Regulation, competition and the politics of air access across the Pacific

David Timothy Duval *

School of Business, University of Otago, New Zealand

A R T I C L E   I N F O

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A B S T R A C T

The article examines from a regulatory and political economy framework the 2006 decision by the Australian Government to deny access by Singapore-based carriers to the Pacific Route between Australia and the US. It is argued that a framework of understanding the balance between protectionist and liberal air access policy needs to consider prior international trade provision. Additionally, the mechanics of the decision are considered from the perspective of accessibility, with consideration of commercial reasons and the economics of protectionism. The article traces the decision chronologically, and situates the negotiations between the two governments in the context of the Free Trade Agreement and subsequent revisions to existing air service provision. Conclusions are offered that consider economic realities and the potential for future liberalization of the route.

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1. Introduction

The purpose of this article is to draw correlations between regulation and competition within the aeropolitical environment in the Pacific from the context of protectionist/liberal international trade agreements, and the wider trade and policy frameworks relating to air service provision. Aeropolitics is defined here as policy environment within which commercial aviation interests and government policy frameworks meet. The article examines negotiations between Australia and Singapore to allow access by Singapore carriers (although primarily Singapore Airlines) to the lucrative Pacific Route (between Australia and the US) as well as the refusal in 2006 by the Australian Cabinet to grant access. The arguments herein follow Hodgkinson’s (2006) review of the subject from a civil aviation policy perspective, yet considered more closely here are the wider policy frameworks and communities relating to international trade in air services.

Air transport is a undeniably a critical element in the flow of capital and people through the Asia Pacific region (Oum and Lee, 2002). Airlines in the region have come under tremendous strain in the past few years owing to increasing marginal and fixed costs (especially volatile fuel prices), the rapid growth in competition and uncertain market behavior due to unknown (and in some cases, known) externalities. At the same time, however, the region has witnessed significant expansion in air access, with numerous routes being added by both traditional full service airlines and upstart, low cost carriers. These new routes have covered many Southeast Asian countries as well as Australia and New Zealand, resulting in dense air transport networks. Importantly, these developments are not unique to the Asia Pacific; they are mirrored in other regions, notably the Europe and North America.

The expansion in capacity and services in the Asia Pacific is concurrent with critical examinations of the regulatory structures surrounding access (e.g., current negotiations toward an ASEAN open sky agreement). There is some recognition that a balance exists between liberal access and the desire to ensure productive and profitable national-based carriers (Chin et al., 1999). Despite liberal approaches to air access in some areas of the world, political and/or economic influences still ensure that a vast amount of air access agreements generally remain heavily regulated (Krueger, 1998).

2. Aeropolitics, civil aviation policy and international trade

It is first important to set the scene for decisions of access by reviewing the nature of aeropolitics from a civil aviation perspective. Governments have varying approaches in adjudicating the extent and composition of market access for overseas-originating trade goods and services. Protectionist policies favor trade barriers and high tariffs, ostensibly to protect domestic firms from foreign competition. Conversely, liberalized approaches to trade orient domestic production of goods and services within global currents and flows, thus allowing in theory unfettered access to local markets by foreign producers. This apparent dichotomy relates strongly to state/globalization debates in political economy and economics (Hobson and Ramesh, 2002). The reality, however, is that even under liberalized policy structure, substantial restraint of access by foreign goods and
services can still feature, and international air services represents an idealized example of this (Baliles, 1997).

Aeropolitics is defined as the processes through which, and reasoning behind, nation states develop and implement policy with respect to air access by foreign air carriers. Globally, air access falls generally under the purview of negotiated air access rights or air service agreements (ASAs). These address specific air transport operations (usually both passenger and freight) between two states, particularly the extent to which access by a carrier (or carriers) designated by one country is granted access to another. With respect to passenger services, agreements may include routing (i.e., any or specific intermediate points), frequency, capacity, fares, ownership restrictions, and levels of nation-based control. The negotiation of ASAs governs the shape and flow of transnational tourist travel (Forsyth, 2006), and is thus an integral component in any analysis of global commerce and trade. In addition to market protection and liberalization discussed above, ASAs are embedded within government regulation, but they are also influenced by economic conditions and political aspirations (Melville, 1998). As Warren and Findlay (1998: p. 447) note, air access between nation states is, in essence, a tradable service.

