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International  
Aviation

# International Aviation

## *Promoting competitiveness in Australia's international air services*

### **Issues Paper Themes**

- > International air services policies that balance the need to have an Australian based industry with robust competition from international competitors
- > Facilitating growth in trade, tourism and employment opportunities for Australians in the aviation and tourism industries
- > Australia's negotiating priorities
- > Increasing services to international airports outside the four major gateways
- > An "open-cargo" policy for dedicated cargo services
- > Foreign airline access to the domestic market
- > Foreign airline access to Australia - third country international markets
- > The implications of expanded international operations at secondary airports, including for border security

### **What the submissions said**

There was broad consensus that Australia's international air services agreements need to serve the national interest, but stakeholders varied significantly in terms of what this meant.


Australian international airlines were generally supportive of the current policy where the national interest is determined on a case by case basis, balancing the need to obtain useable commercial rights for Australian carriers and the benefits that potentially flow from increased foreign airline access.

Other stakeholders argued the national interest would be better served through allowing greater access for foreign airlines to the market, either through the pursuit of more 'open-skies' type agreements, relaxing the restrictions on capacity to most airports, or allowing foreign airlines to take up rights not being utilised by Australian carriers. Some stakeholders argued that Australia should move unilaterally in these directions by not linking the suggested changes with additional opportunities for Australian international airlines. Many stakeholders supported Singapore Airlines' desire to provide services between Australia and the US.

Many stakeholders acknowledged the current policy of offering unrestricted access to and from all Australian airports other than Sydney, Melbourne, Brisbane and Perth (the 'regional package') has not been sufficient to encourage international airlines to serve regional airports. A number of suggestions were made as to how this could be improved, including requiring international airlines to service regional airports in return for increased capacity into Australia, removing restrictions on domestic cabotage between regional and major airports and direct intervention through the use of subsidies to encourage services.

Most stakeholders supported a continuation of the policy of pursuing open cargo arrangements to facilitate trade in high-value, time sensitive products.

Australian airlines and some other industry stakeholders argued that the current cap of 49 per cent



on foreign ownership of Australian airlines through the *Qantas Sale Act 1992* (Qantas Sale Act) and the *Air Navigation Act 1920* (Air Navigation Act) constrain their ability to access global financial markets. It was also argued that the restrictions were incompatible with international efforts to reform the investment regime for airlines. In contrast, other stakeholders viewed the restrictions as essential to the maintenance of a strong Australian-based aviation industry and the retention of highly-skilled aviation personnel.

Many submissions focused on the need for border agencies to be flexible and responsive to resourcing needs, arguing that quarantine risk in particular needs to be reassessed and that the cost of delivering the border agencies' services should be clearly articulated and transparent. The most common concern raised was the pressure on the incoming passenger clearance process and, in particular, the secondary screening (quarantine) process, which were seen as the key barrier to achieving any significant improvement. Many stakeholders also expressed concern about the Passenger Movement Charge (PMC), arguing that there is a lack of transparency about the purpose for, and use of, the charge and that increases in the PMC discourage overseas tourists.

Australian airlines and other stakeholders argued that Australian taxation policy in relation to depreciation of aircraft, the lack of investment allowances and other aspects do not align with those applying to their major competitors and represent a competitive disadvantage to Australian airlines in the international marketplace.

## **Australia's reliance on international aviation**

As an island continent combining vast internal distances with geographic isolation from major international markets, Australia is arguably more reliant on aviation as a means of transport than any other country.

International air services provide vital connections for Australian businesses and tourists to the global market, generating billions of dollars for the Australian economy. The role of aviation in the export of goods from Australia, particularly high value and time critical goods is also significant. An efficient aviation industry is one of the cornerstones of the modern economy.

The gross value added contributed to the Australian economy by the air and space transport industry was \$6.4 billion<sup>4</sup>, or around 0.6 per cent of GDP, and it is estimated that the air and space transport industry employs nearly 50,000 workers<sup>5</sup>.

While the aviation industry is a significant generator of economic activity and a major employer in its own right, the greater benefits of the industry are derived from the flow-on effects created through the facilitation of trade, tourism and general economic activity.

One of the major flow-on benefits of the aviation industry is tourism. Aviation and the tourism industry are highly interdependent, with over 99% of inbound tourists to Australia arriving by air. The Tourism and Transport Forum (TTF) estimates that the tourism industry employs some 470,000 people, with a gross output of \$66.6 billion, while airports and air services employ some 170,000 people, with a gross output of \$43 billion. TTF estimates that by 2020 tourism is expected to employ more than 1 million people, with a gross output of \$145 billion, while airports and air services are expected to employ 350,000 people, with a gross output of \$80 billion<sup>6</sup>.

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<sup>4</sup> ABS, Australian National Accounts: National Income, Expenditure and Product (ABS cat. no. 5206.0, Table 33).

<sup>5</sup> ABS, Labour Force, Australia, Detailed, Quarterly (ABS cat. No. 6291.0.55.003, Table 6).

<sup>6</sup> Tourism and Transport Forum, "Response to Towards a National Aviation Policy Statement – Issues Paper", 2008, p11-12



## How is access to international aviation markets regulated?

The regulatory framework governing international air services is complex. While most sectors of international trade operate on the presumption that the market is open unless governments restrict that market, international aviation is different as the market is closed until governments act to open the market.

The underlying framework for the regulation of international aviation is contained in the 1944 Convention on International Civil Aviation, which is commonly referred to as the Chicago Convention. The Air Navigation Act gives effect to the Chicago Convention in Australia.

International aviation is governed by a series of government to government bilateral treaties determining levels of market access for countries' respective airlines. Over 3,500 of these bilateral air services agreements are in place, operating for the most part outside the World Trade Organisation (WTO) and international free trade agreements frameworks.

