



Productivity Commission research paper – Australia’s international tourism industry: trends, drivers and barriers to growth

Department of Infrastructure and Regional Development submission

This submission provides the perspective of the Australian Government Department of Infrastructure and Regional Development (Infrastructure) on international aviation, the trade in international air services in the Australian market, the importance of international tourism to regional economies, and relevant issues in relation to transport security. International aviation is a complex industry, operating within a complex regulatory environment that is often unfairly maligned by industry stakeholders as a barrier to growth.

The trade in international air services

The Bilateral System

The trade in international air services is governed by a complex system of multilateral and bilateral agreements between Governments. This system of bilateral air services treaties flows from the international civil aviation’s global architecture under the Convention on Civil International Aviation, opened for signature on 7 December 1944 (the Chicago Convention). Unlike most other areas of international trade, the Chicago Convention reverses the conventional presumption that trade is allowed unless it is prohibited: the trade in international air services cannot occur without special agreement between governments.

The structure of international civil aviation under the Chicago Convention also imposes a requirement that every airline have a ‘home’ country. Each country is then responsible for regulating the operations of their ‘home’ airlines, and each country then negotiates to secure commercial entitlements and market access rights for their ‘home’ airlines, which the airlines require in order to operate international services. The main commercial rights sought by airlines include: capacity, the cities that can be served in the other country, the ability to serve intermediate or points beyond these cities, rights for dedicated cargo services and code share rights.

Airlines cannot commence services between two countries unless arrangements are in place between both governments that authorise such services. Those arrangements usually comprise:

- an Air Services Agreement (ASA) which is a treaty-level agreement settled between governments to provide a regulatory framework for the operation of international air services, providing the general authorisation to operate international air services and covering aspects such as safety, customs charges, aviation security, application of competition laws and dispute settlement; and
- a Memorandum of Understanding on air services (MOU), or similar less-than-treaty-status instrument, which sets out the commercial entitlements available to airlines of both sides, such as the number of services that can be operated between the two countries.

Collectively, the ASA, MOU and any other associated documents are generally referred to as ‘air services arrangements’.

Within this negotiated framework, the Australian Government does not and cannot unilaterally ‘grant’ market access to airlines; the framework is always a negotiated outcome.

International Air Services / Aviation Policy Settings

The Australian Government's vision for aviation is to foster aviation industry growth in an environment that is safe, competitive and productive. The Government also acknowledges the importance of international aviation to our tourism industry, international trade and our broader economy.

Australia has one of the most open aviation markets in the world. Since the current process of liberalisation and privatisation began in 1992, passenger and international aircraft movements have trebled. Significant unused capacity, scope for growth on existing services and unrestricted international access to smaller airports all make Australia a comparatively open market.

The Government's 'Policy for Aviation' sets out its objectives for the promotion of aviation liberalisation in recognition of its role in supporting industry growth:

- recognise the potential of Australia as a prime tourism destination within the Asia-Pacific region;
- work to increase global aviation liberalisation while recognising the need to protect our national interest;
- strongly support the entry of Australian airlines into foreign markets and negotiate to remove barriers that prevent access; and
- prioritise bilateral air services agreements to ensure we have the aviation capacity necessary to meet future demand.

The role of Infrastructure in negotiating air services arrangements

Infrastructure's role in international air services is primarily that of regulator. Infrastructure negotiates a framework that allows airlines to operate, setting the limits within which airlines make commercial decisions about the services they wish to offer. Infrastructure is then the economic regulatory authority, issuing International Airline Licences and Timetable Approvals under the *Air Navigation Act 1920* to permit airlines to operate international air services.

Over recent decades, Australia has negotiated air services arrangements with some 94 economies, creating a global network of market access rights covering all major markets around the world.

Maintaining and expanding this network of arrangements is essential for international flights to/from Australia and all the economic benefits that flow on to the broader economy, particularly tourism.

