke systems involving countries in different regions.

If we take for example the US and New Zealand both these countries are hubs in their own right in the bilateral sense, not in the geographic sense, and if we try and incorporate them as spokes in a hub and spoke arrangement in Australia there can be certain problems. As noted by the Bureau of Transport and Communication Economics study in 1993 a complex hub and spoke system based on regions rather than a global network may offer some of the benefits of opening up a market. But

overall regional divisions may create a less than optimal route network. Hubs and spokes developed within regions may be ideal within one geographic region but not operate effectively when the range of hubs and spokes are meshed within a global perspective.

Paradoxically regional aviation blocks may result in lower barriers hence greater competition between member and non-member countries, but raise barriers worldwide between member and non-member countries. Hence the BTCE concluded that the individual gains may not give us some benefit on a world basis. On a related point, AIPA believes the hub size and the geographic location determines the optimal number of spokes required. For example Australia, being a smaller hub and an end of the line destination, may find that optimally it is an eight-spoke hub or an X-spoke hub, to keep with the algebra being floated around here.

The report failed to discuss how the hub size and geographic location might determine the optimal number of spokes. While the commission's report advocates the formation of a regional open skies club there was no discussion of various membership aspects which are crucial to the club's success including first of all compensation of those made worse off, secondly the optimal or preferred attributes of member countries; thirdly the conditions surrounding club expansions in the form of new member countries, and fourthly the optimal number of members to have in an aviation block. As noted earlier, the BTCE study cited some of the complications that can arise between the club and the multilateral system itself. Here we simply note that complications can arise within the club itself.

Finally we just wanted to touch on some of the points that were raised earlier by various participants, in particular the Department of Transport and Regional Development and also briefly by Qantas, and those relate to the unique nature of the Australian air services industry. AIPA believes that too little attention was paid to the unique nature of the Australian airline services industry. The unique character has important implications for the Productivity Commission's recommendations. The specific features are that the Australian industry constitutes a natural duopoly where two airlines effectively service the domestic market and according to Quiggin in his study the market is not contestable.

Further, the likelihood of new carriers competing in the domestic market, if they were given the opportunity, is rather small and in view of the relationship between BA and Qantas and Ansett and Air New Zealand the only possibility of new entrants would be in the form of a US carrier or charter carriers. Secondly, Australia's geographic location: Australia's considerable distance from major aviation hubs and its status as an end of the line destination as opposed to an intermediate destination means that Australia will always be a spoke fitting into a hub located outside Australia. While Australia is well positioned to be a key player in the growth in the fee to service market it seems less likely that it will be a major player and secondary players or spoke feeders will service a market that is constrained by its size. Indeed much of the discussion that we've heard so far has been about market constraints.

Finally any assessment of welfare changes due to deregulation in which air travel is treated as a homogeneous commodity is going to be fundamentally flawed, as noted by Quiggin.

PROF SNAPE: Thank you very much. Rod, are you - - -

MR CORK: That's it.

PROF SNAPE: Good, thanks very much. I would like to just pick up one thing first of all which was in your introduction and we understand very well how you've got several things on your desk at once and it was very difficult to deal with them all and that they are all coming from the government. You speak of there that the inquiry was first announced in June last year - I'm sorry, 96. But I should say on this one we're not guilty. We cannot as a commission start formal action on it until we receive the terms of reference, as you will appreciate. We received the terms of reference on Friday, 12 December, and we had the issues paper on in what I suspect is a record time for any inquiry, from this commission or from any other government body, in that we had the issues paper out on Tuesday following that.

MR CORK: The point of that first paragraph is that we're taking it to the government after this when we've actually got time, so we wanted it in there so we can - - -

PROF SNAPE: Maybe you might say how speedy the response was from the commission because I think the staff did a remarkable job in getting the issues paper out and it was a fairly extensive issues paper, as many people mentioned at the time. We do not like to get our terms of reference in December for obvious reasons, but we seem to get them then on a fairly regular basis and getting them then for a 9-month inquiry puts great pressure on us and we realise that that in turn puts it on participants but that's not of our choice.

MR CORK: We understand that. It's part of an ongoing saga but we've also been bound up with the whole industrial relations system. There has just been a massive load.

PROF SNAPE: Yes. As to us being concerned only or mainly with tourism, I might say that had we in fact been looking only at tourism we may very well have gone - I'm not saying we would have, but we may very well have recommended unilateral open skies. The fact that we have not gone down that path, that in fact we have worked very much within the bilateral system and taken from that and gone with the bilateral negotiations etcetera, is very much because we were not looking only at tourism.

