

International Air Transport Policy

May 2012



BACKGROUND

1. New Zealand is the most remote developed economy in the world. Despite the growth of the cruise ship industry, 99 percent of New Zealand's international passenger movements are by air. In addition, over 22 percent of New Zealand's imports by value and around 14 percent of exports are carried by air, primarily in the belly holds of passenger airliners.
2. A broad range of aviation linkages are thus essential to New Zealand's economic and social well being.
3. The current institutional structure of international air transport regulation dates from 1944. It involves bilateral treaties and understandings between countries, based on the fundamental concept that states have sovereignty over the air space above their territory and therefore the right to control access by airlines. Globally there are now thousands of such arrangements.
4. These arrangements, among other things, can regulate what routes airlines may operate, what capacity (specifying limits on frequency, seat numbers and even aircraft types), where passengers and freight can be picked up and dropped off, and how tariffs will be regulated. The traditional approach to air services negotiations has involved restricting the amount of capacity provided on the basis of the size of end-to-end markets.
5. New Zealand's international air services policy sets out the framework for the negotiation and implementation of Air Services Agreements (ASAs) which enable international air services. A liberal air services policy was set in 1985, updated and reaffirmed in 1998, and has subsequently been followed by successive governments.
6. The 1998 policy restatement set out an overall and determining objective of maximising economic benefits to New Zealand, including trade and tourism, consistent with foreign policy and strategic considerations. Therefore, New Zealand would conclude with other countries the most liberal and flexible air services arrangements possible, providing freer access for international airlines and thereby increased competition among them. Increased access for foreign airlines to the New Zealand market would continue to be balanced with a fair opportunity for New Zealand airlines to compete.

DEVELOPMENTS

7. Since 1998, the aviation industry has been subject to a number of shocks including terrorism, pandemics, global and regional financial crises, and fluctuating oil prices. A wider range of stakeholders are taking an active interest in the policy's implementation than in 1998. Many of the specific policy objectives, including open skies¹ arrangements with Australia and negotiating agreements with APEC economies, have largely been achieved.
8. At the same time, while some new tourism markets such as China and India are growing rapidly, growth from established markets, with the exception of Australia, has stalled or is in decline.
9. Airline business models have changed with a deepening of code-share and alliance arrangements, and a growth of the low-cost or no-frills business model.
10. For these reasons it is timely to consider whether the current international air transport policy is still serving the best interests of New Zealand.

¹ Open skies arrangements remove limits on the points that may be served, the capacity that may be offered, and liberalise other provisions including tariff regulation and ownership.

TRENDS IN AIR SERVICES

Air services arrangements

11. In the period leading up to and following the 1998 policy restatement, New Zealand has had one of the most liberal air services policies in the world.
12. Since 1998 the New Zealand government has negotiated air services relationships with 15 countries, put in place entirely new and generally significantly more open agreements with 13 countries (with whom we had previous relationships) and negotiated amendments to others. New Zealand now has negotiated air services agreements or arrangements with 49 countries or territories.²
13. Key achievements for New Zealand since 1998 have included new open skies agreements with:
 - Australia (signed in 2002³) our largest source of visitors
 - the United Kingdom (2005⁴) which enabled Air New Zealand to double its services to London and compete with third-country airlines in our second largest visitor source market
 - Canada (2009) following its adoption of a 'Blue Sky' policy
 - partners in the Multilateral Agreement on the Liberalisation of International Air Transportation (MALIAT) (2001)
14. Increased opportunities were also made available for airlines to offer services to and from emerging markets including China, India, Brazil and Russia.

Air services

15. The total number of carriers operating to New Zealand has fluctuated, with between 17 and 23 passenger airlines and up to six freighter operators offering scheduled services. There has been considerable turnover in the foreign airlines operating to New Zealand as they test the market and withdraw if the route does not prove profitable as market conditions change. The growth in code sharing has also contributed to the turnover, with a number of major developed-world airlines that formerly operated to New Zealand opting instead to cooperate with Star and oneworld alliance partners based in Australasia. In 2011, four scheduled airlines entered or re-entered the New Zealand market and the third major global alliance, Skyteam, established a greater market presence.

Air freight

16. In the 10 years to June 2011, the value of air freight exports increased by 47 percent while the value of sea freight exports increased by 85 percent. This figure demonstrates the desirability of New Zealand increasing the amount of light-weight, high-value export goods suitable for carriage by air. Much of the recent increase in total New Zealand exports has been to China, a market where New Zealand disproportionately exports the sort of high-volume low-value goods that are typically shipped by sea.

² Includes the Netherlands (which is in administrative effect), Taiwan, and MALIAT partners (including Mongolia which is cargo only). See: <http://www.transport.govt.nz/ourwork/air/newzealandsairserviceagreements/>

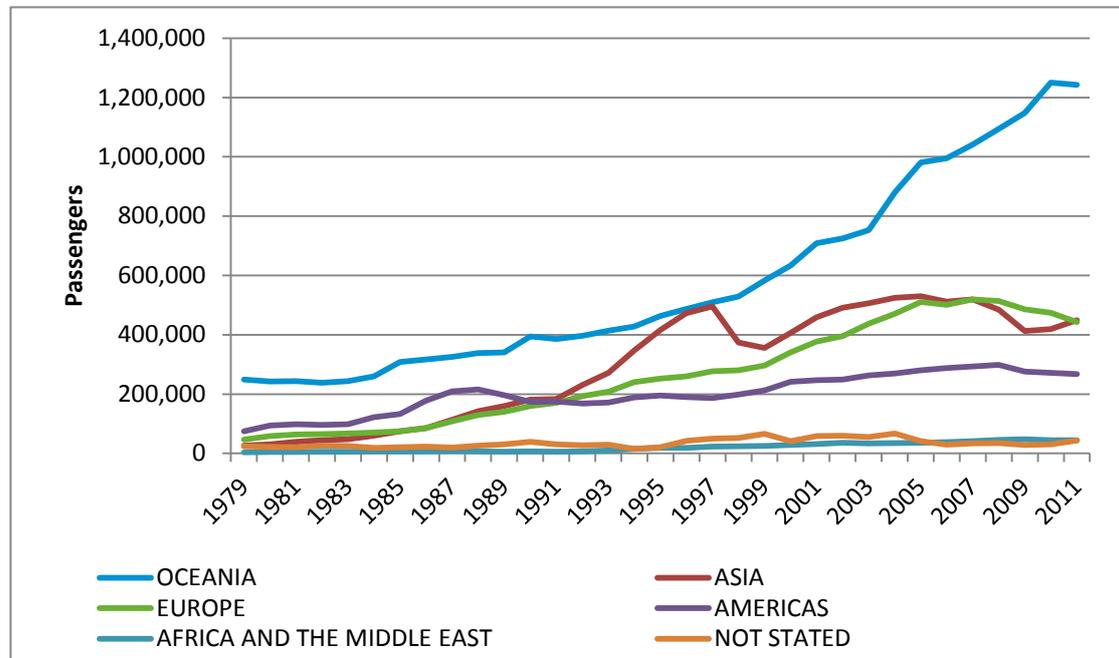
³ <http://www.nzlii.org/nz/other/mfat/NZTS/2003/13.pdf>

