

CHAPTER 11

TOURISM BENEFITS

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INTRODUCTION

- 11.1 The Applicants' original submission argued that the Alliance would have a significant positive impact on New Zealand tourism, increasing the number of tourists to New Zealand by approximately 53,000 visitors a year. It estimated that this increase in tourism would result in a public benefit of over NZ\$148 million in year three.
- 11.2 The Commission, in its Draft Determination, did not accept this forecast. It estimated that the tourism benefits of the Alliance would range between NZ\$-2.6m and NZ\$13.5m. The Commission discounted the tourism benefits estimated by NECG on the basis that:
- it was not satisfied that the Alliance would provide a sufficient incentive for Qantas Holidays (QH) to focus on products that bring benefit to New Zealand;
 - QH's initiatives would be unlikely to result in 50,000 additional tourists because QH's initiatives would encroach on other providers' market shares, divert mono-destination tourists to dual destination tourists and invoke a competitive response from other destinations including Australia's various state tourism bodies;
 - the increased promotional effectiveness under the Alliance would not result in additional tourists;
 - the negative effects of increased fares and reduced capacity had been underestimated;
 - there may be negative effects as a result of the loss of the Star Alliance in the New Zealand market; and
 - the method used to convert increased tourists into a public benefit was not appropriate.
- 11.3 This Chapter develops the case made in the original application in order to demonstrate that these conclusions are incorrect and that the Alliance will in fact lead to a substantial increase in tourism with consequential public benefit gains to New Zealand far in excess of any detrimental effects.
- 11.4 The estimated net increase in tourist numbers and the resulting net public benefit have been revised from the figures used in the original submission. NECG has extensively reviewed the modelling assumptions used previously, taking into account suggestions made by the Commission in the Draft Determination. NECG now estimates that the net increase in tourists under the Alliance will be in excess of 60,000, and the net public benefit will be at least NZ\$73 million in year three. The change in public benefit is a result of the use of revised welfare multipliers to convert increases in tourism exports and domestic tourism to welfare gains. Welfare gains associated with tourism expansion derived using different models range from NZ\$66 million to NZ\$133 million.¹ The bases upon which these figures were derived are outlined in greater detail in the remaining sections of this Chapter.

¹ The welfare gains derived using the Monash welfare multipliers are estimated at NZ\$73.2 million. Gains derived using ABARE welfare multipliers are estimated at NZ\$66 million. The Infometrics model yields a substantially higher welfare gain of NZ\$133 million. The Infometrics model, which yields the highest welfare gain, is specifically designed as a model of the New Zealand economy.

- 11.5 The second section provides details as to how the Alliance will expand New Zealand tourism by at least 60,000 net new tourists in year three, and explains why this result could not be achieved by the airlines acting independently. The third section explains how this net increase in tourist numbers translates into public benefits of at least NZ\$73 million in year three of the Alliance.

EXPANSION OF NEW ZEALAND TOURISM

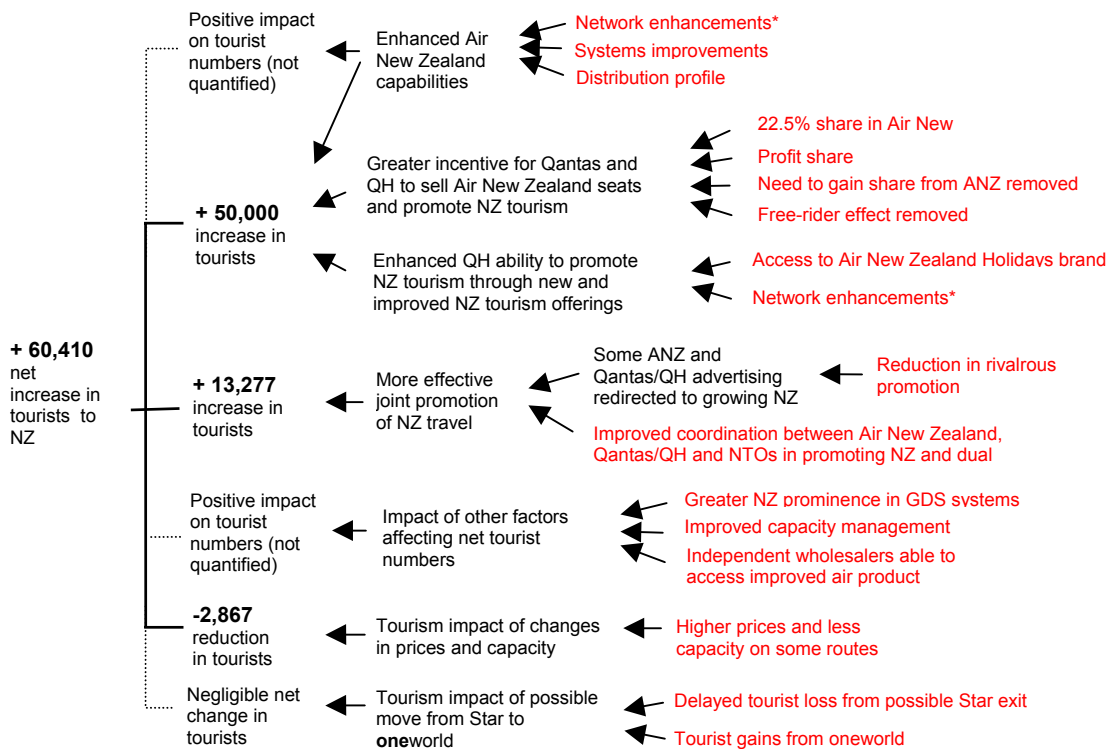
Introduction

- 11.6 The Alliance will increase New Zealand tourism by providing a number of network, systems and distribution improvements that will enable the Applicants to create new and improved New Zealand tourism products, and effectively promote and sell them throughout the world.
- 11.7 The enhancements generated by the Alliance could not be independently developed by the Applicants because they rely on the connection of complementary domestic networks and international feed. Furthermore, Air New Zealand has certain intractable systems and distribution weaknesses that constrain its ability to grow New Zealand tourism. QH in contrast, has excellent systems and distribution capabilities but it lacks the incentive to market New Zealand as a destination.
- 11.8 The Alliance will achieve market growth that would simply not be possible without the Alliance. This Chapter provides a better understanding of how the Alliance will achieve these results.
- 11.9 It describes the following effects of the Alliance:
- (a) The network, systems and distribution limitations that have constrained Air New Zealand's ability to grow tourism to New Zealand will be effectively addressed and resolved through:
 - network enhancements that are not otherwise available to Air New Zealand; and
 - system improvements and distribution access that is not otherwise available to Air New Zealand;
 - (b) Qantas' and QH's incentives to expand the New Zealand tourism market and to sell seats on Air New Zealand will be much greater than without the Alliance ;
 - (c) QH's ability to expand the New Zealand tourism market will be increased through:
 - access to a combined Air New Zealand and Qantas network;
 - access to the Air New Zealand Holidays brand;
 - (d) The effectiveness of both parties' promotional activities will be enhanced; and
 - (e) Other changes, such as improved capacity management, greater prominence in global reservation distribution systems, and access by independent wholesalers to improved air product, will have a positive impact on tourist numbers.

Enhancements generated by the Alliance could not be independently developed by the Applicants.

- 11.10 Together, these factors will increase the number of tourists to New Zealand by at least 63,277 visitors per year as compared to the Counterfactual. This will be offset to some extent by potential differences in fares and capacity levels under the Factual and Counterfactual, which are expected to reduce the number of tourists to New Zealand by 2,867. The expected net increase in tourist numbers is therefore at least 60,410 visitors per year.
- 11.11 The possibility that Air New Zealand may exit the Star Alliance and join oneworld has been considered. Should this occur (and it is not certain that it would), the net impact on tourism numbers is likely to be negligible for reasons explained later in this Chapter.
- 11.12 An overview of the Alliance’s net impact on tourism to New Zealand is provided in the following diagram:

The Alliance will create a wholly new and non-substitutable opportunity to increase tourism to New Zealand by over 60,000 net new visitors per year.



* Network enhancements include new routing options and better scheduling, flight frequency & connection times on key tourist routes

- 11.13 Through these effects, the Alliance will create a wholly new and non-substitutable opportunity to increase tourism to New Zealand by over 60,000 net new visitors per year.

Air New Zealand's enhanced capabilities

11.14 Although Air New Zealand has managed to compete for market share in the past, its ability to grow the market has been constrained by three factors:

- It has certain network weaknesses that limit the range of itineraries it is able to offer;
- It lacks the necessary IT systems to develop and support attractive own branded product; and
- It lacks a strong global distribution profile for packaged holiday product.

11.15 The Alliance will ensure that Air New Zealand will at last have access to an affordable and effective vehicle for developing Air New Zealand branded holiday packages for distribution throughout the world. This is because the Alliance will resolve the key network, systems and distribution limitations that have hampered Air New Zealand's attempts to expand demand for package travel to New Zealand from key source markets.

Network

11.16 Air New Zealand currently faces a number of network weaknesses, notably:

- The lack of a relationship with a strong domestic Australian carrier;
- Constraints on operating eastbound flights from Europe; and
- The inability to increase fifth freedom flying on the Auckland to London via Los Angeles route.

Air New Zealand currently faces a number of network weaknesses.

11.17 These weaknesses currently constrain Air New Zealand's ability to offer attractive itineraries to tourists from certain source markets. It is unable to remedy these weaknesses alone because it cannot economically develop a domestic Australian network and bilateral agreements preclude it from adding eastbound flights from Europe or increasing Fifth freedom flying on existing routes. These weaknesses will be eliminated by the ability to codeshare on Qantas flights. Some of the key benefits are outlined below.

Australia

11.18 The Alliance will provide Air New Zealand with better access to a much needed Australian domestic network. The lack of a relationship with an Australian domestic carrier has severely restricted Air New Zealand's ability to cater for tourists to New Zealand from Australian cities and regional areas that require domestic connecting flights to cities served by Air New Zealand.

11.19 The impact of the demise of Ansett provides an indication of the importance of a relationship with an Australian domestic carrier. In the year immediately prior to the collapse of Ansett Australia, Ansett provided Air New Zealand with 123,000 sector passengers per annum. In the twelve months ending April 2003 the corresponding number was only 40,000 sector passengers with Qantas.

Dual Destination Passengers

11.20 The lack of an allied Australian domestic carrier has severely restricted Air New Zealand's ability to cater for international dual destination passengers. For example, it has had great difficulty in cost effectively satisfying demand from the USA for itineraries that include Australian destinations such as Darwin or Ayers Rock. Development of dual destination offerings is difficult to achieve without access to extensive domestic networks in both countries. The Alliance delivers this essential ingredient, allowing Air New Zealand to offer much more competitive itineraries with a domestic Australian component.

UK

11.21 Air New Zealand currently operates a daily service from London to Auckland via Los Angeles. Under the bilateral agreement it cannot increase any fifth freedom flying from Los Angeles to London, which is required to make the addition of capacity economic. Qantas combined with Air New Zealand would offer an alternative routing from London to New Zealand via Singapore. Qantas' current schedule of twice daily 747s from London to Singapore would provide excellent feed to Air New Zealand's daily Singapore – New Zealand services.

Continental Europe

11.22 Air New Zealand's withdrawal from FRA-LAX due to poor profitability has diminished its ability to cater for tourists from Germany and Central Europe. Qantas' current schedule of daily 747s from Frankfurt and twice weekly flights from Paris would add additional one-stop Europe–New Zealand routes, with good feed to Air New Zealand's daily Singapore – New Zealand services.

11.23 The additional feed from Europe and the UK into Singapore, connecting to Air New Zealand's Singapore – New Zealand services, will provide the catalyst for Air New Zealand to add additional capacity. (Under the Factual scenario NZ AKL-SIN daily B763 services are upgraded to daily B744 services by year three of the Alliance.)

IT Systems

11.24 Air New Zealand suffers from significant weaknesses in its holiday development IT systems, and this severely constrains its ability to develop package products in many source markets. This section describes Air New Zealand's current systems, summarises previous attempts to establish better systems, and explains how access to the Qantas Holidays systems will resolve Air New Zealand's system weaknesses.

Air New Zealand suffers from significant weaknesses in its holiday development IT systems.

Current Air New Zealand systems

11.25 In New Zealand, Air New Zealand operates its own tour product for domestic and out-bound business under the Air New Zealand Destinations brand. Tour Plan, the IT platform for this product, is small scale, has no on-line connectivity to global reservations distributions systems, has limited automation and is 20 years old. The market size does not justify Air New Zealand investing in new technology on a stand-alone basis.

11.26 In Australia, Air New Zealand distributes an Air New Zealand Holidays product, outsourcing production to Concorde Holidays, using Concorde's IT platform. This product primarily promotes New Zealand in the Australian market. The only other market in which Concorde has a presence is the USA, where it represents QH

using the Qantas IT platform. Due to contractual issues, Air New Zealand cannot use Concorde in this market.

- 11.27 In Japan, Air New Zealand's subsidiary, Blue Pacific Tours, provides an in-house tour product which is not technologically advanced and cannot be expanded to service other markets. In particular, it has no on-line connectivity into the global reservations distribution systems used by travel agents, and it has no web-based connectivity.

Previous attempts to establish a better system

- 11.28 Previously, Air New Zealand has endeavoured to expand its own wholesale product, both off-shore and domestically. One initiative was the acquisition of Jetset Tours and Technology Holdings Pty Ltd, an Australian based travel company. Maintaining the technology to produce a competitive holiday product proved too expensive for the sales volumes achieved. The business traded unprofitably for several years.
- 11.29 The acquisition of Ansett Australia provided the benefit of access to the Ansett Holidays product and IT platform. At that time Ansett Holidays was Australia's largest domestic holidays operator. Implementation of plans to expand the product globally and merge it with Jetset Holidays was nearly complete at the time of Ansett's demise in September 2001.
- 11.30 Since then, Air New Zealand has evaluated many options, but has been unable to identify an affordable IT platform that meets its global requirements. Air New Zealand has relied upon tour wholesalers in overseas markets to package New Zealand destined product. Although this strategy has been successful to a degree, an airline-branded product would significantly increase opportunities for Air New Zealand to promote and sell New Zealand and the Region as a destination.