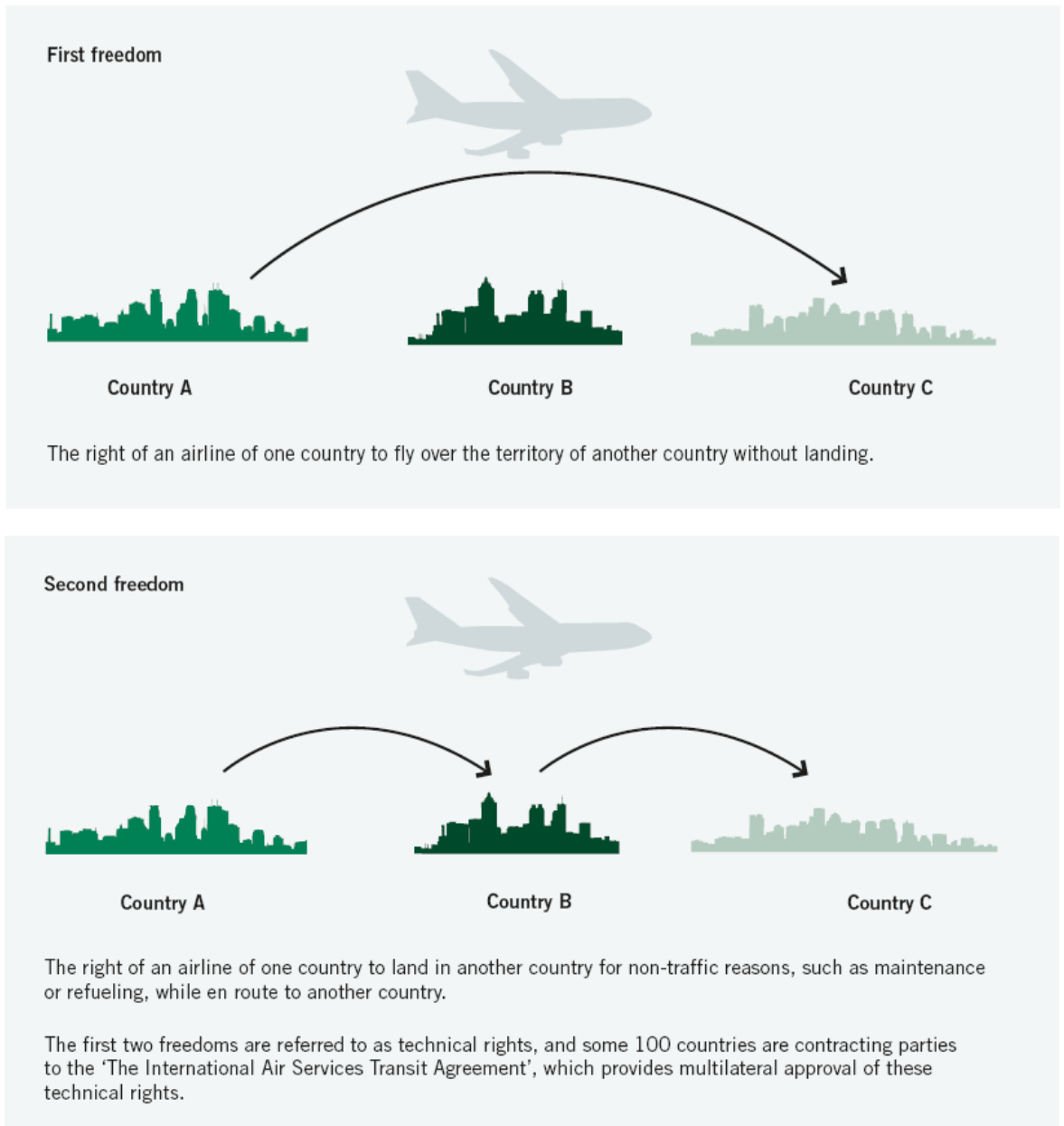
While some tentative steps have been taken in multilateral forums, such as the WTO, the global application of free trade principles to international aviation remains a longer term goal. Liberalisation within the bilateral system is likely to remain the only way to open up aviation markets for the foreseeable future.

Bilateral air services agreements set out the number of weekly flights that airlines of the two countries can operate, cities they can serve in the other country and rights to operate via or beyond to third countries. The agreements typically also include provisions related to such matters as airline ownership and control, competition law, safety and security.

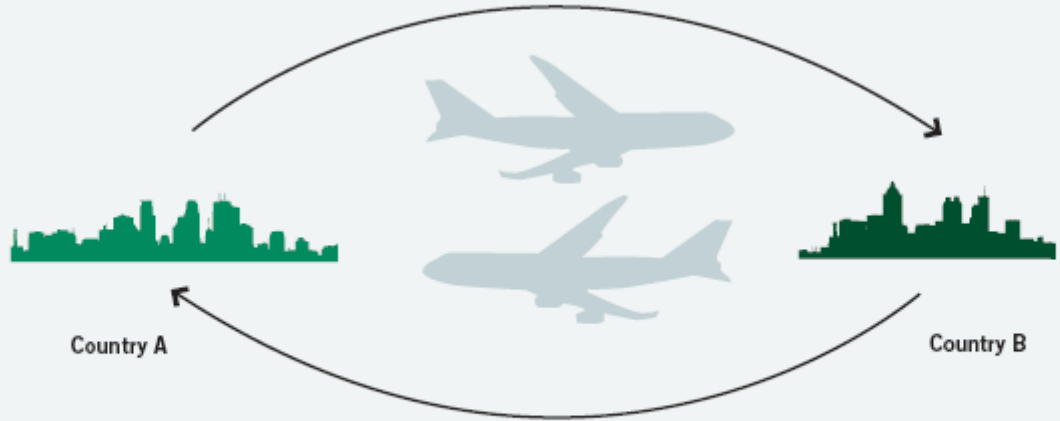
The outcomes of bilateral air services negotiations often represent a compromise outcome that balances the needs of both parties, with each side seeking to maximise the benefits for their respective countries. In such an environment it can often take several rounds of negotiations, over many years, to achieve the most favourable outcome.

Figure 3.1 outlines the types of air service rights established under the Chicago Convention, commonly referred to as the freedoms of the air, which form the basis of bilateral agreements.

**Figure 3.1** Freedoms of the Air  
International Aviation Rights of Passage (commonly known as freedoms)

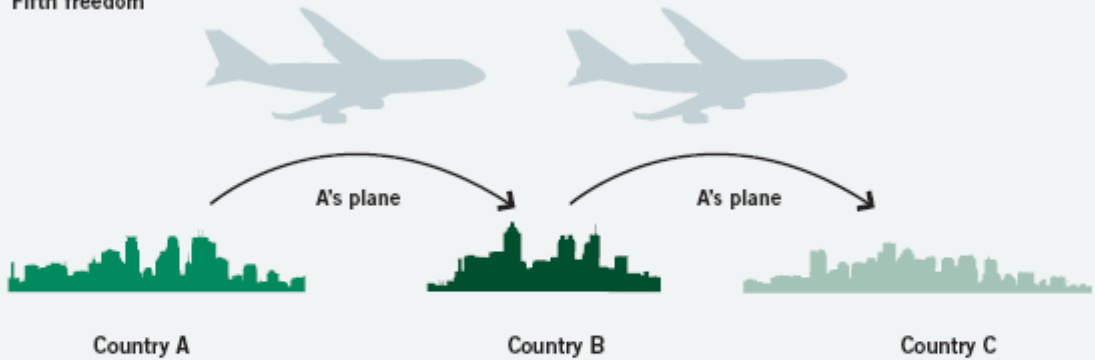


### Third and fourth freedoms



The right of an airline of one country to carry traffic (passengers, mail, cargo) to another country (third freedom).  
The right of an airline of one country to carry traffic from another country to its own country (fourth freedom).

### Fifth freedom



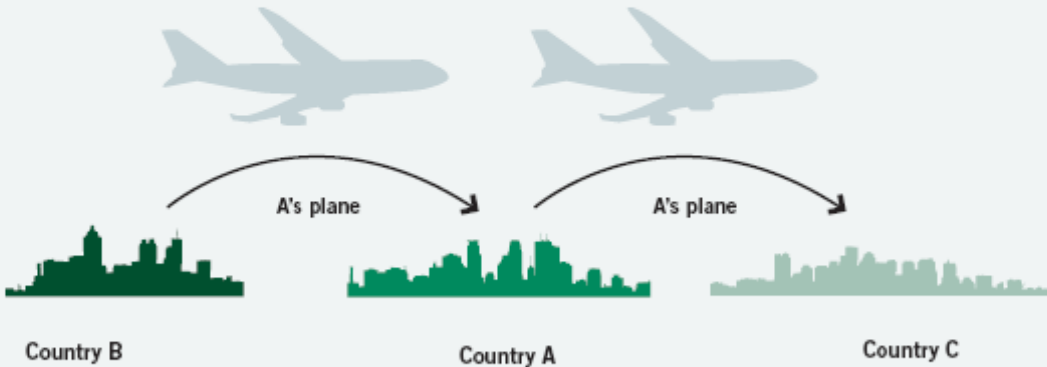
The right of an airline of one country to carry traffic between two foreign countries as long as the flight originates and terminates in its own country.