⁴ <http://www.fco.gov.uk/resources/en/pdf/3706546/3892733/4190568/4356125/Av8>

Tourism

17. Tourism directly contributes \$6.8 billion (or 3.8 percent of GDP) to the New Zealand economy. A further \$8.8 billion (or 4.8 percent of GDP) is indirectly contributed. Tourism also directly supports 91,900 full-time equivalent jobs (4.8 percent of the total workforce in New Zealand).

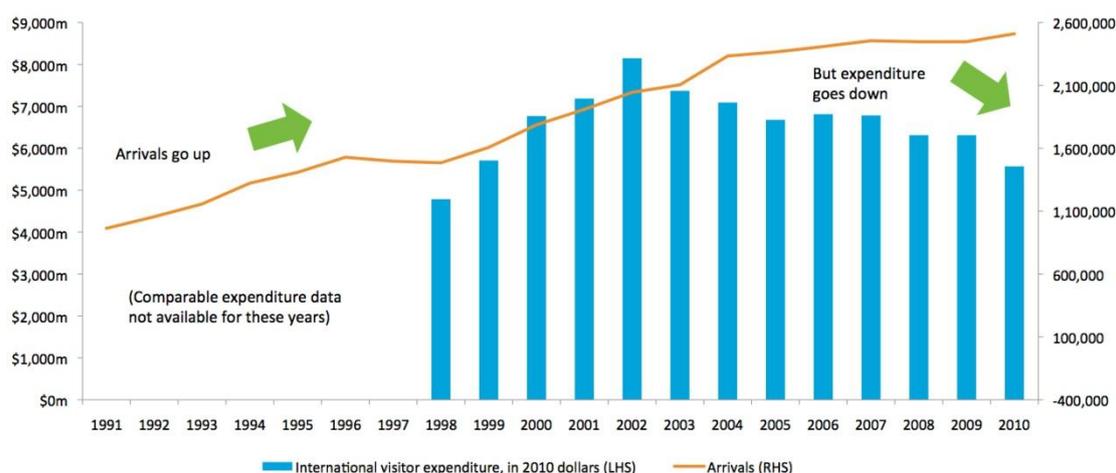
Figure 1: Visitor arrivals by regions



Source: Ministry of Transport, Statistics New Zealand

18. The chart above shows that there has been an increase in the number of Australian visitors (who make up 90 percent of Oceania arrivals) in recent years, but since around 2005 the numbers of Asian and European visitors has not grown. Within the Asia group, a particularly notable trend has been a decline in Japanese visitors and an increase in Chinese visitors.
19. Also notable has been an increase in arrivals to New Zealand who have 'visiting friends and relatives' as the primary purpose of their visit, from 26 percent in 2000 to 31 percent in 2010. The impact of the changes taking place in the passenger mix is demonstrated by the chart overleaf, showing visitor expenditure in New Zealand in real terms.

Figure 2: Arrivals and expenditure (real terms) over time



Source: Ministry of Economic Development, Statistics New Zealand

20. The Ministry of Economic Development has identified three drivers for the decline in the economic contribution of the visitor market:

- unfavourable exchange rates
- a market shift with growth in markets with lower spend and a decline in higher spending markets
- competition from alternative destinations

21. International air transport policy is only part of the economic, policy and regulatory environment that impacts on visitor numbers. The policy sits alongside a range of government initiatives such as: tourism partnerships between the private and public sectors; ease of obtaining visas; international education; development of the conventions market; and growth of international trade which drives and requires business travel. In terms of New Zealand's economic performance, particularly in the areas of tourism and trade, the current air services policy has not been widely identified as a problem, but an optimal air services policy can be a part of the solution.

OBJECTIVE

What should the objective of New Zealand's international air transport policy be?

1998 Policy

The overall and determining objective of New Zealand's international air transport policy is to maximise economic benefits to New Zealand, including trade and tourism, consistent with foreign policy and strategic considerations.

International air transport policy has a key role to play in supporting the government's broader strategy of strengthening external linkages, strong economic growth, and encouraging enterprise and innovation, leading to an open, dynamic and internationally integrated economy.

Discussion

22. The broad principles behind the objective set in 1998 remain valid. The government's overall goal for New Zealand is to grow the economy to deliver greater prosperity, security and opportunities for all New Zealanders. The transport system provides vital connections - both domestically and internationally - for our communities and businesses. In order to support the overall goal, the government's objective for transport (as set out in Connecting New Zealand⁵) is an effective, efficient, safe, secure, accessible and resilient transport system.
23. The negotiation of air services arrangements to provide greater access to major trade and tourism markets has been identified as a key government action in the Connecting New Zealand document.
24. While the government cannot drive economic growth by itself, it can help to remove the regulatory and other obstacles that hold businesses back from thriving.
25. Air services policy can contribute to the government's priority of building a more competitive and productive economy by supporting the efforts of business to connect internationally and increasing the returns from tourism.

⁵ <http://www.transport.govt.nz/ourwork/KeyStrategiesandPlans/Pages/ConnectingNewZealand.aspx>

Policy Proposal

The objective of New Zealand's international air transport policy is to provide New Zealand-based and foreign airlines with opportunities to provide their customers with better access to global supply chains and New Zealand's key passenger and goods markets. This will be done in order to help grow the economy and deliver greater prosperity, security and opportunities for all New Zealanders.

APPROACH TO AIR SERVICES LIBERALISATION

What should New Zealand's approach to air services liberalisation be?

Should the basis of the policy continue to be putting into place the most open and flexible reciprocal arrangements possible?

Will there be situations where open skies arrangements are not in New Zealand's best interests? If so, what would those situations be?

To what extent should the policy take specific account of the benefits that New Zealand owned and based airlines bring to the economy?

