



31 August 2011

International Freight Transport Services Inquiry  
New Zealand Productivity Commission  
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Submission on behalf of the Aviation Industry Association of New Zealand

## **Who are we and the areas of our interest?**

The Aviation Industry Association represents the interests of commercial aviation in New Zealand. In respect of this inquiry it is interested in:

- ensuring that the supply chain for goods imported and exported produced by the sector is operating a maximum efficiency; and
- optimizing the competitiveness of the air transport to, through and within New Zealand

The Association's membership includes New Zealand based operators; importers and exporters of New Zealand aviation products and some very specialized freight forwarders, who provide import and export services to the aviation industry, for example: the import and export of helicopters, aircraft engines, parts and components.

In total there are 270 company members and 100 individual members representing around 90% of the volume of aviation in this country.

The Aviation Industry's contribution to the New Zealand economy was quantified in 2009 as around \$9.7Bn, with \$5.9 billion from domestic activities and \$3.8 billion from export activities.

There are more than 1,000 organisations participating in the industry, employing 23,525 staff with wages and salaries estimated at \$1.3 billion. Using input / output economic modeling, the direct

and indirect impacts of the New Zealand aviation industry together have been calculated at 11.8% of total revenue across the New Zealand economy and 6.9% of GDP in the year to December 2009.

The aviation industry is estimated to have grown from a total of \$6.8 billion in 2005 to \$9.7 billion in 2009. This represents a growth rate of 9.5% per annum over the five year period. The data indicated increased productivity during this period, with average revenue per employee growing from \$366,700 to \$456,861.

A copy of the New Horizon's report is attached. This report highlights the vertical integration and in particular the importance of Air New Zealand as the "national" carrier and the defence forces along with horizontal integration along supply chains.

While the matter of air freight is not specifically addressed in the report, from information gleaned:

- pricing of international air freight is on a by product basis. The critical consideration is that air freight can be carried at marginal rates during periods other than peak passenger demand;
- the domestic main trunk and trans Tasman operations between Auckland and Sydney are of sufficient size to warrant dedicated air freight capacity;
- on occasions a dedicated global route has operated, however this is largely driven by greater than usual volumes of high value imports and the ability to back load the operation
- peak seasonal capacity constraints occur and at times this has disrupted the export of time and life sensitive horticultural and flower exports. However these constraints are not so great to justify a dedicated freighter aircraft on those routes.

**Question One: Are there important issues that may be overlooked as a result of adopting an economic efficiency perspective for this inquiry?**

**1. Delinking passenger and freight markets addresses issues at the margin** - we are not so certain that it is possible to de-link international air freight from the carriage of passenger services. In our view the two are inextricably linked and much more so than sea, road or rail. This is true of most international services and largely so for domestic operations.

**2. The role of international agreements and treaties** - the New Zealand passenger and air freight services have been deregulated for over 30 plus years, however the domestic air freight industry largely is a “main trunk” operation plus Palmerston North (a hub specialist operation). Similarly the international market for air freight is very liberal and largely operates in an unconstrained manner, irrespective of the specifics of bilateral air service agreements. Market forces have prevailed for a long time, thus we believe the air freight market is probably exhibiting all of the characteristics of dynamic efficiency, even though there may appear to be bilateral air service agreement constraints. We don’t think these are material.

**3. The advent of the low cost carrier in the international aviation market particularly to short haul international destinations** – these carriers tend to focus almost exclusively on the carriage of passengers and are not engaged in the air freight market. As this becomes the more dominant model will this have any impact on the access to “belly space”- positively or negatively? We simply do not know, however we note that the low cost carrier model now extends to Auckland Singapore.

**Question Two: Is the framework described in Section 3.2 appropriate for this inquiry? Are there any important issues that might be missed?**

**The role of air Freight Forwarders and Consolidators** - these important elements of the air freight transport framework appear to be missing from figure two. These parties are important in terms of consolidating air freight to create affordable loads; assessing and evaluating the most efficient logistic chain particularly in terms of dispatch of time sensitive parts and creating a contestable market. We see their role similar to stevedores and therefore are surprised they are not part of the “supply chain”

**Question Three: Which components and components interface warrant greater attention? What is the evidence that they are inefficient? What contribution could changes make to an improvement in the overall efficiency of the freight system?**

Interface issues

- the landing charges for a freighter aircraft relative to aircraft in their normal configuration of passenger and freight

- service levels i.e. rate with which freight can be discharged off airport
- rental and “on airport costs” for freight forwarders and consolidators and the like.