So if you think that we in fact were not paying attention to the opportunities for the Australian development of the Australian provision of air transport then I can assure you that it was in fact fundamental. That concern was in fact fundamental to the way that we have in fact chosen. So I think that may not have been immediately

apparent but the whole concern with that negotiating process and the fact that this is different from other commodities, and the product's spelt out fairly thoroughly in the last chapter of it as to why this is different from other products under the services and why we were going in that way, that's because we were concerned about the producers as well as the consumers, international air services.

MR CUMBERWORTH: So that's reflected in the model?

PROF SNAPE: No, it is reflected very much - it is reflected in the model and the model where of course producers' surplus is incorporated as well as consumer surplus - and of course we haven't put forward any measurements of what might in other circumstances have been consumer tax equivalent, for example, of any assistance. It has in fact been producers and consumers' surplus that has been incorporated in there. Anyway they're sort of basic points there. On the points of the quality of product, the moral hazard and the experience of the US market - and that is all to do with safety - I think that we're very appreciative of drawing our attention to various articles and we've had a look at those articles and I think that what is very clear, what of course matters, is the evidence.

I mean, one can have arguments about the quality of the product etcetera and one can talk about the moral hazard. But in the end of the day what matters is the evidence. Is the evidence there that deregulation does have an effect upon safety and not, of course, talking about deregulation of safety inspection? Of course, the whole regulation of safety inspection etcetera was on one side and was not included in our terms of reference. So it's only the wash-off, as you point out, of deregulation of the market, if you like, and what implications that could have for safety.

You quote the point there, of course, that we've got, that we saw no evidence that deregulation in that sense was having no effect upon safety and one can accept the theoretical point of moral hazard and so on but, at the end of the day, it's the evidence that matters. We said in the relevant part, which you quote, that we saw no evidence that that type of deregulation was in fact having significant effects upon safety records. Reading the articles which you so kindly drew our attention to, I'm afraid that I would tend to stick to that point. It is true, as you say, that there was some evidence in Rose's article - I'm speaking about the later one which of course summarises the earlier one, as well as some other reports as well, that one can find some small differences between various categories of carriers in terms of whether greater profits were associated with better safety records or not, and that evidence goes - the connection is very statistically quite weak, but to the extent that it is there, it goes in various directions.

She says, for example, that the smaller and mid-size carriers - there may be some association that lower profits are associated with a higher number of airline incidents, but then she also says that higher profits are associated with higher incident rates for the very largest carriers, which tends to imply that in fact if that could be transferred to the Australian experience, that if in fact Qantas and Ansett were having higher profits, that they would have a higher number of incidents. However, I don't

believe that. I'm not going to argue that. I'm just simply saying that the very same sentence in which you draw from - the same part of the thing in which you draw one conclusion - has also got that other point, going the other way. Overall, they tend to wash out and I think that I would tend to stick with what we have got in the report, failing further evidence, rather than just discussion of moral hazard etcetera further evidence that in fact greater competition arising through gate deregulation would in fact be associated with higher actual incident or accident threats.

I might also point out that this same article points out that travel by air is so much more safe than travel by road and grossed greatly by a very substantial multiple, even correcting for the type of distances and the type of drivers who might alternatively fly rather than drive. So correcting for what might otherwise be a bias, that even taking that section of the population, flying is far safer than driving by road. That's very, very good, but the implication of that is that if, in fact, deregulation is getting more people in the air and off the road, the total number of accidents or fatalities, road or air, is decreasing, which in turn implies that if one is in fact getting - irrespective, in a sense, of what is happening to the air safety - more people in the air is saving lives. Irrespective of what happens within our margin of course, it is saving lives.

So it would seem to me that the evidence in this article - I'm not suggesting of course that we would use it to support an argument against the argument that you are putting, but it does not seem to me to support the argument that you are putting.

MR CORK: The question here is that given the - this came out in the IFALPA conference we went to, where they're projecting - and this was before the Asian crash - that there would be one major accident a week worldwide by the turn of the century, which is rapid. The big problem is that given what we've now invested in simulation, given what we've invested in human factors, training, given the improvement in aircraft equipment, in fact the accident rates should be dropping, and they're static. That is the real problem. In the deregulated markets, basically the accident rates are remaining constant, and they shouldn't be.

MRS OWENS: But is that a problem with deregulation as such or with the specific safety regulation that's taking place in the United States. I mean, how can you establish causality. You've got overall deregulation going on across the market, but at the same time you have, within the regulatory system, a safety regulatory arrangement. I mean, is it a failure of that?