The third, fourth and fifth freedoms are granted as rights in bilateral air services agreements.

### Other “freedoms”

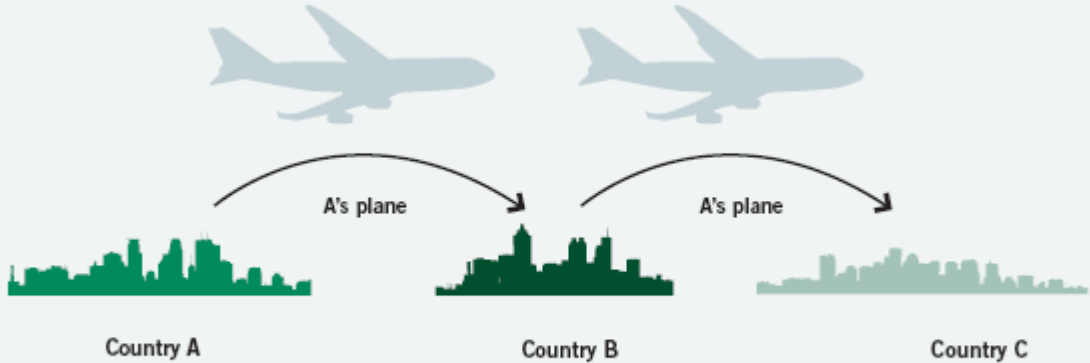
There are a number of other so called “freedoms” which, although not officially recognised by the Chicago Convention or granted in bilateral air services agreements, are referred to and taken into account in bilateral air services agreements, are referred to and taken into account in bilateral negotiations (particularly the sixth freedom). The so called sixth, seventh and eighth freedoms are described below.

#### “Sixth” freedom



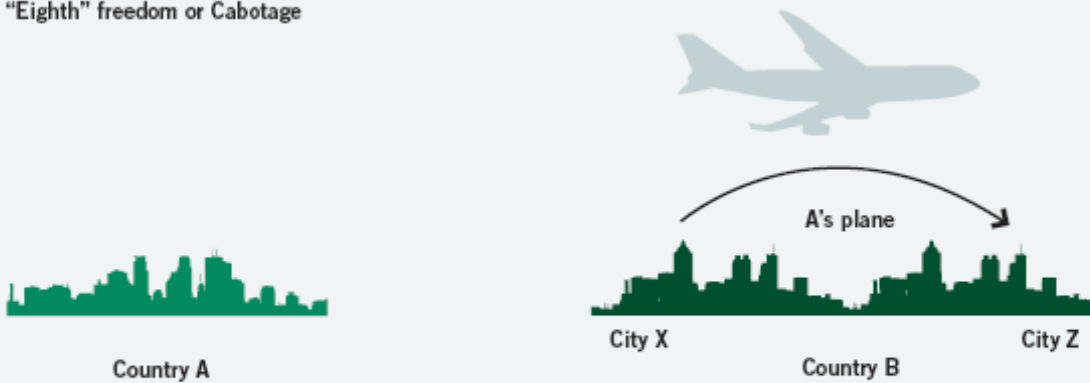
The right of an airline of one country to carry traffic between two foreign countries via its own country. This is a combination of two sets of third and fourth freedoms (with countries B and C).

### "Seventh" freedom



The right of an airline of one country to carry traffic on stand alone services between two other countries.

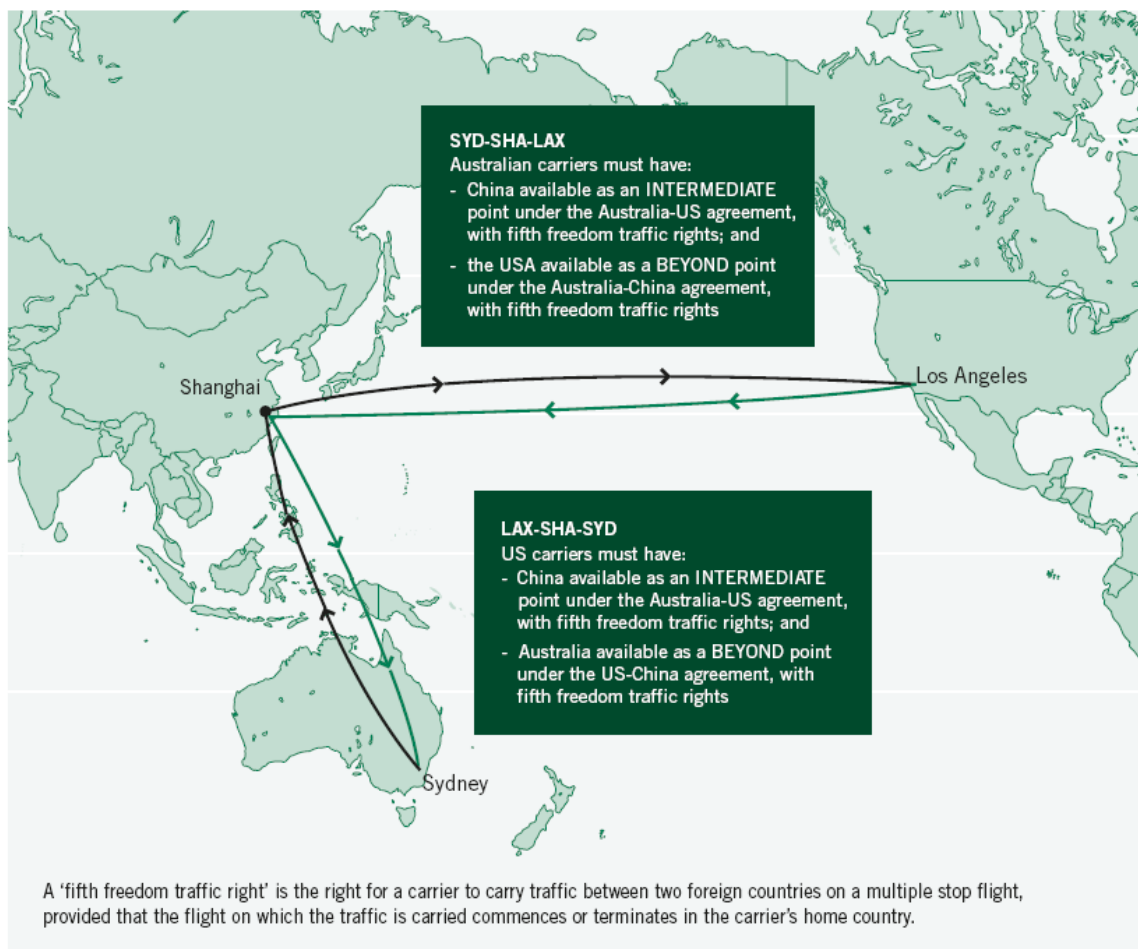
### "Eighth" freedom or Cabotage



The right of an airline of one country to carry domestic traffic between two points within the territory of another country. Also known as cabotage, this right is rarely granted to foreign airlines, although this may change in a single aviation block comprised of a number of countries (eg the European Union).