There is a tendency to overlook rental costs for land owned by airports. We suspect there are significantly higher than land 5-10 kms from the airport. In our light handed regulatory environment it is assumed that rent is set via an arbitration process if no agreement can be reached. However we believe not all airport contracts for freight forwarders and the like have such dispute provisions. Some have advised us that it is a take it or leave it environment. Few are prepared to speak out against these arrangements and they require a good working relationship with the airport to continue in their businesses.

**Regulation of Natural Monopolies** - New Zealand’s key airports were corporatised and some partly privatised over twenty years ago. While the investment in new terminals and key infrastructure has been a feature of virtually all of the international and larger regional domestic airports the issues raised by the users (primarily airlines) remain largely unchanged.

The light handed approach of transparency and disclosure has not prevented some of New Zealand’s airports, relative to the rest of the world, becoming extraordinarily expensive to undertake business whether it be landing aircraft, discharging cargo, parking vehicles and using land.

We would wish to see some of these benchmark statistics included in the report. International landing fees it is said are very difficult to compare as they do not include like with like, however IATA publish comparative data on charges <sup>1</sup> and the ACCC in Australia is a frequent commentator on airport service delivery levels, pricing etc. These reports appear not to look at the issue specifically of air freight, however, because of the volume of freight services provided by passenger operators the comparisons are valid and clearly have an impact on the cost of freight into and out of the country.

**Ownership of airports** - the mixed ownership model, whether it be private/ local or local/central government is a feature of New Zealand’s airports. The corporatisation and semi privatization of a

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<sup>1</sup> IATA Fuel, Fees and Charges data base

number of the airports, accompanied by constraints on ownership of strategic assets, means that our airports are neither in one form of ownership nor the other. The regulatory framework around these models has attempted to be addressed over a long period of time, however, the ownership model itself seems largely not to have been addressed.

A distinguishing feature of New Zealand's ownership model relative to Australia is that the owners of airports in New Zealand were sold the land, whereas the land is on tenure and reverts to public ownership after a period of years.

In our view the airports are stuck in "no mans land", they are neither one thing nor the other. Full privatisation would only be possible with a change in the regulatory environment, however on the other hand the very dispersed local government ownership model does little to encourage efficiency. Each of the 26 certificated airports in New Zealand has their own boards of directors and corporate management structures. It is difficult to effect any changes without local government being disenfranchised or the airlines objecting because of the "light handed" regulatory approach, which fails to address in a robust manner a perceived concentration of power in the hands of a few natural monopolies.

**Question Four: What environmental considerations should fall within the scope of this inquiry? What issues are of particular importance?**

All domestic transport operators pay the ETS levy. Internationally this matter is being dealt with by ICAO. This is a more difficult and challenging discussion and one we consider the Productivity Commission is not well resourced to participate in. Emissions from aircraft are reducing with technology change and use of bio fuels. We anticipate these changes will deliver much greater efficiency gains.

**Question Twenty Seven: Are Auckland, Christchurch and Wellington airports subject to competitive pressure for the air-freight related services they provide? Do they exert market power to the detriment of New Zealand exporters and importers?**

There is no competition in the market – Auckland is the natural entry and exit point. Because of the by product nature of air freight there is an even greater concentration of market power.

If the Commission wishes to reduce the cost of air freight it must tackle the cost of landing aircraft; the cost of providing services on airport controlled land and the various controls exercised by the airport company in terms of access to airside.

The power exerted by airport companies on exporters and importers is not direct. Airport companies would claim that many encourage new entrant airlines into the market and this increases competition in the air freight market.

Where pressure is exerted this tends to be in areas of access to and rental of airport land. Neither of these matters are subject to any specific regulatory regime. Airports would submit that they shouldn't be as market forces prevail, however we suspect that a number of freight forwarders and consolidators would express concern over the very high cost of renting land and premises from airport companies. This may be an area where the Commission could assist in lowering the cost of air freight.

