



Australian Government
Productivity Commission

September 2023

Inquiry into Commonwealth bilateral air service agreements

Productivity Commission submission

The Productivity Commission acknowledges the Traditional Owners of Country throughout Australia and their continuing connection to land, waters and community. We pay our respects to their Cultures, Country and Elders past and present.

The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long-term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

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Introduction

The Productivity Commission welcomes the opportunity to make this submission to the inquiry into Commonwealth bilateral air services agreements.

This submission makes two key points:

- **Benefits of further liberalisation:** The Commission has previously found that although Australia's international aviation policy settings have generally served Australia well, there would likely be net benefits to the Australian community from further liberalisation of international air services – specifically, from granting international airlines greater access to Australia's major airports (Brisbane, Melbourne, Perth and Sydney).¹ We remain of this view.
- **Transparent cost-benefit analysis:** The Commission also found – and remains of the view – that decisions and outcomes could be improved with greater use of transparent cost–benefit analysis, which includes a clear statement from the Australian Government about how it assesses the aggregate national interest and how any trade-offs are made when balancing the interests of different groups.

The remainder of this submission sets out these points in further detail.

There is scope for further liberalisation of air services

Access to international aviation markets is governed by a complex web of government-to-government bilateral air services agreements. These agreements set out what routes international airlines can fly and their capacity entitlements (the number of seats or flights that can be operated on a particular route). The Australian Government has negotiated over 100 air services agreements that provide foreign airlines with varied levels of access to Australia's aviation market.

Under most of Australia's air services agreements, access (capacity) is restricted for international airlines flying to and from Australia's major airports but is unrestricted to other Australian airports – a policy referred to as the 'regional package'.

As in all markets, restrictions on access to aviation markets *can* impede competition between airlines, reducing the range and quality of services offered, discouraging innovation and increasing prices. These effects are ultimately felt by the community, particularly passengers travelling abroad, tourism operators and users of international freight services. But the extent to which these effects are experienced depends on whether capacity limits are binding.

Capacity has grown significantly but is constrained on some routes

International aviation capacity into and out of Australia has grown significantly in recent decades, from nearly 15 million available seats in 1991-92 (PC 2015a, p. 59) to nearly 54 million available seats in 2018-19 (BITRE 2022, p. 6).² However, lack of capacity on some routes has been a recurring issue. This

¹ See *International Air Services* (PC 1999), *Australia's International Tourism Industry* (PC 2015a) and *Barriers to Growth in Service Exports* (PC 2015b).

² Available seat capacity in 2018-19 is provided to indicate growth over recent decades because the years since 2018-19 have been impacted by COVID-19. Available capacity reached a low of 5.6 million seats in 2020-21 but increased to just over 12 million seats in 2021-22 (BITRE 2022, p. 6).

is despite the longstanding (and continuing) policy to negotiate bilateral air services agreements that provide ‘capacity ahead of demand’ (Australian Government 2023, p. 185).

In 2015, the Department of Infrastructure and Regional Development acknowledged that some markets were constrained – including Hong Kong, Malaysia and Qatar – but stated that the overall strategy for negotiating bilateral agreements was not impeding tourism growth (Department of Infrastructure and Regional Development 2015, p. 3). Since then, capacity entitlements for airlines from Hong Kong providing services to and from Australia’s major airports have not been increased. They have been increased by 11% for airlines from Malaysia and have doubled for airlines from Qatar, from 14 to 28 services per week.³ However, these entitlements for airlines from Qatar have been fully exhausted (Department of Infrastructure, Transport, Regional Development, Communication and the Arts 2023, p. 2), and the Transport Minister recently decided not to grant a request from Qatar to increase the number of flights permitted under the Australia-Qatar air services agreement.

In addition, all capacity entitlements under the ‘Enhanced Regional Package’ (ERP) have been exhausted for Qatar (Department of Infrastructure, Transport, Regional Development, Communication and the Arts 2023, p. 2). The ERP allows international airlines to access Australia’s major airports but only if they operate via or beyond another airport in Australia as part of the same trip.

For example, Qatar Airways operates a service that travels from Doha to Melbourne, and then on to Adelaide. However, this flight is not permitted to take on domestic passengers at Melbourne (due to cabotage restrictions⁴) and so the final leg of the Doha-Melbourne-Adelaide flight often travels as a ‘ghost flight’ with few or no passengers (Visontay 2023).

The Commission cautioned in 2015 that this sort of triangulation without cabotage could result in an inefficient allocation of international air services if airlines choose to use it to access major gateways that they are otherwise unable to access due to capacity constraints within bilateral agreements (PC 2015b, p. 119).