While ASAs are based in international legal and regulatory environments, a wider context features international trade regulations (access for wider economic benefit) and foreign direct investment (ownership and control). Unlike other trade goods air services are generally not subsumed under the rules of the General Agreement on Trade in Services (Forsyth, 2001), although principles such as most-favored nations, national treatment and transparency apply to maintenance, marketing of air services and customer reservation systems (International Civil Aviation Organisation, 2006). Governments are thus tasked with determining whether air access is worthy of protectionist policies that ultimately (1) favor a national carrier in terms of airlift, or (2) adopt a more liberalized approach and thus allow foreign carriers (with the appropriate local certification) access. At present, the scale of liberalization of air services around the world is extremely variable, although two extremes can be noted and these generally follow the patterns as applied to other goods and services. One is the full liberalization of services under open skies where market demand and efficiency govern access. The other is represented by preferential access provided by state regulatory authorities to select carriers, often those where substantial ownership and effective control is relegated within the state itself. Importantly, provision air access is influenced by public policy and politics, and can vary considerably with changes in government or economic conditions (Nayar, 1995).

2.1. Liberalized air services

Globally, there has been an increasing trend toward what appears to be more liberal ASAs. China, for example, has traditionally been restrictive of competition, but has, since 2005, introduced measures of increased liberalization, particularly with the US. Movement toward liberal air access policies among ASEAN nations began in 2003 (Forsyth et al., 2006), and in July 2007 an agreement was reached for a phased introduction of a regional open skies policy for passenger transport by 2015. In the Asia Pacific, the Multilateral Agreement on the Liberalization of Air Transport (MALT) between Brunei, Chile, New Zealand, Singapore and the US and the Pacific Islands Air Services Agreement (PIASA) are regional outcomes of more liberal air transport policy.

Full liberalization can culminate in open-skies agreements (for example, the recent EU-US Open Skies Agreement, although the EU is perhaps the largest open market) or even single aviation markets (e.g., Australia and New Zealand). In such cases, restrictions on routing, frequency, capacity and fares may be open and thus restricted only on the basis of infrastructure support such as slot space at airports. Ownership and effective control may still be restricted, however. Liberal policies in air access need not only be associated with full open skies access, however, and more managed access on a piecemeal basis is far more common and prevalent in bilateral, multilateral and plurilateral (where exclusivity can be aided by geographical proximity (Hettne, 2005)) treaties. Full liberalization can be inhibited by existing logistic or infrastructural limitations. A good example is the limitations in slot space (for aircraft movement) at major gateway airports, which can impede expansion by both incumbent foreign and national carriers and act more or less as a barrier to entry for new entrants.

One example of how commercial carriers have benefited from more liberal ASAs is the success of the 6th freedom carriers, who have received significant media attention owing to their expansion of routes and rapid capitalization of fleets. Indeed, some of the largest sixth freedom carriers are based in Asia or the Middle East (e.g., Emirates, Qatar) and route passengers from major markets such as Europe, transfer them through their own hubs (e.g., Dubai) before on-flying them to other regional or international destinations.