As the diagrams highlight, the development of a network of bilateral agreements throughout a region or through a region to a more distant point (for example, from Asia to the US) can be complex. For a country at one end of a long-haul route such as Australia, it becomes difficult if rights to the intermediate point are difficult to obtain. As an example, the right for an Australian carrier to operate between Asia and the United States with full fifth freedom traffic rights requires separate negotiations with both the Asian country (to obtain the US as a beyond point) and the US (to obtain the Asian country as an intermediate point).

**Figure 3.2** Indicative route for air services: Australia to USA via Asia




The relative inflexibility of the bilateral system has facilitated the rise of large “hub carriers” such as Emirates, Etihad, Cathay Pacific and Singapore Airlines. These airlines have inherent geographic advantages over end-point carriers such as Australian airlines and are able to consolidate traffic from a range of destinations into their hub to provide a level of commercial service not readily available to end-point carriers.

Australia has been at the forefront of aviation liberalisation since the late 1980s when the domestic industry was deregulated and the then Government embarked upon a series of reforms opening up access on international routes, moving from negotiations based almost exclusively on promoting interests of national airlines to negotiations based on promoting broader trade and tourism benefits.

Australia has continued to move towards ensuring the levels of aviation services are determined by market forces, not government regulations or restrictions. Australia currently has one of the most liberal open skies agreements in the world; the Single Aviation Market agreement with New Zealand. Under this agreement all barriers to each other's domestic and international markets have been removed. Australia also has an open skies agreement with the United States, and there are no restrictions on capacity in Australia's agreements with the United Kingdom and Singapore.

There are few, if any, individual markets that are constrained by the provisions of our bilateral air services agreements and international airlines continue to have the opportunity to grow the market. It is estimated that there are over 150 Boeing 747 equivalent units of unutilised weekly capacity



currently available for foreign airlines under Australia's air services agreements across the top 20 origin/destination markets that still have capacity limits. As outlined above, there are no capacity limits for third and fourth freedom traffic in our agreements with Singapore, New Zealand, the US and the UK.

## **The Government's broader competition reform agenda**

The key to enabling Australian industries, including our aviation industry, to become more competitive is to remove impediments to growth, both at home and abroad. Australian industries can also only compete to their full potential in global markets if barriers to trade are lowered. The Australian Government's approach to trade policy is based on two pillars:

- opening up new markets through international trade negotiations; and
- improving productivity and competitiveness behind the border<sup>7</sup>.

The Australian Government is working to improve productivity through investing in infrastructure and skills, reducing the regulatory burden on business and making Australia's tax system more internationally competitive. Reform is essential for enhancing the efficiency of our industries and to drive economic growth and prosperity.

The Government is committed to pursuing a policy of trade liberalisation at all levels: multilateral, regional and bilateral. At the same time it is important to recognise that not all countries play by the same rules. Tariffs, subsidies and other forms of industry assistance continue to distort trade flows and to place Australia's exporters at a disadvantage in many markets. The Australian Government continues to pursue broader trade liberalisation in the national interest and aviation is no different.

## **The development of a National Tourism Strategy**

In parallel with the development of the Aviation White Paper, the Australian Government is developing a National Long Term Tourism Strategy. The Strategy will assist the Government in achieving its overarching policy goal, which is to maximise the net economic benefit of the tourism industry to the Australian economy. It will provide a long-term vision for the tourism industry and establish the basis for consistent long-term policy engagement with the tourism industry by governments.

The primary focus of the strategy will be on the development of the productive capacity or supply side of the tourism industry. Issues to be considered will include tourism investment, labour and skills, climate change and infrastructure. Consideration of tourism, both supply and marketing, will broaden the focus beyond leisure tourism to include other high yielding segments such as education and business tourism. It will also consider the impact of changing tastes and preferences across Australia's key and emerging markets.


The Aviation White Paper will complement the National Long Term Tourism Strategy, helping ensure continued growth in one of Australia's most important industries.

## **Key challenges**

The international aviation industry faces a number of ongoing challenges. Following a recent period of record high fuel prices, global economic conditions have deteriorated significantly and created conditions of reduced demand, excess capacity and increasing pressure for industry consolidation. To meet these challenges a flexible policy framework is needed that can accommodate growth in international markets over the medium to long-term, with a focus on key growth markets, while maintaining a strong Australian-based industry.

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<sup>7</sup> The Hon Simon Crean MP, Minister for Trade, 17 January 2008, <[http://www.trademinister.gov.au/speeches/2008/080117\\_gurgaon.html](http://www.trademinister.gov.au/speeches/2008/080117_gurgaon.html)>



Australia's policy settings need to give the aviation industry the opportunity to compete effectively with its international competitors, including so-called "hub carriers" that have inherent geographic advantages not available to Australian airlines.

Ensuring safety and security standards are not compromised as the industry grows and foreign airlines continue to expand their presence in the market is also a key policy imperative.

## **Australia's approach to liberalising access to international markets**

Australia's aviation market is small by world standards. As an island nation with a significant tourism industry, the airline industry is a major contributor to Australia's economy. Australia's tourism industry and high-value, time sensitive export industries depend on these links, supporting a range of downstream industries. The Australian Government is committed to maximising the benefits that a strong Australian-based aviation sector provides to the economy.

The Australian Government will continue to pursue a more liberal international aviation market, including "open skies" style agreements in some cases. This does not mean, however, opening our skies while other countries keep their own markets closed. This would allow other airlines to exploit the Australian market without allowing the Australian airline industry to compete in their market.

Some foreign airlines are active in marketing Australia as a tourist destination and have made investments in Australia through sponsorships and establishing maintenance and training centres. The Australian Government is keen to encourage foreign airlines to commit to a long term presence in Australia and invest in our future prosperity.

The Government sees merit in including as a factor to be taken into account in assessing the national interest for bilateral negotiations, the extent to which international airlines are prepared to invest in Australia, through marketing Australia as a tourist destination and through direct investments, such as enhanced commitments to employment of Australian based staff and establishing maintenance and training centres.


There is unutilised capacity in nearly all of our bilateral agreements that provide for continued growth by foreign airlines. The Government will ensure the capacity available to foreign airlines under our bilateral agreements remains ahead of demand to ensure that airlines can plan for long term growth into the Australian market. The long term forecasts produced by Tourism Research Australia (TRA) provide an important framework for assessing demand requirements into the future.

Australia is disadvantaged as a long-haul, end-point destination. As a result we have few competitive traffic rights to trade in order to gain access to valuable markets overseas and we need to maximise what negotiating leverage we do have.

One of the few competitive rights Australia does have is access to the trans-Pacific route between Australia and the United States. The Australian Government has made it clear that it has no immediate plans for additional third country access to the route at this time to allow V Australia a reasonable opportunity to establish its operations. The Government has not ruled out trading such access in the future, where this is considered to be in the national interest. The maximum national benefit possible would be sought if a decision is made to trade such access in the future.

Like many areas of international trade, international aviation is subject to a range of market distortions that advantage some airlines and disadvantage others. Continued government ownership of some international airlines, the presence of government subsidies and support, differing approaches to bankruptcy protection and divergent tax regimes create market distortions beyond the scope of bilateral air services arrangements. These accentuate the competitive advantages many foreign airlines enjoy, compounding inherent geographic advantages many enjoy over end-point carriers such as those based in Australia.

