

RESPONSE TO PRODUCTIVITY COMMISSION INTERNATIONAL AIR SERVICES DRAFT REPORT

New Zealand is supportive of the general aims of the Commission's draft report. We note in particular the Commission's recommendations relating to the Australia - New Zealand air services relationship, and the adoption by Australia of an "open skies" approach to international air services liberalisation. We look forward to the Australian Government's response to these aspects, in particular, of the report.

This response is intended to provide the Commission with an understanding of the process by which New Zealand's International Air Transport Policy is implemented, and to comment on some of the aspects of the draft report.

Implementation of New Zealand's International Air Transport Policy: Process Issues

New Zealand's international air transport policy is implemented by the External Aviation Policy Committee (EAPC), chaired by the Ministry of Transport and including representatives of the Ministry of Foreign Affairs and Trade, the Office of Tourism and Sport Policy, the Treasury and the Department of Prime Minister and Cabinet (the Ministry of Commerce's Business and Enterprise Policy Group is also consulted when specific competition issues are raised). This group is responsible for considering all proposals to enter into negotiations on air services and to seek Government endorsement of these proposals. Input is also sought from the New Zealand Tourism Board and New Zealand international airlines.

Securing a Negotiating Mandate

Negotiations arise for a variety of reasons: the EAPC identifies a need (either during the process of formulating the annual Strategic Action Plan or in response to a particular bilateral circumstance); a bilateral partner calls for talks; or a New Zealand international airline identifies a need.

To secure a negotiating mandate, the Ministry of Transport prepares a draft memorandum to the Cabinet Economic Committee and circulates this to other EAPC members for comment. (The Cabinet Economic Committee is tasked with considering policy issues relating to the growth and development of the economy and the protection and enhancement of the environment, including international trade, immigration, population, and labour market issues - chaired by the Treasurer, membership includes the Prime Minister, and the Ministers of Transport, International Trade, Tourism, Commerce, and Finance.) If necessary a meeting of the EAPC will be convened to discuss the issues raised by the particular bilateral air services relationship. The New Zealand Tourism Board and New Zealand international airlines are advised in general terms of the proposed course of action and invited to comment.

Once the details of the memorandum and recommended mandate are finalised, the memorandum is forwarded to the Officials' Economic Committee, a group of senior officials which assists with the management of the Cabinet Committee's agenda, and ensures that all papers to the Cabinet Committee meet relevant quality and consultation criteria. After the memorandum has been considered by the Officials' Committee it is forwarded from the Chair of the EAPC to the Minister of Transport. If the Minister agrees with the recommendation or otherwise decides that the memorandum should proceed, it is then forwarded for consideration by the Cabinet Economic Committee at its next weekly meeting. Officials are required to make themselves available for such meetings, in case Ministers seek clarification of particular points made in the memorandum or otherwise seek to question officials on the proposal. Once the Cabinet Economic Committee has made a decision, this decision is forwarded to the next full Cabinet meeting for endorsement or further discussion.

The Negotiation

New Zealand delegations at air services negotiations are led by a representative of the Ministry of Transport, with support from an Adviser from the Ministry of Transport's International Relations Branch. The delegation invariably includes also a Wellington-based member of the Ministry of Foreign Affairs and Trade's Trade Negotiations Division, who is responsible for overseeing that Ministry's input into international air services matters. Where appropriate and when available, representatives of the Office of Tourism and Sport Policy, the Ministry of Commerce, and the Treasury are also included in the delegation. New Zealand airlines have the opportunity to be represented at all negotiations, in an advisory capacity only.

All members of the delegation have an opportunity to contribute to the strategy adopted in a negotiation. The Leader of the New Zealand delegation is ultimately accountable for the outcome. The Leader may also seek advice from the Minister of Transport in particular circumstances.

All negotiations are conducted on an ad referendum basis, with the outcome subject to approval by the New Zealand Cabinet. A process similar to that followed when seeking a negotiating mandate is used to report to Cabinet on the outcome of a negotiation.