2.2. Protectionist policies

Despite what may appear to be increasing liberalization of services, Oum et al. (2001) argue that air transport remains a highly regulated sector in international trade. Protectionism in air services stems from policy decisions by national governments that may deny (or limit) access by foreign carriers to domestic markets or refuse ownership and effective control provisions that may see majority ownership being held by foreign nationals. As Forsyth (2001) notes, countries may also adopt a protectionist stance to prevent domination by foreign operators. Hanlon (1999) argues protectionist policies may be problematic:

Governments traditionally regarded air transport as, in some sense, a public utility. Strictly speaking, it is not. Economists prefer to reserve the term ‘public utility’ to enterprises that have characteristics of natural monopolies. Natural monopolies exist where the advantages of size are so great that a service can only be provided at least cost if it is supplied by one, and only one firm

Further complicating the matter is the fact that, despite massive deregulation in the global aviation environment, governments may act as majority shareholders in carriers. In these cases, critics argue that protectionist policies represent a conflict of interest, although governments counter that their protection of the carrier in which they hold control is designed to ensure access and future economic growth.

3. Civil aviation policy in Australia

International trade of goods and services was liberalized significantly in the 1980s in Australia, contrasting significantly with its previous strongly protectionist stance (Murphys et al., 1998). Australia’s two airline policy, in place from 1952 until 1990, ensured continued operation of two carriers (in this case, Ansett and Australian Airlines toward the end of the policy) to ensure “stability of provision” (Painter, 2001) through continuous, if not publicly unpopular, services (Quinlan, 1998). Beginning in the early 1990s, Australia moved further toward liberalized
provisions, with the removal of restrictions on equity investments between international and domestic carriers, as well as multiple designations, allowing more integration between these services (Productivity Commission (Australia), 1998).

Since the early 1990s, and in parallel with increasing liberalized access agreements negotiated elsewhere, Australia has signed numerous trade agreements, including free trade agreements with the US, Singapore, Thailand and with New Zealand a Closer Economic Relations agreement which covers numerous regulatory issues. Currently, Australia generally favors open multilateral trading systems (Krueger, 1998). Under negotiation at present are agreements with several Asian countries, including Japan, Malaysia, China and ASEAN countries.

Importantly, a distinction is necessary between international and domestic air policy in Australia. At present, domestic policy is significantly liberalized, with foreign ownership levels of 100% possible (although subject to ratification by the Australian Foreign Investment Review Board). Internationally, however, Australian policy is based roughly on a series of bilateral reciprocal agreements. The Productivity Commission released its International Air Services Enquiry Report in September 1998, which made several recommendations relating to Australia's international air services (Webb, 2006). Rather than recommend full open skies approaches to future bilateral negotiations, the Report noted that reciprocal open skies would instead be favored:

The aim of a reciprocal ‘open skies’ policy would be to remove restrictions in ASAs on competition and trade between the airlines of each of Australia’s bilateral partners, consistent with technical and safety regulation. Australia would only agree to remove all of the current restrictions on the ability for foreign carriers to fly to Australia if the bilateral partner also agreed to the removal of constraints on Australian carriers.

The Government, which agreed with the Commission’s recommendation, responded in June 1999 by announcing that international airlines would be granted unrestricted access (with no limits on capacity) to all ports with the exception of Sydney, Melbourne, Brisbane and Perth (although dedicated freighter services would be allowed access to all ports). A formal review of the government’s policy toward liberalization was conducted in 2006. The review did not signal any substantial change in policy, although it was largely sparked by requests from Singaporean Government to allow Singapore Airlines access to the Pacific Route.

4. The Pacific Route

The Pacific Route broadly refers to air access between Australia and the US, but more commonly to the direct non-stop routing between Sydney and Los Angeles (although San Francisco may be considered to be just as lucrative as onward regional connectivity at that port is not insignificant). Qantas has operated non-stop services on the route for several decades, and several US-based airlines (including Continental and United Airlines) at one point also provided services. Financial difficulties facing these carriers both prior to and immediately after the 11 September 2001 attacks has meant that their market share of has been steadily eroded.

The route is seen as exceptionally lucrative from an operational perspective, and at the same time strategic in terms of linking wider US and Canadian markets to Australia. The importance, both strategically and financially, for Qantas should thus not be underestimated. This, and Qantas’ strong performance on the route, forms the political backdrop for Singapore’s requests for access. Importantly, these requests from the Singaporean government have been situated within the spirit of international trade and access, yet how these requests were managed by the Australian government, however, forms the basis of the aero-political nature of air access rights.