Improvements available with QH

- 11.31 The Alliance would provide Air New Zealand with immediate access to the QH booking engine and its array of land packages to create Air New Zealand Holidays (or similarly) branded products. Air New Zealand would then have a ready made, own-brand tour product, which it currently does not have in offshore markets other than Australia and Japan.
- 11.32 At the core of QH's IT platform is the Calypso tour management system, which is the largest and longest established implementation of this major tour wholesaling and retailing solution anywhere in the world. QH has been the major investor in the ongoing development of Calypso over a period of 16 years, and many of the key features in the system are specifically tailored to meet the needs of both QH and its markets.
- The QH Calypso production system can support hundreds of concurrent internal reservations staff and externally-connected travel agents, and can be expanded considerably beyond the existing user base.
 - The servers that run Calypso are located within the Qantas IT data centre in Sydney, which provides comprehensive support 24 hours a day, 7 days a week.
 - Calypso is supplemented by other Qantas IT systems which support:
 - Supplier & product management processes;

- Brochure production;
 - Analytical and reporting functionality (OLAP);
 - Automation of customer call handling (IVR);
 - A “direct connect” facility for travel agents to access Calypso over the Internet without having to go through third-party distribution systems; and
 - An extranet solution for the distribution of product information and services to the trade.
- QH currently has several major technology initiatives under way to target new distribution channel opportunities and provide automation of supplier connectivity, further supplementing Calypso’s capabilities.

11.33 Air New Zealand does not have the resources to invest in such a platform. A standard Calypso system would cost \$[] m, but this would be outdated and would not have any of the added functionality of the QH system. To replicate the full functionality of the current suite of QH systems would cost considerably more than \$6 million.

11.34 More importantly, even if Air New Zealand could acquire a system with this functionality, it would take years for Air New Zealand to become as effective in using such a system as QH is today. To be able to produce world-class holiday package products, Air New Zealand would need to replicate the skills, knowledge, processes and relationships that QH has developed and refined over the years. This would be a costly undertaking with no guarantee of success.

Distribution

11.35 With access to the QH system and distribution relationships, there will be a major increase in the exposure of Air New Zealand Holidays branded product to travel agents worldwide. For the first time, Air New Zealand will gain a permanent, high profile product presence in around 25 new source countries. Air New Zealand Holidays product will be actively promoted and sold through the 37,000 outlets across the world that currently distribute Qantas Holidays product. This benefit is described in more detail in the QH business plan later in this Chapter.

11.36 In addition to this, Air New Zealand Holidays’ distribution effectiveness will also be strengthened by being able to offer Air New Zealand Holidays branded product through direct channels and travel agents outside the QH network. These products will have been developed and promoted with the assistance of QH, but will not be exclusively marketed by QH. Air New Zealand will be able to offer these improved air products for packaging by offshore tour operators with whom it has established its own relationships over the years. In addition, not all tourists travel on packages. Therefore, to the extent that Air New Zealand can provide a better air product as a result of network enhancements, it may be able to attract additional non-package tourists through existing ticket sales channels.

With access to the QH system and distribution relationships, there will be a major increase in the exposure of Air New Zealand Holidays branded product to travel agents worldwide.

Summary of impact of Air New Zealand’s enhanced capabilities on tourist numbers

11.37 Air New Zealand has had great difficulty developing strong product packaging and distribution on its own. Under the Counterfactual, these problems would not be resolved. Air New Zealand’s ability to develop and market Air New Zealand Holidays branded product globally would remain highly constrained.

- 11.38 Under the Factual, those constraints will be effectively resolved. Network enhancements will give access to an improved air product. Air New Zealand will join forces with QH to develop and distribute that product throughout the world under the Air New Zealand Holidays brand. Distribution will be enhanced through access to the QH distribution network. Benefits in this area are described in the QH marketing plan.
- 11.39 Using the improved product generated under the Alliance, Air New Zealand will also contribute additional positive effects on tourism numbers above and beyond those quantified in the QH plan. It will independently market the improved Air New Zealand Holidays branded product through non-QH channels, including direct channels and trade shows. It will also use the improved air product to strengthen its offerings to existing offshore tour operators. These initiatives will promote New Zealand even further in offshore markets.
- 11.40 To avoid any possibility of double-counting, the Applicants have not attempted to separately quantify these additional benefits. Nonetheless, they make the estimated impacts all the more conservative, credible, and deserving of weight in the overall assessment of the Alliance.

Qantas' incentives to expand New Zealand tourism

- 11.41 Qantas has broader commercial interests at stake than does QH. Because QH serves primarily as a vehicle for furthering those interests, each company's incentives to market New Zealand tourism are closely connected.
- 11.42 This section describes the incentives that Qantas and QH have to promote New Zealand tourism under both the Counterfactual and the Factual.

Qantas' and QH's incentives under the Counterfactual

Incentive to sell Air New Zealand product

- 11.43 Under the Counterfactual, Qantas' primary focus will be on competition with Air New Zealand. Accordingly, while it could be profitable for QH to sell some Air New Zealand product under the Counterfactual, the reality is that such sales would undermine Qantas' wider commercial interests. Even if this did not cannibalise Qantas passengers, promoting a competitor's brand and enhancing its revenues would seem inconsistent with the very nature of a rivalrous situation. For these reasons, under the Counterfactual, as is currently the case, Qantas would not give QH a mandate to sell Air New Zealand product, just as QH does not promote the products of other major Qantas competitors.

Incentive to market New Zealand as a destination

- 11.44 Likewise, given Qantas' objectives under the Counterfactual, any incentive to expand the market for New Zealand tourism will be weakened if those initiatives also benefit Air New Zealand. While promoting New Zealand as a tourist destination would no doubt help fill Qantas seats (albeit much less effectively than under the Alliance), Air New Zealand would also benefit from the increased demand for travel to, from and within New Zealand that this creates. In fact, given that Air New Zealand provides more direct capacity into New Zealand than Qantas from most source markets, the potential for Air New Zealand to free-ride on Qantas' efforts to grow New Zealand tourism is very significant.
- 11.45 This is readily demonstrated with an example. All passengers travelling on Qantas aircraft to New Zealand other than from the USA need to transit through Australia.

Given Qantas' incentives under the Counterfactual, any incentive to expand the market for New Zealand tourism will be weakened if those initiatives also benefit Air New Zealand.

For example, Qantas provides 45 departures per week (12,118 seats) from Japan to Australia, but passengers wishing to travel to New Zealand on Qantas have to catch a connecting flight in Australia. Air New Zealand provides 27 direct departures from Japan to New Zealand per week (8,070 seats) and the average journey time for a direct NZ flight is around 5 hours shorter than one via Australia. Therefore, it is to be expected that Air New Zealand would capture a large proportion of any demand stimulated by QH promotion of New Zealand as a destination.

Qantas' and QH's incentives under the Factual

11.46 The Alliance will radically alter Qantas' incentives both to sell seats on Air New Zealand and to expand New Zealand tourism.

- Taking market share from Air New Zealand would no longer be a Qantas objective. On the contrary, because of its 22.5% shareholding in Air New Zealand, Qantas would have a strong incentive to improve Air New Zealand's profitability.
- The profit sharing arrangements provide an added incentive for Qantas to sell Air New Zealand seats or facilitate activities that improve Air New Zealand's profitability. This is all the more the case as most of the opportunities to do so will involve sales that do not displace or reduce revenues that would otherwise have gone to Qantas.
- The return on activities to promote travel to New Zealand will be significantly greater because of the above two factors, and also because the problem of Air New Zealand free-riding on Qantas' efforts to promote New Zealand as a tourist destination would be eliminated.

The Alliance will radically alter Qantas' incentives both to sell seats on Air New Zealand and to expand New Zealand tourism.

11.47 Therefore, under the Alliance, Qantas would not only give QH a mandate to sell Air New Zealand seats, but would strongly encourage QH to expand the market in order to maximize the utilization of both Qantas and Air New Zealand capacity.

11.48 As detailed below, access to the Air New Zealand network will allow QH to create a range of new products that would not be feasible without the Alliance. Examples include New Zealand holidays with direct flights from more source countries and dual destination holidays with genuine triangular itineraries. These new product offerings represent an attractive incremental business opportunity for QH that would not be available to it under the Counterfactual because of the constraint on selling Air New Zealand seats and the lack of co-ordination between Air New Zealand and Qantas flights.

11.49 QH will be able to pursue a very economical expansion strategy with no significant capital investment by distributing the new offerings under both the QH and Air New Zealand Holidays brands through its existing distribution outlets in most source countries. The prospect of new sources of growth is particularly attractive for QH in markets where its current business is relatively mature, such as domestic Australia, New Zealand, UK/Europe and the USA.

11.50 Free-riding by Virgin Blue would not be a significant problem for the parties under the Factual because their combined capacity on most routes will be much greater than Virgin Blue's, allowing them to capture the lion's share of the expanded demand. This is especially so in the long haul markets that Virgin Blue does not serve or readily connect to. Furthermore, Virgin Blue does not benefit from the strong generic association with New Zealand that Air New Zealand enjoys.

QH’s ability to expand New Zealand tourism

11.51 The economic impact of Qantas’ much greater incentives to sell New Zealand tourism into the global market will be enhanced by the scope that the Alliance provides for QH to develop and offer attractive New Zealand products.

- Access to the Air New Zealand Holidays brand makes it unnecessary for QH to invest in repositioning its brand in international markets to become identified with New Zealand.
- The Alliance creates an opportunity for QH to construct new and improved New Zealand itineraries by exploiting the strengths of both parties’ domestic networks and the greater connectivity between these networks and key source markets.

11.52 Both these factors will allow QH to cost-effectively expand its product offerings to include a wide range of new mono New Zealand and multi-destination offerings, and sell these through its distribution outlets in key source countries.

Access to Air New Zealand Holidays Brand

11.53 It is important to distinguish between QH’s role as a manufacturer and distributor of holiday offerings, and the use of the Qantas Holidays brand for a subset of those offerings. Both the Air New Zealand Holidays brand and the Qantas Holidays brand will continue to exist under the Alliance, each with distinct and clearly defined roles. These roles are summarized in the table below.

Both the Air New Zealand Holidays brand and the Qantas Holidays brand will continue to exist under the Alliance.

Brand	Key Roles under the Alliance
Air New Zealand Holidays	<ul style="list-style-type: none"> – Main brand used in foreign markets for exclusively New Zealand itineraries – One of two brands in foreign markets for dual New Zealand / Australia itineraries – Main brand used in New Zealand market for domestic and overseas itineraries
Qantas Holidays	<ul style="list-style-type: none"> – Main brand used in foreign markets for exclusively Australian itineraries – One of two brands in foreign markets for dual New Zealand / Australia itineraries – Main brand used in Australian market for domestic and overseas itineraries

11.54 Both brands will be sold and distributed through QH’s distribution operations in 25 countries, supplying over 37,000 outlets (the vast majority of which are not exclusive to Qantas), as well as through Air New Zealand Holidays’ 500 outlets in Japan (also non-exclusive). A range of brochures will be used in each market, some of which will be branded Air New Zealand Holidays and some QH. Both brands will use Air New Zealand and Qantas as carriers.

11.55 Under the Factual, therefore, New Zealand travel will be promoted in foreign markets primarily under the Air New Zealand Holidays brand. The maintenance of distinct Qantas Holidays and Air New Zealand Holidays brand identities is an essential aspect of the Alliance’s market expansion strategy.

Access to Air New Zealand network

11.56 Absent the Alliance, Qantas’ network to and within New Zealand has significant limitations. For example, all passengers to New Zealand other than from the USA need to transit through Australia. These network limitations make many New Zealand-related itineraries from most inbound markets uneconomical, and raise the cost of constructing combined Australia / New Zealand itineraries. (Even if QH were allowed to use Air New Zealand in its itineraries, Air New Zealand fares would cost it about 10% more than they would under the Alliance.) This in turn either raises the price or limits the supply of products featuring such itineraries.

Absent the Alliance, Qantas’ network to and within New Zealand has significant limitations.

11.57 Air New Zealand carriage is an essential component of many of the new New Zealand related itineraries that will be offered under the Alliance. Most of these would simply not be feasible absent the Alliance. The table below provides examples of improved international itineraries that the Alliance is likely to offer, all of which require Air New Zealand carriage.

Example of Potential QH Itineraries	Why Air New Zealand is not substitutable	Best QH alternative absent the Alliance
TYO-AKL (NZ) AKL-SYD (NZ / Qantas) SYD-CNS (Qantas) CNS-TYO (Qantas) - 4 legs	Qantas cannot fly direct from TYO to AKL No Qantas code-share partners fly direct from TYO to AKL, requiring a double Tasman crossing.	TYO-SYD (Qantas) SYD-AKL (Qantas) AKL-SYD (Qantas) SYD-CNS (Qantas) CNS-TYO (Qantas) - 5 legs
LON-LAX (NZ) LAX-AKL (NZ / Qantas) AKL-SYD (NZ / Qantas) SYD-SIN (Qantas) SIN-LON (Qantas) - 5 legs	Qantas cannot codeshare on LON-LAX with BA.	LON-LAX (BA) <i>non codeshare</i> [] SIN-LON (Qantas) - 5 legs
LON-LAX (NZ) LAX-NAN (NZ) NAN-AKL (NZ) AKL-ZQN (NZ) ZQN-SYD (NZ/Qantas) SYD-SIN (Qantas) SIN-LON (Qantas/BA) - 7 legs	Qantas cannot fly direct from LON to NAN and requires an additional stop in SYD. Code-share travel to NAN and AKL.	LON-SIN (Qantas) SIN-SYD (Qantas) SYD-NAN (Code-share) NAN-AKL (Code-share) [] SYD-SIN (Qantas) SIN-LON (Qantas) - 9 legs
LON-LAX (NZ)	For many island stopovers Qantas has no flights or codeshare. In theory, QH could construct an itinerary using NZ	Not feasible absent the Alliance.