The Strategic Action Plan

In recent years, the EAPC has produced an annual Strategic Action Plan for implementing the policy, outlining the priorities for negotiation and the specific issues needing to be addressed in each bilateral relationship over the coming year. Once EAPC members have agreed in general terms on the priorities, input is sought from interested parties, such as the New Zealand Tourism Board, New Zealand international airlines, Tradenz, the Manufacturers Federation, the Inbound Tour Operators Council, the Travel Agents Association of New Zealand, and the Hotel Association. Priorities are established through balancing pressing priorities (e.g., where another country has requested bilateral negotiations on behalf of its airline(s)) with those of a more strategic or long-term nature (based on the size and potential of the markets concerned, the opportunities that further liberalisation of access to a particular partner would create, and the likelihood of it agreeing to comprehensive liberalisation). Priorities for seeking greater access will in part be driven by what the New Zealand airline industry is seeking. The industry's priorities for greater access will frequently but not always coincide with New Zealand's most immediate air services priorities.

The Ministry of Transport then prepares a draft plan and circulates this to all EAPC members for comment. Once finalised, the Strategic Action Plan is forwarded to EAPC Ministers for their information, and circulated to New Zealand's diplomatic posts.

The Single Aviation Market/Common Market

The 1992 Single Aviation Market concept did not necessitate the development of a "joint bloc". While the concept envisaged a completely open regime of beyond rights for the airlines of each country, Australia and New Zealand would continue to negotiate separately with third countries. Australia would continue to designate Australian carriers to operate capacity entitlements it had negotiated with those third countries, and New Zealand would continue to designate New Zealand carriers to operate capacity entitlements it had negotiated with those third countries. It was not intended that New Zealand carriers could be designated to utilise Australian entitlements, and vice versa. Indeed this is one of the errors some commentators have made in respect of the current beyond rights entitlement, where Air New Zealand operations beyond Australia have been said to be utilising Australian capacity. This is not the case.

The intent of the 1992 arrangement was to move towards a situation where Australian airlines' operations beyond New Zealand would be constrained only to the extent that Australia and the third country involved

did not agree to make the rights available, and vice versa. This would enable each country to continue to adopt separate approaches in its dealings with third countries.

Having said that, the 1992 Memorandum of Understanding did register the intention of the parties to examine “the possibility of both countries establishing at some future time a joint bloc for the purpose of negotiating international traffic rights.” This work was never undertaken. When the Single Aviation Market Arrangements were negotiated in 1996, it was agreed that this matter would not be pursued.

While seen as supporting the Single Aviation Market, the common border concept was never an integral part of the Single Aviation Market. The common border concept focused instead on air facilitation/border control matters, and removing or minimising impediments to travel between Australia and New Zealand. This raised issues in various spheres, including differences in visa policies.

P.93 of the draft report suggests that the Single Aviation Market included some element of fifth freedom rights. The 1996 Single Aviation Market Arrangements, which completed the liberalisation of air services within and between Australia and New Zealand negotiated in 1992, have no impact on fifth freedom rights. This was noted in the preamble to the 1996 Arrangements, i.e.:

“recognising that the handling of air services beyond each country to third countries will continue to be governed by the 1961 Air Services Agreement and understandings made pursuant to it, including the 1992 Memorandum of Understanding on Air Services Arrangements”

P.101 of the draft report suggests that third country carriers would gain access to fifth freedom rights between Australia and New Zealand by way of the Single Aviation Market. The 1996 Single Aviation Market Arrangements are the vehicle by which Australian and New Zealand airlines, or airlines with ownership in each country, are granted rights to operate within and between the two countries. The 1996 Arrangements have no impact on opportunities for third country carriers to exercise fifth freedom traffic rights between Australia and New Zealand. These opportunities are granted (or not) pursuant to individual bilateral agreements between Australia and the third countries involved, and New Zealand and the third countries involved.