Will there be situations where it may be in New Zealand's best interests to allow a foreign airline to operate even where these rights are not fully reciprocated in bilateral arrangements? Can extra-bilateral approvals (on an interim basis) bring benefits?

1998 Policy

New Zealand therefore seeks to conclude with other countries the most liberal and flexible air services arrangements possible, as a means to securing enhanced quantity, quality and breadth in our international civil aviation links.

We believe that the best way to achieve our objectives is to encourage bilateral partners towards mutual liberalisation of air services arrangements, with the aim of facilitating access to existing and potential air markets of interest to New Zealand. Such an environment maximises opportunities for market-place competition. This is more conducive to achieving a mix of prices and services that can give New Zealand consumers and business a better deal.

Increased access for foreign airlines to the New Zealand market will continue to be balanced with a fair opportunity for New Zealand airlines to compete.

The government will, in the interests of consumers and to maintain a competitive industry, continue to ensure that adequate safeguards are in place to counter anti-competitive or predatory behaviour by airlines.

Discussion

26. Air services liberalisation can influence economic growth through the mechanisms set out below.



27. A large number of studies have shown or predicted significant benefits to economies from general or market specific liberalisation. Such studies can however, be difficult to interpret given the range of factors that influence the impact of air services policy on actual services provided, and the differing methodologies leading to differing results. Despite these difficulties, the majority of studies show a positive economic benefit from air services liberalisation, in some cases a substantial benefit.
28. The Ministry of Economic Development has commissioned work to value air transport to New Zealand beyond simple expenditure multipliers based on tourism spend. This work may, in future, help to provide a robust analytical basis for determining how to implement international air transport policy in particular cases.

Are air services agreements a constraint?

29. New Zealand has followed one of the most liberal air services policies in the world for many years. We already have a comparatively large number of open skies agreements, particularly with major established markets and there is either unused capacity or no limit on capacity under many of New Zealand's air services arrangements. In these cases there is not a market access constraint to be removed. One market with unused capacity is India, identified by many as a key growth area, but where there are no direct air services.
30. The fact that many of New Zealand's international air routes are serviced by one carrier is not unusual in a global context. Around 70 percent of the world's air routes are operated by one single carrier and 91 percent by no more than 2 carriers.
31. The Ministry is aware of a number of cases where airlines have made preliminary inquiries of government or airports regarding services to New Zealand where the necessary rights were not available, and the proposal has not been pursued to the point of rights being negotiated and services being introduced.

32. Availability of rights under an ASA is a necessary but not sufficient pre-requisite for airlines to offer or expand services. A large number of commercial, regulatory/political and infrastructure considerations enter into the calculation, including:
- regulatory constraints
 - the rights need to be available between the airline's home country and New Zealand, and also in any relevant agreements between the airline's home country and third countries
 - sometimes the airline's own government may be seeking to prevent it competing with other airlines from that country or 'divide the world' among its airlines
 - requirements to meet safety and security standards
 - supply factors
 - aircraft availability and performance
 - infrastructure constraints, including availability of landing and departure slots at airports
 - costs — including fuel, labour and taxes
 - availability of border services
 - demand factors
 - distance (including travel times)
 - historic, cultural and language ties
 - relative attraction of alternative destinations
 - GDP in source market
 - visa requirements (including those in third countries, such as Australia)
 - exchange rates
 - actual and potential competition from other airlines.⁶

⁶ Competition can be direct or indirect. Singapore Airlines and its subsidiary Silk Air, for example, offer 81 services a week to 10 Indian cities. In terms of New Zealand's connectivity to India these numerous one-stop services far outweigh the daily (or less than daily) service on one city pair that would likely be offered by a New Zealand or Indian carrier starting services on the route.

Proposed approach

Introduction

33. The approach taken in developing the proposed policy has been that there is no guarantee that removing barriers in air services arrangements will lead to significant additional services (particularly given that New Zealand already has a very open air services environment). However, removing those barriers that do exist will allow airlines to make decisions based on the factors they face in the market on when to enter, expand or exit routes. This will, on balance, lead to more services being provided than when airlines face economic regulatory hurdles. Additional services will, in turn, improve New Zealand's connectivity, bringing economic and social benefits.
34. The three main options that could be considered for New Zealand's overall approach are:
 - more cautious liberalisation than the 1998 policy
 - variations broadly around the approach set out in the 1998 policy
 - unilateral liberalisation.
35. The general proposition set out in the 1998 policy, of seeking to conclude with other countries the most liberal and flexible air services arrangements possible, remains valid in most cases.
36. Reciprocal open skies is the approach that will in most cases maximise the prospects for additional air services to be provided that will benefit New Zealand. Around this there are options for clarifying where liberalisation may not be in New Zealand's best interests, on the one hand, and providing for liberalisation outside of the fully reciprocal bilateral model, on the other.

Unilateral approach

37. At the extreme end of the liberalisation spectrum would be the approach of unilaterally granting foreign airlines entry to New Zealand without the need for an ASA (in such circumstances, entry may be subject only to safety certification). Regulatory barriers for foreign airlines accessing New Zealand would be minimised and contestability among foreign airlines would be maximised.
38. However, while we continue to operate in the current global aviation regulatory environment, bilateral (or plurilateral) agreements are necessary for New Zealand airlines to have an equal opportunity to offer services.
39. Therefore, the effect of unilateral liberalisation could be that New Zealand airlines are exposed to greater levels of competition at the same time as opportunities for expansion into new or existing markets are severely curtailed. The competitive and commercial position of New Zealand airlines would be threatened by such a policy and competition in some markets might be reduced.
40. Treaty-level air services arrangements also provide a government-to-government link that may be important in seeking opportunities for the wider aviation sector (such as mutual recognition for standards in traded services). A unilateral approach that did not include an agreement between New Zealand and the other government could also make it more difficult to maintain the nexus between an airline and the party providing safety oversight or to resolve disputes that may arise regarding the operation of the air services.

41. We are not, therefore, proposing a unilateral approach. However granting rights for airlines to operate to particular airports or for particular types of services that are not fully reciprocated at the time, and authorisation of services provided in advance of bilateral negotiations (extra-bilateral services) may bring benefits to New Zealand by increasing access to international air services and will be considered on a case-by-case basis.