4.1. The Singapore–Australia free trade agreement (SAFTA)

Trade in goods and services between Singapore and Australia is largely open. A formal Free Trade Agreement between Singapore and Australia (SAFTA) became operational in July of 2003 and technically included provision for the encouragement of open skies, which would allow airlines designated by either country (and in possession of foreign air operating certificates) rights of access to the other country:

While both Parties affirm their rights and obligations under the Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore relating to Air Services, signed on 3 November 1967 and any subsequent amendments thereto, both Parties agree to work towards an Open Skies Air Services Agreement and to review that work in accordance with the provisions of Article 22.4 (Section 22 Para 5)

As it is not entirely uncommon for some degree of aviation liberalization to be wedded, at least in spirit, to Free Trade Agreements (e.g., NAFTA, the EU), the SAFTA was no exception. In September of 2003, shortly after the SAFTA was signed, Australia and Singapore revised an existing ASA through a Memorandum of Understanding that allowed designated airlines from either country unrestricted rights of access between both countries. This new expanded ASA meant that designated airlines of either country (e.g., Qantas, Singapore Airlines) could operate to and from either country (using, if necessary/desirable, most intermediate points) without restriction. The Memorandum did not specify access to the Pacific Route, but it marked a significant step toward more liberal access in general involving air services of both countries.

This move toward enhanced liberal access was to feature in the first annual review of the SAFTA in 2004, which acknowledged the importance of more liberal air access from an international trade perspective and considered the positive benefits to the wider economy and tourism between the two countries. As the review notes, full movement toward open-skies, including liberalizing the Pacific Route, would only be considered, however, “when there is greater stability in the global aviation environment” (Department of Foreign Affairs and Trade, 2004). As liberal as the SAFTA and the 2003 expanded ASA agreement between Australia and Singapore are, and despite the pledge by both parties to move toward an open skies arrangement, neither agreement provided Singapore with beyond rights to the US via the Pacific route.

4.2. Singapore’s access requests

In addition to the tacit knowledge of Qantas’ continued profitability on the route as noted above, the failure to fully liberalize air access provision declared in the SAFTA and the expanded MOU in 2003 was the catalyst for the Singaporean government to consistently lobby the Australian government between 2003 and 2005 to allow, Singapore Airlines, access to the route. Singapore’s rationale can be framed in terms of market access:

- Access to the lucrative market between the US and Australia, currently dominated by Qantas (the current MALIAT described above already provides for open traffic rights between Singapore and the US).
Increased flows from the US to smaller Asian destinations via Australia and Singapore.

As part of the SAFTA, Singapore has allowed Australian airlines (notably Qantas) liberal access rights into and beyond Singapore, yet Australia argued that, despite rights into and beyond Singapore granted by Singapore, access to these beyond markets was still restricted by existing (and limited) agreements held with European countries deemed critical for Qantas’ network. It was argued (primarily by Qantas) that allowing Singapore (but more specifically, Singapore Airlines) access to the Pacific when reciprocal arrangements for access to markets considered key by Qantas should not be allowed.

The second point above aligns with the expansion of Singapore Airlines’ into the Asian continent in recent years, as well as the launch and success of Tiger Airways, an Asian regional low-cost carrier of which Singapore Airlines holds 49% ownership. As well, demand for travel between Australia and the US is strong, with over 635,000 passenger uplift/discharges on the Sydney/Los Angeles city pair (Bureau of Transport and Regional Economics, 2007).