Plurilateralism

New Zealand has raised the concept of a plurilateral approach to air services liberalisation with a number of bilateral partners within APEC (Singapore, Malaysia, Chile and Brunei). As noted in section 8.6 of the draft report, there are a number of issues associated with development of such an agreement. Issues we have identified include:

- many potential signatories have aeropolitical or other difficulties which may preclude them from joining in a plurilateral agreement with certain other countries.
- there are often differences in countries’ laws relating to ‘doing business’ activities which could prove difficult to harmonise.
- there is a balance between seeking to conclude a very liberal agreement which few countries would be prepared to agree to, and a less liberal agreement which more countries might agree to, but which, by locking in some restrictions, might slow liberalisation between individual pairs of countries.

New Zealand intends to continue exploring the possibility of a plurilateral approach to air services liberalisation.

Multilateral Liberalisation

As noted in the February 1998 International Air Transport Policy of New Zealand, the review of the General Agreement on Trade in Services scheduled to begin in 2000 will be a good opportunity to advocate a broadening of GATS' application to air services. As the Productivity Commission has noted in its draft report, "it would not be easy to obtain the two thirds majority necessary to repeal or amend the Annex" (p.199).

There would also be some drawbacks to using the multilateral process where MFN principles apply. MFN would have an inhibiting effect whereby one country might be willing to a bilateral exchange, but would not do so if this meant it would then be required to similarly make available those rights to all other countries. New Zealand has experienced this effect in a recent open skies negotiation where the other partner was not prepared to adopt a more liberal approach because of an MFN provision it had included in its arrangements with a third country.

Similarly, including international air services as part of the total services sector could inhibit liberalisation if countries decided to use air services as "negotiating coin" in an effort to secure liberalisation of some other sector. (There is an element of this evident in respect of the "soft rights" already included in the GATS Annex.)

Recommendation 8.6

The Australian Government should invite the New Zealand Government to establish a full common aviation market with multiple designation of Australasian carriers in international markets.

Designation of "Australasian carriers" would require substantial re-negotiation of all our bilateral agreements. Indeed, adopting such an approach may only mean the substitution of substantial ownership by New Zealand and Australian nationals, in each case, with substantial ownership by New Zealand and/or Australian nationals, in all cases (as in the SAM Arrangements). New Zealand prefers to adopt an approach whereby the investment source is immaterial and provisions relating to investment are not included in our agreements.

If we were able to secure agreement with our key bilateral partners to designation of Australasian airlines, it is likely that we could also secure agreement to removing investment as an issue to be considered. As noted above, this is a more desirable objective.

New Zealand would not wish to be involved in a joint negotiating bloc if our interests were not able to be maintained with all our bilateral partners. New Zealand has developed quite distinct and strong air services relationships with its bilateral partners, which flow into the overall relationship with those partners. We would not wish to see any dilution of these relationships through participation in a joint negotiating bloc with Australia.

This is particularly the case if Australia was not prepared to adopt New Zealand's approach of negotiating open skies agreements, including seventh freedom and cabotage opportunities where possible. In cases where the third country did not wish to adopt a totally liberal approach, New Zealand would be concerned to ensure that its interests and policy objectives were maintained. These might not necessarily coincide with Australia's.

Bilateral Open Skies

P.188 of the draft report states that the New Zealand open skies policy is based loosely on the model suggested by the ICAO Secretariat in 1994. The New Zealand model does not explicitly draw on the recommendations of the ICAO World Wide Air Transport Conference held in 1994. It did however, use the US model as a basis, and incorporate additional elements of liberalisation we thought desirable (i.e., seventh freedom passenger, and cabotage opportunities). The element which most explicitly drew on the work of ICAO related to moving away from "substantial ownership" provisions to those relating to "place of incorporation and principal place of business".

P.189 of the draft report states that "Passenger cabotage is not normally granted to other countries in 'open skies' agreements, apart from members of preferential trading groups. Thus, Australia and New Zealand have cabotage rights with each other, as do EU members."

New Zealand's policy is to seek to include cabotage opportunities in all its bilateral agreements, not just with members of preferential trading groups. This relates to eighth freedom or "consecutive cabotage" operations only. New Zealand has now included such rights in three of its bilateral arrangements.