Extra-bilateral services

42. There are alternative approaches that could also ameliorate some of the difficulties associated with ensuring bilateral liberalisation can keep pace with rapidly changing commercial opportunities.
43. Where an airline is able to offer services that would benefit New Zealand, but a mutually agreeable bilateral arrangement cannot be put in place, consideration could be given on a case-by-case basis to a form of temporary 'extra-bilateral' approval of such services.
44. If the other government later proved unwilling to grant market access to New Zealand airlines (a breach of the principal of 'comity and reciprocity'), such authorisation could be withdrawn (or more likely not renewed) more readily than if the rights were part of an arrangement of international treaty status.
45. Such authorisations would fall outside the criteria currently set out in the Civil Aviation Act 1990 for operation of both scheduled and non-scheduled services. An additional mechanism may be required for these services to sit alongside the existing licensing and non-scheduled services provisions.

Non-open skies agreements

46. Arrangements that fall short of full open skies may be considered appropriate in the following situations:
 - Negotiation factors: the other party will not agree to a balanced exchange of opportunities for New Zealand airlines, agreeing to incremental liberalisation may undermine the long-term objective of full liberalisation, or providing access to the other party risks the ability to gain access to a third party's much larger market.
 - Market structure factors: the services to be provided under new arrangements will threaten existing services or other future services to/from significant markets by New Zealand or foreign airlines, to the overall detriment of New Zealand's interests. For example, new one-stop services which may affect the viability of a non-stop operator on a route, or additional services by a dominant operator that may undermine the viability of competitors on a route.
 - Behaviour factors: A foreign airline is not operating on a commercial basis or is engaged in anti-competitive behaviour.

Negotiation factors

47. A particular issue has been negotiations where a party with a geographical advantage can link New Zealand to most of the world via its home country (giving it what are called sixth freedom opportunities), but New Zealand airlines

generally require fifth freedom beyond rights⁷ explicitly included in an agreement to serve these long-haul markets, notably between Europe and New Zealand.

48. These factors, and the actual likelihood of services (by foreign or New Zealand airlines respectively) will be taken into account in assessing the balance of opportunities in any agreement where the other party will not agree to open skies.
49. A number of countries, including Australia, the United Kingdom, the Philippines and India have, for example, proposed packages where access to regional airports or for cargo-only services, is given without full reciprocity being required.
50. We will consider such an approach on a case-by-case basis.

Market factors

51. Given the number of open skies agreements already in place, and the range of factors that influence whether an airline will serve New Zealand, the ability for government to influence market structure through the sequencing or holding back of traffic rights is now limited. While the government may have a view on the air services that would most benefit New Zealand (for example, favouring non-stop over indirect air services), it will rarely be appropriate to attempt to pick winners through air services arrangements or withhold market opportunities from other airlines to bring this about.

New Zealand airlines

52. New Zealand airlines are a particular case where the policy may need to ensure a particular airline obtains traffic rights, as they can only gain market access through air services arrangements. Additionally, New Zealand-based airlines play a role in the transport system and the economy distinct from that played by foreign carriers.
53. New Zealand airlines may be able to provide services in circumstances where foreign carriers cannot or will not:
 - Services by a foreign airline are dependent on traffic rights with third countries. Japan has in the past not granted third-country airlines the rights to fly to New Zealand and Emirates is facing restrictions from governments such as Canada and Germany.
 - New Zealand airlines are the only airlines that have to serve New Zealand⁸. While they can and do withdraw from particular routes as markets change, New Zealand airlines, unlike other airlines, cannot withdraw from the New Zealand market altogether.
 - An airline with New Zealand at the core of its network may face a different set of decisions about routes to New Zealand than an airline for which New Zealand is just one of many 'spokes' and at the 'end of the line'.
 - Different airlines face different cost structures and incentives. One example is where (because of their high value for use to other

⁷ See Annex 1 for an explanation of the 'freedoms of the air'

⁸ With the very limited exception of agreements providing for 7th freedom rights, all routes for New Zealand airlines are expressed as starting or finishing in New Zealand.

destinations) only a New Zealand-based airline would use scarce slots at an airport such as Narita for services to New Zealand.

54. Even where equivalent capacity is provided, New Zealand airlines can have a greater positive impact on the economy than foreign carriers because of:
- return of investment and taxation accruing to New Zealand
 - greater spending on tourism promotion
 - playing a cornerstone role in the wider aviation industry (a source of high-paying, high-tech jobs)
 - community participation
55. Following substantial government re-investment in the wake of the collapse of Ansett in 2001, Air New Zealand has proved to be an innovative and relatively successful airline as it has worked within the current liberal policy. However, Air New Zealand is currently undertaking a review of its long-haul services.
56. While Air New Zealand is a relatively large airline for the size of its home market, it still only operates to 28 points overseas in 17 countries or territories. In light of the global economic situation and delays in B787 aircraft delivery, the airline has pulled back from plans to inaugurate at least one new long-haul international destination every year⁹, although it has announced its intention to test the Bali market.
57. New Zealand's aviation system and global connectivity will be strongest and most resilient when there are both strong and successful New Zealand-based airlines, and a network of other services operated by a range of different airlines.

Policy proposal

New Zealand will pursue a policy of putting in place reciprocal open skies arrangements except where it is not in the best interests of the country as a whole.

Where the other party will not agree to open skies agreements, we will seek to put in place the most open package that is in New Zealand's overall best interests, both in the short and long term.

In doing this we will recognise the benefit to New Zealand of new or additional services by overseas airlines, while ensuring that New Zealand airlines have a fair and equal opportunity to compete.

We will consider extra-bilateral approvals pending the putting into place of new or expanded arrangements. These will be provided on the basis that such authorisation may be withdrawn if New Zealand airlines are denied opportunities to offer services to, or through, the home market of the foreign airline in question.

⁹ Other New Zealand holders of open aviation market licences (Airwork and Vincent Aviation) do not provide scheduled services from New Zealand.

AIRLINE INVESTMENT

Air New Zealand

- Currently the New Zealand government holds around 73 percent of the shares in Air New Zealand. The government has announced that it is considering a partial sell down of some of its shares in the airline in the context of the mixed ownership model.
- As well as its ordinary shares, the Crown is the holder of the Kiwi Share. Under the Air New Zealand constitution the written consent of the Kiwi Shareholder is required to change to the name of the company, its place of incorporation, its principal place of business, the location of its head office and the nationality of directors.
- The consent of the Kiwi Shareholder is also required: (a) for an owner or operator of an airline business to hold or have an Interest in an Equity Security in the company; and (b) for a non-New Zealand national to hold or have an interest in shares that confer 10 percent or more of the total voting rights in the company.
- The controls in the company's constitution will continue to take precedence over any any changes to general policy being considered in this review
- The primary intent of the Kiwi Share is to protect Air New Zealand's access to other countries under inter-government air services agreements by ensuring that "substantial ownership and effective control" of the airline remains in New Zealand hands
- Air New Zealand has been allocated rights under ASAs with restricted capacity that contain the 'substantial ownership and effective control' formulation (for example, Japan, China and Fiji).