LAX-PPT (NZ)	on some legs, albeit at high cost. In practice, Qantas does not allow QH to do this.	
PPT-RAR (NZ)		
RAR-AKL (NZ)		
AKL-SIN (NZ)		
SIN-LON (Qantas)		

11.58 The Alliance will allow QH to improve existing offerings by taking advantage of the improved air product into and out of New Zealand created by the Alliance. More specifically, the Alliance will deliver:

- increased frequencies and capacity on key routes, such as Europe – New Zealand via Singapore and on all Trans-Tasman sectors;
- more direct routing options between some city pairs such as SIN-AKL, CNS-AKL, PER-AKL and AKL-ZQN;
- new non-stop routings AKL-ADL, AKL-CBR, AKL-HBA and WLG-CBR;
- quicker connections through certain centres such as SYD and AKL (and possibly also SIN); and
- a greater variety of route options between most source markets and New Zealand.

The Alliance will allow QH to improve its existing offerings by taking advantage of the improved air product into and out of New Zealand.

11.59 The ability to codeshare with Air New Zealand will also substantially strengthen QH’s domestic New Zealand offerings. Qantas currently has a limited New Zealand domestic network, restricting the range of products that it can offer. Granting Qantas code-share on Air New Zealand’s far superior domestic network (comprising 72% of total domestic capacity), will increase flight frequency and double the number of destinations served throughout New Zealand. This will be achieved at far lower cost than direct Qantas expansion in the domestic New Zealand market (as occurs under the Counterfactual). This will greatly improve the economics of Qantas’ total New Zealand offering and increase New Zealand’s attractiveness, not only to the very important Australian market, but to all Qantas’ customers throughout its network.

11.60 QH will take advantage of these network enhancements to offer better and more economically attractive products. Access to additional seat inventory and alternative routings will also allow QH to flow customers over different networks, reducing the loss of business due to capacity constraints in peak periods.

11.61 QH will also benefit from access to Air New Zealand’s volume discounts on New Zealand land packages, and it will therefore be able decrease the prices of some of its New Zealand offerings to consumers. While the overall impacts are not easy to quantify, the costs to QH of New Zealand product under the Factual are likely to be substantially lower than under the Counterfactual.

The QH plan

- 11.62 Reflecting these substantial gains from the Alliance, the QH plan focuses on the specific opportunity to develop and sell New Zealand related holiday product, primarily under the Air New Zealand Holidays brand, via QH's distribution network in 25 key countries.
- 11.63 The plan describes how QH will leverage the network enhancements created by the Alliance (including its ability to access Air New Zealand's superior domestic network and direct connections from key source countries) to develop both new and improved holiday products.
- 11.64 It will use its powerful distribution network to promote and sell these products into key markets, giving New Zealand much greater retail, direct channel and media exposure than it has at present.
- 11.65 In turn, this will raise awareness of New Zealand as a holiday option in target markets, improve the attractiveness of the New Zealand holiday offerings available to consumers in these markets, and improve the ease with which consumers are able to find and purchase a suitable product.
- 11.66 This will shift the demand curve for travel to New Zealand to the right, increasing the total number of tourists visiting New Zealand.
- 11.67 The numbers in the QH business plan are estimates of the extent to which the QH initiatives will expand demand for New Zealand tourism from various source countries. They are not premised on QH gaining share from other providers of inbound tourism product. Any gain of this nature would be negligible given that the QH plan focuses on addressing new segments with new products through distribution channels that currently sell little New Zealand product. The following table provides a summary of the New Zealand tourism growth targets detailed in the QH plan.

The QH plan focuses on the specific opportunity to develop and sell New Zealand related holiday product via QH's distribution network in 25 key source countries.

New Zealand tourism growth targets detailed in the QH plan

Market	New Zealand Arrivals Data 2001/02				New Holiday Visitors Targeted		
	Total Arrivals (000)	Regional Share (%)	Total Arrivals for Holiday (000)	Holiday Share of Total Arrivals	QH Target	As Share of Regional Arrivals ²	% of Current Holiday Visitors
Australia	624	23.86%	241	38.5%	13.5	0.52%	5.6%
Asia (Ex Japan)	340	1.24%	197	57.8%	11.3	0.05%	5.7%
Japan	150	1.47%	123	81.7%	7.7	0.08%	6.3%
USA	195	3.67%	125	64.2%	6.2	0.12%	5.0%
Canada	39	3.42%	23	60.6%	0.8	0.07%	3.4%
UK	228	7.27%	121	53.2%	5.6	0.18%	4.6%
Germany	49	3.32%	38	77.8%	1.9	0.13%	5.0%
Ireland	13	n/a	8	64.7%	0.8	n/a	9.7%
Other Europe	107	n/a	67	62.6%	1.1	n/a	1.7%
Other	212	n/a	70	33.2%	1.0	n/a	1.4%
Total	1,956		1,013	51.8%	50.0		4.9%

Source: TFI (Tourism Futures International)

- 11.68 The targeted growth in passengers is equivalent to 4.9% of current holiday visitors to New Zealand and 2.6% of total visitors. Other things being equal, the 50,000 additional visitors would represent a 0.1% increase in New Zealand's share of regional arrivals. These proportions highlight the fact that even a small change in consumer awareness and preference in the relevant source markets is sufficient to generate a large change in the absolute number of inbound tourists to New Zealand.
- 11.69 The following section provides a market-by-market summary of how the increased demand for New Zealand tourism will be created in each of the target markets.

Australia

- 11.70 QH currently produces dedicated New Zealand brochures for flexible travel arrangements and skiing holidays, but New Zealand is not a high priority destination. QH will attract an additional 13,500 visitors from Australia through the network, product, distribution and promotion changes outlined below.

² For the purposes of this analysis, TFI defines the regional market as those countries in the Asia Pacific region that compete for visitors: Australia, China, Hong Kong, Japan, South Korea, Malaysia, NZ, Philippines, Singapore, Taiwan and Thailand. This is a fairly narrow market definition. Clearly, if other competitors, such as USA / Canada and South Africa were included in the market definition, New Zealand's market share and the projected share gain would be significantly smaller.

Factor	Description
Network enhancements	<p>QH's ability to offer attractive holiday packages to the Australian market will be greatly enhanced as a result of:</p> <ul style="list-style-type: none"> • Qantas being granted code-share on Air New Zealand's domestic flights (72% of total capacity) resulting in higher flight frequency and double the number of destinations served throughout New Zealand • Greater choice of frequency and inventory over the current range of Tasman sectors • Access to New Zealand sectors not currently served by Qantas e.g. Auckland to/from Perth, Cairns • New direct sectors such as Auckland to / from Adelaide, Canberra and Hobart; Wellington to / from Canberra
New products	<ul style="list-style-type: none"> • New product offerings will include an expanded range of New Zealand product, special interest & sporting event packages, New Zealand short breaks, adventure and nature packages, ski and snowboarding packages, coach tours, luxury and indulgence products and self-drive packages
Expanded distribution	<ul style="list-style-type: none"> • The expanded range of New Zealand holiday product will be sold and promoted through QH's powerful domestic distribution network, including 4,200 travel agents and its direct sales channels • NZ revenue targets and incentives will be introduced into agency agreements, and New Zealand's profile raised in the recognition program • Direct targeting of New Zealand product to specific segments using Qantas Frequent Flyers database • Greater emphasis on New Zealand product sales on Qantas.com.au
Promotion and other	<ul style="list-style-type: none"> • Dedicated New Zealand brochures & point of sale material for FIT, Ski and short breaks; expand current New Zealand brochures; new range of flyers for specific offerings • Upgraded media and co-operative advertising programs for NZ • Industry specialist program (KEA) • Direct segment marketing campaigns

UK and Ireland

11.71 New Zealand product is currently a marginal offering for QH in this market, with all marketing and sales activities directed towards Australia destination traffic only. Independent direct sell retailers currently dominate the holiday market to NZ, with only a limited number of specialist wholesalers servicing retail outlets. QH estimates it will generate an additional 6,400 visitors from the UK and Ireland through the network, product, distribution and promotion changes outlined below.

Factor	Description
Network enhancements	<ul style="list-style-type: none"> • Air New Zealand currently operates a daily service from LHR to AKL via LAX. Under the bilateral agreement it cannot increase any fifth freedom

	<p>flying, which is required to make capacity addition economic.</p> <ul style="list-style-type: none"> • Qantas combined with Air New Zealand will offer a better one-stop 747 service from LHR to New Zealand via Singapore. • Pacific Island stopover options, which are very attractive to the UK market, would be greatly enhanced.
New products	<ul style="list-style-type: none"> • New product offerings will include sporting events, special interest events, youth traveller program, ski, dual destination itineraries, “sun and sand” offerings with Pacific Island stopovers for the UK winter and coach tours for more mature visitors.
Expanded distribution	<ul style="list-style-type: none"> • NZ will gain a greatly expanded retail presence with active promotion through QH’s 4,403 retail outlets in the UK & Ireland • NZ product sales on UK website
Promotion and other	<ul style="list-style-type: none"> • Dedicated New Zealand brochures and POS materials to support retail sales • Dedicated New Zealand co-operative advertising program, and New Zealand to feature in all advertising, trade events and travel agent communication programs • Introduce New Zealand trade specialist program

USA and Canada

11.72 The majority of marketing and sales through QH’s USA wholesale operation are directed towards Australian traffic only; most current business to New Zealand comes from customers who are also visiting Australia. QH estimates it will attract an additional 7,050 visitors from North America through the network, product, distribution and promotion changes outlined below.

Factor	Description
Network enhancements	<ul style="list-style-type: none"> • Access to Air New Zealand flights will give QH greater choice and frequency of inventory on the key AKL-LAX sector • Air New Zealand has greater frequency and capacity share in the Pacific Islands, allowing more scope for stopover options, including Fiji, Samoa, Tahiti and Honolulu • Access to Air New Zealand’s domestic network will improve QH’s ability to offer dual-destination itineraries and cater for US tour groups • Increased trans Tasman capacity available to QH will make it easier to secure inventory on the dates required
New products	<ul style="list-style-type: none"> • Expanded range of offerings to include coach touring, luxury, nature and adventure products, ‘go as you please’ and pre-booked itineraries and dual destination itineraries.
Expanded distribution	<ul style="list-style-type: none"> • New Zealand product will gain greatly expanded retail exposure through QH’s 21,800 retail outlets in the USA and Canada

Promotion and other	<ul style="list-style-type: none"> • Dedicated New Zealand brochures and POS materials to support retail sales • Dedicated New Zealand co-operative advertising program, and New Zealand to feature in all advertising, trade events and travel agent communication programs • Greater New Zealand profile on <i>Qantasvacations.com</i> website and direct response campaigns • Introduce New Zealand trade specialist program
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Japan

11.73 QH's current focus is almost exclusively Australian product (98% of total sales). QH estimates it will attract an additional 7,700 visitors from Japan through the network, product, distribution and promotion changes outlined below.

Factor	Description
Network enhancements	<ul style="list-style-type: none"> • QH will gain access to direct Air New Zealand flights between Auckland and Tokyo, Osaka and Nagoya (sectors not currently served by Qantas), allowing QH to offer mono-destination New Zealand packages using non-stop New Zealand services • It will also allow the creation of genuine triangular product options, combining New Zealand and Australian holidays without the need to backtrack
New products	<ul style="list-style-type: none"> • New pre-booked individual product; organised group tours; specialised ski program; Japanese Meet & Greet and customer services • Incentive group and student educational tours • Specially contracted packages for media sales e.g. shopping stays
Expanded distribution	<ul style="list-style-type: none"> • Air New Zealand Holiday's retail presence in Japan will expand from 500 to 860 retail outlets in Japan • NZ product sales through <i>qhi.co.jp</i> website, telephone sales and system-to-system links • Group sales to companies, schools and other tour organisers
Promotion and other	<ul style="list-style-type: none"> • Dedicated New Zealand brochure and POS materials for use in travel agencies, trade events and other promotions • Introduce New Zealand trade specialist program

Asia (excluding Japan)

11.74 QH's operations in Singapore, Hong Kong, Thailand, Malaysia, Taiwan, South Korea and China currently sell very limited New Zealand travel, and no New Zealand product is included in the brochures for these markets. QH estimates it will attract an additional 11,300 visitors from this region through the network, product, distribution and promotion changes outlined below.

Factor	Description
Network enhancements	<ul style="list-style-type: none"> QH will gain access to direct Air New Zealand flights between Auckland and Singapore, Hong Kong and Taipei, allowing QH to offer dedicated New Zealand packages using non-stop New Zealand services It will also allow the creation of genuine triangular product options, combining New Zealand and Australian holidays without the need to backtrack
New products	<ul style="list-style-type: none"> Range of new New Zealand group touring and prebooked individual products Meet & Greet and customer service specifically for this market
Expanded distribution	<ul style="list-style-type: none"> Retail exposure with of New Zealand product will be significantly strengthened with active promotion through 326 QH retail outlets in Asia outside Japan; new brochures to support retail sales New Zealand sales and higher New Zealand profile on regional websites
Promotion and other	<ul style="list-style-type: none"> Dedicated New Zealand plan for tactical initiatives in each market Dedicated New Zealand brochures for South Asia and North Asia NZ to feature in all advertising, trade events and travel agent communication programs Introduce New Zealand trade specialist program

Continental Europe

11.75 All of QH's marketing and sales activities in continental Europe are currently directed to Australian destination traffic only, and there is very limited New Zealand product in the brochures for each market. QH estimates it will attract an additional 3,050 visitors from mainland Europe through the network, product, distribution and promotion changes outlined below.