MR CORK: Both, I would say. In the initial submissions, we gave some of the summaries from the Value Jet finding of the National Transportation and Safety Board and there was a failure in that of both the regulatory authorities and the airline. I mean, the airline totally lost control of their maintenance facilities.

MRS OWENS: But this article - the Rose article - that Prof Snape has just referred to, says things like, "Aggregate statistics on US airline safety provide reassurance for travellers concerned that deregulation has led to increased risk in air travel," and it

goes on to say that, "The long-term trend towards increased airline safety has continued since the economic deregulation of the airline industry in 1978." There's lots of statements like that throughout. So I don't know how it can be both.

MR CORK: I think the answer is that what we're looking at is where the thing is basically not improving and not getting worse so people are saying it's maintaining - there's a real problem here because from when the Rose study started with the data from 78, we're talking about transition from predominantly propeller-driven fleet in the USA to modern electronically-controlled jets. So there's all kinds of things coming into this. But the fact remains that we should expect that the accident rate of RPT carriers, not only in the States but worldwide now, should be approaching zero. The equipment is there to do it and the Australian carriers, under their current circumstance, proves that a zero accident rate is achievable, and yet it's not happening worldwide.

We've got to say, "Is there a relationship between the fact that we still have some controls here, some guarantee of some financial stability, and in other parts of the world we don't." We've had situations in Asia only recently where a particular Asian carrier has had the second episode of a fatal accident where their crew did exactly the same thing as a crew the year earlier, on exactly the same model of aeroplane. You would have to say that something has fallen down pretty dramatically there for that to occur, because the normal stance is when an accident occurs in an airline that the cause is identified rapidly and a massive crew training program to stop it happening again goes into place. Yet it's unheard of for an airline to have a copycat accident within a year, and yet it happened.

PROF SNAPE: I guess that part of the problem in finding statistics and finding the evidence on this is that fortunately the incident and accident - particularly accident - rate is extraordinarily low as a means of transport. When you've got such a low rate, it is very susceptible to blips. Statistically, one then needs a very long period to be able to - - -

MR CORK: You do, and you've also got the problem of changes in technology. So when you look at something like the Rose article, you're actually transitioning probably four levels of technology. So it's very hard to draw conclusions.

PROF SNAPE: As I said, and my position before, I was saying that we have yet to see any evidence that would lead us to depart from that conclusion.

MR CORK: The problem is when we see the evidence it will come in a big rush, as the accident rate in Asia over the last 18 months did, and then we'll clean it up and then it'll happen again. In the meantime, if you happen to be the unfortunate that's involved in it - - -

PROF SNAPE: I don't think that one can ever deal with the argument in whatever context that a disaster is just around the corner. I don't mean it as an aircraft disaster, I mean in any context that the sky is suddenly going to fall in.

MR CORK: This is the problem that people from outside the industry have from when you enter the technical side of the airline industry and whether you're a maintainer or a crew. The safety environment is massive and it doesn't exist virtually in any other industry. The emphasis there, and the big worry, is that when we change the culture of the industry, which we're moving into - in the past we had all the airline management work their way through and they understood the culture. Now we're getting a situation which in fact James Strong spoke about earlier about what happened in the USA, going back 20 years ago, that there's the real danger that you move people into the aviation industry and create an economic environment where the safety environment is not understood, and by the time it's sorted out there has been big problems and it's very hard to reverse that culture once you've gone in a different direction. It's very hard to reverse the culture back the other way.

MR CUMBERWORTH: Just if I may comment about the Rose article, the JPE 1991 offers the insight that if you differentiate amongst the carriers on the basis of size, then you'll see that profitability effects are most pronounced for small carriers, and in the travel accidents model that she develops, the operating margin coefficient for small firms ranges from - there is a range from minus two at the low end to higher minus two, but it's statistically significant that 10 per cent were level or better. That's over a good time-frame. She controls that there were quite a few other variables too.

We're interested in what the new entrants into the market will be and whether they're going to be small carriers or not. There was no indication, really, from the draft report as to whether they'd be charters or whether they'd be US major carriers, or who. So our concern is that the new entrants may be small to medium-sized players who don't have the safety investment attitude that Qantas or Ansett has. The point I think that needs to be brought out here is that the Australian consumers of aviation services are accustomed to a high quality product in terms of the safety dimension, and I think that the commission has a role to recognise the safety issue in terms of what may happen following its recommendations.

PROF SNAPE: We did, in another point in it, make some comments about ramp inspections etcetera which were in fact attempting to take up some of the points which you had put earlier.

MR CORK: Yes, and I think the answer is there - having spoken to the CASA staff since given the rapid turnaround - I think the possibility of ramp inspections and determining suitability of operators is very difficult.