A final decision to denied access to Singapore Airlines was levied in February 2006 by the Australian Cabinet following the international air services policy review noted above. Several details from the decision would suggest cautiously protectionist trade policies with respect the request by Singapore Airlines. First, the Media Release (Minister for Transport and Regional Services, 2006) noted that open skies policies would be pursued on a “case-by-case basis” but only if “we can gain benefits to Australia”. Thus, the decision re-enforced the International Air Services policy following the 1998 Productivity Commission report. Second, it noted that the “Australian-based airline industry” made a significant contribution to the national economy and that it was important to consider access requests ahead of demand to allow airlines time to shape their operations and respond to demand. Curiously, this is a suggestion to attempt to foreshadow demand fluctuations and shifts in a volatile market where sudden externalities can render markets unresponsive from a business perspective. With respect to Singapore’s requests, the then-Minister of Transport made it clear that any access in the future would be “limited and phased”, and that in the meantime other Australian carriers (Virgin Blue is specifically mentioned) could be given an opportunity to offer services (Minister for Transport and Regional Services, 2006).

### 4.3. Denial of access: policy and politics

The Singaporean Government was critical of the decision, suggesting that the Australian Government was open to competition as long as that competition did not originate from outside of Australia. Singapore Airlines released a statement that was widely reported in the Australian media in February 2006, suggesting that “It is a sign that free trade principles, open market competition and consumer choice have again been sacrificed to protect sectional interests.” The Singaporean Government also used the results of a commissioned study by Econtech consultancy of Canberra to suggest that consumers in Australia paid 38% higher fares on the protected trans-Pacific route when compared with the Kangaroo route between Australia and London (The Australian, 2006a).

Politically, the decision was both applauded and criticized. The decision was supported by the then Australian MP Bruce Baird who argued: “We’ve got to remember that there are some 38,000 Qantas employees in Australia and we simply opened up the door to Singapore Airlines it would be providing jobs for people based in Singapore not Australia” (Australian, 21 February 2006). There were calls for the government to withdraw its protectionist support of Qantas. The opposition party claimed that the Australian Government “misled” the Singaporean government over moves toward open skies access as well as refusing to release the economic modeling data that informed the Cabinet’s decision (The Australian, 2006b).

For the Australian government, denying access to Singapore may have been strategic in that it allowed for other interests to establish market entry without risk of incurring entry-deterring behaviors on the part of larger incumbents (such as Singapore Airlines) had the decision been rendered in favor of Singapore (Huschelrath, 2005). Significantly, Australia’s Virgin Blue announced its intention to fly the route shortly after the 2006 review of the Government’s international air access policy. In addition, and perhaps more significantly, Air Canada announced that it planned to utilize Boeing 777 aircraft (when delivered) to fly YYZ-LAX-SYD route if both the Canadian and Australian government agree to amend the existing ASA between the two countries, which currently does not allow such a routing to be operated. Not unlike Qantas, Air Canada operates a substantial international network with a similar domestic feeder service network), and thus may not have the capacity or ability to compete as aggressively as Singapore Airlines would if they were granted access. The timing of the announcement by Virgin Blue and Air Canada regarding potential services was fortuitous in many respects: it allowed the Australian Government to deflect criticism that it was being protectionist in its decision regarding Singapore Airlines. The argument could be made that the Government was actually being selective in its ability to shape international air access. Because one (Virgin Blue) would be based in Australia while the other (Air Canada) would not realistically be interested in beyond rights, both would have been seen as being more committed to tourism and access to Australia.

Competitive parity in competition remains the central focus of the Government’s rationale to deny Singapore Airlines access to the route. Just one week before the 2003 signing of the expanded air services Memorandum between Australia and Singapore, Geoff Dixon, CEO of Qantas, made it clear how liberalization should proceed:

> Before agreeing to open our markets to foreign competitors, it is vital in the national interest that, through a sequenced approach, we secure effective access to our key overseas markets. Unless we do this, Australian carriers will not have equality of opportunity from open skies or any other form of market liberalization. (Qantas, 2003)

Dixon’s comments, echoed to some extent in Government policy some three years later at the review of International Air Services, are intriguing in that the expectation of parity is pronounced before liberalization is acceptable. The 1992 International Air Services Commission Act states that:

> The object of this Act is to enhance the welfare of Australians by promoting economic efficiency through competition in the provision of international air services, resulting in:

- (a) increased responsiveness by airlines to the needs of consumers, including an increased range of choices and benefits;
- (b) growth in Australian tourism and trade; and
- (c) the maintenance of Australian carriers capable of competing effectively with airlines of foreign countries.