Factor	Description
Network enhancements	<ul style="list-style-type: none"> Qantas' current schedule of daily 747s from Frankfurt and service twice per week from Paris will add additional one-stop Europe–New Zealand routes, with good feed to Air New Zealand's daily Singapore – New Zealand services The additional feed from the UK and Europe into Singapore, connecting to Air New Zealand's Singapore – New Zealand services, may provide the catalyst for Air New Zealand to add additional capacity
New products	<ul style="list-style-type: none"> Expanded range of 'go-as-you please' product, coach touring, ski, nature and adventure products, budget accommodation, and special events
Expanded distribution	<ul style="list-style-type: none"> Greatly improved New Zealand product retail presence through 25 QH GSA offices in Europe covering a large number of outlets, including 6,000 outlets in Germany and 1,500 in the Netherlands
Promotion and other	<ul style="list-style-type: none"> New dedicated New Zealand brochures, plus new dual destination itineraries in QH brochures

- | | |
|--|--|
| | <ul style="list-style-type: none"> NZ to be featured in all advertising, trade events and travel agent communication programs |
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Response to specific questions by the Commission relating to QH's promotion of New Zealand tourism

11.76 The discussion to this point has focused on explaining how the Alliance will increase incentives for Qantas and QH to market Air New Zealand Holidays branded product and New Zealand as a destination. It has also addressed ways in which the Alliance will enhance QH's marketing effectiveness. This section addresses specific concerns raised by the Commission in its Draft Determination relating to whether the QH projections will be achieved.

How effective will Qantas Holidays be in promoting New Zealand as a tourist destination?

11.77 The Commission raised the question of how effective QH might be in promoting New Zealand as a destination.

11.78 In addition to the arguments and evidence already presented above, there are other considerations that lend credibility to the Applicants' claim. First, QH has repeatedly demonstrated its ability to grow traffic to specific destinations and events. Examples provided in the QH business plan include Thailand, Canada in Winter, The Melbourne Cup Carnival, and Broome and the Kimberley. In each of these cases, there was no evidence of cannibalisation or substitution i.e. aggregate demand was increased. For convenience, these are summarised below.

- Viva! Thailand: In 2001, QH identified growth potential for Thailand, a destination not served comprehensively by Qantas, through using Thai Airways and it's Viva! Brand. Since its introduction, and prior to Bali terrorist activity and SARS, both the QH and Viva! Holidays brands demonstrated strong growth rates of over 80% per annum³.
- The Melbourne Cup Carnival: following the demise of AN and AN Holidays, QH decided to promote the event for the first time in 2002. The resulting ticket sales for QH almost tripled those achieved by AN Holidays in 2000.
- Broome & the Kimberley: After the Demise of Ansett, it took QH just over 12 months to grow the total market to Broome over and above Ansett Holiday's share. Growth has continued following the introduction of direct MEL/BME flights. Forward bookings for the remainder of this financial year are +79% on last year.
- Canada in Winter: In 2002 QH recognised promotion of winter holidays to Canada as a new opportunity. Passenger numbers have grown strongly across the entire year, with results for the winter months up 48% on the previous year.

11.79 More generally, QH has played a significant role in growing the package travel market to Australia, where tourists on packages account for around 32% of Australian inbound visitors as compared to 21% for New Zealand. QH has a number of specialised capabilities that have been the basis for its success in the market:

³ Following an assessment of the impact on Qantas' broader commercial interest, Qantas granted QH a mandate to sell seats on Thai Airways, but only for the specific purpose of promoting holiday travel from Australian to Thailand under the Viva! brand.

How effective will Qantas Holidays be in promoting New Zealand as a tourist destination?

- a sophisticated bookings and reservations platform with functionality that goes well beyond standard booking systems, allowing it to efficiently create and market well-designed travel packages;
- a powerful distribution network, with operations in 25 countries distributing QH product through 37,000 outlets;
- strong relationships with a large number of agents and specialist operators;
- excellent strategic marketing and market research capabilities;
- sophisticated inventory and yield management practices; and
- a highly developed sales and delivery infrastructure, including call centres, travel agent sales support tools and a highly experienced global sales team.

11.80 With its world-class tourism product development, marketing and distribution capabilities, combined with access to both parties' networks and the Air New Zealand Holidays brand, QH is perfectly placed to expand the market for tourism to New Zealand. No other potential partner for Air New Zealand has the same level of capability as QH, nor does any partner under the Counterfactual have access to the network enhancements that will be created by the Alliance.

Is the target of 50,000 additional inbound tourists reasonable?

11.81 To put the QH target of 50,000 additional arrivals in context, it is helpful to compare it to the Japan Recovery Campaign launched in January 2002 by Tourism New Zealand in response to the events of September 11. The campaign has been credited with creating an *additional 12,456 bookings* from Japan to New Zealand over a six month period. New Zealand's share of the Japanese outbound market was estimated at 0.8% before September 11, and grew to 1.2% over the period January to May 2002.

11.82 The Japan Recovery Campaign was primarily a promotion-based initiative without any of the network, product and distribution enhancements that the Alliance will create. In this context, by comparison the QH business plan target of 7,700 additional tourists from Japan appears quite modest, despite being the largest target for any source country other than Australia.

11.83 Tourism Futures International (TFI) reviewed the original QH report, and adopted three different approaches to test whether the tourism growth estimates are reasonable. All three tests indicated that the projections appeared to be conservative, leading TFI to the conclusion that there is no reason to believe that QH's targets are unrealistic. The approach and outcome of these three tests is summarised briefly below.

Test 1 - Package Sales

11.84 In Australia, tourist packages accounted for approximately 35% of inbound tourists from countries other than New Zealand. In New Zealand, packages accounted for 25% of inbound tourists from countries other than Australia. If, as a result of the Alliance, QH were able to grow the package market in New Zealand to 35% of the

Is the target of 50,000 additional tourists reasonable?

total non-Australian inbound tourism market, as in Australia, there would be 184,000 new non-Australian package tourists visiting New Zealand⁴.

- 11.85 This figure assumes that the growth in package market tourists will be additional to the existing numbers of tourists. This is a reasonable assumption because the great majority of new package tourists will be visitors who would otherwise have chosen to take a holiday in a different country. They will have chosen New Zealand because attractive New Zealand holiday product will be available. The QH plan focuses on stimulating demand by developing products that address the needs and interests of specific segments by packaging flights and accommodation with relevant attractions and activities⁵. It is unlikely that a significant number of the new package tourists would have chosen to visit New Zealand anyway, because package and non-package offerings tend to address different needs and appeal to different types of travellers. In other words, any significant increase in the number of package tourists is likely to occur as a result of a shift in preferences (albeit a very small one) within the market for package travel, rather than substitution away from non-package travel.
- 11.86 This is a useful test because it speaks to the fact that virtually all of the growth from the QH initiative will come from package travel. QH brings to the Alliance precisely what Air New Zealand has been struggling to develop: world-class product packaging and distribution capabilities. As explained earlier, Air New Zealand's efforts to grow the inbound tourism market have been hindered by outdated systems and weak tourist package distribution capabilities in many source countries. This has been an important contributing factor to the relatively low levels of New Zealand holiday package sales. Without the Alliance, this factor would persist under the Counterfactual. It is a difficulty that the Alliance addresses and resolves.

Test 2 - QH market penetration

- 11.87 If QH were able to achieve the same level of penetration in New Zealand as it has in Australia, the net impact would be an increase of around 78,500 visitors⁶. This test simply confirms that QH will not have to achieve an unusually level of high market penetration to meet the target of 50,000 visitors.

Test 3 - Sales outlets

- 11.88 QH currently sells [] sales per year through its 37,452 outlets worldwide. This equates to [] sales per outlet. If QH could achieve one-third to one-half this volume of sales per outlet for New Zealand, the outcome would be an additional 44,000 to 67,000 visitors.
- 11.89 Again, this is a useful test as it speaks to one of the key benefits of the Alliance, namely the greatly expanded retail distribution presence that Air New Zealand

⁴ The original TFI estimate of 117,000 additional tourists was conservative because it was derived by multiplying the total number of non-Australian visitors by 35% and observing the difference between this number and current number of non-Australian visitors on packages. A more accurate method is to increase the number of non-Australian visitors on packages, and hence the total number of non-Australian visitors, until the former is 35% of the latter. This yields an increase of 184,000 visitors.

⁵ Alan Collier writing in *Principles of Tourism: A New Zealand Perspective (6th Edition)* points out that "attractions perform a motivating role and therefore constitute part of the primary motivation for the destination of choice for leisure travellers". He notes further that "Many attractions and activities can become 'lost' when offered in isolation, but may gain in appeal if presented as a package."

⁶ This figure was derived using the following formula: $X = 7.2\% * (1.012m) / (1-7.2\%)$. The original TFI figure of 73,000 visitors was a conservative estimate because it was derived by simply multiplying the existing visitor base of 1.012 million visitors by 7.2%.

Holidays product will enjoy under the Alliance. It makes the cautious assumption that Australian product will remain at least two to three times as popular as New Zealand product in these outlets, even taking into account the fact that around 50% of the incremental non-Australian visitors to New Zealand will be travelling on a dual destination itinerary. Furthermore, additional sales will be driven through QH's direct channels, including media campaigns, web sales and group sales.

To what extent would QH's initiatives increase demand as opposed to taking share from other providers?

To what extent would QH's initiatives increase demand as opposed to taking share from other providers?

- 11.90 The Commission raises the concern that some of the QH gains may come about as a result of taking share from other providers.
- 11.91 As a general point, the focus of the Alliance is to create market growth, and not to increase market share. With specific reference to the QH plan, the parties expect that the primary effect of QH's initiatives will be to generate visitors who would have chosen other destinations under the Counterfactual, but have decided instead to travel to New Zealand under the Factual. Other things being equal, the 50,000 additional visitors would represent a 0.1% increase in New Zealand's share of regional arrivals⁷ and an extremely small increase in its share of the international tourism market. Consequently, only a small change in consumer awareness and preference in the relevant source markets is sufficient to generate a large change in the absolute number of inbound tourists to New Zealand.
- 11.92 There are a number of reasons why these tourists will shift their preference from other destinations to New Zealand under the Factual:
- A greater awareness of New Zealand as a holiday option due to the increased level of promotion of New Zealand by QH in many source countries (brochures and advertising);
 - The increased availability of New Zealand packages in source countries due to the greatly increased profile of New Zealand product (under the Air New Zealand Holidays brand) in QH's network of 37,462 outlets in 25 countries;
 - An expanded range of New Zealand packages, providing greater choice and thus appealing to a broader spectrum of consumers; and
 - More attractive New Zealand packages, leveraging the Alliance partners' improved and expanded air product and better customer service (as described in detail in the QH business plan).
- 11.93 The figures quoted in the QH plan relate to the increased demand for travel to New Zealand that the QH initiatives will create and capture. They expressly exclude any gains resulting from "encroachment on other providers' market shares". However, QH is unlikely to gain a significant number of additional customers as a result of share gains from other providers of inbound holiday packages. This is because the QH plan focuses on addressing new segments with new products through distribution channels that do not currently sell much New Zealand product. Furthermore, other wholesale package providers will also be able to exploit the enhanced connectivity between the Air New Zealand and Qantas networks to

⁷For the purposes of this analysis, the region is defined as Australia, China, Hong Kong, Japan, South Korea, Malaysia, NZ, Philippines, Singapore, Taiwan and Thailand on the basis that they compete for tourist visitor share. If other competitors, such as USA / Canada and South Africa were included in the market definition, New Zealand's market share and the projected share gain would be significantly smaller.

develop and market more attractive New Zealand tourism products to their customers.

- 11.94 In addition to bringing new tourists to New Zealand, the expanded and improved range of packages may encourage a proportion of current tourists to stay longer in New Zealand. However, no attempt has been made to quantify these benefits.

Is the increase in dual destination tourism attainable?

Is the increase in dual destination tourism attainable?

- 11.95 The Commission expresses a concern that the QH marketing plan's target for dual destination travellers may be unrealistic.
- 11.96 The initiatives detailed in the QH plan project an increase of 50,000 tourists, of which 36,000 are visitors from countries other than Australia. Of these, only 18,000 (50%) will be dual destination tourists, 12,600 of whom would have been expected to be dual destination tourists even if the proportion of dual destination visitors was no higher than normal (35%).
- 11.97 Furthermore, it is important to understand that the Applicants are not claiming they will significantly increase the level of dual destination tourism across the board. They merely predict that a higher-than-average percentage of the 36,000 additional non-Australian visitors will be dual destination visitors, simply because many of the products on offer will feature dual destination itineraries.
- 11.98 Dual country products are currently difficult to develop and market on a commercial basis for a number of reasons. First, triangulated international fares cannot be constructed on terms attractive to tourist markets. The Alliance removes this constraint. Second, dual country packages are also difficult to develop without access to extensive domestic networks in both countries. The Alliance delivers this essential ingredient through greater connectivity between and within Australia and New Zealand. Well constructed dual destination offerings can improve the attractiveness of the two countries relative to other competing destinations, with the potential to increase tourism into both markets.

Would dual destination marketing provoke a competitive response from Australian state tourism bodies?

Would dual destination marketing provoke a competitive response from Australian state tourism bodies?