PROF SNAPE: I appreciate it's difficult.

MRS OWENS: Can I come back to this point about culture change among new entrants. Again, coming back to the Rose article, it does provide those statistics that you referred to earlier, but it also says that the higher risk, that is among new entrants, arises from the fact that entrants carried relatively fewer passengers. I sort of wonder, you know, thinking about new entrants, on what basis would we assume that there's a

culture change. I mean, it comes back to on what basis are they going to compete? Is it just going to be on price, or are they going to be competing on price and quality? Competition isn't just about price. It's about providing a safe service.

MR CUMBERWORTH: Exactly.

MRS OWENS: People are fairly well informed about airlines and airline accidents. In that same article - I think it's this one - there's a table right at the end. I haven't got page numbers, I'm sorry, but it's got New York Times front page stories in relation to risk sources, and I think commercial jets is 51 stories in this time period from 88 to 89, whereas for cancer it's seven, for suicide it's one, automobiles four. So people are, through normal channels such as newspapers, actually getting probably quite more information than they actually want to know about aircraft accidents. Whenever there is an accident or an incident, you get a lot of sensational press.

MR CORK: Not the incidents, though. That's the problem.

MR CUMBERWORTH: The incidents aren't always observable and, again, as a hidden action following here because you can't see what people are actually doing, the airlines aren't going to reveal their safety investment and the public doesn't have access to the incident rates.

MRS OWENS: But what about this point about on what basis airlines are competing. I mean, Qantas obviously goes out there and competes on its safety record.

MR CORK: Yes, but there are other airlines who I would have people say to me, "The cabin service is wonderful, they get away on time and I wouldn't fly on them," and they would equate them to Qantas, and they're well-known carriers. But their maintenance and their cockpit crews are very different and that's the problem, nobody is going to do - there's another company that has a habit of when they have problems, suddenly taking out full-page colour ads in every paper in Australia and suddenly the incidents don't appear. I mean, it's just coincidence. But this is the problem, it is very hard for the incidents to be informed. Because the other problem is that when the reports come out of the incidents through things like the quarterly Bureau of Air Safety - what we call the crash comics - they're a year, a year and a half apart, they're stale news. Even when a major incident occurs in Australia or worldwide, by the time it's investigated it's a year or 18 months afterwards and nobody wants to print it, that's the problem.

Even under the current circumstance the incidents are not well-known and I can assure you people make judgments on how they travel. But from working 33 years in the industry I wouldn't make the same judgments. I wouldn't fly with some of the airlines that people think are good airlines.

MRS OWENS: So you think it is achievable to have an airline industry where there is zero accidents?

MR CORK: Approaching it, yes, I do.

PROF SNAPE: Even though most of the incidents and accidents are attributable to human rather than mechanical failure?

MR CORK: I think that's actually a disputable point. Any accident, particularly when you go through the incident stage and get to the accident stage, is a very complex chain of events. I think it's the latest Bureau of Air Safety crash comic has got an interesting diagram which had a series of about eight sheets held up with a little tiny hole and they were explaining that - and a line going through - and it's got to go through a series of barriers and things like firstly, well maintained aircraft which you don't get by definition the moment you start to get on the cheaper end of the market, coupled up with weather conditions, coupled up with poor crew training. Eventually all those links in the chain join up and you have a chain and you have an accident. But there is never ever one cause of an aircraft accident, just like there is no one cause of a car accident.

I mean, the answer to preventing accidents is good maintenance and good crew training and the third one is fatigue, not overworking your crews, and that's the other big problem you run into the moment you start to get on the cheaper end. I mean, the classic example here is the current US freight operators who come through Australia who come under all kinds of exemptions and supposedly use ferry flights and I mean, they can fly their crews for incredible lengths of time compared to a passenger aircraft, and that is a real worry when you get on the cheaper end of the market. We have fairly strict rules here right now on crews and how much they can fly and it relates to shift work, it relates to time changes, it relates to many things. The moment you get on the cheap end of the market or you start to reduce cost there is a pressure on crews. Some of that pressure on crews is probably valid.

I think if James Strong were still here he'd tell you he's getting a large amount more out of his crews than he would have got 10 years ago. We were probably mollycoddled and we probably did too well. But the fact is ultimately there comes a stage in moving down the line where you have to say it is physically impossible for your crews to go any further, they will start making mistakes.

MRS OWENS: So airlines can spend more money on maintenance and have more regular maintenance arrangements - you can spend more money or they can spend more money on training and they can have shift arrangements which will reduce the potential for fatigue among crews. All those things cost money, okay, and when it costs you more to run your airline, then inevitably you have to charge your consumers more or else you're going to go out of business eventually.