The Australian Government proposes to continue to take a pragmatic approach to liberalisation



based around achieving a balance between the economic, trade and tourism benefits that flow from opening up international aviation markets and the need to ensure a strong Australian-based aviation sector.

## **International market outlook and market priorities**

Today's industry also faces serious global challenges. The world economy is changing rapidly and has become increasingly unpredictable. Earlier this year the industry was dealing with record high fuel prices and is now dealing with softening demand due to the effects of global economic conditions.

The International Air Transport Association (IATA) reported earlier this year that the aviation industry made a profit of \$5.6 billion in 2007, the industry's first profit since 2000. However, record high fuel prices and slowing traffic growth were expected to result in industry losses of \$5.2 billion in 2008. IATA has since revised this forecast following a three per cent decline in international passenger numbers in September. This was described as the largest decrease since the outbreak of SARS in 2003. IATA now predicts industry-wide losses could exceed its original estimate, despite the recent fall in world oil prices<sup>8</sup>.

The aviation industry is familiar with shocks, with demand adversely affected by airline collapses, terrorist threats and incidents and disease outbreaks such as SARS. Softening economic conditions, changes in currency rates, airport capacity constraints and policy responses to climate change will all influence future demand. Despite this, international aviation is still expected to grow strongly in the medium to long term.

Longer-term forecast growth to and from Australia is expected to continue as reflected in the most recent TRA forecasts. Notwithstanding short-term effects currently being experienced, the number of arrivals to Australia is forecast to increase at an average annual rate of 4.4 per cent to 2017, to reach 8.7 million<sup>9</sup>. However, in the short-term, taking account of current pressures arising from the global financial crisis, a temporary decrease in the number of international passengers is likely.

Australia's negotiating priorities will continue to be designed to ensure that emerging opportunities in key markets are taken up and that capacity remains ahead of demand.

Much of the medium to long-term growth will be driven by Asia and the Middle East, with inbound visitor arrivals from India increasing at an average annual rate of 16.5 percent, China 12.2 percent, and the Middle East 10.9 percent. The Asian region remains a market of strong growth potential, while some of our more mature markets such as Japan, the UK and Europe are expected to experience more modest growth, and may even contract.


Negotiations are underway on a comprehensive air services agreement with the European Union (EU) that would replace the current bilateral agreements with EU Member States. Such an agreement would remove many, if not all, of the traffic right restrictions currently in place for services by Australian and European airlines between our respective markets. Other priority markets to which the Government is seeking greater access include China, India, and countries in the Asia-Pacific and South American regions.

While the commercial interest of Australia's airlines are an important consideration, Australia's broader economic and tourism interests are the top priority when setting negotiating priorities. The Government is strongly committed to ongoing consultation to plan Australia's forward negotiating priorities to ensure that these broader interests are taken into account. The National Tourism and Aviation Advisory Committee (NTAAC) will continue to be an important consultative body for discussing negotiating priorities with the tourism and aviation industries.

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<sup>8</sup> IATA Press Release, 24 October 2008, Alarming Drop for September International Traffic <>

<sup>9</sup> Tourism Research Australia: Forecast 2008 Issue 1



It is not always possible to act quickly on these priorities or to achieve the outcomes that Australia may be seeking from negotiations. What may be a priority for Australia may not be a priority for our bilateral partner. What may be a good outcome for Australian airlines may be resisted by our bilateral partner. As a result, our bilateral arrangements often represent a compromise outcome that seeks to balance the needs of both parties.

## **Improving access to regional areas**

The Australian Government offers foreign airlines unlimited access to airports other than Brisbane, Sydney, Melbourne and Perth, often referred to as the 'regional package'. This policy is designed to spread the benefits of international tourism more broadly across Australia, and in particular to regional centres.

To date few foreign airlines have taken up the opportunity to operate to regional airports. While this could change in the future as low cost airlines target smaller secondary airports that have lower charges, less expensive facilities and less competition than the major airports, it is not expected that significant numbers of foreign airlines will take up the available opportunities in the short to medium term.

A number of submissions have raised the difficulties in attracting foreign airlines to regional airports and put forward suggested solutions including:

- improving the cost-competitiveness of regional airports by reducing government imposts (such as Airservices Australia charges and costs of border security); and
- changes to the ownership requirements for Australian international airlines to enable majority foreign-owned domestic airlines, such as Tiger Airways Australia, to operate international services from Australia.

While sympathetic to the difficulties faced by regional airports in attracting foreign airlines, the Australian Government does not believe that the proposals suggested would result in foreign airlines commencing services to regional airports. Airlines will continue to make decisions based on commercial considerations, with aircraft deployed to routes where they can make the greatest profit. In difficult economic conditions it is the marginal routes and those routes that can be accessed indirectly via capital city markets that are placed under the most pressure. As a result, services to regional airports are often the first to suffer.

Regions can play an important role in improving the quality of the tourism product and the associated tourism infrastructure to attract international services. The Australian Government will examine these issues through the National Long Term Tourism Strategy. It is also open to state governments, tourism authorities and regional airports to work with international airlines to develop a sustainable package for services into regional Australia.

Increased access by international airlines into regional airports also raises issues about the provision of appropriate border control arrangements for international services and how border control services such as customs, immigration, quarantine and policing at secondary airports would be funded were they to become international airports. These issues are discussed further later in this chapter.

The Australian Government recognises the importance of minimising regulatory barriers to international airline services in regional Australia and proposes to continue offering foreign airlines unlimited access to secondary gateways (international airports other than Brisbane, Sydney, Melbourne and Perth).



## **Air cargo – continuing on the path to growth**

Long-term global forecasts for international airfreight point to continued strong growth over coming decades. While the global financial crisis will impact the growth of air freight in the short-term, as economic conditions improve air freight is expected to grow strongly. Most of Australia's international freight is carried in the belly hold of passenger aircraft, but dedicated freighters are an important and growing part of the international freight business.

In recent times Australia has pursued a policy of 'open skies' for dedicated cargo services and this is reflected in over 30 of our bilateral agreements. These arrangements have provided benefits to the Australian economy and to our export industries in particular. The Australian Government proposes to continue to seek removal of limits on all cargo capacity in our bilateral agreements wherever possible to support our vital air freight export industries.

## **International charter flights – are changes necessary?**

Most international flights operate to a scheduled timetable year-round and are directly subject to the capacity provisions of the relevant bilateral air services agreement. International charter flights, or non-scheduled flights, are different. Such flights often seek to capitalise on the seasonality of demand in some markets or are used by airlines to 'test' whether or not there is a sustainable market for international services, particularly to regional Australia.

Successive Australian governments have been supportive of a liberal approach to the approval of international charters, subject to the operator meeting key regulatory requirements related to safety and security. This liberal approach has provided greater opportunities for Australian consumers and visitors to travel internationally and has delivered benefits to the economy.

The Australian Government's preference is for a liberal access regime for international charters, including:


- linking favourable consideration of a charter approval to broad public interest criteria, which focus on consumer needs, the promotion of trade and tourism, and benefits to regional Australia;
- maintaining the current wide range of charter flight categories that receive automatic approval; and
- ensuring that charter operators protect consumers from financial loss in the event that the charter operator fails to fulfil its obligations to them.