Government policy on the ongoing ownership of Air New Zealand is being considered in the context of implementing the mixed ownership model for Air New Zealand.

What policy should New Zealand follow regarding foreign airlines being designated to operate to New Zealand?

What level of New Zealand ownership is sufficient for international airlines to be able to exercise New Zealand traffic rights?

1998 Policy

Our key objectives in negotiating such agreements are to achieve comprehensive reciprocal liberalisation in terms of ... open investment in airlines.

An important aspect in this regard is to make provision, ahead of the APEC 2010 timeframe, for open investment in airlines.

Until such time as the government can be confident that an airline it designates would not be denied access to traffic rights with other bilateral partners, designated New Zealand international airlines will continue to be required to be substantially owned and effectively controlled by New Zealand nationals.

Introduction

58. There are two aspects of airline ownership that need to be considered as part of New Zealand's international air transport policy:
- the circumstances under which we accept that a foreign airline is entitled to exercise the traffic rights negotiated by the relevant government
 - the ownership-based criteria to be used by the New Zealand government for the designation of New Zealand airlines
59. Globally, the airline sector has not been subject to the liberalisation of capital flows seen in other industries.
60. Under the bilateral system a means is required for determining what is, for example, an Indian airline entitled to exercise India's traffic rights and what is a New Zealand airline entitled to exercise New Zealand's traffic rights. There have been concerns that without ownership limits, airlines could seek 'flags of convenience' in regimes which offer competitive advantages such as lower safety standards or lower wages.
61. The Intervistas reports, prepared for the International Air Transport Association's 'Agenda for Freedom' discussions, estimated the GDP impacts of investment liberalisation as ranging from 44 percent of the impact of market access liberalisation (India) to 280 percent of the benefit of market access liberalisation (Morocco).

Rationale for and impact of ownership constraints

62. There are a number of reasons why a country may choose to continue a policy of requiring designated airlines to be owned by its nationals, including reserve military airlift capacity, and concerns about safety and labour standards. New Zealand's concern is that a foreign-owned airline would be denied operating authorisations by those bilateral partners where agreements state that airlines should be substantially owned and effectively controlled by nationals of the designating state. Another concern is that a foreign-owned airline will have less commitment to the New Zealand market, and may be more likely to withdraw (either from particular routes or overall) when traffic declines (possibly leaving some key markets unserved).
63. Designation without any criteria could also allow an airline to 'jurisdiction shop', by-passing restrictions in its home country agreements, thereby reducing the incentive on its government to liberalise.
64. Requirements regarding nationality have a constraining effect on the ownership and governance decisions of airlines. In New Zealand's case it limits airlines' access to equity capital by restricting New Zealand airlines in large part to the relatively small local capital markets.
65. Less formal arrangements, such as code sharing or joint marketing or aircraft maintenance initiatives, have often been used to navigate around ownership restrictions. However, such arrangements do not usually demonstrate the same long-term commitment provided by a cornerstone equity stake.
66. Mergers have been possible, particularly between European airlines or between airlines from the United States of America. However the structures put in place in cases such as BA-Iberia, TAM-LAN, and Air France-KLM demonstrate that elaborate ownership and control measures may be needed to ensure that both constituent parts of the new entity can continue to exercise traffic rights.
67. The lower cost of capital resulting from access to deeper capital markets was clearly evidenced in New Zealand when Air New Zealand's shareholding was split between 'A' and 'B' shares — the 'B' shares that were able to be held by foreign nationals, traded at a premium to 'A' shares that were available to New Zealand nationals only.

Ownership and control criteria for foreign airlines in ASAs

68. While a country may designate any airline it wishes, the other country has the right, if it chooses, to refuse operating authorisations to an airline that does not meet the specified ownership and control criteria.

Evolution of criteria

69. The criteria applicable differ between agreements, but they all require that the airline must have some connection with the designating country.
70. The traditional criteria refer to an airline being 'substantially owned and effectively controlled' by nationals of the designating state.
71. There is a clear modern trend toward adoption of 'principal place of business' and 'place of incorporation' criteria in ASAs, alongside 'effective control', or more recently, 'effective regulatory control' to replace 'substantial ownership'.

72. Many states have also chosen not to exercise the right to deny operating authorisations to an airline that is foreign owned. For example, Aerolineas Argentinas continued exercising Argentine traffic rights (including to New Zealand) during a period of Spanish ownership. On the other hand, Russia has questioned the status of various Lufthansa subsidiaries, in particular Austrian Airlines, on the basis that they are German owned and controlled.
73. In this regard a potentially significant initiative is the proposed Multilateral Convention on Foreign Investment in Airlines (MCFIA). A draft was presented by the United States of America to ICAO in September 2009. The convention would provide a reciprocal mechanism for countries to remove barriers to cross-border investment by pledging to waive the ownership and control provision in their ASAs. It would formalise the more liberal approach that many states have taken.

New Zealand policy

74. New Zealand has been part of these trends. Many of our traditional bilaterals referred to substantial ownership and effective control. However, from around the mid-1990s, our preferred model became one of 'principal place of business, place of incorporation and effective control'. The formulation then became (from around the time it was being put forward by ICAO as its 'liberal option') 'principal place of business, place of incorporation and effective regulatory control'.
75. This formulation could be regarded as the most liberal that ties an airline to its regulating state. Effective regulatory control ensures accountability for safety regulation. Place of incorporation and principal place of business are criteria to ensure that such regulatory oversight can in fact be 'effective'.
76. This was agreed with Vietnam in 2003 and the United Kingdom in 2005. As a consequence of the 'horizontal' agreement with the European Commission agreed in 2005 it also applies to New Zealand airlines under our agreements with Austria, Belgium, Denmark, Spain and Sweden.
77. Special cases are the Single Aviation Market (SAM) with Australia which provides for an additional category of 'SAM' airlines operating solely within and between Australia and New Zealand which can have a mixture of Australian and/or New Zealand ownership and control factors. Another case is the horizontal agreement with the European Commission, where New Zealand recognised the concept of a community carrier, namely the right of businesses (in this case airlines) owned by EC nationals, to establish themselves anywhere in the European Union.
78. New Zealand's existing policy is predicated on the view that while under the bilateral system, and for safety reasons, it is necessary to retain a nexus between an airline and the designating state, it should be the right of each country to determine the investment environment for its own airlines.
79. The reasoning behind this policy remains sound.