In preparation for bilateral air services talks, Infrastructure undertakes extensive consultation with our major airlines, airports, tourism groups and other Government Agencies including the Department of Foreign Affairs and Trade (DFAT), and the Australian Trade Commission (Austrade). Advice from these consultations is taken into account in developing a proposed negotiating mandate that reflects Australia's national interest and the Government's policy settings.

As a regulator, Infrastructure does not have a role in attracting airline services to Australia. The decision to operate a service is a commercial decision for an airline, and may involve private commercial negotiations between airlines, airports and state and local governments.

Tourism Australia is the Australian Government agency responsible for attracting international visitors to Australia through the promotion of Australia as a tourism destination,

and as a tourism promotional authority, Tourism Australia is active in seeking to attract airline services to Australia.

The current state of Australia's bilateral air services arrangements

There are currently no markets in which existing bilateral arrangements prevent airlines from adding services to/from Australia.

In some markets, airlines are not able to add services to/from Australia's Major Gateways of Brisbane, Sydney, Melbourne and Perth; in most cases it is foreign airlines that are constrained, but in others Australian airlines are constrained. In all of these cases, the Australian Government's policy of negotiating (where possible) open access to/from all international airports in Australia other than the Major Gateways means that even if an airline is constrained in adding flights to a Major Gateway, it can add flights to a smaller/regional gateway such as Adelaide, Cairns, Darwin or the Gold Coast.

Attachment A contains a Fact Sheet, prepared by Infrastructure, which sets out foreign airline capacity entitlements in Australia's 15 largest Uplift/Discharge markets for inbound traffic and the capacity entitlements and growth potential already available to foreign airlines.

As shown in Attachment A, there are only a limited number of markets in which airlines are not currently able to increase services to Australia's major gateways. Infrastructure is aware of all of these markets, and in accordance with Government policy, actively prioritises consultations with the relevant foreign governments. However, it is important to acknowledge that the bilateral system is not a one-way street but based on negotiation between governments. There are many different approaches to aviation negotiations amongst our bilateral partners, and the government is unable to force foreign counterparts to accept Australia's policy, even on key issues such as the concept of keeping capacity entitlements ahead of airline demand.

It is also important to acknowledge that bilateral air services negotiations are not just negotiations to make it possible for foreign airlines to increase flights to Australia. Bilateral air services arrangements negotiate the full legal framework for the operation of flights, covering safety, security, border protection and other matters, as well as negotiating the commercial rights available to airlines of both sides.

In many of the markets where foreign airline growth is constrained, growth in passenger numbers is not. In Australia's very open and competitive market there is substantial scope for passenger flows to move via third countries on sixth freedom services. This free movement of traffic flows is in part due to the Australian Government's policies of promoting a liberal and competitive environment across the board.

This not only increases access to Australia by allowing a variety of airlines to operate in the market, but also helps facilitate competition on the route/s.

The Australian aviation market and barriers to growth

One of the myths among many airline industry commentators is that liberalisation of the international market will always lead to more flights. Liberalisation is not about guaranteeing more flights - it is about letting market forces operate and allowing airlines to respond to supply and demand in a competitive environment. A liberalised environment allows airlines not only to add additional services but also to withdraw them again as the market dictates.

The international aviation market is highly competitive and at times irrational. With the recent introduction of multiple low-cost carriers serving nearby markets, Australia has seen long-haul international airfares drop to short-haul domestic prices. This may be desirable for many aviation stakeholders, including airports and the tourism industry, and certainly

benefits the Australian public who enjoy cheap access to international travel. But the dumping of excessive aviation capacity into Australia by some airlines has the potential to distort the market and in the long term, damage the profitability of the aviation industry as a whole. Extended periods of discounting and loss-making will not only impact airlines; it will eventually flow through to airports and the tourism industry as airlines rationalise unsustainable routes.

Today (in contrast to the early post-war years of the development of modern air travel) airlines, even state-owned airlines, are businesses rather than government-run public utilities. It is therefore important that airlines have an ability to make a profit within a competitive marketplace. New and existing routes are not a public service but a product offering that must make a financial return.

