

## Senate Inquiry Submission

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This submission is the sole work of Dr Peter Forsyth. I was formerly Professor of Economics at Monash University. I have retired, but maintain a role as a Consultant and remain active as a researcher. Much of my research has been on applied microeconomics and especially on the economics of aviation.

This submission addresses Terms of Reference items a and c

The submission consists of two short articles. The key issues raised are:

Article 1. Qatar Airways and Australia – Pragmatism or Protectionism?

- 1 How can the economic dimensions of the national interest be assessed?
- 2 While Qantas will be affected moderately by the Qatar decision, much of the impact will be felt by foreign airlines.
- 3 While a pragmatic approach to international aviation policy has its possible merits, the Australian approach has been unnecessarily protectionist.

Article 2 Should there be a Review of Australia's international aviation policy?

- 1 There have several Reviews and the issues have been canvassed in detail, though there are emerging issues, notably the role of aviation on climate change.
- 2 A good option would be for Australia to move to an open skies approach where feasible with its bilateral partners.
- 3 This would involve a greater emphasis on competition, moderating the emphasis given to the interests of airlines.

## Article 1

### **Qatar Airways and Australia – Pragmatism or Protectionism?**

International aviation policy has not been given much attention until lately, and with the Federal government's rejection of Qatar Airways request to have more flights into Australia, we have been given a wake-up call that reminds us that Australia does not have a particularly liberal international aviation policy. While several countries have moved to open skies, Australia has continued to impose regulation in many of its airline markets. In several of its major markets, Australia has said that it will allow more capacity, but only "when there is a need for it". Ministers have argued that they are taking a case-by-case approach to airline policy, and that they are making decisions to promote the national interest. If so, how can the economic aspects national interest be measured?

Some countries consider that they gain most from liberalised, competitive, international airline arrangements. By contrast, Australia has preferred what might be termed a pragmatic approach, though it has been a reluctant liberaliser. It is sometimes prepared to open up its markets, but in other cases not. It also does have some open skies arrangements, such as those with the US and New Zealand.

Given that Australia makes a virtue of its pragmatism, are decisions based on rigorous analysis of the costs and benefits of liberalisation, or based on the whims of Ministers? Australia has had probably more Reports on international aviation policy than most other comparable countries. This might be an indication its pragmatism. Some of the Reports have analysed the international market in detail and these Reports have analysed the costs and the benefits of liberalisation quite thoroughly. The approach of assessing the costs and benefits of liberalisation dates back at least to 1978, when the ICAP (International Civil Aviation Policy Report) took a welfare economics approach to measuring the costs and benefits of opening up markets to a range of countries. Perhaps the most thorough review was that done by the Productivity Commission in 1998, which concluded that liberalisation was in Australia's interests, when other countries enter agreements with Australia, to liberalise these bilateral markets, though it would not be in Australia's interests to liberalise unilaterally. The government of the day did not, in effect, accept this recommendation, and it still restricts access to the four major cities of Sydney, Melbourne, Brisbane and Perth.

How can the economic dimensions of the national interest be assessed? A pragmatic approach would be to conduct a cost benefit analysis of the pros and cons of liberalisation in a particular case, for example, of a proposal for liberalisation with a particular country. This is something which the Department of Infrastructure and Transport has done from time to time.

Some of the key costs and benefits are:

- The benefits to Australian passengers from lower airfares;
- The possible reduction in profits for Australian airlines such as Qantas;
- The benefits from increased tourism receipts from inbound tourism;

- The costs or benefits of the impact on jobs, in both the airline industry and the tourism industry and
- The impact on greenhouse gas emissions from the airline industry and tourism.

These factors can be examined to determine whether Australia gains or loses in economic terms from allowing Qatar Airways more flights. Extra flights can be expected to reduce air fares in the short term. Fares have been high due partly to ongoing inflation, and partly due to the fact that airlines have been struggling to achieve their pre Covid capacity. They have been finding it difficult to find staff, and they are taking time to get all their aircraft back into operation. Shortages of capacity means that they can charge higher than usual fares, but over the next two to three years, airlines will add more flights and fares will moderate. Additional flights, such as those requested by Qatar, will lower fares for a couple of years.