Policy Proposal

New Zealand's policy with regard to third-country investment in foreign international airlines will be to:

- continue to seek to negotiate agreements that provide for the link between airlines and the designating state to be based on principal place of business, place of incorporation and effective regulatory control
- continue to consider, on a case-by-case basis, not exercising the discretion to withhold authorisation from airlines that do not fully meet the designation criteria of the relevant ASA, where there is no overt circumvention of other bilateral agreements or detriment to future liberalisation with the states involved
- continue to monitor the work by ICAO on the MCFIA with a view to acceding to such an agreement should an acceptable outcome emerge

Ownership criteria for the designation of New Zealand airlines

80. The current policy requiring New Zealand airlines to be substantially owned and effectively controlled by New Zealand nationals is defined (as a matter of policy) as:
- (a) that New Zealand nationals own at least 51 percent of the paid-up capital of the airline, and hold a majority of the positions on the board, including that of chairperson
 - (b) that not more than 25 percent of the airline is owned by any single foreign airline interest
 - (c) not more than 35 percent in aggregate of the airline is owned by foreign airline interests
 - (d) 49 percent foreign ownership in total
 - (e) that the airline's head office and operational base is located in New Zealand
 - (f) that arrangements relating to the operation of services do not vest effective control of the airline in a foreign interest
81. In 1998 there was a real concern that traffic rights allocated to a foreign-owned, New Zealand airline would be at risk. In light of developments over the last 20 years a more liberal policy may now be possible.
82. New provisions could be applied to New Zealand airlines seeking to operate only to countries where the ASA does not allow for licences to be withheld on ownership grounds. This could open up the way for designation of Australian-owned, New Zealand-based SAM airlines regulated by the New Zealand CAA such as Virgin Australia Airlines (NZ) Limited and JetConnect.

83. Additionally, there will be cases where a bilateral partner will, as a matter of policy, accept the designation of New Zealand based but foreign owned airlines. This might particularly be the case for cargo-only airlines.
84. We also propose removing the 25 percent and 35 percent limits for foreign airline ownership. Such policies reflect a distinction between ownership and control that have not been widely adopted around the world. Australia has also decided to remove similar limits that applied to Qantas.

Policy Proposal

The policy on designation of New Zealand airlines (other than Air New Zealand) will include:

- removal of the policy limits of 25 percent ownership by any one foreign airline or 35 percent by foreign airlines in total
- considering, on a case-by-case basis, designating New Zealand-based airlines whose ownership and control structure is consistent with the bilateral arrangements with all the markets it proposes operating to or where the risk of operating authorisations not being accepted is assessed as small
- considering, on a case-by-case basis, applying a more liberal policy for cargo-only airlines

ELEMENTS OF AGREEMENTS

What elements should be included in New Zealand's model open skies agreement?

1998 Policy

Our key objectives ... are to achieve comprehensive, reciprocal liberalisation in terms of:

- no route restrictions, including by way of code-sharing, rights of establishment in other countries and cabotage;
- unlimited capacity, through no constraints on the number of flights or types of aircraft;
- open investment in airlines; and
- The ability for airlines to charge whatever prices they wish without having to file such prices for notification or approval with any authorities.

Also of significance are the objectives of securing multiple designations of airlines, and of ensuring there are as few restrictions as possible in non-scheduled services.

Discussion

85. Many of the provisions contained in an open skies ASA (particularly 'doing business' matters and generic international treaty clauses) are relatively standard articles which are common across all types of ASAs.
86. Various components have evolved over time as the industry has changed and as countries have moved towards a more liberal approach. This is reflected in various countries' model agreements and in ICAO guidance which sets out templates for traditional, transitional and liberal ASAs.
87. The key components distinguishing an open skies agreement from others fall within the categories of grant of rights, operational flexibility, designation, capacity principles and tariffs as set out below.
88. A model open skies agreement would include the following components (in addition to 'doing business' and normal treaty provisions).
 - *Grant of Rights*
 - Open route schedule
 - Wording that allows for 7th, 8th and 9th freedom services¹⁰
 - Operating flexibility

¹⁰ see Annex 1

Designation, Authorisation, Revocation

- Multiple designation (that is, each country is not limited in the number of airlines that it may designate)
- Criteria based around principal place of business, place of incorporation and effective regulatory control
- *Capacity, fair competition*
 - Free determination by airlines of capacity
 - No approval of schedules required
- *Tariffs*
 - Tariffs to be established freely based on commercial considerations in the market place
 - No filing or approval required
- *Commercial Opportunities*
 - Code sharing (including third-country code sharing)
 - Leasing, including wet leasing
 - Ground handling
 - Intermodal transport
 - Non-scheduled services

Matters for consideration elsewhere

89. There are a number of other matters, principally relating to the environment and taxation, but also labour standards, that counterparts at times seek to include in ASAs. We consider that in general such matters are best dealt with on a cross-sectoral and multilateral basis. However, it may be appropriate to include provisions on wider civil aviation co-operation.

Policy Proposal

Where open skies is determined to be in the countries' best interest, New Zealand will continue to seek to put in place agreements that provide for:

- no restrictions on routes or capacity (including 7th freedom services and cabotage (8th and 9th freedom))
- no regulation of tariffs
- open investment provisions

In other cases, or where the other party will not agree to full open skies, the provisions that are in New Zealand's best interest (taking into account the overall package on the table) will be agreed for each Article.

THE FORWARD NEGOTIATION PROGRAMME

What should be the basis for determining the forward negotiation programme? Should there be a priority list or a set of criteria? Are there specific areas where current arrangements, or lack of arrangements, are hindering the development of services?

What process should be in place for stakeholder involvement in setting the forward negotiation programme?

Should specific policies apply in the South Pacific?

What should New Zealand's approach to liberalisation through regional and multilateral processes be?

1998 Policy

The negotiating priorities were:

- achieving a greater exchange of beyond rights [with Australia] remains a key objective for the Government
- the growth in visitor movements from [countries in Europe] must be matched by increasing opportunities for airlines to serve the markets, with as few restrictions on their ability to do so as is possible
- we will continue to encourage our APEC bilateral partners towards the early application of APEC's Bogor principles in air services agreements

Within the Pacific, the New Zealand government is very much aware of the particular air transport needs of the Forum Island Countries, and will maintain flexible and positive attitude in the negotiation and implementation of air services arrangements with them.

