



AIR NEW ZEALAND

INTERNATIONAL AIR TRANSPORT POLICY

Air New Zealand submission on MoT May 2012 Discussion Document

18 June 2012

1. SUMMARY

- 1.1 Air New Zealand supports an international air transport policy that promotes economic growth to maximise prosperity, security and opportunities for all New Zealanders. The proposed policy objective should be turned on its head. Providing opportunities to airlines should support the objective of economic growth not the other way around as currently drafted.
- 1.2 Air New Zealand supports the proposed change to a 'case by case' approach to air services liberalisation whereby New Zealand pursues reciprocal open skies arrangements where that is in the national interest. In particular:
 - a New Zealand needs sufficient policy flexibility to deliver the best international air transport outcomes for New Zealanders including maintaining a resilient international airline based here;
 - b The current purist approach to liberalisation has not delivered growth and it should not be assumed that further liberalisation is required for growth;
 - c It should not be assumed that 'new or additional' services are automatically in the country's best interests. New Zealand long haul routes compete for the same connecting traffic to maintain viability and any new or additional carrier / route will typically take traffic from an existing carrier / route. In some situations, it may be in the national interest to use air services arrangements strategically to manage for this; and
 - d New Zealand should retain some ability to use air rights as

leverage to secure outcomes that are in the national interest. Examples may include higher value inbound tourism or access to scarce airport slots for New Zealand based carriers.

- 1.3 Air New Zealand opposes unilateral liberalisation and granting extra-bilateral rights. Market access for foreign carriers must continue to be balanced with fair and equal opportunities for New Zealand based carriers to compete with those foreign carriers. New Zealand's remote location and relatively small population already disadvantage New Zealand based international carriers compared to 'hub' or mid-point carriers. This is exacerbated by the fact that New Zealand has liberalised its air services arrangements ahead of many other countries. Unilateral arrangements or extra-bilateral approvals would further disadvantage and undermine a New Zealand based international carrier.
- 1.4 In addition to matters raised in the discussion document, Air New Zealand supports the Minister of Transport retaining jurisdiction over airline cooperation applications and the policy should expressly acknowledge this. Such arrangements (e.g. alliances and code share arrangements) between airlines have become increasingly important for the maintenance and development of financially sustainable routes to and from New Zealand. The Ministry of Transport remains best placed to assess the economic, competitive and other policy implications of such arrangements within an international air transport policy framework.

2. BACKGROUND

A New Zealand based carrier benefits New Zealand

- 2.1 Air New Zealand drives enormous value into the country's economy. Examples of this value include:
 - a Air New Zealand's comprehensive domestic and international passenger and cargo network includes marginal routes served in New Zealanders' best interests that would not sustain services but for their overall network contribution;
 - b NZIER has assessed the impact of Air New Zealand to be equivalent to 2.6% of the country's GDP¹. It is the only international carrier serving New Zealand that contributes directly and materially to New Zealand's foreign exchange earnings;

¹ Air New Zealand's Regional Economic Impact, NZIER, December 2008

- c Air New Zealand underpins New Zealand's tourism industry which contributes almost 9% of GDP;
- d The airline directly employs 11,000 people with more than 90% based in New Zealand. Total labour expenditure for the year ending 30 June 2011 was \$1.03billion including New Zealand payroll taxes of approximately \$250m;
- e A further \$2.6billion of operational expenditure;
- f Air New Zealand provides a core for a successful and growing domestic aviation industry involving more than 1000 businesses and organizations with a total of 23,500 employees and an estimated revenue of \$9.7 billion including \$3.8 billion in export receipts²;
- g Many Air New Zealand employees such as pilots and engineers are highly skilled workers supported by significant training and skills development. Air New Zealand leverages this skills development with its Aviation Institute that includes five schools based at two main campuses in Auckland and Christchurch, with eight Auckland based flight simulators. The Institute delivers around 35,000 individual courses annually to New Zealand and international students;
- h Over the past five years, Air New Zealand engineering businesses have attracted \$450m in third party contracts to New Zealand;
- i Basing high value and innovative businesses in country such as the world class Christchurch Engine Centre, a joint venture with Pratt & Whitney, and Altitude Aerospace Interiors;
- j Air New Zealand is the largest corporate contributor to marketing destination New Zealand offshore with an annual investment of approximately \$100m.
- k Air New Zealand's koru is synonymous with New Zealand and is a strong symbol and generator of national pride and identity;
- l Air New Zealand plays a significant role in national emergency planning including in aid to Pacific countries – e.g. expediting emergency personnel and equipment to Samoa after the 2009 earthquake and Tsunami; to Greymouth after the Pike River coal mining disaster in 2010; to Fiji after the floods earlier this year; and providing 'mercy' flights to and from Christchurch after the 2010/11 earthquakes;