- 11.99 The Commission raises a concern that dual destination marketing would provoke a competitive response from Australian state tourism bodies:
- “Gullivers’ submission makes the point that an attempt to market Australia and New Zealand as a dual destination product would encourage Australian States to react with regional campaigns”
- 11.100 It is unlikely that attempting to market Australia and New Zealand as a dual destination product would encourage Australian States to react with regional campaigns given that the 18,000 dual destination visitors are new and would therefore be a welcome addition to current visitor numbers. Also, if the States could expand their in-bound tourism cost effectively by further increasing their promotional outlays, it is relevant to ask why they not already doing so. It seems unlikely that the incremental effect on their efficient promotion levels of enhanced promotional effectiveness by the parties is likely to be significant.

Would there be a strategic response by other competitors to the campaign to increase tourism to New Zealand?

Would there be a strategic response by other competitors to the campaign to increase tourism to New Zealand?

11.101 More generally, the Commission asserts that NECG has incorrectly assumed that there would be no strategic response by other competitors to the campaign to increase tourism to New Zealand.

“A campaign to increase tourism would not be ignored by other competing destinations or activities. The NECG numbers assume, incorrectly in the Commission’s view, that there would be no strategic response by competitors.”

11.102 The campaign to increase tourism to New Zealand is unlikely to provoke a significant competitive response in Australia or elsewhere. The 14,000 additional Australians that QH believes it can attract to New Zealand represent 2% of the number of Australians currently visiting New Zealand. These visitor numbers are comparatively small, although their economic impact is material. They are unlikely to prompt a competitive response by Australian States, all the more so as the increase in tourism numbers arises from a reduction in the costs (and an increase in the benefits) QH incurs in securing such tourists.⁸ Similarly, the 36,000 additional non-Australian tourists represent a regional market share gain of about 0.1% by New Zealand, which is unlikely to provoke a significant competitive response by other countries.

11.103 More importantly, the QH initiatives will also focus on providing product to repeat visitors. This will involve selling packages that involve the promotion of Australia and New Zealand. Thus, it is highly unlikely that Australian States will commence their own campaigns given that a major focus of the QH initiatives will be to promote the region as a whole emphasising the differences between the two countries. This strategy will expose the repeat visitor to potential packages involving both countries.

Why is the market opportunity not already being exploited?

Why is the market opportunity not already being exploited?

11.104 The Commission questions why neither the parties themselves nor any other airlines are pursuing the market opportunity identified in the proposal:

“The question is not only if the strategy proposed by Qantas Holidays of increased expenditure, new products and additional sales outlets can profitably expand the market, why are they not doing it already, but if there are these untapped sales opportunities, why is no one else doing it already”

11.105 A detailed explanation of why the parties cannot effectively pursue the market opportunity absent the Alliance has already been provided. In a nutshell, Air New Zealand has a significant gap between its current product development and distribution capabilities and those required to successfully expand the inbound market. In Qantas’ case, both the incentive to expand New Zealand tourism and its ability to do so are considerably weaker under the Counterfactual than under the Factual.

⁸ The efficient level of incremental effort for any player to devote to offsetting a competitive move by another player is a decreasing function of the cost advantage of the player initiating the competitive move. In other words, it would make more sense for competitors to respond to an increase in QH’s promotional outlays if that increase was not based on an increased QH cost advantage. The greater the extent to which the increased outlays reflect an increased cost advantage, the less rational it is for QH’s competitors to respond to it by increasing their own outlays. Rather, it would make sense for them to essentially accommodate the increased QH market share.

11.106 The Alliance will be in a unique position to significantly increase demand for package travel to New Zealand. An alliance between any other combination of airlines would not provide a similar result. This is illustrated by the table that follows, which lists the prerequisites for capturing this market opportunity, and assesses Qantas, Air New Zealand and a number of other relevant airlines against each of these criteria. The rating scale covers a spectrum from negligible (-) to very strong (+++). As can readily be seen, only an alliance between Qantas and Air New Zealand comes anywhere close to scoring “very strong” on all criteria.

Prerequisites for Capturing the Market Opportunity Identified by the Alliance		Assessment of Airlines’ Capabilities				
		Qantas	Air New Zealand	Virgin Blue	SIA	CX
Brand strongly associated with New Zealand		+	+++	-	-	-
Brand strongly associated with Australia		+++	+	+	-	-
Strong Australian tourism market knowledge and industry relationships		+++	++	+	+	-
Strong New Zealand tourism market knowledge and industry relationships		++	+++	-	-	-
Extensive Australian domestic air network		+++	-	++	-	-
Extensive New Zealand domestic air network		++	+++	-	-	-
Direct flights from source markets to Australia		+++	+	-	+	+
Direct flights from source markets to New Zealand		+	+++	-	+	+
Strong distribution network in key source countries promoting Australia and New Zealand	Australia	+++	+	+	+	+
	North Asia	+++	+++	-	++	+++
	South Asia	+++	+++	-	+++	++
	UK	+++	+++	-	++	++
	Europe	+++	+	-	+	+
	Canada	++	+++	-	+	+
	USA	+++	+++	-	-	-

Can national tourist organisations and airlines promote national tourism effectively?

11.107 The Commission questions whether national tourist organisations and airlines are able to promote national tourism effectively. The successful Japan Recovery Campaign described earlier is a good example of effective promotion by a national tourism body, and the QH case studies summarised earlier provided examples of how QH has been able to grow total demand for travel to specific destinations.

Can national tourist organisations and airlines promote national tourism effectively?

- 11.108 On the specific question of airline promotions, there is ample evidence that airlines directly and indirectly influence the choice of destination made by many tourists. For example, a recent Roy Morgan survey of 372 respondents found that around 11.5% of Australians were *directly* influenced in their decision to come to New Zealand by one of the airlines. In addition, airlines were likely to be indirectly responsible for influencing some visitors' decisions through advertising mediums including radio and TV ads, newspaper and magazine articles as well as promotions by some travel agents.
- 11.109 Given Australia's proximity to, and familiarity with, New Zealand, it is likely that airline advertising would be even more important in long-haul markets. This is because word of mouth promotion is less prominent in those markets due to the much smaller proportion of people in the total population who have visited New Zealand and the lower level of day-to-day exposure to New Zealand in the media.
- 11.110 The submission to the Commission by Tourism Industry Association New Zealand (TIANZ) provides the following assessment of the value of Air New Zealand's marketing efforts to New Zealand:

"Air New Zealand's marketing efforts contain intrinsic public good promotion of New Zealand and TIANZ estimates that this has a present value of \$1.4 billion (estimated from an average of \$100m spend per year at a discount of 7%). If Air New Zealand ceased to be a separate entity, Tourism New Zealand's budget would need to rise to over \$155 million per annum to purchase similar public good exposure. TIANZ observes that this expenditure would be enjoyed by other inbound carriers that have their own national identities and agendas."

- 11.111 Some specific examples are provided below of the effect on destination demand of airline promotional activities, network choices and alliance arrangements.

Qantas – Aerolineas Argentinas Codeshare

- 11.112 Aerolineas Argentinas (AR) had operated to Australia for over a decade, but had not expanded their operation beyond 2 services per week in low season and 3 during peak. Qantas announced it would fly to South America in mid 1998 and commenced operations to Buenos Aires with a twice per week schedule in November 1998. Qantas worked jointly with AR to increase tourism traffic flows between South America and Australia / New Zealand (and vice versa). The additional capacity along with the codeshare arrangements gave wholesalers an improved spread of services. This allowed them to package more flexible holiday products.
- 11.113 The market responded well. Total passenger numbers more than doubled, from 39,999 passengers in the two years preceding the Alliance (11/96 to 10/98), to 83,496 in the first two years of the Alliance (11/98 to 10/00). This growth was driven by the additional capacity, together with the commercial relationship the two carriers established to improve the customer offering.
- 11.114 It is unlikely that this growth would have occurred without the Alliance. For example if AR had simply added more capacity of its own. AR had operated for more than a decade and had never moved beyond three services per week. If Qantas had simply entered the market without a commercial relationship with AR, results would also have been mixed given the limited offering of 2 services per week. However, the joint venture, leveraging Qantas' distribution strength in Australia and New Zealand and AR's in South America, proved to be highly effective in growing the market.

11.115 The alliance ended when AR went in receivership in June 2001, a casualty of the severe economic crisis that affected Argentina in 2001/02. Since then passenger numbers have fallen significantly, from 46,365 in the twelve months to June 2001 to 36,839 in the twelve months to June 2002. (AR recommenced services December 2001)

Air New Zealand's withdrawal from Germany

11.116 Air New Zealand previously operated services from Frankfurt to Auckland. In March 2001 it cancelled the service due to poor profitability. In the year following Air New Zealand's withdrawal from Frankfurt, German tourist arrivals into New Zealand dropped by 3,700, a 7% decline from the previous total of 52,800. Since then the market has grown slightly but is still 3,000 visitors lower than when Air New Zealand operated the Frankfurt flights.

11.117 Clearly, the decline out of Europe may not be solely due to FRA-LAX exit. World events, economic factors and a decline in Air New Zealand's Tasman schedule may all have exacerbated the decline. However, the number of total visitors to New Zealand in the 12 months to Nov 2002 actually grew by 5.5% compared to the previous corresponding period, and visitors from Europe grew by 7.5%, whereas German visitor arrivals *declined* by 8.8% over this period⁹. This suggests that German arrivals have been affected by the FRA-LAX withdrawal.

11.118 In a letter to Air New Zealand, Tourism Holdings Limited comments that "... the market misses the much-reduced energy previously put into promoting New Zealand by Air New Zealand with the travel trade and at times direct with consumers. This has dramatically reduced overall exposure for New Zealand and in our view is stunting longer-term growth potential from Germany."

Air New Zealand – JL

11.119 Following the code-share agreement with JL, NZ was not only able to increase schedule between NRT and AKL, but the incremental traffic also enabled NZ to add services to both Osaka and Nagoya.

United – Lufthansa revenue sharing CHI-FRA

11.120 Prior to the alliance between these two carriers, United operated a daily 767 service. Within 2 years following the alliance and operating code-share service on the one UA flight, LH started service in their own right and both carriers increased capacity with aircraft change from 767 to 747.

Does the increase in tourist numbers take account of risk?

11.121 The Commission expressed a concern that the numbers suggested by QH seemed to be independent of the general volatility of the international tourist market as a result of risk factors such as war or fuel price increases. It is difficult to understand the basis for this concern given that such adverse events would affect tourism under both the Factual and the Counterfactual.

Does the increase in tourist numbers take account of risk?

⁹ Source: Tourism New Zealand

Would there be sufficient air capacity and tourism infrastructure to cater for the 50,000 additional tourists?

Would there be sufficient air capacity and tourism infrastructure to cater for the 50,000 additional tourists?

11.122 The Commission asked whether an extra 50,000 tourists is achievable given aircraft capacity and tourism infrastructure constraints. Given that the load factors on virtually all sectors in Year 3 of the Factual are projected to be less than []%, air capacity will not be a significant constraint on the predicted level of tourist growth.

11.123 On the question of tourism infrastructure, New Zealand has historically accommodated annual growth rates in holiday arrivals of 6.7% pa since 1992, according to Statistics New Zealand. The growth rate in some years was considerably higher than this average, for example between 1999 and 2000 tourist arrivals increased by 11.2%, indicating that capacity is quite responsive to demand. Given that the 50,000 incremental tourists represent an increase of about 5% of the 1.07m holiday arrivals to New Zealand in 2002, tourism infrastructure capacity is unlikely to be a constraint on the projected growth.

Summary of QH's enhanced ability to expand New Zealand tourism

11.124 In summary, the Alliance will greatly improve the effectiveness of QH as a vehicle for promoting tourism to New Zealand:

- It gives QH access to the Air New Zealand Holidays brand, avoiding the need for a costly brand repositioning exercise.
- It gives QH access to a superior New Zealand domestic network, and improved connections between source markets and New Zealand.
- This will enable QH to improve and expand its range of New Zealand and dual destination products, which will allow it to market New Zealand more effectively through its powerful international distribution network.

11.125 The QH plan summarised in this section provides details of how it intends to tackle this on a market-by-market basis, bringing at least 50,000 additional tourists per year to New Zealand by the third year of the Alliance.

The Alliance will greatly improve the effectiveness of QH as a vehicle for promoting tourism to New Zealand.

Improved promotional effectiveness and levels

11.126 The Applicant's original submission argued that the Applicants would be able to improve promotional effectiveness by cooperating in advertising in their home markets, and by extending cooperative advertising with the Australian Tourist Destination and Tourism NZ. This would produce a concerted effort to promote Australia and New Zealand as a dual destination.

11.127 Modelling of these gains in promotional effectiveness indicated that this would increase net tourist arrivals in New Zealand by 13,277 per annum. The Commission expressed reservations with various aspects of the modelling of promotional effectiveness. This section provides a response to each of the Commission's concerns.

Estimated increase in promotional effectiveness

11.128 The Commission's doubts over the increase in promotional effectiveness seem to be at odds with advice it received and with the modelling of Professor Gillen. For example, the Commission cites Gulliver Pacific as stating that airlines "can

influence the choice of customers by price and promotion". Similarly, a feature of Professor Gillen's model (albeit one which the Applicants consider to be flawed) was that it was seen as being consistent with the incumbents being sales (revenue) maximisers "as this seems to better reflect their actual motivation in maintaining market share" (paragraph 666).¹⁰

11.129 If the incumbents are focused on maintaining market share and/or if they cannot influence the overall quantum of demand, then most if not all of their promotion would be rivalrous. Any changes which allow them to refocus their efforts on market expansion rather than contending for market share should allow a substantial proportion of their promotional budgets to be redirected to this end.

11.130 Consistent with this view, Qantas estimates that [] of its international advertising expenditure in Australia is dedicated to New Zealand destined traffic. Qantas indicated that virtually this entire amount could be considered tactical i.e. designed to drive passenger volume and therefore compete directly with Air New Zealand for sales and market share.