Pursuit of the liberalisation of international air transport services is an integral part of, and consistent with, the government's overall trade policy strategy whereby it seeks to achieve the best outcomes for New Zealand through bilateral, regional and multilateral tracks. At present, the bilateral and regional tracks offer the best opportunities to secure the government's objectives in international air transport.

Discussion

90. Significant progress has been made across the priority areas set out in the 1998 policy.
91. An open skies agreement (excluding 7th freedom passenger rights) was concluded with Australia in 2000. Arrangements that ranged from full open skies to quite restrictive, were negotiated with all APEC economies.¹¹
92. Negotiations with several European countries were held in the late 1990s and the early 2000s. These agreements have allowed for a number of code-sharing arrangements between airlines. However, with the significant exception of via Hong Kong to London operations by Air New Zealand (started under an agreement negotiated in 2005) no additional direct New Zealand–Europe operations have eventuated.
93. Air services negotiations are not a costless exercise and priority must be placed on which negotiations to actively seek, or agree to, and how much resource to put in to them.
94. In determining the forward negotiation programme, the key consideration will be the contribution that a particular air services agreement can make to the objective of this policy, that is, to what extent it will provide better access to global supply chains and New Zealand’s key passenger and goods markets.
95. The following factors will also be taken into account:
 - short- and medium-term commercial requirements of airlines (both New Zealand-based and foreign airlines)
 - the desirability of achieving ‘headroom’ — negotiating capacity ahead of demand, particularly in growing markets, or new markets important to New Zealand’s global connectivity
 - requests by foreign governments¹²
 - a likelihood of achieving an outcome consistent with New Zealand policy (how ‘like-minded’ is the counterpart)
 - wider foreign and trade policy objectives
 - dispute resolution
 - the willingness of the other party to engage.
96. The Ministry of Transport is working closely with the Ministry of Economic Development, the Ministry of Foreign Affairs and Trade, and other relevant government agencies on New Zealand’s global connectivity. This work is looking at key markets and how New Zealand connects with those markets. This will assist in identifying future priority areas, along with work in related areas such as trade, immigration and education.

¹¹ However the arrangements with Peru are not currently in effect.

¹² Most ASAs include an Article obliging us to meet with a bilateral partner if requested within a specified timeframe (generally 60 days). There is however some discretion in when to meet with a country with which there is not an existing arrangement,

97. The Ministry will also put in place processes to ensure that tourism, freight, airport and airline interests contribute to the ongoing assessment of priorities and approaches to particular markets.
98. Traditionally, air services negotiations focussed very much on movement between the two countries¹³. New Zealand has ASAs in place with our top 37 markets and 44 of the top 50 markets.¹⁴ The largest market in terms of two-way movements with which we do not have an ASA in place is Saudi Arabia. This market could be catered for by one B777 return service a fortnight.
99. Selecting targets for new arrangements based on current movements between New Zealand and the other party is no longer a particularly meaningful exercise.
100. However, some markets have the potential to grow very rapidly once air services are in place. In 1992, less than 13,000 Korean tourists came to New Zealand. An ASA was concluded in 1993 and Korean Air started direct services that year. In 1995 104,000 Korean visitors came to New Zealand.
101. Additionally, much of the new aircraft capacity around the world is being ordered by 'hub' airlines often from relatively small states, particularly in the Arabian Gulf. It is these airlines that are looking to expand into new markets, and to take advantage of their geographic position to link a large number of markets across the globe.
102. Although their home markets are insignificant sources of tourism in their own right, and in some cases there is a risk that they will displace services by airlines with larger home markets, these airlines can use their hub and spoke networks to offer services to a far larger range of destinations than is feasible by direct services. In response to approaches by such states a case-by-case approach will be adopted as to whether to seek an open skies agreement or a more limited exchange.
103. New Zealand has in place relatively open agreements with many of our traditional visitor markets. However, in many cases, these markets are stagnant or declining. Much of the forecast growth in tourism numbers comes from emerging markets in Asia and South America, particularly India and China. New Zealand's ASAs with its Asian and South American bilateral partners are generally more restrictive, and expanding the opportunities available under these will be a focus in coming years. There is also potential for New Zealand to function as a hub between parts of Asia and South America.

South Pacific

104. Some South Pacific countries are very important visiting friends and relatives (VFR) routes for New Zealand, with long standing and deep people-to-people links. South Pacific destinations are also popular with New Zealanders, and tourism from New Zealand is very important to the economies of some of these countries.
105. New Zealand and Australia have not joined the Pacific Islands Air Services Agreement (PIASA). New Zealand already has very open arrangements with Samoa, Tonga and the Cook Islands through the MALIAT.

¹³ Many ASAs include a capacity principles article which, inter alia, provides that "the agreed services ... shall have as their primary objective the provision, at reasonable load factor, of capacity adequate for the current and reasonably anticipated requirements of passengers, cargo and mail originating from or destined for the territory of the Contracting Party which has designated the airline".

¹⁴ Assessed as the sum of arrivals of residents from that country, and departures of New Zealanders with that country as their main destination.

106. New Zealand has air services relationships with 10 South Pacific countries and, through an ASA with France, the territories of New Caledonia and French Polynesia. Air services are offered between New Zealand and the Cook Islands, Niue, Samoa, Vanuatu, Tonga, Fiji, New Caledonia and French Polynesia.
107. An issue has been the marginal viability of some services linking Pacific island countries with the United States of America which led to support from New Zealand's aid budget being provided. Air services to Niue have also been indirectly underwritten by New Zealand aid. Changes to the aircraft types in airlines' fleets will further affect the nature of some airlines' route networks in the future. Some airlines in the region have contracted or collapsed, while in other cases, South Pacific states have set up joint ventures with larger airline groups (for example, Virgin Samoa).
108. New Zealand's aid emphasis in the Pacific is now on sustainable economic development, rather than poverty alleviation. This is resulting in aid being provided for aviation infrastructure. In addition there is continued New Zealand Government interest in sustaining viable air links for Pacific states, to assist their trade and tourism sectors. Air transport is also being viewed in the wider context of the Pacific Agreement on Closer Economic Relations (PACER-Plus).