MR CORK: Yes, that's right.

MRS OWENS: The more you've charged consumers the higher the relative costs of travelling by air vis-a-vis road, which is what Richard said before, and then you start to get into other problems.

MR CORK: Yes, that's right.

PROF SNAPE: I do acknowledge the ability to travel internationally by road from Australia is fairly - - -

MRS OWENS: It's very difficult.

MR CORK: Yes, I was going to bring that up at the appropriate time. I had it noted.

MRS OWENS: There are boats but not that one would want to do that any more, but it can be done. But, I mean, there are other - it does lead down another track.

MR CORK: It does, and the problem is what is the minimum cost? I mean, one of the other areas that there has been much discussion of is obviously there's a downward pressure on crew wages which is one of the reasons our organisation gets concerned about deregulation, I'd have to be honest. But the problem is how far, for instance, in a deregulated environment can you push your crew wages and your staff wages - remembering that there's two very skilled and different groups in airlines. One of them is the air crew and the other is the ground engineers, the people who maintain aeroplanes.

I mean, James Strong alluded today to the fact that a 747-400 is \$240 million, it's a lot of money. How far down do you push your crew wages and your engineer's wages before you start losing the kind of people you want in the job? That kind of thing takes a while to come through. I mean, obviously a 45 or 50-year-old pilot of licensed aircraft maintenance engineer will probably stay in the job, even though his wages are being pushed down or her wages are being pushed down, because he has got nowhere else to go. But ultimately the new entrants - you start to lose the kind of people you want in this job or in these jobs. So a lot of the deregulatory effects will take many, many years to flow through. I mean, one of the reasons the deregulated US environment when it first occurred was so successful and didn't have a lot of accidents was there was the total demise of airlines like PanAm, Braniff(?), Eastern and that threw up a large number of well trained crews and ground engineers. Now, they took jobs at whatever rate they could get, but they've now retired, they've lost them.

So now we're starting to get the various accidents that have gone on over the last few years because you're starting to move in now - because the wages are much lower you're starting to move in the lesser skilled people than you would have had in airlines in days gone by. So you can push your prices down so far and somewhere you reach a limit to where they can't be pushed any longer unless there's a massive change in technology like the 747. I mean, the 747 is responsible for a massive

change in economics because it changed the whole relationship of cost structure. When I was in Montreal a few months ago Boeing and Airbus are now talking 800-seat aeroplanes. That will change the whole cost structure again.

PROF SNAPE: Just a point on page 2 of the main body of your submission - I think you may have misunderstood and I'll put it another way, I think we may not have expressed it properly.

MR CORK: I gathered you were talking about us at the earlier session.

PROF SNAPE: I'd forgotten which one it was in as a matter of fact at that time. It's to do with the secondary gateways and that was supposed to be within the total capacity and you haven't expressed it properly obviously.

MR CORK: I understand that now.

MR CUMBERWORTH: Just to follow up a point Rod made. If you actually look at the primary cause factors for whole loss accidents which is in the appendix we provide which is from Boeing you actually see that, as I mentioned, maintenance type accidents have increased and also cockpit crew accident type errors have decreased but it's still there the bulk of - -

PROF SNAPE: They're still the greatest.

MR CUMBERWORTH: They're the bulk primary cause.

PROF SNAPE: I take the point that Rod was saying before and it was in fact that chart that I had in mind when I was speaking before that most were crew error, but of course I take the point that it will be a combination of many things and to ascribe it to one thing may not be adequate.

MR CUMBERWORTH: Yes. Cockpit crew I would probably put down as being more attributable to the airlines safety investments rather than operating conditions, given that the current training technology available for technical operators in the form of simulators and I think they can do - Rod can answer this one, how many simulations you can run with pilots who are captains these days. It's a very large number.

MR CORK: Basically the Qantas procedure is that every 2 years we cover every known emergency. We do eight simulators at four a year. Over every 8 years we cover every known emergency.

PROF SNAPE: I also take the point which you made earlier - I'm not quite sure whether it was in the hearings or in private conversation earlier on - that there's also sort of psychological checks which are done on crews which may be skimmed in some cases - -

MR CORK: Yes, that's right.

PROF SNAPE: - - - and may have had some disastrous results earlier in the year.

MR CORK: Yes, there have been.

