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AIR TRANSPORT LIBERALISATION IN EUROPE

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INTRODUCTION

1. I aim this morning to give you an outline of the history and the effects of air transport liberalisation in Europe, which has now been in place for almost ten years. I shall organise my presentation under the following headings:

1. BACKGROUND
2. THE ECONOMIC REGULATORY FRAMEWORK
3. THE TECHNICAL REGULATORY FRAMEWORK
4. CONSTRAINING FACTORS
5. KEY INDICATORS OF EFFECTS OF LIBERALISATION:
 - Industry structure
 - Output
 - Competition
 - Fares
6. CONCLUSION

BACKGROUND

2. By developing two international agreements in 1987 which permitted partial capacity and tariff liberalisation, the European Civil Aviation Conference (ECAC) took the first steps in Europe towards liberalising the air transport market. However it was within the European Community (EC) that rapid progress towards full liberalisation was achieved.

3. The primary legislative framework for air transport liberalisation in the EC was adopted between 1987 and 1992, coming fully into effect in April 1997. The main changes, which came into force in 1993, were introduced against a background of actual or impending recession; of major national

airlines with relatively high cost levels and dominant in their home markets (and in some cases heavily dependent on state aid); and of increasing congestion at many of the Community's major airports.

4. Liberalisation of aviation within the EC brought together a number of distinct national markets into a single internal market, but did not in itself affect the existing bilateral air services agreements between Member States and countries outside the EC. The creation of the single aviation market paralleled moves to a single internal EC market across a whole range of economic activity in both goods and services. These changes were put into law, and subsequently enforced, by the Community institutions. Establishing the single aviation market in Europe was comparable to the earlier airline deregulation in the United States in the sense that it was carried out under a common political and judicial framework.

5. Compared to the US market, journey lengths within Europe tend to be much shorter, averaging less than 700kms on the denser routes between EU states, and a higher proportion of passengers begin or end their journeys at hub airports. This places greater emphasis on head-to-head route competition, and also means that intra-EC air services increasingly face strong competition from other modes, particularly high-speed rail.

6. Early in the liberalisation process the EC reached agreement with the European Economic Area (EEA) countries, including Norway and Iceland, bringing them inside the single aviation market. Similar arrangements with Switzerland have recently come into force, and the single aviation market is soon to be extended to include ten other Central and Eastern European countries, creating the "European Common Aviation Area".

THE ECONOMIC REGULATORY FRAMEWORK

The "Third Package"

7. Prior to 1993 the air transport market within the EC was a collection of national markets, with air services between them governed by traditional bilateral agreements. Although some of these agreements were relatively liberal, others contained significant restrictions on market access, capacity, frequencies or pricing, and all contained traditional ownership and control clauses. Domestic services (cabotage) were governed by national rules.

8. The progressive liberalisation of the Community's aviation market, which culminated in the so-called "Third Package" of 1992, dismantled these regulatory barriers to entry and competition. Most fundamentally it introduced the concept of a "Community air carrier", which must be majority owned and effectively controlled by EC interests. Any airline meeting this condition, and which complies with specified safety and financial requirements, must be granted an Operating Licence by the Member State in which has its registered office and principal place of business. In general terms, the Third Package entitled an airline with an Operating Licence to provide services anywhere in

the Community, offering frequencies and capacity as it chooses, and allowed carriers to set fares freely, subject to regulation only in closely defined circumstances. But the 1992 legislation also provided a transitional period during which some restrictions on access to domestic routes could be maintained until 1997.

Competition Rules

9. The removal of restrictions on market entry, capacity, frequency and pricing resulting from liberalisation placed greater emphasis on the use of normal competition law to safeguard against anti-competitive behaviour and abuse of market power. The European Commission is responsible for applying the competition rules of the EC Treaty to air transport within the Community, including assessing the competition implications of proposed airline mergers and alliances. The Commission has adopted specific block exemptions permitting certain categories of agreements in air transport, notably for slot allocation, removing the need for operators to apply for individual exemptions each time they participate in these practices.

State Aid

10. In the early 1990s a number of major carriers in Europe were dependent on state support. To promote efficiency and ensure fair competition in the new liberalised environment the Commission applied the EC Treaty's provisions on state aid to the airline sector strictly. It attached a clear "one time, last time" condition to any state aid that it approved, leaving no doubt that a further injection of state aid not in accordance with the "market economy investor principle" would be considered only in the most exceptional of circumstances and in light of unforeseeable events external to the company.