² New Horizons Report to New Zealand Trade and Enterprise, June 2010

- m Air New Zealand provides leadership in and is a major supporter of tourism, the environment, sport and the arts e.g. through its active engagement with the Tourism Industry Association, its \$1m sponsorship of the Department of Conservation and the Great Walks, the Air New Zealand Environment Trust, its sponsorship of the All Blacks, of the annual Air New Zealand Wine Awards and the World of Wearable Arts; and
- n Air New Zealand has 26,000 share holders providing an opportunity for in-country investment. It has also paid over \$370m in dividends to the Crown since recapitalization.

2.2 Air New Zealand is the only international carrier with its network centred on New Zealand and it has no choice but to deploy its assets to serve this country. By contrast, other carriers make network decisions in their own interests. There have been plenty of illustrations of this recently: Air Asia X, Royal Brunei and Aerolineas Argentinas exits; Qantas' withdrawal from the New Zealand/Los Angeles route; capacity reduction by Jetstar long haul, Korean and Cathay; and United's about turn on Houston/Auckland.

2.3 The policy should expressly acknowledge the benefit to New Zealand of a resilient New Zealand based international airline and aviation industry.

Liberalisation has not delivered growth

2.4 As pointed out in the discussion document, New Zealand has one of the most liberal air services policies in the world.

2.5 Despite this and New Zealand's increasingly liberal air services arrangements, the country has not seen sustained growth in its international long haul³ air services and there is no evidence that liberalisation delivers better air links.

2.6 On the contrary, and as shown for a 7 year period in figure 1: there has been no sustained increase in the number of carriers (there were 10 carriers in 2005, there are 10 carriers today); Air New Zealand remains the only long haul carrier based in New Zealand; and total long haul capacity has decreased during that time from 1.96 million outbound seats in the year ended June 2005 to 1.90 million outbound seats scheduled for the year ended June 2013.

³ Long haul is considered ≥ 10 hours for the purposes of this discussion.

2.7 As a comparison, albeit imperfect, IATA's figures show an increase with greater than 30% growth from 2007 to 2012⁴. New Zealand is failing to keeping pace with international air traffic growth.

