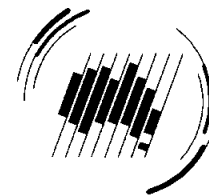


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**INDUSTRY
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Mr Tim Grimwade
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Grimwade

Application by Qantas and British Airways of a Restated Joint Services Agreement

The Department of Industry, Tourism and Resources offers the attached submission in respect of the application made by Qantas Airways Ltd (Qantas) and British Airways Plc (BA) for re-authorisation pursuant to the Trade Practices Act 1974 of a Restated Joint Services Agreement (JSA). This submission was drafted following input from the Australian Tourist Commission, the agency responsible for Federal Government marketing of inbound tourism to Australia.

The submission does not attempt to comment on all the applicants' claims but focuses on the issues most relevant to the tourism sector.

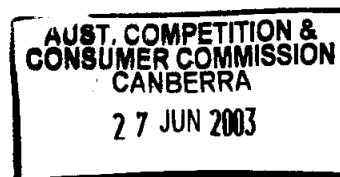
In summary, the Department supports the approval of the restated alliance application. There does not appear to have been any significant lessening of competition on the JSA routes since the alliance was last authorised and the Department does not believe there are any major competition concerns over the short to medium term. On balance, the benefits for tourism are likely to be positive and there are wider community benefits from supporting the competitive position and sustainability of Qantas. This Department favours authorisation for a limited period of not less than five years.

Yours sincerely

A handwritten signature in black ink that reads "Janet Murphy".

Janet Murphy
A/g Head of Division
Tourism Division

25 June 2003



SUBMISSION TO

THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

IN RELATION TO

**THE APPLICATION BY QANTAS AIRWAYS LIMITED AND
BRITISH AIRWAYS PLC
FOR RE-AUTHORISATION OF A
"RESTATED JOINT SERVICES AGREEMENT"**

**DEPARTMENT OF INDUSTRY, TOURISM AND RESOURCES
AUSTRALIAN TOURIST COMMISSION**

June 2003

SUMMARY

The submission does not attempt to comment on all the applicants' claims but focuses on the issues most relevant to the tourism sector¹.

Overall, the Department supports the approval of the restated alliance application. There does not appear to have been any significant lessening of competition on the JSA routes since the alliance was last authorized and the Department does not believe there are any major competition concerns over the short to medium term. On balance, the benefits for tourism are likely to be positive and there are wider community benefits from supporting the competitive position and sustainability of Qantas. However, due to uncertainties in the global aviation environment and the question mark over longer term competitive pressures, we do not believe that authorisation should be for an unlimited duration and instead favour authorisation for a limited period of not less than five years.

BACKGROUND

The tourism industry makes an important contribution to the Australian economy. In 2001-2002 tourism generated 4.5 per cent of Australia's GDP, with a total consumption of \$70 billion by tourists and direct employment of 6 per cent of working Australians. International visitors to Australia consumed \$17 billion worth of products, which represented 11 per cent of total exports and was the largest export earner within the services sector.

Due to Australia's geographic position, Australian industry has a heavy reliance on the provision of efficient air links for the transport of people and goods. In 2002, some 4.8 million short term visitors arrived in Australia and over 99 per cent of them arrived by air. Australia is also a medium to long haul destination for the majority of our tourism markets.

The 'Kangaroo Route', denoting services between the United Kingdom (UK) and Australia, is particularly important as the UK is Australia's largest inbound tourism market by value. In 2002, tourist spending by UK visitors on their trip to Australia totaled A\$3.4 billion. Between 1995 and 2002, the number of UK visitors grew at an average annual rate of 9 per cent. The number of visitors from other Europe grew at 4% per year over the same period. This increase in tourism has been aided by the ability of airlines, including the operation of third country carriers, to respond to the market².

However, the tourism industry is vulnerable to external forces such as the downturn in tourism numbers visiting Australia due to the events of 9/11, the outbreak of the Severe Acute Respiratory Syndrome (SARS) and the Iraq war. Despite this, the Australian Tourism Forecasting Council is expecting a recovery in 2004 with total visitor arrivals forecast to grow by 9.8 per cent to just over 5 million visitors. This growth reflects the expected realisation of some pent up demand. International visitor arrivals are predicted to grow at an average annual rate of 4.6 per cent to 7.6 million in 2012.

IMPACT ON TOURISM OF A RESTATED JSA

The impact of the Qantas/BA restated JSA on tourism is assessed by its impact on:

- Competition;
- Benefits of a strong and sustainable Qantas;
- Airfares, including availability of discount fares;
- Product and service benefits; and
- Net benefits to tourism.

¹ While the JSA has some implications for freight, generally speaking, the level of competition in freight markets will depend on many of the same factors as the passenger market. This is because the majority of freight is carried in the belly-holds of passenger aircraft.

² Tourists are increasingly looking for value for money, quality of service, choice and convenience when determining their holiday destinations. They are very price conscious and airfares can constitute a significant proportion of the cost of travel to Australia. Airfares, travel time and connectivity, and comfort are therefore key factors in attracting visitors.

Competition

The applicants submit that the JSA is pro-competitive and that since the formation of the alliance, competition in markets for air travel between Australia and Europe and South East Asia has been intense. This Department largely agrees with this view. Although European airlines such as Alitalia, KLM and Lufthansa have withdrawn from the market over the past 7 years, their market shares were small and their presence has been replaced by other carriers. They also maintain a marketing presence through code shares on other airlines³.