In respect of ninth freedom, or stand-alone domestic operations, New Zealand's foreign investment regime makes no distinction between investment in airlines and investment in any other sector. Consequently, there are no specific investment restrictions on any foreign entity which might wish to establish, or buy into, a domestic airline operation within New Zealand. Thus we have a domestic airline, Ansett New Zealand, owned 100% by NewsCorp, a US company.

In respect of New Zealand international airlines, as noted on p.3 of the External Aviation Policy Committee's submission to the Commission, "*New Zealand policy provides for an airline seeking designation as a New Zealand airline pursuant to our bilateral air services agreements to be up to 49% owned by non-New Zealand nationals, with up to 35% ownership by foreign airlines or airline interests in aggregate, and up to 25% ownership by a single foreign airline or airline interest. These limits are similar to those applied to Qantas.*"

The scope for negotiating a more liberal agreement with the US

As we understand it, the agreement we reached last year with the US represents the extent of US policy, i.e., the US is not at this time able to make provision for seventh freedom passenger, or cabotage opportunities, or for removal of substantial ownership provisions. We were advised that further liberalisation of the US policy can only be achieved following extensive consultation with the various US domestic constituencies involved in the aviation industry.

Airline investment restrictions are currently set out in legislation and, while the current US policy is to provide for up to 49% foreign investment in US airlines, current legislation provides only for up to 25%.

These foreign investment requirements are tied to US national security, whereby US airlines are required to make aircraft available to the US defence forces for movement of personnel and equipment in times of crisis. There is some concern that airlines with substantial foreign ownership may be less willing to do this.

US labour groups would also play a prominent part in any consultation, possibly resisting any moves which could see an airline of one country establish stand-alone passenger operations between the US and a third country, on the basis that this was an attempt to lower wages and conditions. Such labour imperatives are evident in current proposals from US legislators in respect of e.g., foreign aircraft repair stations.

Nevertheless, the US has accepted that APEC's Bogor commitments apply to air services. In this regard, it would need to remove all restrictions on trade, including trade in services, and investment, in respect of APEC member economies, consistent with the 2010 timeframe.

Benefits of an Open Skies Approach

New Zealand has not undertaken any quantitative analysis of the benefits arising from concluding open skies air services agreements. However our experience is that our wider economic interests are best met through removing as far as possible, all barriers to trade. Concluding open skies agreements is the most effective way of providing maximum opportunity for the development of competition in the provision of international air services to and from New Zealand.

Since November 1994, when the final element of the trans-Tasman reforms came into effect, New Zealand and Australia have had an all-points exchange with no restrictions on capacity or aircraft type which may be operated. Australian and New Zealand airlines are continuing to develop the trans-Tasman market in response to competitive forces. Consequently, we have seen the commencement (and subsequent demise) of Kiwi International Airlines and the commencement of Freedom Air. Air New Zealand and Qantas are currently structuring their operations so as to provide more frequent services with smaller aircraft between the main gateway airports. Similarly the carriers are both looking to open up regular services from Australia to Queenstown. The open regime certainly creates an environment where these decisions can be made by the airlines, on the basis of market considerations, rather than being subject to restrictions which might be contained in Air Services Agreements.

Similarly, the 1997 Air Transport Agreement with the United States has made available to New Zealand airlines all points in the US, whereas previously only four points were available. Air New Zealand has moved quickly to take up additional opportunities in the US market and now provides service to ten points within the US, two with its own aircraft, and a further eight beyond Los Angeles on a code-share basis.

The 1997 Agreement with Singapore has also provided planning certainty for Air New Zealand and Singapore Airlines whereby they are able to put capacity into the market in response to commercially determined need, without reference to either Government. Consequently, Singapore Airlines has recently announced its intention to operate from November this year 3 A340 services per week between Singapore and Christchurch, and Air New Zealand has recently announced its intention to operate 2 B767-300 services per week between Auckland and Singapore, also from November. This capacity is in addition to that already operated by the airlines.

External Aviation Policy Committee

July 1998