- Most likely, the benefits to Australian travellers will be one of the biggest sources of benefit. More competition in airline markets to Europe will bring down prices. There are some costs from outbound tourism where travellers switch (taxed) domestic trips to (mainly untaxed) international trips as a result of lower fares.
- Another form of benefit comes from additional inbound tourism. The benefit from this is often exaggerated, though it is positive. Often the “benefits” are measured in terms of the extra spending of the inbound tourists. However, it needs to be taken into account that this is a gross measure of benefit, not a net benefit measure. The inbound tourists will spend money, but Australian resources will be needed to produce the goods and services they use. They will employ workers, but these are not free; they will stay in hotels, but these services have to be produced; and they will use restaurants, but again, the food is not free to provide. If we had to measure the *net* benefits from tourism it is more likely to be of the order of 5 to 10% of total spending. These inbound tourism benefits are worthwhile, but not as big as the benefits from additional travel by Australian tourists. Some of the numbers quoted in the press in the current debate are obviously measures of gross benefits, such as gross spending, or the gross number of jobs created, not the net benefits, and thus they need to be treated with caution.
- Liberalisation typically comes at cost to the airlines – but which are the airlines which will suffer? Lower airfares are quite likely to reduce Qantas profits directly through its own services, but also, to a lesser extent, through its arrangements with Emirates. Emirates is a major player in the Australia to Europe market, and it would be affected by Australia giving Qatar Airways the rights for more flights. However, we have to remember that Qantas is only around about 50% Australian owned and many of its international staff are not Australians. This means that any reduction in profits will be shared between Australia and other countries- an important proviso when measuring the impact on the national interest. Qantas profits will be reduced initially, but it will be able to claw back some of this reduction if it is able to improve its productivity over time. The loss of profits to Qantas will be relatively minor since most of the reductions in profit accrue to foreign airlines, not Qantas. Since Qantas has very few flights in this market, this will be a cost falling on foreign airlines.
- The impact on jobs markets of Australia granting more flights to Qatar Airways, in the current situation, will probably not be large. Overall Australia has little unemployment, and this is particularly so for the airline industry, which has great difficulty in attracting

enough staff. Things might be different if overall unemployment were high, but that is not the case.

- The impact of additional flights by Qatar Airways to Australia on greenhouse gas emissions is unlikely to be very much. The airlines' contribution to global emissions is now recognised as being very substantial, but additional flights by one airline will be cancelled out by reductions in flights by other airlines (not necessarily to Australian destinations), so that the net effect is not likely to be very large.
- On balance, while the gains from allowing Qatar more flights, as a result of benefits to Australians from lower fares and benefits from more tourism, the costs will mainly accrue to foreign airlines and their staffs. Australia will be paying less for its imports of airline services, which will lead to an increase in its National Income. From Australia's perspective, there will be a clear economic gain from additional flights by Qatar Airways.

It should not be assumed that if we take this cost and benefit approach to evaluating airline liberalisation the result will always be that liberalisation is in the economic dimensions of the national interest of the country. It can be the case that the calculus will indicate that liberalisation will not be worthwhile. The Productivity Commission, in its 1998 report, recognised that airline liberalisation was not always in Australia's interests. Around 2005, Singapore Airlines was seeking to enter the direct Australia-to-United States market. At this stage Qantas was the dominant player in this market, and the market was very profitable. This meant that for a relatively small addition to competition, there would be a significant reduction in Qantas profits. The net effect was that it was likely that the gains from competition and benefits to Australian travellers would be outweighed by the reduction in Australian airlines' profits. As a result, the cost benefit approach would suggest that allowing Singapore Airlines onto the route would not be in Australia's interests. The Government did not allow Singapore Airlines access (though Singapore airlines was one of the major beneficiaries of the current Qatar decision).

It would seem likely that allowing Qatar Airways to operate the flights it requested would be in the economic national interest of Australia. The benefits to Australian travellers, plus the benefits from inbound tourism, would most likely outweigh any reductions in (the Australian share of) the profit to Australian airlines and any reductions in the benefits of those who work in them. However, economic factors are not the only ones which need to be taken into account when determining policy. There is the 2020 event at Doha airport which is relevant, and there may be other factors which are yet to be revealed. The 2020 event is a serious one, but it may be possible to address this by diplomatic and legal means, to the satisfaction of those affected, clearing the way for the economic benefits from additional flights by Qatar to be reaped.

The Qatar crisis poses questions about Australia's approach to bilateral aviation negotiations. Australia in most cases has chosen a pragmatic approach, but is this based on careful evaluation of the merits of the case, or an ad-hoc political judgement? If it is the latter in the Qatar case, then there is a good reason for a review, as several have called for. The Aviation Green Paper Towards 2050 skirts around the question of Australia's approach to bilateral negotiations, basically claiming the things are just fine. The Qatar case is evidence that things are quite the contrary. There is a strong case for reconsidering the overall policy, not just the Qatar decision.

A pragmatic approach to working out the national interest needs to be backed up by estimating all the costs and benefits of the proposal. If it is not, there will be a justified suspicion that it is not pragmatism but rather protectionism which is carrying the day. If this is so, it would be a curious form of protectionism, since the main beneficiaries of the decision will be foreign, not Australian, airlines, and the main losers would be Australian travellers.