Because of this, in the majority of cases, it is not regulation or bilateral restrictions that act as a barrier to airlines increasing international air services to/from Australia – it is the commercial reality of the market.

In a market in which airlines can add services on new routes, or increase capacity on existing routes, airlines will move to increase their commitment to a particular market only if they satisfy themselves that the route is commercially viable. In support of this, Australian airports, state and local governments, and Tourism Australia, undertake significant work to market and sell particular route opportunities to airlines, at times offering ‘incentives’ packages to support the launch of a new route. The prevalence of this practice highlights that the barrier to new services being launched is (mostly) not a matter of regulation, but a matter of commercial viability.

Removing regulatory barriers at regional international airports

Successive Australian Governments have pursued a policy approach of seeking to provide Australian and foreign airlines with open access to/from Australia’s smaller international airports. To do this, Australia routinely negotiates the ‘Regional Package’ in its air services arrangements which provides open capacity entitlements to all points outside Brisbane, Sydney, Melbourne (both Melbourne Airport and Avalon Airport) and Perth. Under the Regional Package, international airlines can operate unlimited services to/from all other international airports, without ‘using up’ the capacity entitlements available to serve the Major Gateways. This is available to airlines of many economies, including Singapore, Malaysia, Hong Kong, Indonesia, Thailand, China and the Philippines among others.

The Regional Package is designed to remove regulatory barriers to airlines serving regional destinations; as with liberalisation in general, simply having traffic rights and/or capacity available does not guarantee services to these points. Ultimately, while some regional airports are attractive to international airlines, smaller destinations are often less commercially attractive than larger airports.

In addition to the Regional Package, the Australian Government has a well-established policy of negotiating ‘own stop-over rights’ whenever possible, to support smaller international airports. These rights allow airlines to include stopovers at multiple Australian locations as a part of an international journey. Own stop-over rights are a limited exception to the general prohibition on cabotage, which reserves the Australian domestic market for Australian-based airlines operating under Australian regulatory oversight. For example, an airline from the Philippines is permitted to carry a visitor from the Philippines to Brisbane with a stop-over in Darwin, including carrying that foreign visitor on what would otherwise be a purely domestic sector, provided the overall journey is a through international journey. Domestic own stop-over rights are included in most of Australia’s air services arrangements; their limited uptake

reflects the commercially challenging proposition of multi-stop international services, in comparison to non-stop services.

Tourism objectives

Aviation and tourism are intrinsically linked but the objectives of the two sectors do not necessarily align. The Minister for Infrastructure and Regional Development considers the broader national interest on a case-by-case basis when determining Australia's negotiating position at air services talks. A key aspect of this assessment (and indeed during the negotiations themselves) is to ensure Australian airlines have a comparable opportunity to compete in foreign markets and to allow them greater flexibility in operating services and building their strategic alliances. As a result, Infrastructure pursues a holistic approach to market deregulation that does not focus exclusively on short-term tourism priorities, such as 'securing' a new air service on a specific route.

Despite these broad considerations, the Government does not seek to use the bilateral system as a constraining framework. Over the years, a very liberal market has developed in Australia, one of the most liberal in the world. Around 50 per cent of all travellers coming to Australia do so under an open skies or open capacity agreement.

The Australian Government and tourism industry participants have set targets for the Australia tourism sector under the Tourism 2020 Strategy. Facilitating growth in aviation capacity is an important aspect of this strategy, with a target of growing operated seat capacity to/from Australia by 40-50% over the period 2009-2020. But aviation is only one aspect. Given the aviation industry's strong progress towards its 2020 goal, investing in Australia's tourism product and developing the right incentives for that investment is also an important consideration in meeting the goals of Tourism 2020. Growth in aviation services alone will not deliver the long-term goals.

Prospects for further liberalisation

On occasions, some industry commentators argue for 'sweeping aside' the bilateral system, or press the Australian Government to do more to liberalise the international aviation market. This view is based on a presumption that other governments are all trying to push forward on liberalising the international industry. In many other parts of the world, governments are working to wind back past liberalising measures by imposing new regulation aimed at so-called 'fair competition', new controls on consumer service standards, or other measures that undermine the concept of a market-driven aviation system. Against this emerging anti-competitive, protectionist sentiment, Australia's market-driven approach to liberalisation remains one of the most open in the world.