PROF SNAPE: The inconsistency with other trade policy, well, I think that the point on that is fairly straightforward, that this industry is organised like no other industry. When you start from the point of a product specific set of bilateral agreements in marked contrast to what is done, for example, under the World Trade Organisation agreements where it is multiproduct, multicountry, multilateral agreements. Starting from having at that other end and having to work from that, then of course the recommendations will likely look different from any other trade policy because of where you're starting from with the structure. Of course, the plurilateral system which we were recommending is to be a step towards a multilateral system rather than an end in itself.

While I'm fairly nervous about regional trade agreements as being a step towards multilateral agreements in other contexts, when you start from the sort of set of arrangements that you've got in this industry, then I think it is reasonable to think that it could be. But as I think is made quite clear we see that plurilateral-multilateral is a desirable end, particularly the multilateral, that we're a long way away from it and it's a long-term goal rather than something that come up tomorrow.

MRS OWENS: I was going to raise another issue and I just really want a bit of clarification. It was on page 3 of your submission where you're talking about - you refer to our recommendation in relation to unrestricted rights for foreign airlines to carry on stopover traffic and you say that you're opposed to that proposal because it will result in a lower quality of product to all user of air services in Australia. I wasn't sort of quite clear on what you were saying there.

MR CORK: Okay. What we are trying to get at is the initial one - say, for instance - I'll just read what we've written. There's a number of areas in that - I mean, the big problem is this multitude definition of what code sharing is. By definition I suppose you're talking about carriers arriving in Australia with one operator. There was much discussion in the first round of the inquiry into - I think Richard mentioned the fact that he went to Canberra and it was actually a Malaysian flight as well as an Ansett flight or something.

PROF SNAPE: And Air New Zealand and probably United as well.

MR CORK: Yes, it probably was. We've got to read them. We sit there with a list in front of the captain and read them. I think part of the problem is when you start to mix up your passengers you're starting to get a fairly major handling problem. It's a matter of crossing them over and - my comments there are really to do with the physical constraints of Australian airports. There are all kinds of areas here where if you had a finite resource and you could structure your buildings there wouldn't be any

real disadvantage. But given the current physical restraints which don't look like going away but look like getting worse, starting to mix your passengers through international and domestic and putting five services into one which is really what - the practical implication is say, five aircraft arrive in Sydney and they're all code sharing on a domestic operator or one international operator to Melbourne. You've got to put them all together somehow.

The five aircraft won't all arrive on time. The baggage won't all be transferred on time. Some people have to go through customs, customs will want to look at somebody's bag. The end result is that the flight that's due to leave at 5 o'clock will leave at 5.30 or quarter to 6 or 7 o'clock. So, sure, the last people to get on are advantaged but probably three-quarters of the people to get on aren't advantaged. They're disadvantaged as distinct from a smaller aircraft doing one service on its own.

PROF SNAPE: I take that point. But I was puzzled by the same point because I would have thought that code sharing on Australian carriers would in fact have provided greater employment for Australian domestic operators and, of course, their crews and their staff and if one again is thinking of the Canberra route, just - -

MR CORK: Yes.

PROF SNAPE: Now, no-one is clearing customs in Canberra so they have all cleared customs at Melbourne.

MR CORK: At Melbourne - that's the problem we're looking at.

PROF SNAPE: That then can delay the flight and I understand that. But if I compare the service and frequency of service to Canberra now from, say, half a dozen years ago or 8 years ago, the frequency is much greater.

MR CORK: But it probably had little to do with code share. I mean, those passengers probably would have bought a ticket or their airlines would have supplied them at a price, whether it was a code-share flight or whether it was an Ansett or Qantas flight.

PROF SNAPE: They may or may not. I think that one reason that they go for code-sharing is to make it easier for their own passengers. I mean, that's why they do it.

MR CORK: Or so that passengers can find their gate, but that's about it.

PROF SNAPE: Yes, but they make it easier so it's Malaysian right through - and sure, they have to go on to another if they're code-sharing but they do it for a particular reason and that is to encourage more people to do it. Now, I'm not prepared to believe that the airlines are completely misguided in this matter - that they do it because they think it generates business. If it's generating business for them it is generating business for the Australian carrier.

MR CORK: There's no disputing that, providing the product ends up as at least equal or a superior product, but our experience so far is it hasn't.

PROF SNAPE: But that of course comes back to the point, has it contributed to additional frequency. I suspect that there has been some contribution to that. I don't have the data for it of course but I suspect that code-sharing and the probable increase in the demand for that route that has come from that code-sharing has made it much easier to get to Canberra and back than it was. There are many more flights than there used to be. Now, it may be that flights on average are 5 minutes late because of the problems that you describe.