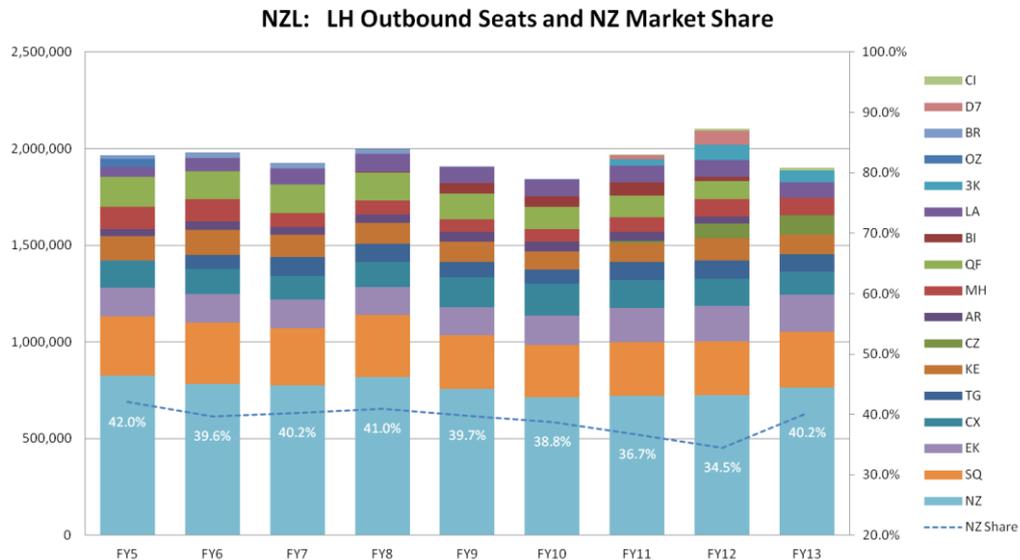


Figure 1: Long haul seats outbound from NZ and Air NZ market share

Where carriers are operating via Australia, seats allocated as long haul are based on the proportion of long haul passengers onboard (e.g. if 25% of passengers are from long haul destinations then 25% of seats are counted as long haul)

2.8 The key point is that New Zealand's international air transport markets have not grown despite New Zealand's extremely liberal policy settings. The current policy has not delivered growth and it should not be assumed that New Zealand needs to liberalise its air services arrangements further to achieve growth. Accordingly, Air New Zealand supports a flexible policy that delivers the best international air transport outcomes for New Zealand.

Any new carrier / route has significant network impacts

2.9 The constraints on New Zealand's long haul travel and air freight markets are primarily marginal operating economics and low passenger and freight demand.

2.10 The economics of long haul operations for all carriers are fragile due primarily to high and very volatile fuel prices. Currency fluctuations also impact significantly on air travel to and from New Zealand – while the high New Zealand dollar of recent years has stimulated outbound

⁴ IATA's figures are for system wide RPK growth from the start of 2007 to the end of 2012. IATA Global Traffic Forecast March 2012, IATA Econ Industry Financial Forecast Table. Data is available from 2007 only. Comparing capacity v RPKs is obviously imperfect.

traffic it has disadvantaged the much higher volume of inbound New Zealand traffic relative to competing destinations.

- 2.11 The reality in terms of demand is that there are very few non-stop New Zealand routes to/from markets with sufficient traffic to sustain a viable service of at least 3 frequencies per week let alone a daily service⁶. Most if not all New Zealand long haul routes rely heavily on connecting traffic and compete for it to top up point to point traffic. Capacity changes on one route invariably impact significantly on other routes (e.g. Guangzhou / Auckland capacity draws traffic that would otherwise travel Hong Kong / Auckland or Shanghai / Auckland thereby diminishing the viability of existing services and growing little, if any, new traffic).
- 2.12 The tables below illustrate the demand reality of New Zealand routes. Table 1 ranks non-stop market sizes by country of origin / destination⁷. Table 2 shows the passenger numbers required to achieve between 1 and 7 weekly frequencies with an 80% load factor for a wide body aircraft (assuming 300 seats). 175,000 passengers per year are required to sustain a daily wide body service. As shown in table 2, New Zealand has only three non-stop long haul markets that meet this threshold: the USA, Mainland China and Japan.

Origin /Destination	Inbound and Outbound Passengers	Origin /Destination	Inbound and Outbound Passengers
USA	584,796	Thailand	110,470
China	431,489	South America	98,872
Japan	175,537	Hong Kong	87,641
South Korea	140,893	South Africa	81,659
Canada	139,887	Taiwan	59,477
India	133,735	Indonesia	57,526
Singapore	119,007		
Malaysia	118,718		

Table 1: Market sizes ranked by country of origin/destination (source: Stats NZ)

⁶ Three services a week is typically a minimum requirement for a 'leisure traffic' route to be viable and daily services are typically required to support a combination leisure / business route.