Associated Measures

11. The Community has adopted a number of other legislative measures to accompany the freedoms granted under the Third Package, in particular aimed at enabling airlines to secure fair access to key infrastructure and services. Common rules were established in 1993 for the allocation of slots at congested Community airports, ensuring non-discriminatory treatment for airlines whilst giving a degree of priority to new entrants in the allocation of available slots. The market for ground-handling services at EC airports was progressively opened to greater competition in 1996 in order to reduce operating costs for airlines and improve the quality of handling services. A code of conduct for computer reservation systems, introduced in 1989 and subsequently amended, aimed to ensure that the distribution of airline products was neutral and non-discriminatory between airlines. The Community has also adopted consumer legislation, for example on compensation in the event of denied boarding, primarily to protect passengers but also to ensure fair competition between airlines. It is noteworthy that much of the preparatory technical work underlying this associated EC

legislation, notably on slots and on computer reservation systems, was undertaken initially in ECAC.

THE TECHNICAL FRAMEWORK

12. Harmonisation of **safety** standards was not seen as a prerequisite to liberalisation of the European air transport market, but since the early 1990s significant progress has been made towards achieving common safety standards in the single market through Community legislation. A number of Joint Aviation Requirements (JARs) in the fields of airworthiness and maintenance of aircraft and products have been incorporated into EC law, and on many occasions the Member States of the Community have taken co-ordinated positions in ICAO and other international organisations. After prolonged negotiations the Community has now established a new European Aviation Safety Agency (EASA), which in the first instance will take over rule-making and type certification for airworthiness, and in due course will extend its remit to cover operations and personnel and (in all likelihood) to safety of airports and air traffic management

13. There has been some legislative harmonisation of equipment in the field of **air traffic management (ATM)**, and the Community is on the point of acceding to EUROCONTROL. The Commission has also made far-reaching proposals for a "Single Sky" in Europe, which would involve much extended regulation of ATM at EU level.

14. In the **environmental** arena, Community-wide action has focused primarily on aircraft noise rather than gaseous emissions. In particular, legislation in 1992 enshrined the agreement reached in ICAO in 1990 to phase out Chapter 2 aircraft by 2002, setting out a seven-year transitional process.

CONSTRAINING FACTORS

15. Two external factors have constrained significantly the response of the European airline industry to liberalisation, affecting the degree to which new competition has been stimulated, and inhibiting changes in the structure of the industry.

16. The impact of liberalisation in terms of new entry and development of competition on many of the denser routes within Europe has been constrained by the lack of capacity at key airports. While existing aviation infrastructure has shown considerable ability to handle increased demand, scope for further expansion within the existing infrastructure at certain airports such as Heathrow is strictly limited. Well over half of the 20 densest routes within the Community have a seriously congested airport at one or both ends. Existing airport capacity is being expanded in some parts of the Community, but concerns about adverse environmental impacts often make such expansion difficult.

17 There was some expectation that introducing the concept of a “Community air carrier”, with the right of establishment anywhere within the EC, might lead to a process of consolidation among the larger EC airlines. That this has not occurred is due in large part to the fact that under the majority of Member States’ bilateral agreements with third countries, those third countries would be entitled to reject the designation of a carrier not owned and controlled by nationals of the home country. Any cross-border acquisition or merger between airlines from more than one Member State would therefore place at risk the combined entity’s ability to enjoy traffic rights to third countries.

THE EFFECTS OF LIBERALISATION: KEY INDICATORS

18. Despite the constraining factors identified above, it is generally agreed that the liberalisation of air transport markets in Europe has promoted greater competition to the benefit of passengers and shippers. The following is a brief overview of the main changes in key indicators since 1992, which are set out in tabular form in the Annex.

Industry Structure

19. The lowering of barriers to entry appears to have encouraged innovation and entrepreneurship. The total number of EC airlines offering scheduled services has changed little between 1992 and 2002, increasing from 124 to 131 over that time. But this disguises that there has been extensive entry and exit, with only just over half of the airlines present at the start of 1993 still operating scheduled routes under their own code now. Of the 144 start-up airlines, less than half (64) were still flying by early 2000 (though note that airlines which become full franchisees of other airlines are treated as withdrawals, while airlines which switch in and out of scheduled services are treated as start-ups at each entry). Many new airlines have emerged operating totally within the liberalised area, stimulating competition especially on domestic routes.