MR CORK: It depends on the size of the aircraft doing the code-share too. I mean, if you're talking a 737 you're probably right. If you start to get to the stage of 747, where you're complexing five lots of passengers from four international destinations, I can tell you from experience it gets fairly late.

PROF SNAPE: I have yet to catch a 747 to Canberra, fortunately.

MR CORK: No. We can do it.

PROF SNAPE: Or to take off, which is the really difficult one.

MR CORK: We can take off as well. It's just that we block the runway until they get filled. There's nowhere to park. You can land but you can't park.

PROF SNAPE: I think that another point which may have been misunderstood a little bit is on page 4 and I think another participant also had the same - it may have been Qantas actually. Where we were talking about the freight and the unrestricted rates for foreign airlines to offer freight services in Australia, we weren't just thinking of dedicated freight.

MR CORK: Right.

PROF SNAPE: We were thinking of under floor - - -

MR CORK: So you would have the same effect even for under floor?

PROF SNAPE: Yes.

MR CORK: If you take a 747 with the freight capacity - for instance we, amongst other things - I think we only represent two groups of employees. One of them - we represent Independent Air Freight, which is a company that operates a couple of DC9 freighters out of Melbourne. The spare underbelly capacity of a 747 doing Sydney-Darwin would exceed that of the DC9 total. The real worry is - I did quite a bit of research on this - I spoke to the current Australian domestic freight operators. There's a company called Aeromarine operated a couple of 727s, Independent

Airfreight two DC9s and a 727, Australian Express who operated a 727 on behalf of DHL. All those carriers are operating their aircraft on the bottom end of their return. If you reduced one day of the 5 days they all say that they would probably close up operations.

So I think the point still stands, whether we're talking about a dedicated freighter or a passenger aircraft carrying freight capacity. If you were to put that freight capacity on the Sydney-Darwin route, say, on Wednesday there is a very good chance that the DC9 or 727 wouldn't operate Monday through to Friday any more because the utilisation rate - certainly the daily service. I mean, nobody's going to operate an empty aeroplane to Darwin to bring the load back the other way and there's a very good chance that if you drop below the five times a week that the service is no longer viable.

MR CUMBERWORTH: Is that an example of wasteful competition?

PROF SNAPE: I won't answer that. Perth-Sydney, South Africa?

MR CORK: Same story with the freighter. There's two 727 freighters at night do the Melbourne-Perth route which are fed from Sydney before it gets to Melbourne. It's all to do with curfews. So the freight is brought down by wide-bodied aircraft or sometimes dedicated freight to Melbourne, then do the night flight. Those two aircraft are also right on the bottom end of their returns. They went to four nights a week, that's the end of the service. Of course there again the South African - see those services are all about - this is your package freight that's advertised on TV. It's all about being able to post a package from here after business tonight, having it arrive in Perth tomorrow morning for opening of business and vice versa.

So the real problem is - South Africa's a good example. Even if it met the market times one way it wouldn't meet it the other way. But the operator wouldn't operate empty one way so assuming that, say, it did Perth to Melbourne the Melbourne-Perth sector wouldn't be operated so the consumers miss out on that day.

PROF SNAPE: I suspect the market response there would be very much that the operator Melbourne-Perth would be offering some sort of incentives to get two-way bookings. I mean, you can think what the market response would be there.

MR CORK: I'm not sure. The problem is with freighter aircraft as distinct from passengers they operate on - there's two distinct freighter markets, the FedEx type market that they put up where they use - similar to passenger market where they fly their aircraft about 20 hours a day utilisation, high returns. There's also the lighter market, which this is one, where the average operation, night operation, is about 5 or 6 hours 5 days a week. Most of them are in there hoping the market is going to get better. They're just breaking even or making a small profit. There's no rapid change in technology. The aircraft are old aircraft being converted. There won't be anybody in the market because it just can't pay.

There's no alternative service. All you do - you've got two choices: pull out or raise your price. So whichever way it goes somebody gets on it, say, on one service a week Perth-Melbourne, at the right time. Sure, you get your cheaper prices that day but the rest of it either increased prices or reduced services and there is no other market response - send it by road.

MRS OWENS: Could I just clarify something, your comment on the club proposal on page 9, and you talk about - you welcome a regional approach to an open skies club formation and I just wondered how that reconciled with your actual opposition to an open skies approach?

MR CORK: The big problem is - and it was touched on by the Department of Transport the other day when they spoke about people actually being afraid of predatory Australian airlines, which I really enjoyed. The problem is, we have absolutely - I'd say as an organisation we recognise that Qantas and Ansett have to be competitive and we realise our members work for in a global industry. Our concern is so far we've never seen a level playing field and everything we've seen so far that has been thrown at us seems to want us to run uphill and everybody else to run downhill. So we have some fairly severe reservations on the whole process because all we want to do is play on an equal field. That's really what that's at. So that's why we say no club member being made worse off through the freeing up of international air services and the like.