Items a and c might be seen to be at odds with each another, yet regulation of air services is critically tied to political economy, political image and related public capital and overall economic
growth targets. While the Australian Government could, on the one hand, be accused of protectionism and perhaps not living up to (b) by fostering competition, it can be suggested that wider economic interests prevented the Government for allowing access to Singapore Airlines if it could not demonstrate benefits to the Australian economy. In other words, in assessing factual/counter-factual competition policy, the social and economic cost (if any) must be weighed against the future potential for predatory actions by a new competitor, which could thus erecting barriers to entry to other potential future competitors (Warren and Findlay, 1998).

Significantly, Australia signed an open-skies agreement with the US in April 2008, but access to Singapore Airlines and Air Canada would not be allowed as the focus of the treaty was on access by Australian designated carriers. Shortly after the announcement, a new international Virgin Group carrier, branded V Australia, announced daily services to Los Angeles commencing December 2008. The announcement in early April 2008 of movement toward a National Aviation Policy Statement (to be finalized in mid-2009) highlighted once again the issue of access rights by foreign carriers, noting that “Australia has not traded access for foreign airlines beyond Australia to the US in recent years. However, the Australian Government may seek to trade such access in the future, if it is judged to be in the national interest to do so” (Department of Infrastructure, Transport, Regional Development and Local Government (Australia), 2008). For immediate future, then, the policy of protecting Australian carriers remains in place.

5. Conclusions

The Australian Cabinet’s decision can be framed from several perspectives. First, it can be approached from the context of protectionist government policies of access and the liberalization of aviation markets. In one sense, Australia is one of the more liberalized air markets in the Pacific region (e.g., Graham, 1998; Kissling, 1998), yet despite this it represents an example of national governments exerting more restrictive policies to external providers (and these can be non-tourism and centered in other service or manufacturing sectors) to protect local production and service offerings. As Lyle (1995) pointed out, commercial realities are a driving force for regulatory reform in air transport provision, yet these same commercial realities may be used to secure market performance for incumbent national carriers. What may appear to be protectionist policies, then, may simply be efforts of regulatory bodies and institutions to ensure parity in commercial operations. Yet the complex global aviation environment can often obscure such efforts and thus produce the unintended consequence of appearing to be protectionist.

From the perspective of accessibility, a key consideration of protectionist versus liberalized air transport provision is the impacts on passenger and cargo flows and the extent to which the degree of accessibility is couched with government policy. In one sense, the Australian Cabinet’s decision can be said to be a directed and intentional effort to reach a Pareto frontier in international air service provision, with the prospect of Singapore Airlines’ access perceived as inferior, in a competitive sense, within the wider system. In this sense, the Pacific route decision can be said to be a case of protectionism given that, on the surface, producer interests (in the form of Qantas) are put ahead of consumer interests. Yet international trade in air services is difficult to assess in terms of competitive advantage given multiple rights of access. Thus, an argument could be made from a producer’s perspective that a protectionist stance in the case of the Pacific route decision was viable given that Australia does not hold enough access rights beyond Singapore.

As this article has shown, decisions on the rate and openness of air transport access are often couched with wider policy imperatives and frameworks (e.g., existing bilateral or free trade agreements) established by the sitting government and what implications these can have on tourist flows, both outbound and inbound. Since the Productivity Commission’s report in 1998, which itself acknowledged that significant worldwide movement to more reciprocal open skies agreements was taking place, global liberalization has increased substantially. What remains to be seen is whether, or when, the Australian government will adopt a less protectionist view of the Pacific Route beyond provision granted to both US-based and Australian carriers by the recent Open Skies agreement.

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