

20 October 2010

Mr Shane Ardern MP
Chairperson of Primary Production Committee
Parliament Buildings
Private Bag 18041

WELLINGTON 6160

Dear Mr Ardern

Airports (Cost Recovery for Processing of International Travellers) Bill

During its hearing on Thursday 19 October Committee members expressed interest in the questions of whether new international services simply drew existing passengers from other airports or generated additional traffic and thus net economic benefits, and asked whether further evidence was available; and whether economies of scale at larger airports were a factor to be considered. NZ Airports had also intended to make an additional point to the Committee (which is not in our written submission) but in the event this was not possible on Thursday. We have addressed these issues in this letter.

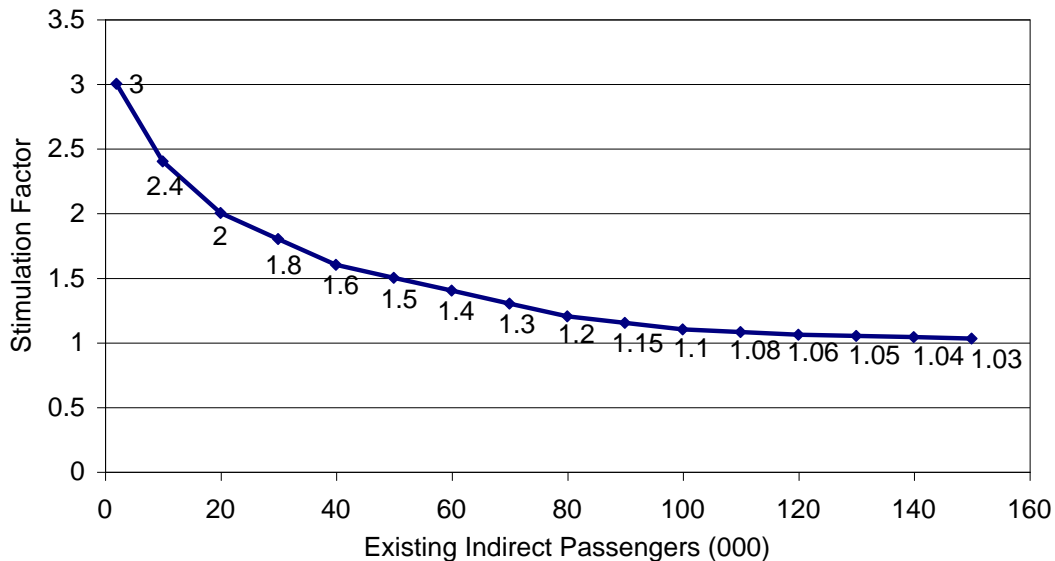
Generating additional passenger traffic

Air traffic is stimulated mostly by low fares, but also by the availability of a direct route. This effect has been demonstrated a number of times and is encapsulated in the International Air Transport Association (IATA) chart over the page. The IATA chart is based on airline data sources.

To illustrate the use of the chart, if the international passenger volume from a location is 20,000 per year using indirect flights, a doubling of passenger numbers can be expected when a direct flight to the same destination becomes available. This stimulation does not include the separate stimulation effect of reduced fares. Research in a number of countries has confirmed the stimulation effect¹ of direct flights.

¹ Gordon Bevan, Airport Strategies and Marketing, speech to NZ Airports Conference, Queenstown 2010
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IATA stimulation Curve on Indirect Markets



There are clear New Zealand examples. Queenstown’s direct international connections started with one service a week in 1995 and grew to 24,000 international passengers in 2005, and 108,000 in 2010.

The Dunedin case is even more illustrative of the traffic stimulation effect, because the impact of removing a direct service can also be seen.

Historically, international services had not been offered from Dunedin. However, in the mid 1990s, Freedom Air commenced direct international flights between Dunedin Airport and the eastern seaboard of Australia. These flights were provided in competition with a service that had been started by Kiwi Air, a low-cost carrier that pioneered discount flights between regional New Zealand cities and Australia. The Kiwi Air services were short lived, as that airline collapsed in September 1996. By contrast, the Freedom Air services continued for a decade or so.

In effect, Freedom Air’s **direct** trans-Tasman services from Dunedin were competing against Air New Zealand’s **indirect** trans-Tasman services from Dunedin.

Experience proved that the direct flights (and competitive fares) provided by Freedom Air stimulated passenger demand and resulted in strong market growth on the Dunedin routes.

International passenger movements on direct flights between Dunedin and Australia for the calendar years between 1998 and 2006 grew from 30,254 to over 98,000².