⁷ Note that the UK and European markets are excluded as they are not non-stop. Also, this table assumes that India, South America and South Africa are within 'current aircraft range'.

Weekly frequency	Passengers needed for 80% LF	No. of Long Haul Pac Rim Markets available
7	174,720	3
6	149,760	3
5	124,800	6
4	99,840	9
3	74,880	12
2	49,920	>15
1	24,960	>15

Table 2: Passenger numbers or market size required to support frequencies

This assumes an 80% load factor. The chart shows, for example, that more than 15 markets have sufficient passengers for 1 service a week, 12 can support 3 services a week, and only 3 can support daily services.

- 2.13 Compounding this, all three of these markets have multiple origin and intermediate points. For example, fewer than 30% of Mainland Chinese passengers actually arrive in New Zealand on non-stop passenger services from Mainland China. More than 50% of Mainland Chinese arrivals are via Australia.
- 2.13 Any new entrant/route competes with other carriers/routes for connecting traffic and will typically impact significantly on the network of existing long haul services to New Zealand. At the extreme, if all connecting traffic from UK/Europe was carried via one intermediate point (say Hong Kong) then other points (e.g. Thailand, Singapore) would cease to be viable.
- 2.14 Additional capacity on one route or a new route is not necessarily in New Zealand's interests e.g. where it is at the expense of competing/alternative routes and particularly where it leads to fewer points in New Zealand's overall network. Policy should be sufficiently flexible that capacity can be managed in the country's best interests.

Leverage

- 2.15 In the Asia/Pacific region, airport slots will increasingly be a constraint on air services. Environmental and social concerns mean that airport capacity will not necessarily be added. Air rights, in situations where arrangements are not already fully liberal, may be an important lever in obtaining slots for New Zealand based airlines.
- 2.16 The way that airlines use the air rights granted to them influences the value that New Zealand derives from tourism. For example, airlines flying to New Zealand via Australia can bring tourists from Australia

(with a median holiday spend of \$1,720¹⁰) or from higher value source markets in Europe (e.g. the UK with a median spend of \$2,950 or Germany with a median spend of \$3,025) or Asia (e.g. Japan \$2,800). Within air service agreements there exists the facility to influence/control this mix. Open arrangements remove this potential influence or leverage. Absent the existence and enforcement of these types of arrangements it is easy for international carriers to focus on carrying high value tourists to Australia and lower value Australian tourists on the trans Tasman sector. Retention of leverage through an air services arrangement can influence the mix of tourists and thereby be in New Zealand's best interests.

Cooperation / competition

- 2.17 Many routes to/from New Zealand are not viable for one airline in isolation but may be viable for two airlines working together with combined marketing power, route and schedule options and loyalty benefits. Traffic is strongly influenced by airline brand loyalty and hence overall demand (and potentially the viability of a route) will be enhanced by multiple airline/alliance brands.
- 2.18 This can be illustrated using a Jakarta/Auckland route as an example. Annual traffic to and from Indonesia is currently 57,500 and not all of this is Jakarta traffic. Any service would have to draw a significant volume of connecting traffic to be viable. If a New Zealand based carrier were to operate Auckland/Jakarta, it would be limited in its ability to carry 'beyond' passengers by a lack of access to connecting flights from Indonesia to third countries. An Indonesian carrier's ability to attract New Zealand residents is likely to be limited by a lack of qualifying loyalty benefits. In this example, service may not be viable for either airline individually but it may be viable for the airlines in co-operation
- 2.19 International air transport policy should recognise that collaborative/co-operative arrangements may be the best way of achieving the policy objectives, and facilitate those arrangements. Specifically the consideration and approval of these arrangements needs to consider national interest policy objectives as well as consumer interests.

¹⁰ Ministry of Economic Development and Stats NZ information for the year ended December 2011.

QUESTIONS FROM DISCUSSION PAPER

For comments on policy proposals: additions are underlined and deletions are shown in strike through text.