**Question 28: Do current ownership and governance arrangements of New Zealand's international freight airports have any significant positive or negative effects on their long term efficient configuration and operation, with respect to the supply of freight services?**

Possibly, although we are not aware of any analysis of the issue.

**Question 29: The objective of a port company under the Port Companies Act is to "operate as a successful business". Should airport companies owned by local authorities have the same single objective rather than multiple objectives specified in the Local Government Act?**

The regulatory environment for airports should not simply parallel ports – there is a much greater level of competition between New Zealand's ports than there is competition between New Zealand's airports.

Before there is a change in administrative direction these entities should be subject to an appropriate regulatory environment which reflects their natural monopoly position in the market. Airports with smaller volumes or where there is one dominant airline operator

could be subject to the single directive, although this too would probably present some fairly severe challenges.

Investment in these smaller airports tends to be a matter of local pride and decisions are not always made on an immediate and rationale basis. Quite often there are long terms growth aspirations mixed in with short time decisions of local government aspirants.

We think a process of transparent benchmarking of performance will deliver superior efficiency gains than a change in operating mantra.

**Question 30: What levels of investment have Auckland and Christchurch airports undertaken in international freight, and are they consistent with accessible and efficient services for New Zealand exporters and importers?**

We suspect the issue is not constrained investment, but rather competitive pricing for rent of the premises

**Question 31: Should the future size and shape of New Zealand air freight services be left to market forces and individual airport owners, or do lumpiness and interdependence including with investments in connecting parts of the overall supply chain) call for a more deliberate and co-ordinated approach**

Increased air freight services is largely a product of growth in tourism. Growing tourism is a function of competitiveness and disposable incomes. Factors which constrain tourism will impact on the availability of air freight. The exception is the trans Tasman market. This market is unconstrained by the New Zealand government who operates under a very liberal air service policy. The Australian government can be less liberal for air passenger services, but for freight only dedicated services operate in an unconstrained manner.

**Question 32 What are the most appropriate measures of airport performance in international air freight? Can you assist the Commission by providing data that compare New Zealand airports against others?**

IATA provides data globally as does Airports International Council World Report provide both data and performance benchmarking information.

**Question 33: Are there opportunities to introduce or increase competition in the provision of air freight related services at airports? Would such competition lead to better outcomes?**

Yes we believe so, but this requires matters such as rental agreements and access contracts to be examined and their ability to build their own premises on airport land.

**Question 34: Is the existing and planned Commerce Commission regulation of airports sufficient to restrain monopoly pricing and induce an efficient level of investment? If not, what should be changed?**

In our view the Commerce Commission's regulation of airports has become so complex and there are so many loop-holes that it is almost impossible to address the issue in any meaningful way.

The airports argue that the constraints are sufficient, the airlines argue that they are not. There is a need to undertake some international benchmarking work to assess on a like for like basis whether or not the individual international airports and the services they provide are performing.

There is indication of over investment in the domestic market with very large terminal facilities under utilized. This is largely paid for by the travelling public via a levy. There are examples of over investment in runways and the like.

There is little pressure on domestic regional airports to become more efficient, although clearly some airports are operated and managed in a highly efficient manner. These airports should be the benchmark for performance. This type of work is outside the activities of the Commerce Commission who are only charged with examining the exercising of market power – the Productivity Commission could assist in addressing domestic efficiency issues.

**Question 35: To what extent is the international air freight industry competitive?**

This is an open and competitive market. The entry barriers are very low

**Question 36: Are there specific air freight routes to or from New Zealand with low levels of competition? Is there evidence of overpricing or poor service levels on these routes?**

Not that we are aware of. Pricing is clearly variable and peak demand for air cargo belly space tends to coincide with peak passenger demand. We suspect there are significant swings and roundabouts and it depends on ones perspective. It is very difficult to justify on an economic basis dedicated freight services except across the Tasman and within New Zealand's main trunk operations

**Question 37: How do bilateral air services agreements affect the accessibility and efficiency of air freight services available to New Zealand exporters and importers?**

Bilateral air service agreements in respect of freight are open and liberal. To our knowledge it is possible to operate dedicated freight services even without a specific bilateral agreement in place as most foreign countries take a very different view of freight relative to passenger services.