11.131 Viewed in this light, the assumption of a 10 per cent increase in promotion effectiveness is highly conservative.

The assumption of a 10 per cent increase in promotion effectiveness is highly conservative.

Effect of rivalrous promotion on market expansion

11.132 The Commission asserts that duopoly advertisers increase the overall market size through advertising. However, the Commission does not cite any research to support this assertion. Furthermore, this assertion is at odds with the submission from Gulliver's Pacific Group cited by the Commission, which contends that "airlines have little influence in the overall quantum of demand for a destination".

11.133 This section provides a short review of the literature on the economics of advertising, and concludes that, without a thorough analysis of the strategies of duopoly advertisers, the Commission is not in position to assess the impact of advertising on the overall market size.

The economics of advertising does not produce a definitive conclusion about the impact of promotional activity in a duopoly market.

Informational versus persuasive advertising

11.134 Informational advertising provides consumers with truthful information about price and quality. Firms advertise to inform consumers about the existence of product without aiming at changing their preference. Seminal papers on the analysis of advertising as enhancing information include Stigler (1961)¹¹, Telser (1964)¹² and Nelson (1970)¹³.

11.135 There is some consensus on information being socially beneficial. It genuinely adds to consumers' knowledge of what is available; it improves competition and consumer choice. Informational advertising serves as a tool for transmitting information from producers to consumers about (possibly differentiated) brands and thereby reduces consumers' cost of obtaining information about where to purchase their most-preferred brand.

¹⁰ The parties do not accept Gillen's assumption that airlines are revenue maximisers.

¹¹ Stigler G, 1961, "The Economics of Information", *Journal of Political Economy*, 69-3:213-25.

¹² Telser L, 1964, "Advertising and Competition", *Journal of Political Economy*, 72-537-62

¹³ Nelson P, 1970, "Information and Consumer Behavior", *Journal of Political Economy*, 78-2:311-29

- 11.136 Persuasive advertising, by contrast, aims to change consumer preferences or improve their perception of quality. Persuasion and welfare are analysed in classic papers such as Kaldor (1950)¹⁴, Dixit and Norman (1978)¹⁵ and Shapiro (1980)¹⁶.
- 11.137 Typically, persuasive advertising is seen as ‘manipulative’. It reduces competition and therefore reduces welfare for two reasons. First, it may persuade consumers wrongly to believe that identical products are differentiated. This is because the decision of which brand to purchase depends on consumers’ perception of what the brand is, rather than on the actual characteristics of the products. Second, advertising may serve as an entry-detering mechanism since any new entrant must advertise extensively in order to surpass the reputation of existing firms.

Search goods versus experience goods

- 11.138 Parallel to the different type of advertising, the products firms advertise may be search goods or experience goods. Consumers may learn about the quality and characteristics of Search Goods before purchasing them. As a result, informative advertising can reduce the uncertainty of poorly-informed consumers. Even if firms are otherwise identical, they can be “informationally differentiated”.
- 11.139 A key issue is whether firms provide the socially efficient level of advertising. Grossman and Shapiro (1980)¹⁷ find that oligopolists fail to internalise the full consumer surplus gain that is associated with their advertising, indicating that advertising may be undersupplied. However, it is also possible that advertising is excessively supplied, since each firm is motivated by the prospect of stealing business that would otherwise accrue to a rival firm. The model then includes “constructive and combative roles” for advertising. When the number of firms is sufficiently large, the business-stealing externality dominates, and the supply of advertising is excessive.
- 11.140 An experience good is distinguished by the fact that its quality, and hence its value to consumers, cannot be precisely determined by buyers at the time of purchase. There is, for example, an uncertainty about the quality of the product and, in line with Nelson’s (1974)¹⁸ arguments, advertising may signal the quality of an experience good. The return from advertising and achieving an initial sale is greater for a high-quality product due to the repeat purchases that follow. Schmalensee (1978)¹⁹ offers a formal investigation of this effect. He emphasizes that the marginal cost of production may be greater when a high-quality good is produced. Under the assumption that all sellers must charge the same price, it follows that the value of an initial sale may be greater when a low-quality good is sold, because the mark-up is larger. This effect can counter the repeat-purchase effect. Schmalensee demonstrates that low-quality brands may advertise more, if consumers are responsive to advertising and a sufficient cost difference exists between high- and low-quality production.

Conclusions

- 11.141 In summary, the economics of advertising does not produce a definitive conclusion about the impact of promotional activity in a duopoly market. Analysis of product

¹⁴ Kaldor N, 1950, “The Economic Aspects of Advertising”, *Review of Economic Studies*, 18:1-27.

¹⁵ Dixit A and Norman V, 1978, “Advertising and Welfare”, *Bell Journal of Economics*, 9-1:1-17.

¹⁶ Shapiro C, 1980, ‘Advertising and Welfare: Comment’, *Bell Journal of Economics*, 11-2: 749-52.

¹⁷ Grossman G and Shapiro C, 1984, “Informative Advertising with Differentiated Products”, *Review of Economic Studies*, 51-1:63-81

¹⁸ Nelson P, 1974, “Advertising as Information”, *Journal of Political Economy*, 82-4:729-54.

¹⁹ Schmalensee R, 1978, “A Model of Advertising and Product Quality”, *Journal of Political Economy*, 86-3:485-503.

characteristics and types of advertising is necessary to support any suggestion that duopoly advertisers increase market size in any particular case. Some important results on the relation between vertical product differentiation, endogenous levels of advertising and market structure underpin the works of, for example, Shaked and Sutton (1987)²⁰. The Commission's comments on advertising in a duopoly market do not include reference to prominent economic work in this area, or to the factors relied upon in that work. As a result, the Applicants do not accept the Commission's suggestion that economic analysis finds that duopoly advertisers increase market size. Rather, a finding more closely attuned with the economic literature is that duopolists are likely to advertise in ways that are socially inefficient. This distortion is less likely to occur under the Factual than under the Counterfactual.

Promotional elasticity estimates

11.142 The Commission expressed reservations regarding the estimate of promotional elasticity used in the promotional effectiveness modelling and the assumed increase in promotional effectiveness:

"The Commission is cautious about accepting the promotion effectiveness elasticities and doubtful of the assumed increase in promotional effectiveness. NECG cites one study by Crouch, Schultz and Valerio of promotional elasticities in support of the model's result. The Commission's investigations have suggested that promotion elasticities ranging from 0.15 to 0.25 are commonly reported by national tourism organisations and incorporated into formal models of tourism demand."

11.143 The elasticity of RPKs with respect to promotion expenditure used in the NECG analysis was 0.17. This lies in the range cited by the Commission in paragraph 764 of the Draft Determination. The fact that the derived elasticity is within the range of previously derived elasticities lends support to the use of the estimated elasticity to estimate the effect on arrivals of increased promotion effectiveness.

The use of RPKs as the dependent variable

11.144 The Commission also expresses reservations regarding the use of RPKs as the dependent variable in the promotional effectiveness modelling:

"On the estimate of promotion elasticities, the Commission notes that NECG's model has RPKs as its dependent variable, the variable whose value depends on the other parts of the model. The more relevant variable would seem to be the number of tourists. Since NECG compares its results with those obtained by Crouch, Schultz and Valerio, who use a model specified with tourist numbers as the dependent variable, it is curious that the NECG model is estimated for RPKs. The Commission has some reservations about the Crouch, Schultz and Valerio study, and about information on promotion elasticities gathered by NECG from industry sources. First the study's results are not as confident as the Commission would like. For example, the USA to Australia marketing elasticity is reported as 0.11, but the 95% confidence interval is 0 to 0.23. Second, while tourism authorities may be expert in the effectiveness of tourism promotions, using independent estimates of elasticities would avoid the perception of bias. Finally, it is not obvious that the NECG model includes the kind of lags that the Commission would expect to see in a model of international tourism marketing. Foreigners who see a persuasive advertisement for adventure in New Zealand might not respond straight away, as they might need to arrange leave from work or to save money"

The elasticity of RPKs with respect to promotion expenditure used in the NECG analysis was within the range cited by the Commission in the Draft Determination.

²⁰ Shaked A and Sutton J, 1987, "Product Differentiation and Industrial Structure", *Journal of Industrial Economics*, 36-2131-46.

11.145 RPKs are calculated by multiplying the number of passengers by the stage length. If the stage length remains constant across time, then the growth in RPKs will equal the growth in passenger numbers. That is, RPKs is simply passenger numbers scaled by a constant.

11.146 To examine this issue, the average growth rates of the two (seasonally adjusted) sample series, Passengers and Revenue Passenger Kilometres, were calculated and a test was performed to determine whether the two mean population growth rates are equal.

Two-Sample t-test Assuming Unequal Variances¹

Route	<i>t</i> -statistic	<i>Result</i>
Australia	-0.18944	Growth rates equal
USA	1.6580	Growth rates equal
Japan	0.00163	Growth rates equal

¹ *t*-statistics and degrees of freedom calculated following *Statistics for Management and Business, 4th ed.*, Keller and Warwick (1997)

11.147 All *t*-tests suggest that the two average population growth rates are equal, suggesting that the two series are identical in explanatory power. Thus either data series could be used to estimate the effect of promotion on arrivals in New Zealand. This was confirmed when the models were re-run using passenger numbers as the dependent variables. Almost identical elasticities were obtained (see table below).

Comparison of promotion elasticities with alternate dependent variables

Promotion elasticity of demand (%)	RPKs as dependent variables	Passenger numbers as dependent variables
Australia	0.0925	0.1004
North American	0.1537	0.1683
Japan/Asia	-0.0004	0.0001

11.148 The Commission also commented on the use of the Crouch et al study. The Crouch et al study was cited simply because it reported results which directly related to the effects on arrivals in Australia of promoting Australia in overseas markets. The promotion elasticities derived from the Crouch et al study were also similar to those derived from the NECG model. Apart from lending support to the results obtained from the NECG model, no other use was made of the Crouch et al study in the NECG analysis.

Summary of enhanced promotional effectiveness

11.149 For all of the above reasons, NECG is confident that the original estimate of a net positive impact of 13,277 visitors to New Zealand as a result of enhanced promotional effectiveness is reasonable.

11.150 It is important to note that this figure does not include any positive impact from *increased* levels of promotion other than those associated with the QH initiatives. There is a strong possibility that total promotional expenditure would rise under the Factual, given that the Alliance would increase the return from promotion and open up new marketing opportunities that would generate additional promotional expenditure. For example, Air New Zealand has informed the New Zealand Treasury that it will increase inbound promotional expenditure by 10 percent under the Alliance. Undertakings given to the ACCC commit the airlines to spending an additional A\$5.4 million on promotion in the year following the effective date of the Alliance. These increases in promotional expenditure have not been assumed in the modelling relied upon by the Applicants

NECG is confident that the original estimate of a net positive impact of 13,277 visitors to New Zealand as a result of enhanced promotional effectiveness is reasonable.

Other factors that will increase tourism demand

11.151 A number of other changes brought about by the Alliance are also likely to have a positive impact on the number of visitors to New Zealand. To avoid any possibility of double counting, no attempt has been made to quantify the magnitude of this impact. Nonetheless, a short description of four such changes is provided to further demonstrate that a conservative approach has been taken in estimating the benefits of the Alliance.

Capacity Management

11.152 The Alliance will permit both carriers greater flexibility in capacity management to meet travel demands to New Zealand in peak periods. This could enable one carrier to provide additional capacity without risking a competitive response from the other. Without co-operation a competitive response could make the additional capacity uneconomic for both parties. If the risk of an uneconomic competitive response exists, then it is likely that neither party would be willing to add the extra capacity and the opportunity could be lost and the potential increased tourist arrivals not realised.

A number of other changes brought about by the Alliance are also likely to have a positive impact on the number of visitors to New Zealand.

Improved Marketing Effectiveness of Independent Wholesalers

11.153 It should be noted that *all* travel wholesalers with access to Air New Zealand and Qantas tickets, not just QH, would be able to take advantage of the network enhancements and purchase flights on a combined Qantas-Air New Zealand network to offer better and more economical itineraries. Although the Applicants have not attempted to quantify this effect, it is likely that independent wholesalers would be able to attract additional incremental tourists, over and above those attracted through the parties' initiatives.

Prominence in Global Reservations Distribution Systems

11.154 Tourism to New Zealand will benefit from increased exposure with improved connections and a significantly increased number of displayed flights in the global reservations distribution systems (GDS) to, from and within New Zealand due to Air

New Zealand/Qantas code-sharing, once part of the Alliance²¹. This additional exposure will be further enhanced by the promotion of Qantas code-share flights by Qantas' larger global sales force.

South America

- 11.155 South America has not been a core market for either Air New Zealand or Qantas. However, the opportunity exists to develop it further for Trade, Tourism and VFR, particularly if the economic climate stabilises and improves. Individually Air New Zealand and Qantas have not had the critical mass to maintain a market presence themselves in South America and have instead relied upon relationships with South American carriers. These previous code-share and alliance arrangements have been affected by the uncertain financial position of the South American carriers, and this has restricted market development.
- 11.156 The Factual schedules as submitted to the Commission show Qantas operating to Santiago. While South America has not been included in the QH plan as a source market, the Santiago route is part of the JAO. An alliance relationship may create the opportunity for both carriers to share the risk and develop this market by promoting tourism to Australia and New Zealand.