## Article 2

### **Should there be a Review of Australia's international aviation policy?**

The Qatar dispute raises the question of how well Australia is served by its international aviation policy. If so, is the present system performing well, or should it opt for open skies? Is a review needed?

No, according to the recently published Green Paper. In a brief discussion, this argues that no major change is required - it argues that things are pretty much fine. In fact, it goes on to say that "Over the last 30 years, Australia has been at the forefront of international market deregulation and liberalisation...". Many would dispute this. The fact that the Qatar dispute has emerged is evidence that matters are not as rosy as the Green Paper says. Would a review of policy help?

In fact, Australia has had a series of Reviews. One of the most careful reviews was that done by the Productivity Commission in 1998. It recommended that Australia adopt an open skies policy, and where this was not feasible, encourage its bilateral partners to be as liberal as possible. The government of the day welcomed the Report, but since then little has happened, and Australia's policy is far from one of open skies.

This suggests that what is needed is not so much a review, but a rethink by the government. It is the way that the government views international aviation which is the problem. It regards its policy as being a pragmatic one, assessing requests on a case-by-case basis. In principle, this can make sense, if it assesses the costs and benefits of granting requests rigorously. However, it takes a protectionist approach - it keeps capacity controls, approves international additional flights in a piecemeal manner, and limits bilateral access to the four major cities in many markets. There are several references to the "national interest" in the Green Paper, but over the past few weeks, especially in the Qatar discussion, Ministers have interpreted this in a protectionist way. They say that they are seeking to protect local aviation jobs, Qantas investments in new aircraft, and the long-term sustainability of the Australian aviation industry - all protectionist sentiments. The benefits to Australian travellers and the tourism industry were not mentioned by the government. Their view of the national interest is much the same as that which Qantas has. Qantas is articulate in setting out its view of the national interest, but the government should have a much broader view. The government has a 1960s or 1970s view of what the national interest involves. The Qatar case is a particularly strange one, since Qantas has very few flights to Europe, meaning that the government is mainly protecting foreign airlines and their staffs, not Australian airlines and jobs.

An alternative to this policy is that of actively seeking open skies, as recommended by the Productivity Commission Report. This would put an emphasis on competition, which would serve the interests of Australian travellers and the local tourism industry. It does not ignore the interests of the airlines and their staffs, as long as these airlines are internationally competitive. Australia has some open skies arrangements with some countries, such as NZ and the United States, as well as Singapore, China and the United Kingdom. The major Australian carrier, Qantas, has been quite successful in competing in a number of these markets, especially the

important market to the United States. While it is true that Qantas is not especially competitive in the Australia to Europe market, it has strong alliance relationships with Emirates. In addition, Qantas is planning new routes to Europe on a direct basis from Sydney and possibly other capitals. It does not appear to be facing a problem of long run sustainability. Airlines continually argue that if competition is allowed in a market they would cease to survive. However, when put to the test they do survive, and sometimes thrive.

Reading the Green Paper, it might seem that Australia is actively seeking liberal arrangements and open skies bilateral arrangements. The reality is rather different. Australia has over 100 bilateral agreements with other countries, but it has only 7 open skies agreements. By contrast the US, as of July 2020, had negotiated 130 open skies agreements with its bilateral partners. While the Green Paper states that Australia is seeking open skies agreements with its partners, it does not seem to be trying very hard to do so.

Do we need a full review of international aviation policy? Not really. The issues have been canvassed many times. If the government is serious about reviewing Australia's international aviation policy, each could dust off a copy of the 1998 Productivity Commission Report which went into considerable detail about the pros and cons of liberalisation and open skies. It recommended bilateral open skies, though it did not recommend that Australia liberalise unilaterally.

What is needed is a rethink rather than a review. In particular, what is needed is a rethink of what the national interest in aviation really is. Does the government want to have lower fares for Australian consumers and to attract overseas visitors, by so doing increasing Australia's real National Income? The problem is that the government sees the national interest in essentially protectionist terms, such as improving the environment for the airlines. This is in sharp contrast to the Australian approach to trade in general, which over the years has rejected protectionism.

It would be worthwhile starting with a rethink of the Qatar decision. The government can interpret the national interest in more competitive terms. This can be extended to other items on the agenda – for example, Turkish Airlines has requested more flights into the major capitals. Apart from the Doha airport incident, the other reasons for rejecting the Qatar Airways request, such as protecting local aviation jobs, substantial government ownership of the airline, and decarbonising Australian aviation, apply equally well to the Turkish Airlines request. Will this be rejected too? The government needs to sort out its international aviation policy - the sooner the better.