The route is regarded as highly competitive with significant competition coming from carriers operating from countries that are conveniently placed to operate as hubs between Australia and Europe. Known as 'sixth freedom' carriers, Singapore Airlines and Thai Airways, for example, are able to operate flights to the UK in direct competition to Qantas and BA. Other airlines including Cathay Pacific, Malaysia Airlines and Emirates⁴ offer competitive services on routes that have a high degree of substitution. There is little evidence indicating that there has been any significant lessening of competition due to the JSA. In fact, the nature of the bilateral aviation system constrains consolidation common in other industry sectors and more airlines are operating in the market than may otherwise be the case. Furthermore, competition is expected to increase over time from carriers such as Emirates as they introduce new aircraft capable of one stop services to Europe⁵ and as the liberalisation of the air services rights utilised by these 'sixth freedom' carriers continues.

While the demise of Ansett has weakened the 'Star' alliance's presence in Australia, 'Star' airlines are still able to get their passengers around Australia at a price on Qantas. Singapore Airlines operates to all major city gateways and also receives passenger feed from European airlines such as KLM and Lufthansa. Qantas' claims that without the JSA they would be placed at a competitive disadvantage are supportable to the extent that other carriers have increased their competitiveness over the last 6 years. Data supplied by the *Network Economic Consulting Group* (NECG) notes that between 1995/96 and 2001/02, the JSA parties share of the Australia-Europe (including the UK) passenger traffic has remained fairly steady at 43%⁶. Whereas, the combined market shares of Singapore Airlines, Malaysia Airlines, Thai Airlines, Cathay and Emirates grew from 25% to 39%.

Competition on the routes operated under the JSA and growth in inbound tourism to Australia has been promoted through the progressive liberalisation of air services agreements with Australia's bilateral partners. Australia's active pursuit of liberal international aviation arrangements has ensured that, in most cases⁷, capacity has been negotiated ahead of demand. However, we do not agree with the Qantas/BA view that regulatory barriers are not a constraint on further expansion by mid-point carriers. For example, under the current Australia-United Arab Emirates air services arrangements, Emirates, while recently being granted increased access are constrained for the time being from further expansion into Sydney and Melbourne.

The Department is of the view that further liberalisation of air services agreements is a prerequisite for ensuring that *third country* international carriers can enter the Australia-Europe market to maintain competition over the longer term and promote tourism growth.

³ KLM codeshares on services operated by Malaysia Airlines, Lufthansa codeshares on Thai Airways and Singapore Airlines and Alitalia codeshares on Qantas.

⁴ Emirates commenced services to Australia in 1996 with 2 services per week to Melbourne.

⁵ Emirates operates from its hub in Dubai. New long-range aircraft such as the A340-500 are capable of non-stop services between Sydney and Dubai and are expected to have a time saving compared with current Qantas services via Singapore.

⁶ The JSA parties have benefited from the substantial growth in UK and other European traffic since 1995.

⁷ Significant capacity or other regulatory constraints currently exist in the agreements with countries such as Hong Kong, China, France and Korea.

normal schedules. There has also been substantial product innovation in terms of in-flight entertainment and comfort offered by carriers.

Net benefits to tourism

Increasing liberalisation of air services arrangements and the willingness of carriers such as Qantas to take up these rights has supported substantial tourism growth over the past decade. Short term visitor arrivals to Australia from the UK have grown from 348,000 in 1995 to 643,000 in 2002. Visitation from other Europe has grown from 404,000 to 538,000 during the same time.

However, the applicants' claims with regard to the capacity and promotional effects of losing the JSA seem overstated. NECG estimates a reduction, on average, of between 3,800 and 10,200 tourists each year visiting Australia over the next 5 years, with the difference depending on the amount of capacity replaced by other carriers. Without commenting on the methodology, the worst case scenario represents only 0.2% of short term arrivals in 2002 and would be difficult to distinguish from the broader effects of economic cycles and other impacts affecting inbound markets.

Nevertheless, we acknowledge network benefits that the JSA provides as well as the benefits from synergies between Qantas/BA's international and extensive domestic networks and consider that the impact of the JSA on tourism is likely to be positive.

This conclusion is supported by the Australian Tourist Commission, which emphasises the national benefits of the significant investment by Qantas in co-operative marketing with the ATC of Australian tourism overseas. Inbound tourism marketing is associated with significant market failures due to the inability of individual businesses to capture all the returns on their investment in marketing. In this regard, the contribution of international carriers such as Qantas is particularly valuable. In addition to Qantas' marketing in its own right, Qantas annually provides over \$10 million toward co-operative marketing campaigns with the ATC that extend the awareness of Australia in overseas markets.

It is notable that while Qantas is normally the ATC's primary marketing partner in overseas markets, Singapore Airlines has negotiated this role in the UK. The close relationship between the ATC and Singapore Airlines in the UK market reinforces claims for strong competition on the kangaroo route to the Qantas/BA alliance.

Duration of authorisation

Given the scope of the restated JSA and rapidly changing nature of the global airline industry, the Department does not believe that Qantas/BA have provided sufficient justification to have an authorisation of unlimited duration. Furthermore, while liberalisation of air services arrangements has, up to now, provided for significant increases in market presence and competition on the kangaroo route by mid-point carriers, the intensity of competition facilitated by liberalisation could be a factor in the medium term.

However, the Department accepts that benefits of the JSA are likely to be greater in proportion to the duration of the alliance and furthermore that there are possible benefits to the applicants from increased certainty for investment decisions. The Department is also mindful of the regulatory burden on business and in terms of best practice regulation, encourages minimum effective regulation to achieve desired outcomes. In this regard, we suggest a term of not less than 5 years. We note that the Commission has the power to review the authorisation at any time.

While we do not see any need for conditions to be attached to the re-authorisation, it would be useful if the applicants would continue to collect and calculate bench-mark air fare data.