## **Cabotage – are the restrictions necessary?**

Cabotage, or the right of a foreign airline to carry domestic passengers in another country, is not a right that is normally granted in bilateral air services agreements. There are few countries that allow cabotage, except in the context of the integration of broader economies, such as in the case of Australia and New Zealand, and between EU countries.

Successive Australian governments have taken the view that it is important that airlines carrying domestic passengers be subject to the full regulatory oversight of CASA through a requirement to hold an Australian Air Operator's Certificate (AOC). The restrictions on cabotage also recognise that, given Australia's small domestic market, the routes most likely to be attractive to foreign airlines would be the thicker routes between Melbourne, Sydney and Brisbane, which are already highly competitive. To the extent that foreign airlines could marginally price their services on these routes, the financial impact on Australian domestic carriers could lead to further rationalisation of services on some of the thinner routes that serve our important regional centres.

Some stakeholders have argued that a relaxation of cabotage restrictions could encourage international airlines to service regional airports, while others have argued that it would provide an



additional level of competition in the domestic market. A specific example put forward was that foreign airlines should be permitted to carry domestic passengers between cities in Australia that are not well served by domestic airlines.

The Australian Government does not consider that a compelling argument has been put forward for a substantial change to the current policy at this time. The Government notes that scheduled domestic services are provided to all airports likely to attract international traffic and the provision of cabotage for international airlines is likely to come at the cost of some services provided by domestic airlines.

In coming to this view, the Government notes that Australia is one of the only countries in the world that allows up to 100 per cent foreign ownership of its domestic airlines. This provides foreign international airlines such as Tiger Airways with the ability to establish domestic subsidiaries and have unrestricted access to Australia's domestic aviation market.

There may, however, be an economic case for considering requests by foreign airlines to carry domestic passengers on routes which are not currently served by scheduled domestic airlines or which require a government subsidy. Such routes might include those between some of Australia's external territories and the mainland. Allowing cabotage in such circumstances may arguably be in the national interest as there would be a public benefit in introducing services on routes that are not currently served or require government funding. The Government considers that any decision to grant such rights should only be in exceptional circumstances and with the full agreement of Australia's aviation safety regulator, CASA.

## **Trading of “seventh freedom rights” – worth pursuing?**

Seventh freedom rights, or the right of an airline of one country to operate stand-alone services between two foreign countries, are not something normally granted in bilateral air services agreements. However, these rights are becoming more common for dedicated cargo services and there are signs of a change in the approach of some countries to passenger services also.

In the European Union Common Aviation Area many carriers, particularly low cost carriers, operate flights between two points without connecting to their home country. In October 2007, the United Kingdom and Singapore initialled an open skies agreement that allows unlimited seventh freedom rights.

There have been calls in some submissions for the Australian Government to take a broader view and allow foreign owned airlines to operate stand-alone services between Australia and third countries, particularly where that airline has its principal place of business in Australia.

The granting of seventh freedom rights is complex and requires agreements with at least three countries for a viable service to be operated. As an example, Jetstar Asia currently operates out of Singapore, but because there are no seventh freedom rights in the Australia-Singapore bilateral agreement, it must be majority Singapore owned and controlled. One difficulty with seventh freedom rights is that rights between the country whose nationals own the airline and the country from which the airline wants to operate are not enough. In order to establish a network from its operating base, the countries to which the airline wants to fly would need to have seventh freedom rights with the country in which it is based.

To take the Jetstar Asia example, if Australia had seventh freedom rights with Singapore and Jetstar Asia became majority Australian owned, Singapore would need to have seventh freedom rights in its bilateral agreements with the countries to which Jetstar Asia wished to fly. Nonetheless, if as seems likely seventh freedom rights do become more common, momentum could build and they could become of real value to airlines wanting to establish off shore operations.

The Government proposes to trade seventh freedom rights on a case by case basis subject to a national interest test.

## Liberalisation through multilateral and regional arrangements

Australia has been an active participant in working towards multilateral liberalisation of international aviation through such forums as the WTO, the International Civil Aviation Organization (ICAO) and Asia-Pacific Economic Cooperation (APEC)

While international trade in most services is regulated by the General Agreement on Trade in Services (GATS), air transport services related to air traffic rights are not covered by the GATS and WTO members do not negotiate commitments in relation to air transport services in the WTO.

Ancillary services to aviation are, however, covered by the GATS and WTO members do negotiate commitments on market access and national treatment in relation to ancillary aviation services in the WTO. The ancillary services to air transport, or so called 'soft rights', covered by the GATS include aircraft repair and maintenance, the selling and marketing of air transport services and computer reservation system services. Australia continues to advocate for liberalisation of these services in the WTO. In addition, Australia is seeking to expand this list, initially to include ground handling and airport management services.

The issue of including 'hard rights', or economic regulation of routes and capacity, in GATS is a longer term objective, but nevertheless an important one. Most countries, however, continue to prefer to keep these rights within bilateral arrangements and realistically in the short to medium term the bilateral system offers the best prospect for opening up the skies to more competition.

Since the election of the Rudd Government, Australia has stepped up efforts to liberalise its aviation relationship with its largest aviation market, the EU. In June this year, European transport ministers approved a mandate for the European Commission to negotiate an EU wide open skies agreement with Australia.

Such an agreement could remove many, if not all, of the existing regulatory limitations on Australian and European airlines operating between our two continents and has the potential to deliver greater competition, more flights and lower air fares between Australia and EU countries. The agreement will cover more than market access issues, and is likely to address competition, safety and security and environmental protection issues. The first round of negotiations was recently held and further discussions are planned for early next year.

The Australian Government will also investigate opportunities to work with key regional bodies such as Association of Southeast Asian Nations (ASEAN) and APEC to promote greater liberalisation in the Asia-Pacific region, including the promotion of possible multi-lateral arrangements in the region.

## The regulatory framework for Australia's international airlines

### Foreign ownership rules – is there a need for change?

Australia's international airlines are subject to restrictions on the level of foreign ownership. For airlines other than Qantas, these are set out in the *Air Navigation Act 1920*. For Qantas they are set out in the *Qantas Sale Act 1992*.

The Air Navigation Act requires that no more than 49 percent of the total value of the issued share capital of an Australian international airline may be held by foreign persons. Should an airline be, or become, more than 49 percent foreign owned then the Australian Government will not designate it, or will withdraw its designation, as an Australian international airline and it will be unable to access the available rights under Australia's bilateral agreements.

The Qantas Sale Act requires that Qantas's Articles of Association contain provisions which will ensure that:

- Qantas's main operational base and headquarters remain in Australia;
- the name of Qantas is preserved for the company's scheduled international passenger



services;

- the company be incorporated in Australia;
- at least two-thirds of the board of Qantas be Australian citizens;
- the chairman of the board also be an Australian citizen; and
- total foreign ownership is not to exceed 49 per cent.

The Qantas Sale Act also requires that no single foreign interest can exceed 25 per cent of the equity of Qantas and that total foreign airline equity not exceed 35 percent.

The current ownership restrictions are designed to ensure that Australian international airlines satisfy key elements of our bilateral agreements. Most of our bilateral agreements incorporate provisions that require a country's international airlines to be substantially owned and effectively controlled by nationals of that country.