MRS OWENS: They won't join if they think they're going to be worse off.

MR CORK: Well, no, but we don't know because it depends on what other trade things go with it and - - -

MR CUMBERWORTH: It depends on the size of the market principally and if you look at the Australia-New Zealand market, because of the market size it's a zero sum gain. So Qantas doesn't want to enter into it because - well, neither does Ansett, because they will lose to Air New Zealand. I mean, if we were both gaining then it would probably come about, subject to political factions.

PROF SNAPE: I'm not sure about that zero sum gain assumption? I mean, if it improves networking, if capacity can be rationalised through it so that planes are operating at a higher capacity, it's a positive sum gain.

MR CORK: I would say that it would be very hard to improve the current capacity, looking at what - the current utilisation and capacity of our aircraft has been until the Asian fallover very, very hot. There is no doubt about that. It would be hard to improve it much.

PROF SNAPE: Well, networking?

MR CORK: We don't really need NewZealand, that's the point. I mean, we can fly to virtually anywhere without having to utilise NewZealand. It doesn't really give us a geographical advantage for networking.

PROF SNAPE: Well, Melbourne to Los Angeles, you can't.

MR CUMBERWORTH: At the moment you can't, or just South America.

MR CORK: Actually that's a commercial decision. If we took 2 tonne of passenger entertainment equipment off we probably could.

PROF SNAPE: Well, I did say commercially when I said before - on that one. You may be able to think of other connections there. For example I said Melbourne to Los Angeles but one can think of course of hubbing into Auckland from various points of Australia and flying on from there. Now, the ability to do that is at the moment rather restricted because of the fifth freedom rights. In Australia of course Qantas hubs out of Singapore into various parts of Australia and it does that through the rights that we have. Now, we're not able to do quite the same thing from various points of Australia into Auckland to be able to go on to either North or South America. There's an example of a possible positive sum gain.

MR CORK: I haven't done - I once operated a migrant charter in a 70 Auckland to Lemur. I never want to do it again. No, but the point is there are actually very few areas. I still can't - the technology we've got, Auckland really doesn't give the Australian industry a real gain. We can jump off from Australia for virtually anywhere. Australian operators and Air New Zealand currently operate Los Angeles-Auckland-Sydney now. I flew it the other day going to the Montreal conference.

PROF SNAPE: Yes, that's right. But it is limited by the amount of code-sharing that one has and again, talking about the hypothetical, just as out of Singapore one in fact hubs out of Singapore into Perth, Darwin, Brisbane, Cairns, Sydney and Melbourne and I think probably even Adelaide at times, so one could in fact do the same thing out of Auckland to be getting those feeders into there.

MR CORK: Yes, but it opens the New Zealand market to Australia and the two markets - I mean, if you could do the same thing with Canada we would say fine. All we want is a level playing field. But the New Zealand market is so small the Australian market is big by their standards. It gives them everything, it gives us very little.

PROF SNAPE: Well, it gives us something and- - -

MR CORK: But not much. It's not an equal return.

PROF SNAPE: Well, that's a comment that I made, that you would have heard, to James Strong before, that one doesn't reject marriage because you think the other

partner is going to get more out of it than you do. You go into marriage thinking, "Am I going to get a positive return out of this?" If you do, then that's fine. If the other partner gets a bigger return then great stuff.

MR CORK: Probably asking the wrong organisation: pilot divorce rates are massive.

PROF SNAPE: On that note I think I've just about used up mine. Helen, would you like to make any concluding remarks?

MR CORK: No, thank you.

MR CUMBERWORTH: No, I think we've covered - - -

MR CORK: Thank you very much.

PROF SNAPE: In that case we thank you very much and we do appreciate the effort that you have put into this and we have taken substantial note of it and we have been helped by it. If it didn't permeate the report it was not because we hadn't taken note of it but we'd drawn some conclusions, rightly or wrongly, from what you'd given us. But you've given us more to think about and we thank you very much for it.

MR CORK: Thank you.

PROF SNAPE: The hearings for today will now be adjourned and we shall resume hearing tomorrow, at 9 am tomorrow, when we shall have Ansett International, then after morning tea we'll have the South Australian Government. In the afternoon we'll have the Australian Services Union, Australian World Airways and then the Tourism Commission - so resuming 9 o'clock tomorrow. Thank you very much.

AT 5 PM THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 29 JULY 1998

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