² Source, Dunedin International Airport

Year	1998	1999	2000	2001	2002	2003	2004	2005
Total Trans-Tasman Passengers	30,254	36,197	46,497	56,297	78,144	81,420	90,495	98,503

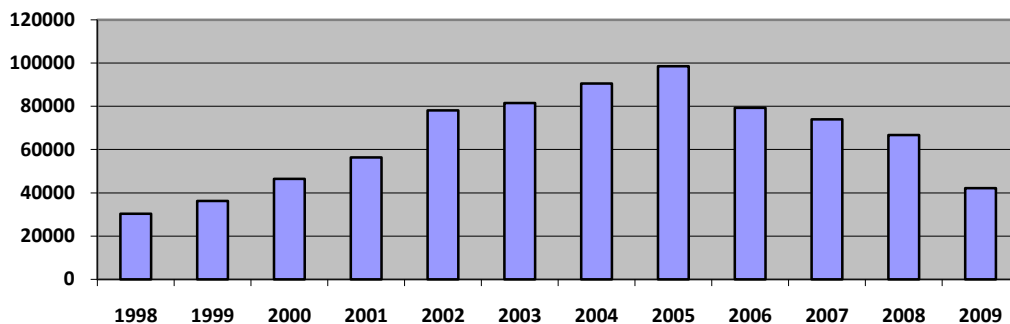
As can be seen, the trans-Tasman air passenger market for direct services out of Dunedin more than trebled between 1998 and 2005. However, Air New Zealand decided in 2006 that Freedom Air should cease operations as an independent business. At first, the Freedom Air brand continued, but its operations were absorbed within the operations of the Air New Zealand group.

The end of Freedom Air as an independent operator also saw a reduction in capacity and trans-Tasman services at Dunedin. The market was effectively encouraged to travel via other airports, because connecting services via other airports became a more competitive option.

In 2008, Freedom Air stopped operating altogether and was replaced by Air New Zealand-branded services. Further capacity and service reductions occurred, with the result that only seasonal direct services were being offered.

The effect can also be seen when the total trans-Tasman passenger numbers from Dunedin Airport over the period 1998 to 2009 are considered:

Total Trans-Tasman Passenger Numbers at Dunedin Airport 1998 - 2009



In September 2009, Pacific Blue began a year-round direct Dunedin-Brisbane service three times weekly. We understand that Pacific Blue will increase that direct service to four times a week from October 2010.

It is too early to have passenger movement data for the full calendar year 2010. However, the experience of Dunedin Airport has been that the trans-Tasman market is responding well to these direct links from Pacific Blue, and that patronage on the Dunedin-Brisbane service is up.

With regard to the size of economic benefits, the University of Waikato has estimated the value of international flights to Hamilton Airport at \$40 million per year, based on just four flights each week.

Economies of scale

Due to the timing pressures associated with the Bill, NZ Airports is not in a position to make specific comments on whether the marginal cost of accommodating additional international passengers at Auckland, Wellington or Christchurch International Airports is greater or less than Hamilton, Rotorua, Palmerston North or a future new destination. However, it would certainly be incorrect for the Committee to assume that airports always exhibit economies of scale. In fact airport operating (and capital) costs can exhibit dis-economies of scale past a certain point (which differs at each location depending on geography, design, congestion, and other factors). Heathrow for example, one of the largest international airports in the world, is also a very expensive one on the basis of operating costs per passenger.

NZ Airports considers that economies of scale are not a factor that the Committee can safely give weight to in this instance.

“Too many international airports”

NZ Airports is aware that there is a school of thought that there may be “too many” international airports serving New Zealand, and we would be very concerned if this was a factor behind some of the provisions of the Bill – particularly the potentially punitive provisions that could see cost recovery from airports that goes well beyond the actual additional costs of establishing (or re-establishing) passenger processing services.

If the Government or individual border agencies have a view that there is a set limit to the appropriate number of international airports, and that the number has been reached, then we consider that the proposition should be made explicitly and consulted widely. This has not occurred.

We would take the same view if there were hidden motivations for the potentially punitive provisions arising from:

- Border agencies simply having difficulty in responding to changes in a fast moving industry, or
- Incumbent airlines or those airlines that have already established sufficient destinations to suit their current business objectives, using the Bill’s provisions to restrict competition.

Neither of these reasons for proceeding with the Bill would be in the public interest.

In our view, the test of whether an airport can sustain international services is one for the interested parties – particularly the airline(s), the local and regional business community, and the airport. The commitment by an airline to scheduled services to a new international destination is a major one with significant financial implications. Such decisions are made only after consideration and analysis that may take several years. The fair costs of establishing passenger processing services should be taken into account in this analysis. The process of establishing a new international service is a tall hurdle for any prospective new destination to pass.

The policy intent of the Bill, which we support, is the fair recovery of the actual costs of starting or re-establishing services, and any additional and artificial barrier based on perceptions of an 'ideal' number of international airports (or other reasons) would not stand the test of open scrutiny.

Nor do we think that the Government intends this Bill to be a *de facto* mechanism for border agencies to limit innovation, growth and productivity in the airport and tourism sectors. We particularly note Transport Minister Hon. Steven Joyce's recent reported comment in relation to a current sea port sector debate:

"I've been pretty clear as minister that I don't think it's a smart idea for me to be sitting in Wellington promoting or discouraging a particular port with a big, black felt pen in a way that doesn't accord with the important wishes of shippers and customers of the ports, who ultimately are the people we should be listening to."³

We trust that the Committee will be alert to any inappropriate assumptions about the number of international airports driving the provisions of the Bill.

Yours sincerely



Kevin Ward

Chief Executive
New Zealand Airports Association

³ 'Joyce opts for productivity not interference in port shakeup', The Dominion Post, October 16, 2010