Capacity and fare changes

- 11.157 The Commission suggested that the detrimental impact of the Alliance on foreign tourist arrivals in New Zealand, a net reduction of 10,333 inbound tourists, may have been underestimated, presumably because the Commission believes the competitive detriments have been underestimated.
- 11.158 In practice, the Alliance is likely to have very little adverse impact on fares at the tourist end of the market, and especially on those from long haul destinations. The parties have nonetheless adopted a conservative approach, and assumed that a Cournot model, that takes no account of the lower fares typically offered to the most elastic segments of market, could be used to estimate price and output impacts. Subsequent to the original submission changes have been made to the model used to calculate the impacts of the Alliance. As a result of these changes, price and capacity effects are estimated to reduce tourism in New Zealand by 2,867 persons in year three²².
- 11.159 That said, it is worth emphasizing that experience, analysis and common sense all suggest that fares to the most elastic market segments would remain low, and would be constrained by the fact that tourists have a wide choice of potential destinations. As a result, the estimated economic impacts, which are based on the modelled outcomes, over-state rather than under-state any adverse impacts the price changes may have.

The estimated economic impacts, which are based on modelled outcomes, over-state rather than under-state any adverse impacts that price changes may have.

²¹ Though Air New Zealand and Qantas might benefit from enhanced GDS exposure, the Alliance would not enable Air New Zealand and Qantas to foreclose other airlines from any of the relevant air service markets through these systems.

²² The changes to the model are detailed in letters to the Commission dated 20/1/2003 and 5/3/2003.

Possible withdrawal by Air New Zealand from Star Alliance

11.160 One of the potential negative effects of the Alliance highlighted by the Commission was the impact of Air New Zealand's withdrawal from the Star Alliance. The Commission took the view that this would adversely affect:

- the marketing effectiveness of Air New Zealand Holidays;
- the ability of members of other Star Alliance airlines' rewards schemes to redeem their points on flights to New Zealand;
- the promotional effectiveness of the airlines and Tourism New Zealand;
- the convenience of travel to New Zealand;
- the range of products available to tourists seeking to travel to New Zealand; and
- the ability of travel agents to find competitive deals for their customers.

11.161 The Commission noted that the losses from Air New Zealand leaving the Star Alliance might be minimal if other Star Alliance partners were able and willing to provide sufficient capacity to New Zealand.

11.162 Although the loss of Star Alliance from the New Zealand market could potentially have a negative impact on tourism, such a loss is unlikely to occur. Air New Zealand has stated that it should not be presumed that it will leave Star Alliance.

[]

11.163 In addition, other Star Alliance airlines currently fly to New Zealand and it is possible that others may decide to do so, particularly if Air New Zealand were to leave Star. Any negative effects would therefore be delayed, and would be minimized by the availability of other Star Alliance airlines. They would also be offset by gains from Air New Zealand membership of oneworld, which it would be likely to join if it decided to leave Star.

11.164 Finally, most of the potential effects identified by the Commission are in areas where the Alliance will produce benefits substantially greater than those currently provided by the Star Alliance.

Effect on marketing effectiveness of Air New Zealand Holidays

11.165 Contrary to the Commission's assumption, the Star Alliance makes no contribution to Air New Zealand Holidays' marketing effectiveness. Air New Zealand does not offer Air New Zealand Holidays products abroad except in Australia and Japan (Blue Pacific Tours). Star do not promote these products in either market. Any detriment to Air New Zealand Holidays from Star withdrawal would therefore be very minor and would in no way compare with the very considerable advantages in product development, distribution, and promotion offered by the Alliance.

Effect on points redemption travel

11.166 The main impact on tourism as a result of possible Star withdrawal would come from the loss of redemption travel. The main market in which this would occur is North America. In the twelve months to April 2003 []% of Air New Zealand

Most of the potential effects identified by the Commission are in areas where the Alliance will produce benefits substantially greater than those currently provided by the Star Alliance.

passengers on the AKL to LAX route were Star Alliance redemption travellers (excluding Air New Zealand Airpoints travellers). As Air New Zealand is currently the only Star Alliance airline to fly direct from North America to New Zealand, once its redemption obligations came to an end, North American redemption passengers to New Zealand would need to travel on United Airlines to Australia from where they could use another Star Alliance carrier to cross the Tasman. However, it is very likely that in the intervening period United or other Star carriers, such as Air Canada, would introduce new direct flights to New Zealand²³. The possibility of a return by United should not be discounted – it has recently restored capacity into Australia.

- 11.167 Other markets are less affected because a smaller proportion of Air New Zealand customers are Star redemption passengers, and there would also be more options for redemption passengers should Air New Zealand exit Star. For example, in Asia-Pacific (including Japan), about []% of customers were Star redemption passengers in the 12 months to May 2003, and redemption passengers can utilise SQ, TG and Asiana to travel to New Zealand. Air New Zealand has a bilateral agreement with JAL outside Star, so redemption travel from Japan would not be impacted if Air New Zealand left Star.
- 11.168 If Air New Zealand were to leave the Star Alliance, it would be likely to join the oneworld Alliance. Therefore any potential loss of redemption travel by Star passengers would be offset to a large extent by increased redemption travel by oneworld passengers. For example, members of American Airlines' frequent flyers scheme would be able to redeem their points on Air New Zealand flights from LAX to AKL through oneworld, thereby partially offsetting the loss of United Airlines redemption travellers. In addition, it is likely that only a proportion of the current redemption passengers would substitute elsewhere if they could no longer redeem their points on direct flights to New Zealand.
- 11.169 The Alliance will not adversely affect existing Air New Zealand and Qantas frequent flyer members. Once the Alliance is fully implemented, Air New Zealand Airpoints members and Qantas Frequent Flyers will be able to earn and redeem points on their alliance partner airlines as well as on both Air New Zealand and Qantas.

Effect on Air New Zealand's promotional effectiveness and Tourism New Zealand

- 11.170 Withdrawal from Star would have a minimal impact on the promotional effectiveness of Air New Zealand. This impact would be more than offset by the much greater promotional benefits offered by the Alliance. More importantly however, the effects on the promotion of New Zealand as a destination would be negligible. Star is a global alliance of airlines, primarily directed to securing increased global market share. It promotes the benefits of travelling on Star Alliance airlines through benefits such as lounge access, frequent flyer points and premium check in facilities. It does not promote destinations.
- 11.171 Tourism New Zealand derives no benefit from Air New Zealand's membership of the Star Alliance.

Effect on the convenience of travel to New Zealand

- 11.172 The considerable benefits of the Alliance to international tourists have already been set out. These include network enhancements, product enhancements and better marketing and distribution. The combined effect of these benefits will be to

²³ The Factual has been modelled on the basis of re-entry of a US carrier in year three.

considerably improve the convenience of travel to New Zealand. The effect of Star withdrawal is likely to be modest in comparison. The principal advantage of Star to tourists is its extensive global network. However, the network created by the Alliance plus Qantas' membership of oneworld will provide similar global reach but with much greater convenience for travellers to New Zealand as a result of the greater variety of routes and greater frequency of flights available, as well as the option of triangulated fares.

Effect on the range of products available to tourists seeking to travel to New Zealand

11.173 Air New Zealand is the predominant promoter and supplier of New Zealand tourism products within Star and would continue to promote and supply these products even if it were not part of Star. Star Alliance does produce some products such as Round the World fares, however most of these are replicated by oneworld. In addition, a much greater range of products, including combined Air New Zealand / Qantas products, will be available to tourists under the Alliance.

11.174 If Air New Zealand were to leave the Star Alliance and join the oneworld Alliance, it would be able to sell oneworld products in addition to Air New Zealand/Qantas products. For example, passengers from the UK and Europe to New Zealand would be able to take advantage of BA and Qantas' connections from Europe into all of Air New Zealand's Pacific Gateways (Singapore, Hong Kong, Tokyo, Los Angeles, etc.).

11.175 [

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Effect on the ability of travel agents to find competitive deals for their customers

11.176 The Alliance will result in much more effective promotion of New Zealand as a tourist destination in overseas markets. It will also allow more efficient use of existing capacity, increasing the likelihood of finding availability at peak periods. It will therefore increase, not decrease the ability of travel agents to find competitive deals for their customers.

Summary of impact of possible Air New Zealand withdrawal from Star

11.177 In summary, it is not certain that Air New Zealand would withdraw from Star under the Factual and, if it did so, the net effect on tourism is expected to be negligible for the reasons set out above. [

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If Air New Zealand were to leave the Star Alliance and join oneworld the detriments of leaving Star would be largely offset by the benefits of oneworld membership.

Total net tourism impact

11.178 The total impact on tourism from the effects considered in this section of this Chapter is summarised in the table below.

Net Impact of Alliance on New Zealand Inbound Tourism

Factor	Net impact on New Zealand tourism
2.1 Improved Air New Zealand capabilities	Significant increase expected, but to avoid any possibility of double counting, this has not been quantified
2.2 Changes Qantas / QH incentives to promote New Zealand tourism	Increase of 50,000
2.3 Improved QH capabilities as a vehicle for promoting New Zealand tourism	
2.4 Increased promotional effectiveness	Increase of 13,277
2.5 Fare and capacity changes	Decrease of 2,867
2.6 Other factors	Significant increase expected, but to avoid any possibility of double counting, this has not been quantified
2.7 Potential Air New Zealand move from Star to oneworld	It is not certain that this would happen, and the net effect is expected to be negligible if it were to occur
Total net impact	60,410

The total net impact that has been used for estimating public benefits is a net increase of 60,410 tourists in year three. This is a conservative estimate because it ignores many Alliance induced effects.

11.179 The total net impact that has been used for estimating public benefits is a net increase of 60,410 tourists in year three. This is a conservative estimate because it excludes any benefits from the following Alliance-induced effects:

- The impact of Air New Zealand’s increased marketing effectiveness over and above the initiatives described in the QH plan;
- Increased levels of promotion by the parties;
- The ability of independent wholesalers with access to Air New Zealand and Qantas tickets to develop improved offerings using the improved air product created by the alliance;
- Improved capacity management; and
- Greater prominence in GDS systems.

PUBLIC BENEFITS OF ADDITIONAL TOURIST DEMAND

Introduction

11.180 This Chapter has so far provided details as to how the Alliance expects to expand New Zealand tourism by at least 60,000 tourists in year three and why this result could not be achieved by the airlines acting independently.

11.181 The additional tourists generated by the Alliance translate into a broader public benefit to New Zealand. NECG estimated the magnitude of those benefits based on:

- the expected expenditure of the incremental tourists; and
- an estimate of the welfare benefits of the additional expenditure using a general equilibrium model.

11.182 The Commission expressed concerns regarding both the average tourist expenditures estimate that was used and the approach taken to converting the increased expenditures into public benefits. It concluded that the range of public benefits inferred from the modelling results, and from different assumptions about changes to tourist numbers, suggest that the welfare effects of the impact on tourism will be much smaller in magnitude than projected by NECG.

11.183 NECG supports its previous modelling approach, but has adjusted certain modelling assumptions as a result of further analysis of the welfare gains associated with an expansion in exports of tourism compared to increased domestic tourism by a country's own citizens. These adjustments reduce the total welfare benefits from \$148 million to \$NZ 73 million. However, the conclusion based on the welfare modelling remains the same, namely that the Alliance will deliver substantial welfare benefits to New Zealand, well in excess of the detriments discussed later in this Chapter.

11.184 The approach is discussed in this section, together with specific concerns relating to public benefits that were raised by the Commission.

Average expenditure

11.185 As the first step in calculating the net benefits of the increased net tourist flows to New Zealand, the expected expenditure of these incremental tourists was estimated. The incremental tourists generated by the Alliance were assumed to undertake expenditure in New Zealand similar to that of the average visitor. Where the country of origin was known, a country-specific average spend amount was used. Where the country of origin of an additional tourist was unknown, an average expenditure figure for all tourists was used.

Average expenditure estimates

11.186 The Commission was concerned that the estimates used may have been optimistic, and that lower estimates might have been more realistic. This section explains why the estimates used are in fact highly conservative.

The Alliance will deliver substantial welfare benefits to New Zealand, well in excess of detriments.

The expenditure estimates used are highly conservative.

11.187 TFI provided average expenditure estimates to NECG as per the table below.

Average Spend Estimates for Visitors to New Zealand

	Australian Visitors	Non-Australian Visitors	All Visitors
Total Spend (\$NZm) ex International airfares	932	4,733	5,663
Visitors ('000s)	524	1,198	1,722
Average (\$NZ)	1,770	3,951	3,289

Source: New Zealand International Visitor Survey, 12 Months to June 2002, Tourism New Zealand

11.188 These are in fact very conservative estimates of average expenditure as most of the incremental tourists would be travelling on a non-group package, and travellers on non-group packages spend more than the average tourist. Average expenditure for travellers on non-group packages is detailed below.

Average Expenditure for Non-Group Package Visitors to New Zealand

	Australian Visitors	Non-Australian Visitors²⁴	All Visitors
Average Spend (\$NZm) ex International Airfares	3,561	5,225	4,776

Source: New Zealand International Visitors Survey, 12 Months to June 2002, Tourism New Zealand

11.189 The reason that such conservative expenditure estimates were used was partly in recognition of the fact that 50% of the 36,000 additional non-Australian visitors will be dual destination tourists, which is a higher proportion than normal (35%), and dual destination tourists tend to spend somewhat less than average. The diluting effect of this higher than average proportion of dual destination tourists on average expenditure is relatively small (less than 5%, as explained in response to specific questions below) and is easily accommodated by the use of very conservative average expenditure estimates, which are over 30% lower than the average expenditure of tourists visiting New Zealand on holiday packages.

Specific questions

11.190 The specific concerns expressed by the Commission are discussed in more detail below.

Would the incremental tourists attracted by QH's initiatives spend less than the average tourist because they are "marginal" tourists?

11.191 The Commission noted that it had received advice to the effect that the incremental tourists generated by the Alliance might spend less than the average tourist.

11.192 The argument seems to be that the incremental tourists would have a lower level of outlays than the average tourist because they were in some sense marginal. This

Would the incremental tourists attracted by QH's initiatives spend less than the average tourist because they are "marginal" tourists?.