3. Objective

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

- 3.1 The objective should be to foster economic growth to maximise prosperity, security and opportunities for all New Zealand. This should drive the provision of air services arrangements rather than vice versa as proposed. The proposed policy should therefore be tipped on its head.

Policy Proposal

The objective of New Zealand's international air transport policy is to help grow the economy and maximise prosperity, security and opportunities for all New Zealanders. This will be achieved by providing ~~to provide~~ New Zealand-based and foreign airlines with fair and equal 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.~~

4. Approach to Air Services Liberalisation

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

- 4.1 New Zealand should pursue open skies arrangements, on a needs basis, where such arrangements are in the country's best interests. New Zealand should retain the flexibility to manage its international air links strategically.

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

- 4.2 Further liberalization, for its own sake, makes no sense. There are very few markets, if any, where air services agreements are constraining supply of services to/from New Zealand.

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

- 4.3 Yes.

4.4 Examples include:

- where carrier behaviour under existing arrangements demonstrates a need for the regulator to retain the ability to safeguard against anti competitive behaviour (e.g. through retention of capacity principles);
- arrangements with ‘mid-point’ countries that are insignificant sources of tourism to New Zealand in their own right and where there is a risk that services by their hub carriers could displace services by airlines with larger home markets (see discussion document paragraph 102);
- where it is in the national interest to retain rights to use as leverage to drive higher value tourism – for example, less than 3% of Emirates’ traffic is Middle Eastern/ New Zealand traffic whereas more than 75% is Australian/New Zealand traffic. Emirates could be carrying higher value European or Middle Eastern passengers on these services but has no policy based requirement to do this;
- where it makes sense to retain air rights to leverage practical access for New Zealand based international carriers e.g. to gain increasingly scarce airport slots.

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

4.5 The policy should expressly recognise the value to New Zealand of a healthy New Zealand based international carrier.

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?

4.6 No.

4.7 For a start, this would inappropriately signal to other countries that there is no need to agree reciprocal rights for their airlines to start services to New Zealand.

4.8 In any event, it is common for carriers to announce new or additional services ‘subject to regulatory approval’. There is no evidence to suggest that rights should not or cannot be negotiated in a reasonable

period.

Policy proposal

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

Where the other party will not agree to reciprocal open skies agreements, we will seek to put in place the most open reciprocal 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 a network of financially sustainable services operated by a range of airlines as well as the benefit to New Zealand of a strong and successful international airline based in New Zealand ~~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.~~

5. Ownership

- 5.1 Any regulatory or policy restrictions on Air New Zealand's access to capital should also apply to any other carrier designated to exercise New Zealand traffic rights.

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

- 5.2 Principal place of business and effective regulatory control of airline operations in the airline's home jurisdiction on the basis that airlines cannot circumvent or abuse bilateral arrangements by operating from countries that offer flags of convenience.

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

- 5.3 A simple majority (e.g. 50% and one vote).

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

Designation

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

6. Elements of Agreements

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

Policy Proposal

Where open skies is determined to be in the country's best interest, New Zealand will continue to seek to put in place reciprocal open skies 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 provided that the whole of such

agreement remains in New Zealand's best interest.

7. 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?

7.1 Demonstrated commercial demand.

Are there specific areas where current arrangements, or lack of arrangements, are hindering the development of services?

7.2 No.

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

7.3 Air New Zealand looks forward to continuing consultation between the Ministry of Transport and airlines.

Should specific policies apply in the South Pacific?

7.4 Any policy applying in the South Pacific should be consistent with policy applying in New Zealand (i.e. there is no place for more protectionist policy in the South Pacific).

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

7.5 Again, liberalisation should be pursued on a case by case basis if and when it is in New Zealand's best interests.

Policy Proposals

Negotiation Programme

The negotiation programme will prioritise relationships where unavailability of rights is preventing airlines from offering services for which there is demonstrated potential demand and a net benefit to New Zealand. 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 aero-political 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.

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.