Bilateral agreements for passenger services are rapidly liberalizing and New Zealand is to the forefront of the changes.

**Question 38: What explanations exist for the different treatment of international air freight in the Civil Aviation Act compared with the normal competition requirements of the Commerce Act? Do the objectives of the current regulatory treatment continue to be justified?**

The Civil Aviation Act was drafted to address civil aviation issues specifically and was written in the context of international air service agreements. Such agreements have very different restrictions than normal competition regimes. For example; there are different ownership constraints on who can access rights determined in a bilateral. This is not something the Commerce Act would address.

In respect of air freight we think this is not a discrete market in the sense that competition in the market is driven largely by the ability to access belly capacity on passenger aircraft. Furthermore the way

in which dedicated air freight has been addressed in global markets is much more liberal than passenger although this is changing as passenger markets become more open. What is not change for passenger operators is the ownership and control of the airline. For dedicated freighter operations this has not been an issue.

**Question 39: Should the regulatory functions in Part 9 of the Civil Aviation Act be the responsibility of the Commerce Commission rather than the Minister of Transport?**

Part 9 of the CA Act covers a number of matters. We think it better that any change in this area be studied carefully by those most familiar with international aviation agreements that are addressed in this review.

**Question 40: Does the Cargo Agents Commission Regime perform an active and useful function in international air freight services? Who does it benefit? Is the exemption from the Commerce Act required to achieve that function?**

No comment

**Question 41: Has Section 90 of the Civil Aviation Act been used in practice? What are the arguments for retention of the ability of the Minister to issue a tariff?**

Not that we are aware of

**Question 42: To what extent are the current regulatory arrangements adequate to deal with the investigation and prosecution of collusive behaviour in international air freight services?**

No comment

**Question 43: Do the current regulatory and competition regimes that affect international air freight transport services work well or not for New Zealand exporters and importers?**

No comment

**Question 44: Is there a case for different regulatory treatment of air freight services vs sea freight services?**

Yes, the international regulatory regimes differ in respect of ownership and control. Aviation does not yet accept flags of convenience, although for dedicated freight services this is probably very close. There remain however issues of safety and registration requirements which are much stricter than sea freight services.

**Question 45: What lessons can New Zealand learn from the different competitive ways the competition law and regulators in other countries deal with international air freight services?**

No comment

**Question 47: Do New Zealand customs and biosecurity systems deliver the required outcomes efficiently? What initiatives might improve efficiency and effectiveness?**

Multiple government agencies operate at the border and potentially a single agency may deliver increased efficiency, however every study that we are aware of does not support this conclusion. Perhaps some back of office merging of functions may be sensible, however we think investment in technology will drive much greater efficiencies.

**Question 51: What changes in domestic transport institutions, policies and regulations might lead to the greatest improvements in the economic efficiency of the international logistics chain?**

We are not certain that there has been any robust analysis of the export/import value chain to look at where maximum efficiencies lie. We would like to see work on such a value chain. Intuitively we think these lie in services provided by monopolies, however this may not necessarily be so

**Question 62: Do domestic air links work as an effective feeder for international air freight services? What could be improved?**

We believe so, but domestic air links are largely driven by passenger movements. The dedicated domestic freight network is to meet largely domestic customer requirements.

**Question 66: To what extent do formal and informal alliances between airlines improve or detract from the efficiency of international air freight services? Are there opportunities to improve?**

Alliances should have the effect of improving connectivity. There is evidence that this is so for passenger services so we cannot imagine why the reverse would be so for mixed cargo/ passenger operations

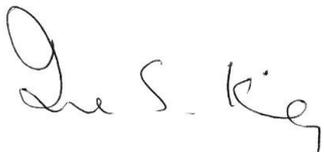
**Question 67: What measures might improve the overall system efficiency of the logistics chain for international air freight?**

No comment

Thank you for this opportunity to make a submission.

If there is any additional information or clarification required please contact us on 04 4722707.

Yours sincerely



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