There has been an increasing trend towards consolidation and/or equity alliances among international airlines. This trend is expected to intensify in the future as airlines seek to meet the global challenges of difficult economic conditions. It is vital that Australia's airlines have the opportunity to participate in this global rationalisation where it provides strategic and commercial advantages.

Consistent with international reform efforts, Australia has increasingly sought to move towards an ownership test in our bilateral agreements based on principal place of business. Principal place of business criteria are focussed on where an airline is based and which country has effective regulatory oversight of the airline rather than who owns the equity of the company. To date Australia has negotiated principal place of business criteria into 39 of our bilateral agreements, though many of our major markets retain substantial ownership and effective control criteria.


The Australian Government proposes to continue to seek principal place of business criteria in all our bilateral agreements to ensure that our airlines can take advantage of consolidation opportunities and equity alliances with other international carriers.

Some submissions have argued that the Australian Government's support for principal place of business criteria is inconsistent with the current foreign ownership restrictions set out in the Qantas Sale Act and Air Navigation Act. The Government considers that the current approach balances Australia's interests in ongoing reform of the international aviation industry with the reality that Australia is arguably more dependent on aviation than any other nation for its long-term prosperity.

The Qantas Sale Act and Air Navigation Act have played an important role in the development and maintenance of a strong Australian-based aviation industry and the Government does not propose to fundamentally change the current restrictions. However, there would appear to be merit in ensuring that the investment regime applies equally and equitably to all Australian international airlines and to consider how we accommodate global moves towards ownership and control criteria based on principal place of business to ensure our airlines are not disadvantaged.

The Government proposes to retain the basic restriction of 49 per cent on foreign investment in Australia's international airlines under the Qantas Sale Act and the Air Navigation Act to ensure that our airlines remain majority Australian owned and controlled, but will consider whether it may be appropriate to:

- remove the additional restrictions on foreign ownership (i.e. 25 per cent for foreign individual shareholdings and 35 per cent for total foreign airlines shareholdings) under the Qantas Sale Act;
- seek greater investment opportunities in international airlines for Australian investors through the incorporation of principal place of business criteria in our bilateral agreements; and
- examine whether Australia should move from a regime based on substantial ownership



and control to one based on principal place of business, consistent with maintaining a commitment to a strong Australian-based aviation industry with high safety and security standards.

The Government will consider removing the intermediate caps of 25 per cent on individual foreign airlines and 35 per cent on aggregate foreign airline interests, which may open additional options for structuring investment, while ensuring the airline remains Australian-run and Australian-based.

At the same time, the Government acknowledges the international trend away from a regulatory environment based on substantial ownership and control, to one based on 'principal place of business' and proposes to continue seeking incorporation of principal place of business criteria in bilateral agreements.

In considering whether to ensure Australia's airlines are reasonably able to take advantage of moves towards airline consolidation in the global aviation industry, the Government will continue to apply the test of overall national interest.

### **Taxation and related issues – industry calls for change**

Industry stakeholders, particularly airlines, argue that some aspects of Australia's taxation system impede airlines' access to foreign capital and place Australia's airlines at a competitive disadvantage to their international competitors.

In particular, it has been suggested that the Government should consider changes to the taxation framework to:

- reduce the current statutory cap on aircraft effective life of 10 years to a level more commensurate with international competitors, e.g. three to five years;
- reintroduce the investment allowance to support fleet growth and re-investment;
- reintroduce the balancing charge offset, but limited in application to the reduction in the depreciable value of replacement assets; and
- revise Australia's double tax treaties to ensure that Australian airlines are not disadvantaged relative to competitors<sup>10</sup>.

The Australian Government is currently undertaking a review of Australia's taxation system. The review will make recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the twenty-first century. The Government considers that suggestions for specific sectoral relief, such as that proposed by the aviation industry, is best considered as part of this broader review. This will ensure that broader economy-wide impacts are taken into account and any sectoral distortions are minimised.

### **Passenger facilitation and border control – coping with growth**


#### **Key challenges**

New generation aircraft such as the Airbus A380 and Boeing 787 are changing the profile of Australia's aviation market. In particular, the Airbus A380 will result in large numbers of passengers arriving at one time at an Australian airport. An additional feature of the new generation of aircraft is their increased range and ability to fly directly to and between secondary airports. This creates the possibility of new destinations becoming attractive to airline operators, particularly low-cost carriers.

Some Australian regional centres see opportunities to become international tourist destinations and to expand their local economies and may consider significant investment in facilities to cater for

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<sup>10</sup> "Towards a National Aviation Policy Statement", Submission by Qantas Airways Limited, July 2008, p xvii



international services. While expanding the number of direct international gateways may provide additional tourism opportunities, there are significant start-up and operational costs and issues to be considered. No new international airports have been established in the last decade, but the emergence of low cost carriers is a relatively new phenomenon and pressures to open up more secondary gateways to international flights are increasing.

The challenge for government is to put in place a framework that ensures Australia's airport infrastructure is capable of meeting the demands of increased passenger numbers and cargo volumes and the introduction of new aircraft types. Australia's border agencies also need to be positioned to meet both the demands of continuing growth at existing airports and the demands for the provision of border control and security agency services at new international airports. The Government will ensure that the existing cost recovery methods and funding models for the provision of border agencies' services are appropriate to meet this continued growth and are transparent to industry.

### **A plan to meet growth at existing airports**

Sustained growth in passenger numbers, cargo volumes and new aircraft types will continue to put pressure on Australia's airport infrastructure. Pressure points appear in a range of areas:

- physical limitations of some existing airports;
- the capacity of existing baggage handling systems and arrival and departure halls; and
- the logistics and infrastructure for cargo handling at on-airport sites in key capital cities.


However, there is a general acknowledgement among stakeholders that there is not a single, easy solution for these pressures. Both industry and the Government's border agencies are taking steps to address many of the existing shortfalls:

- airports are undertaking significant terminal developments, many to help passengers move efficiently through customs, quarantine and baggage collection areas;
- new technology is being adopted where possible to speed up baggage handling and baggage screening processes; and
- border agencies are also introducing processes and initiatives that aim to improve passenger flow and technology, such as Customs' SmartGate.

In response to these pressures the Passenger Facilitation Taskforce (the Passenger Taskforce), comprising representatives from Australian Government agencies, has been established to address the implications of the projected growth in passenger numbers, but in particular to give specific attention to ensuring border security arrangements and elements of the service delivery chain over which the Government has influence are addressed.

The Passenger Taskforce works closely with an industry consultative body comprising airports, airlines and a range of industry associations. The work plan, jointly developed with industry, has identified five key enabling strategies:

- the development and implementation of accurate forecasts and planning strategies;
- improvements to the existing industry/government consultation mechanisms;
- a review of risk assessment, passenger management and passenger interaction practices to improve and enhance passenger facilitation while maintaining border integrity;
- the development and implementation of a National Facilitation Standards framework for all international airports; and
- ensuring efficient and effective infrastructure for passenger facilitation arrangements in consultation with industry.