²⁴ Average weighted by projected source country mix in QH plan

is incorrect, as it confuses the consequences of moving **along** a given demand curve with those of a shift **in** the demand curve. What is happening here is that tourists who might otherwise have gone elsewhere are being attracted to New Zealand. In other words, the demand curve for in-bound tourist services in New Zealand has shifted out because of the product, distribution and promotional enhancements created by the Alliance. This is in stark contrast to a strategy which stimulates marginal demand by using price reductions to capture new, more price-sensitive tourists.

11.193 Expanding on this point, it is correct that a move along a given demand curve for in-bound tourism would involve sales to parties with progressively lower willingness to pay. Even in that case, it could be misleading to assume that the total outlays of the marginal tourist would be below the average tourist outlays: where consumers fall on the demand curve is essentially a measure of how elastic their demand for travel to New Zealand is, not of how much or little they intend to spend should they come to New Zealand.²⁵ That said, what is at issue here is not a move along a given demand curve: it is an outward shift in the demand curve.

11.194 Under these circumstances, there is no reason whatsoever to assume that the expenditure of the incremental tourists will fall below the average expenditure recorded at the equilibrium on the previous demand curve. Rather, one could expect the outward shift to increase average outlays, which will make the approach adopted here conservative.

Would the incremental tourists attracted by QH's initiatives spend less than the average tourist because of the higher proportion of dual destination tourists?

11.195 The Commission also expressed concern that the incremental tourists generated by QH's initiatives would spend less than average because of the high proportion of dual destination tourists in this group:

"Part of the tourism benefits come from stimulating dual destination tourism. However, Tourism New Zealand's submission advised that mono-destination tourists stay longer, spend more and travel more broadly within New Zealand.

11.196 While the Commission's concern may be valid in theory, in practice its impact is not material. In any case, the impact of the Commission's concerns has been compensated for by the use of conservative average spend figures in calculating tourism benefits. A detailed explanation follows.

11.197 According to IVS data obtained from the Ministry of Tourism for the year ending December 2002, visitors to New Zealand that also visited Australia spent an average of 16.5 days in New Zealand. Their average daily expenditure was \$197, and their average total spend was \$3,233. Mono visitors to New Zealand spent an average of 26.6 days in New Zealand. The average daily spend of these visitors was \$170, and the average total spend was \$4,524.

Would the incremental tourists attracted by QH's initiatives spend less than the average tourist because of the higher proportion of dual destination tourists?

²⁵ For example, a high total outlay customer may be indifferent between going to New Zealand and going elsewhere. In that event, even a slight price differential between New Zealand and the alternative destination will drive that passenger elsewhere. Conversely, a low total outlay passenger may have a strong preference for New Zealand and be willing to go to New Zealand even when the New Zealand price is somewhat higher than that elsewhere. The NZCC's argument seems to confuse marginal and total utilities and infer a correlation between **total** outlays and **marginal** utilities where no such correlation exists.

- 11.198 The average expenditure of a typical mix of dual and mono destination tourists would therefore be $35\% \times \$3,233 + 65\% \times \$4,524 = \$4,072$. However, the QH plan projects that 50% of the 36,000 new non-Australian tourists would be dual destination visitors. Therefore, the average spend for these 36,000 new tourists would be $50\% \times \$3,233 + 50\% \times \$4,524 = \$3,879$. In other words, the 36,000 new non-Australian tourists would have an average expenditure only 4.8% lower than the average for non-Australian tourists. Naturally, the average spend of the additional 14,000 Australian tourists would not be affected in this way.
- 11.199 As explained above, this slight dilution of average spend by the higher-than-average proportion of dual destination visitors is more than offset by the use of a very conservative average spend figure for the welfare calculations.
- 11.200 It is also relevant to note that dual destination tourists are higher yielding visitors than average, spending more per day than mono destination tourists while presumably consuming less natural resources because of their shorter average stay.

Welfare benefits

- 11.201 The Commission expressed a view that the tourism effects had not been appropriately converted into public benefits. This section discusses the Commission's concerns and describes adjustments to the approach adopted for estimating welfare benefits.

Treatment of labour in general equilibrium modelling

- 11.202 The Commission took the view that the assumption of fixed wages used in the original GTEM model was not appropriate. NECG sought advice from Professor Peter Dixon of Monash University, a recognised expert in the construction and use of General Equilibrium Models for policy analysis, regarding the appropriate treatment of labour in a Computable General Equilibrium model. Professor Dixon's advice supports the approach adopted by NECG of simulating the Alliance under the assumption of fixed real wages in the short term.
- 11.203 Professor Dixon has indicated that when undertaking policy simulations he normally assumes that real wage rates are sticky in the short run and flexible in the long run. This means that policy shocks can lead to changes in aggregate employment in the short run. However, for the long run, he usually assumes that real wage rates adjust so that shocks have no effect on aggregate employment.
- 11.204 Professor Dixon also noted that some modellers prefer to rule out employment-changing effects of shocks even in the short run. They assume that there is complete flexibility in the wage rate. Thus, adverse shocks are met with an immediate reduction in wages sufficient to prevent any reduction in employment. Similarly, favourable shocks are met with an immediate increase in wages sufficient to choke off any increase in employment. Professor Dixon believes this approach to be descriptively unrealistic. Wage adjustments *are* sluggish, shocks *do* cause changes in aggregate employment, and the short-run employment effects of shocks *are* of critical importance to policy makers.
- 11.205 Consideration of these issues is particularly relevant for the New Zealand economy as unemployment is expected to rise from about 5.2 per cent in March 2003 to 5.6 per cent in 2006 before falling back to 5.2 per cent in 2007²⁶ These figures imply an

Advice from Professor Peter Dixon supports the approach adopted by NECG of simulating the Alliance under the assumption of fixed real wages in the short term.

²⁶ Hon. Dr. Michael Cullen, Minister of Finance, Budget 2003, Fiscal Strategy Report, 15 May 2003, Table A4.1.

increase in numbers unemployed of more than the estimated employment impact of the Alliance. They are also plainly inconsistent with the assumption of such complete wage flexibility that the labour market clears on a continuous basis. Both these forecasts and the advice of Professor Dixon support the approach adopted by NECG of simulating the Alliance under the assumption of fixed real wages in the short term.

- 11.206 The Commission also cites an article by Dwyer, Forsyth, Spurr and Ho in which it is proposed that the welfare effect of an expansion in tourism is found by deducting from GDP the resources used to generate the expansion in tourism. Thus if the expansion in tourism drew labour from the pool of unemployed, the Dwyer et al approach would net out this gain from the calculation of the welfare gain from the expansion in Tourism.
- 11.207 Professor Dixon disputes this approach, which essentially assumes that the unemployed gain utility from the leisure associated with their unemployment and indeed that they are at the margin of indifference between the leisure involved in unemployment and the real wage they secure once employed. Professor Dixon's view is that "leisure" derived from involuntary unemployment is not a positive good. NECG is not aware of any widely used contemporary economic model that assumes, for purposes of medium term policy analysis, that unemployment is largely voluntary²⁷.

Additional resources required to achieve an expansion in tourism

- 11.208 The Commission expressed a concern that the cost of the additional resources required to service the additional demand had not been taken into account in estimating welfare benefits:

"The Commission considers that if sufficient demand were to exist, then resources would be diverted to supply services to meet it. To the extent that these resources were scarce, they would be likely to cost more per additional tourist, and this would be likely to diminish overall benefits. This is another justification for valuing the contribution of additional tourists to public benefits as being less than the Applicants suggest."

- 11.209 The use of the CGE model to value benefits from an increase in tourism does account for the additional resources needed to achieve the expansion in tourism. Indeed, it is this expansion in demand for employed resources which drives the terms of trade gain observed in the simulation results. The welfare measure that was used to value the tourism expansion incorporated all these effects.
- 11.210 The welfare effects of an expansion in tourism also depend heavily on whether an expansion in airline capacity is required to meet the increased demand by tourists. The parties believe that the additional tourists modelled by NECG can be accommodated within the capacity indicated by the Factual schedules. Thus the increased tourists will result in increased load factors on the parties' aircraft, which is effectively an increase in productivity.

The use of the CGE model to value benefits from an increase in tourism accounts for the additional resources needed to achieve the expansion in tourism.

²⁷ The test that is relevant to the proposed authorisation is that of the costs and benefits for the period for which authorisation is being sought. This is a period of five years.

Measurement of Welfare gains

- 11.211 In the original submission, NECG based its calculation of the welfare effects of an expansion in tourism on a multiplier that captured the increase in what ABARE calls Real GNP per dollar increase in tourism exports. ABARE had indicated that Real GNP is an appropriate welfare measure in the GTEM model.²⁸ However, the Commission took the view that this was not an appropriate welfare measure.
- 11.212 Professor Dixon was consulted on how the welfare gain associated with an expansion in tourism should be measured. Professor Dixon noted that, in many MONASH simulations, he assumes that the shock under consideration does not affect the path of public consumption. In these circumstances, the main input to a calculation of the welfare effect of the shock should be the deviations from the base case forecast path in real private consumption. Because computations can be conducted only for a limited number of years, it is also necessary to consider the effect of the shock on the value of national wealth at the end of the final simulated year.
- 11.213 In place of deviations in real private consumption, some modellers prefer to use measure of the compensating and/or equivalent variation. Compensating variation is the amount of money that could be taken away from households in the policy situation (that is the situation after the shock under consideration has been implemented), leaving them with just sufficient money to achieve the base case or forecast level of welfare (often measured via a utility function). Equivalent variation is the amount of money that must be given to households in the forecast situation so that they can just achieve the policy level of welfare. In practice, Professor Dixon has found that the concepts of compensating and equivalent variation do not add much to policy discussions and at the same time cause considerable confusion. Generally Professor Dixon has found that compensating variation, equivalent variation and private consumption deviation give very similar results for the welfare effects of a shock.

Welfare estimates produced by the MONASH model

- 11.214 NECG have previously provided the results of simulations of an expansion of tourism in the MONASH model of the Australian economy. These results indicate that an expansion in tourism would generate an increase in welfare, averaged over five years, ranging from about 50 per cent of the increased tourism expenditure associated with a switch from imported to domestic tourism up to over 100 per cent of the increase in exports of tourism.
- 11.215 When the multipliers derived from the Monash modelling are applied to the estimated tourism effects of the Alliance, the calculated tourism welfare benefit for New Zealand falls from \$NZ148 million to \$NZ73 million. The drop is caused because import replacement of tourism by New Zealanders generates about half the welfare benefit assumed in NECG's original modelling.

Welfare estimates produced using alternative models

- 11.216 Two other models were used to provide alternative estimates of the welfare gains associated with the increase in New Zealand tourism. ABARE were asked to re-run the tourism simulations using the GTEM model in dynamic mode, using fixed

²⁸ Hom Pant, Stephen Brown, Benjamin Buetre and Vivek Tulpule, Measurement and decomposition of welfare changes in GTEM, paper presented to Third Annual Conference on Global Economic Analysis, Monash University, Melbourne, 27-30 June 2000.

real wages for the years 2005 to 2007 and fixed employment thereafter. The Infometrics model was also used to provide estimates of welfare multipliers associated with an expansion in tourism. The multipliers produced by these models are summarised in the table below.

**Alternate sets of welfare multipliers to value an expansion in tourism
(\$ welfare/\$ increase in tourism)**

Model	Welfare measure	Expansion in exports	Expansion in domestic tourism	Comment	Benefits to New Zealand
Infometrics	Change in real consumption	1.49	0.91	Short run result for 2004–05	\$132.9m
ABARE/GTEM	Change in real consumption	0.62	0.43	Average 5 years to 2008	\$65.7m
Monash Model	Change in real consumption	1.04	0.52	Average 5 years to 2007	\$73.2m

The welfare gains derived using the Monash welfare multipliers are estimated at NZ\$73.2 million. Gains derived using other multipliers are estimated to range between NZ\$66 million and NZ\$133 million. The Infometrics model, which yields the highest welfare gain, is specifically designed as a model of the New Zealand economy.

11.217 Welfare gains associated with the tourism expansion derived using the ABARE welfare multipliers are estimated at NZ\$66 million, only slightly smaller than those generated using the Monash welfare multipliers, while the Infometrics model yields a substantially higher welfare gain of NZ\$133 million. The Infometrics model, which yields the highest welfare gain, is specifically designed as a model of the New Zealand economy.

CONCLUSION

11.218 The Alliance will expand New Zealand tourism through the operation of a range of interrelated opportunities that will allow the parties to create new and improved New Zealand tourism products, and effectively promote and sell them across the world. This will attract at least 60,000 net new tourists to New Zealand – tourists that would otherwise have chosen to visit other countries. The net public benefit to New Zealand of this market expansion would be approximately NZ\$73 million in year 3 of the Alliance.²⁹

11.219 The opportunity to increase New Zealand tourism that is offered by the Alliance is unique. No other airline, or any other conceivable airline alliance, has comparable network advantages for serving New Zealand tourism, nor do they have comparable promotion and distribution abilities. Under the Alliance the Applicants will have both the ability and the incentive to exploit the opportunities for increasing tourism to New Zealand that are detailed in their application to the Commission. As a result, they are confident that the Alliance will achieve the benefits outlined in this submission.

²⁹ The change in public benefits is a result of the use of revised welfare multipliers to covert increases in tourism exports and domestic tourism to welfare gains. Welfare gains associated with tourism expansion derived using different models range from NZ\$66 million to NZ\$133 million. Welfare gains derived using the Monash welfare multipliers are estimated at NZ\$73.2 million. Gains derived using ABARE welfare multipliers are estimated at NZ\$66 million. The Infometrics model yields a substantially higher welfare gain of NZ\$133 million. The Infometrics model, which yields the highest welfare gain, is specifically designed as a model of the New Zealand economy.