Plurilateral and multilateral arrangements

109. Plurilateral and multilateral agreements can be an effective way of putting in place or liberalising air services arrangements with several partners at once. Multi-country arrangements can also better reflect the network nature of the aviation industry. However, the need for a broader consensus can make such negotiations time consuming, and there can be a risk of the outcome converging on a lowest common denominator.
110. Along with the MALIAT signed in 2001, New Zealand has been involved in a number of plurilateral or multilateral initiatives over the period since the last policy restatement. These include the negotiation of the PIASA¹⁵ and OECD work on a liberal approach to freighter services (which was not taken up).
111. International air transport, more specifically traffic rights, is the one service industry that is specifically excluded from the World Trade Organization's General Agreement on Trade and Services (GATS). New Zealand has taken an active role in five yearly reviews of this exclusion, but any progress in the near term is likely to be limited to airport-related services.
112. More generally, an increasing number of regional or plurilateral arrangements have been put in place around the world, including by MERCOSUR, ASEAN, and the European Economic Area.
113. The MALIAT was a notable achievement, and the relationships covered under it are some of New Zealand's most open.¹⁶ On the whole, however, the regional and multilateral tracks have not proved as fruitful as was hoped at the time of the 1998 policy restatement. In the short-to-medium term the gains of immediate commercial benefit, particularly in the area of market access, are likely to largely come through the bilateral track.
114. However, New Zealand will need to ensure that it is not left isolated, surrounded by regional groupings that liberalise extensively inside their regions but follow

¹⁵ <http://www.forumsec.org.fj/resources/uploads/attachments/documents/PIASA1.pdf>

¹⁶ Brunei Darussalam, Chile, Cook Islands, Mongolia (cargo only), Samoa, Singapore, Tonga, United States of America

more restrictive policies towards non-members. This is a risk as regional agreements proliferate around the world and air transport links are sought with major trading partners outside of core membership (such as the ASEAN-China Aviation Cooperation Framework). This is particularly the case given that, aside from some Pacific Island states and Mongolia (cargo only), there has been no additional accession to the MALIAT outside of the original parties.

115. The first tranche of open skies agreements that New Zealand entered into preceded Free Trade Agreements with the same countries. More recently, free trade agreements have been put in place with countries such as China and negotiations have commenced with India and Korea - countries with which the relevant ASA is not so open.

116. While traffic rights have not traditionally been included in multi-sectoral trade agreements it will be important to take advantage of any increased opportunities brought about by wider bilateral engagements with these trading partners. We must also ensure that lack of availability of traffic rights under ASAs does not impede the development of air services necessary to ensure that New Zealand can benefit from new Free Trade Agreements.

Policy Proposals

Negotiation Programme

The negotiation programme will prioritise relationships where unavailability of rights is preventing airlines from offering services. The aim will be to have arrangements in place ahead of demand.

A short and medium term focus will be on negotiations within East Asia and South America in line with negotiating mandates already granted by Cabinet.

Other mandates will be progressed over the medium term. We will also continue to monitor developments in Europe with a view to assessing when resumption in negotiations with the European Commission might prove desirable.

Longer term negotiating priorities will shift in line with commercial and aeropolitical developments. The Ministry of Transport will also monitor air transport policy changes in other countries to identify liberalisation opportunities.

Stakeholder input on negotiation priorities

The government will develop mechanisms to allow more systematic engagement with a wider range of stakeholders, including airlines, airports, and tourism and freight interests, on determining priorities and approaches in future years.

Policy Proposals (continued)

South Pacific

New Zealand is aware of the particular air transport needs of the Forum Island Countries, and in particular the need for further development of air transport links and infrastructure, and will continue to maintain a flexible and positive attitude in the negotiation and implementation of air services arrangements with them.

Multilateral and plurilateral negotiations

The New Zealand government intends to continue to engage in multilateral and regional initiatives where these are consistent with the thrust of this policy.

DRAFT

Annex: Freedoms of the air

FIRST FREEDOM



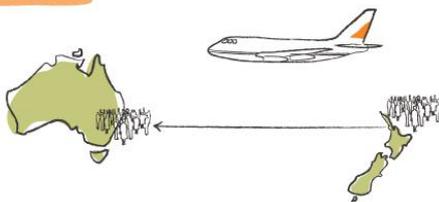
The right or privilege, in respect of scheduled international air services granted by one State to another State or States to fly across its territory without landing.

SECOND FREEDOM



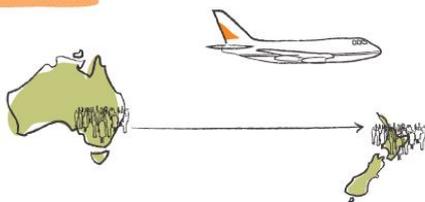
The right or privilege, in respect of scheduled international air services granted by one State to another State or States to land in its territory for non traffic purposes.

THIRD FREEDOM



The right or privilege, in respect of scheduled international air services granted by one State to another State to put down in the territory of the first State, traffic coming from the home State of the carrier.

FOURTH FREEDOM



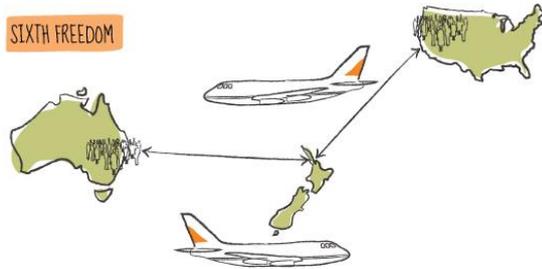
The right or privilege, in respect of scheduled international air services granted by one State to another State to take on, in the territory of the first State, traffic destined for the home State of the carrier.

FIFTH FREEDOM



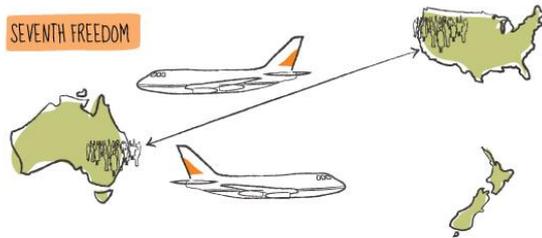
The right or privilege, in respect of scheduled international air services granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third state.

SIXTH FREEDOM



The right or privilege, in respect of scheduled international air services, of transporting, via the home State of the carrier traffic moving between two other States.

SEVENTH FREEDOM



The right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient.

CABOTAGE - EIGHTH FREEDOM



The right or privilege, in respect of scheduled international air services, of transporting cabotage traffic between two points in the territory of the granting state which originates or terminates in the home territory of the foreign carrier.

CABOTAGE - NINTH FREEDOM



The right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State.