The Passenger Taskforce and industry representatives have progressed a large body of work against the enabling strategies. These include:

- Express Path Trials at key international airports that seek to expedite the departure and arrival of defined passengers. The trials demonstrated benefit to overall passenger flows by reducing congestion;
- a travellers' charter has been implemented identifying to passengers the way they can expect to be treated while passing through Australian airports;
- Outwards Redevelopment Principles have been developed that can be applied at any Australian international airport when redeveloping the outwards experience for departing passengers;
- in-line quarantine x-ray feasibility trials have been undertaken at Sydney and Melbourne airports. The trials seek to assess whether in-line x-ray quarantine screening in the baggage area may enhance the efficiency of passenger flows in the secondary examination area. A final report on the outcomes of this process is due shortly;
- a planning and information sharing mechanism has been implemented to improve both industry and government planning activities at the strategic and operational levels through the development of a common set of international passenger forecasts;
- a Passenger Facilitation Performance Framework project is being undertaken to develop a new suite of passenger facilitation standards at Australian international airports for the Government's consideration. The project is expected to be completed in early 2009;
- a Trans-Tasman Passenger Facilitation Working Group (the Working Group) has been established, comprising customs, immigration and quarantine representatives from Australia and New Zealand and select industry representatives. The Working Group is progressing a body of work aimed at streamlining trans Tasman travel; and
- the Passenger Taskforce is developing a Strategic Outlook for informing a whole of airport approach to international passenger processing and facilitation into the future. It will detail the government and industry response for managing passenger processing, facilitation and capacity at Australian international airports while maintaining Australia's border integrity. The Strategic Outlook is expected to be completed by early 2009.


The Government is committed to ensuring appropriate structures are in place to bring a comprehensive approach to passenger facilitation both nationally and at individual international airports.

A coordinated approach similar to that adopted for the Passenger Taskforce may be beneficial in relation to international cargo and freight management issues at airports, noting in particular:

- the impact that industry plans for development of airports and commercial plans for the receipt, storage and management of freight can have on existing mechanisms for delivering border and security controls by government; and
- the potential overlap areas between security related initiatives and broader management of border risks.

### **Principles for provision of government services at new international airports**

The strong growth of low-cost carriers has brought a new dynamic to the Australian aviation market. The Government's regional package, which gives foreign airlines unlimited access to airports other than Brisbane, Sydney, Melbourne and Perth, provides low cost carriers with the opportunity to serve secondary gateways, spreading the benefits of international tourism more broadly across Australia.



While there has been limited take-up of the regional package by international airlines to date, this could change as low cost carriers target smaller airports with lower landing and airport charges and less competition than the major airports. This raises a number of issues about the provision of appropriate border control arrangements for international services and how these services should be funded.

The Australian Government has recently agreed a set of principles and an approach for the provision of government services at new international airports. These principles and supporting guidelines will be released in early 2009. These principles broadly cover the following:

- an assessment against national interest criteria;
- the provision of a sustainable, evidence-based business case demonstrating viability;
- no unreasonable barriers to entry into the market;
- the establishment of a new international airport should not of itself produce a diminution of Commonwealth service standards at existing airports ;
- new international airport proponents pay for infrastructure and capital start up costs consistent with the 'Guide to Airport Operators', which was released in October 2008; and
- the approval process for the establishment of new international airports to be efficient, equitable and transparent.



## **Adequacy of the existing cost recovery methods and funding models for the provision of border agencies' services**

At Australia's eight existing international airports the costs of border protection and the Australian Federal Police (AFP) presence are provided at no charge to either the airport or airlines. However, airports do provide space within their terminals for border and border related agencies to undertake their regulatory functions and some supporting facilities such as staff car parking.

In terms of border agency funding, only Customs and Immigration are funded to some extent in relation to increasing passenger numbers through workload growth mechanisms in their funding arrangements. However, Quarantine and the AFP have no such workload growth arrangements in place.

The Australian Government recognises there are many challenges facing our border agencies if they are to be able to continue to provide and maintain the current, consistently high level of passenger facilitation processing. The Government will ensure the existing cost recovery methods and funding models for the provision of border agencies services are appropriate to meet these challenges.

In relation to resources, particularly staffing levels, border agencies are finding it difficult to keep pace with the demand at airports. This is a problem facing not just the border agencies, but also the aviation industry and the economy as a whole. Skills shortages in the industry are discussed in more detail in Chapter 6.

A number of processes in other areas of government are already underway and will provide further information on issues such as funding and risk assessment processes facing a number of agencies, including AQIS. For example, the outcomes of the Australian Government's *Quarantine and Biosecurity Review* may well have an effect on how future quarantine services are delivered.

## **International air services policy – the way forward**

### **Key objectives**

- The Australian Government is committed to continuing the growth of Australia's international air services, providing additional opportunities for trade and tourism, while maintaining a strong Australian aviation sector.
- The Australian Government intends to pursue an active strategy to further liberalise the aviation sector, seeking co-operation with like-minded partners. Liberalising Australian skies and opening markets for Australian carriers will drive growth through competition and remove unnecessary regulatory burden on businesses.
- Commercial and regulatory settings in other countries, such as government subsidies and support, bankruptcy protection and divergent tax regimes create market distortions that undermine the competitiveness of Australian airlines. Recognising this system of unbalanced economic advantage, the Government will continue to take a pragmatic approach to our liberalisation strategy, acting in the overall national interest.

### **Key features of the policy**

The Australian Government proposes to:

- continue the liberalisation of international aviation towards 'open skies' agreements, balancing the economic, trade and tourism benefits that flow from opening up international aviation markets and the need to ensure a strong Australian-based aviation sector;
- ensure the capacity available to foreign airlines under our bilateral agreements remains ahead of demand to ensure that airlines can plan for long term growth into the Australian



market;

- offer foreign airlines unlimited access to secondary gateways (international airports other than Brisbane, Sydney, Melbourne and Perth) to provide opportunities for regional areas to attract international services;
- seek fully open arrangements for dedicated cargo services to support Australia's vital air freight export industries;
- include as a factor to be taken into account in assessing the national interest for bilateral negotiations, the extent to which international airlines are prepared to invest in Australia, through marketing Australia as a tourist destination and through direct investments, such as enhanced commitments to employment of Australian based staff and establishing maintenance and training centres;
- retain the existing arrangements that prevent foreign operators from carrying domestic passengers, except in exceptional circumstances and subject to a national interest test;
- seek greater investment opportunities in international airlines for Australian investors through the incorporation of principal place of business criteria in bilateral agreements;
- retain the basic restriction to 49 per cent on foreign investment in Australia's international airlines under the *Qantas Sale Act 1992* and *Air Navigation Act 1920* to ensure that our airlines remain majority Australian owned and controlled, but
  - consider removing the additional restrictions on foreign ownership (i.e. 25 per cent for foreign individual shareholdings and 35 per cent for total foreign airlines shareholdings) under the *Qantas Sale Act*; and
  - examine whether Australia should move from a regime based on substantial ownership and effective control to one based on principal place of business, consistent with maintaining a commitment to a strong Australian-based aviation industry with high safety and security standards; and
  - approach issues relating to the scope for consolidation in the airline industry on the basis of national interest judgements.
- use key international trade forums to pursue a multilateral approach to the liberalisation of international aviation; and
- establish a joint government/industry national passenger facilitation committee. The committee will:
  - develop a strategic outlook, or master plan for improvements to international passenger facilitation into the longer term;
  - provide a renewed focus on reform initiatives already underway or planned; and
  - work through international forums such as ICAO for improved standards and recommended practices for passenger facilitation.