The existing bilateral system has a valuable role to play in promoting competition and diversity in international air services. Far from increasing flights to Australia, reforming or abolishing the bilateral system could in fact consolidate global airline ownership and rationalise existing air routes. For end-of-line destinations like Australia, the bilateral system has proved effective in ensuring international services continue.

The international tourism industry in regional economies

Tourism plays an important role in regional economic development, with 46 cents in every tourist dollar spent in regional Australia.¹ Tourism is often location-specific, with many major destinations situated in regional areas such as Uluru, the Great Barrier Reef and the Great Ocean Road.

¹ Tourism Australia, *Tourism 2020 overview*, 2011.

While Sydney, Melbourne, Brisbane and the Gold Coast have large absolute visitor numbers and expenditure, some regions are more dependent on tourism as it comprises a greater share of their economy. For example, Tropical North Queensland attracts fewer total visitors than Sydney, however tourism accounts for a large share of economic activity in that region.²

Many Regional Development Australia Committees (RDAs) have identified tourism as an industry that makes an important contribution to their regional economy. This is particularly important in regions experiencing decline in traditional industries, or with an identified link between tourism and local products and assets.

Given the importance of tourism to regional Australia, Government initiatives which promote international tourism, such as information and marketing, tourism research, grants for events or activities and direct support for tourism businesses, have the potential to contribute greatly to regional economic development, where the investments have clear economic benefits and support the long term strategic plans of the region.

In addition, regional tourism areas are spread across the length and breadth of Australia making accessibility a key issue. Whilst many tourists understand the travel times and distances involved in reaching regional destinations in Australia, investment in infrastructure could make travel to remote destinations more convenient and attractive, particularly for time-constrained visitors. Investment into transport infrastructure, such as roads and airports, can help link regions to international gateways and encourage international visitors to go beyond the capital cities.

Transport security issues

Within Infrastructure, the Office of Transport Security (OTS) is the regulator of Australia's aviation security and plays an important role in supporting Australia's economic and social prosperity.

A key part of this involves the facilitation of safe and secure air travel – both domestically and internationally. It is also responsible for ensuring that Australia's aviation industry meets international security standards.

OTS works closely with international partners to establish an integrated, global approach to aviation security, recognising the importance of balancing security with passenger facilitation. Providing industry with a single, internationally-recognised regulatory framework for aviation security helps reduce the costs associated with international air travel and increases traveller confidence in Australia's aviation industry.

In September this year Infrastructure released the *Transport Security Outlook to 2025*. The Outlook provides a five to ten year forecast for transport security in Australia. It predicts continued global economic growth, and projects that trade and travel volumes will increase and become more complex. This will, however, be coupled with security threats that endure and adapt. The Outlook emphasises the crucial role effective and efficient transport security will play in supporting Australia's economic and social prosperity into the future.

One of the key implications from the Outlook is the need to develop a more risk-based and cost-effective approach to maintaining sustainable and secure aviation into the future. Consistent with this, Infrastructure is starting to look at options for structural changes to the current regulatory framework for aviation security.

With passenger numbers to and from Australia expected to double by 2030, OTS is particularly focused on opportunities to move from the current one-size-fits-all structure to a

² Tourism Research Australia discusses this in its 2011 report, *The economic importance of tourism in Australia's regions*.

more risk-based, proportionate approach to aviation security regulation that is better adapted to meet Australia's needs.

Ultimately, we are looking to introduce reforms which will make the regulatory burden on industry participants more proportionate to their role in Australia's aviation industry, and ensure that both industry and government are able to utilise resources as efficiently and effectively as possible to manage aviation security.

This, in turn, should help industry to meet the projected increase in demand for travel to and from Australia, and ensure that aviation security standards can be maintained with minimal impact on travellers.