A more efficient outcome would be to allow foreign airlines to access, on an unlimited basis, Australia’s major airports through amendments to bilateral air services agreements.

Moving towards unrestricted access to Australia’s major airports

The Productivity Commission has previously recommended a staged approach to liberalisation, starting with providing unrestricted access to Brisbane, Melbourne and Perth airports, and following that, to Sydney Kingsford Smith Airport unless a published assessment demonstrates that the expected costs of doing so would outweigh the expected benefits to the Australian community. The Commission considered that Sydney Kingsford Smith Airport (as Australia’s largest airport) was the only Australian airport where restricting access potentially provided the Australian Government with leverage in its bilateral negotiations (PC 2015b, p. 243).

The potential benefits of this liberalisation (which include potentially lower travel costs and greater choice of services and airlines) would likely be most immediately felt where capacity limits are currently binding, or close to being binding, such as for airlines from Qatar, Fiji and Hong Kong (Department of Infrastructure, Transport, Regional Development, Communication and the Arts 2023, pp. 1-2).

There is no guarantee that additional air services will be provided to particular airports if unrestricted access is granted, as airline route decisions are ultimately based on the commercial interests of airlines. However,

³ Comparisons in permitted capacity over time are based on *Growth Potential for Foreign Airlines* for the Northern Summer 2015 season and the Northern Summer 2023 season (Department of Infrastructure and Regional Development 2015, pp. 13-14; Department of Infrastructure, Transport, Regional Development, Communication and the Arts 2023, pp. 1-2).

⁴ ‘Cabotage’ refers to foreign carriers’ right to carry traffic between two points within a country.

providing unrestricted access would simplify airlines' and airports' assessments of what services to operate and enable decisions to be driven solely by commercial considerations.

Transparent cost-benefit analysis is needed

When negotiating air services agreements with foreign governments, successive Australian Governments have stated an objective of seeking to advance Australia's national interest. The recently released *Aviation Green Paper* noted that this includes 'looking to enhance Australia's international aviation capability, and access to key international passenger and freight markets' (Australian Government 2023, p. 185). Similarly, in 2015, the Australian Government's policy objective for international aviation was to balance the interests of the Australian aviation industry with those of the broader community (PC 2015b, p. 244).

Concerns about how the Australian Government assesses the national interest are not new, and were a key issue raised by participants in previous Commission work relating to international air services (PC 2015a, p. 13).⁵ These concerns related to a lack of transparency in the decision-making process of government and how trade-offs between the interests of the Australian aviation industry and the broader Australian community are made.

Assessing the national interest involves weighing up a range of potentially competing costs and benefits for Australian airlines, tourism operators, air freight users, travellers and the economy more broadly. The ultimate objective of this process should be to enhance the welfare of the Australian community as a whole rather than to protect or promote any particular group, industry or commercial interests.

There may be situations where the Australian Government chooses to adopt negotiating tactics of delaying capacity increases for foreign airlines in order to obtain non-capacity related traffic rights for Australian airlines.⁶ The benefits of these types of negotiating tactics need to be carefully weighed against the costs to the Australian community of delaying increased capacity. These costs include a potential delay in additional services to and from Australia by foreign airlines and, as a consequence, forgone benefits to Australian passengers from additional (and potentially lower cost) services, as well as forgone benefits from increased tourism to Australia.

While the results of cost-benefit analysis may not be the Government's only consideration when determining whether to grant access to airlines under bilateral air services agreements, it is a vitally important input into the policymaking process and a powerful decision-making tool, particularly when it sets out unintended consequences and conducts sensitivity analysis. The Productivity Commission previously recommended that when negotiating international air services arrangements, the Australian Government should undertake an assessment of all relevant costs and benefits of more open air services markets. This assessment should include the benefits to the Australian community arising from lower airfares or access to a wider range of outbound travel destinations, as well as any effects that granting and obtaining additional rights may have on Australian airlines. Importantly, the full assessment of the costs and benefits of the negotiated outcome should be publicly released as soon as practicable. This would help to boost the confidence of stakeholders that the range of costs and benefits are being appropriately weighed, and that decisions are being made in the interests of the broader community (PC 2015b, p. 244).

⁵ See for example, Austrade (2014, p. 18), Sydney Airport (2015, p. 8) and DFAT (2015, p. 15).

⁶ For example, fifth freedom traffic rights so that Australian airlines can extend their international networks. Fifth freedom rights allow airlines of one country to carry traffic between two other countries providing the flight originates or terminates in its own country.

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