20. Apart from Sabena the other 13 national airlines remain, although most are now members of one or other of the principal global alliances. As mentioned above, chief among the factors which prevent closer consolidation are the government-imposed ownership and control restrictions that still form the backbone of bilateral relations with countries outside the liberalised European area.

21. The most striking development has been the emergence of the so-called “no-frills” airlines, which have now taken more than 11% of the total market and which are rapidly expanding. At present the no-frills airlines are mainly based in the UK and the Irish Republic, where their share is even more significant (in 2001, for example, no-frills airlines carried 25% of the traffic on routes between the UK and other Member States and 22% of the total

domestic traffic in the UK), but they are now beginning to expand elsewhere in the Community.

Output

22. The period since liberalisation has seen a strong growth in the number of scheduled intra-EU routes served, particularly international routes (an increase of nearly 75%). The number of domestic routes served has also increased but, reflecting the greater maturity of these markets, at a more modest rate (12%).

23. Output levels of scheduled airlines have increased at a faster rate than the number of routes. Seats and Aggregate Seat Kilometres (ASKs) on domestic routes have grown by 41% and 43% respectively over the period, with corresponding figures of 96% in seats and 129% in ASKs on international routes.

Competition at the Route Level

24. There has been a significant increase in competition at route level. The number of international scheduled routes with three or more carriers has more than trebled. Domestic routes have historically been dominated by national carriers so that the near doubling of domestic routes with a second carrier (an increase of 88%) is particularly significant.

25. The share of domestic ASKs performed on routes with more than one carrier has increased from about one third before 1993 to over two thirds in 2000 and, although the share of international ASKs on routes with three or more carriers rose at a slower rate, over half the international ASKs were on multi-airline routes by 2000.

Fares

26. Overall average inflation in EU states between 1992 and 2000 was 19%. Across intra-EU routes, published Business Class and Normal Economy fares rose on average by 32% and 26% respectively over that period, but promotional fares decreased by 13%, i.e. in real terms published promotional fares fell by 27%. Similar fare changes were seen when the analysis was restricted to the twenty busiest city-pair markets. Increases were generally higher on routes within Northern Europe than elsewhere.

27. Published Business Class fares provide an imprecise indicator of the price paid because of corporate discounts. But in any event competition for business passengers who are the principal purchasers of Business Class and fully-flexible tickets tends to focus more on service quality than on price. It is difficult to quantify all aspects of service quality, although the number of direct services, frequencies, and seat availability are important factors.

28. Following deregulation in the US full fares increased in price, but there was a marked reduction in the proportion of passengers using such fares as

lower-priced alternatives became more easily available. As yet we lack comprehensive data in Europe on the proportion of passengers buying the different types of fares and how these proportions have changed over time.

CONCLUSION

29. Not knowing what would have happened in the absence of liberalisation makes it difficult to assess the impact of the single aviation market in Europe with any precision. But the new regulatory environment certainly has fostered innovation and enterprise, resulting in more routes served and greater competition on many existing routes. The emergence of no-frills carriers, which would have been impossible ten years ago, has changed the way many people think about air transport, and has necessitated a competitive response from their longer-standing rivals. Consumers have benefited from a wider range of choice, both in locations served and in quality and type of service. The evidence on fares is mixed. Fares at the bottom end of the market have fallen, but it is less clear what impact liberalisation has had on premium fares. As a general observation, for many – though certainly not all - users there is a wider range of fares/services packages available than previously. By contrast, liberalisation has had only limited impact on the basic structure of the airline sector, almost certainly because this is influenced to such a key extent by the traditional international regulatory framework, which is outside the direct control of any one country or even group of countries.

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ANNEX

AIR TRANSPORT LIBERALISATION IN EUROPE: KEY INDICATORS

	Pre- Liberalisation	Current (a)	Change	Source
Number of EU Scheduled Airlines	124	131	6%	AEA
Number of EU domestic routes	813	910	12%	EU1
Number of domestic routes with more than one carrier	106	199	88%	EU1
Weekly Seats on EU domestic routes (in thousands)	2,910	4,097	41%	EU1
Yearly ASKs on EU domestic routes (in billions)	74	105	43%	EU1
Share of EU domestic ASKs on routes with more than one carrier	34%	68%	+34%pts	EU1
Number of Intra-EU (international) routes	692	1,202	74%	EU1
Number of Intra-EU routes with more than two carriers	61	217	256%	EU1
Weekly Seats on Intra-EU routes (in thousands)	2,345	4,603	96%	EU1
Yearly ASKs on Intra-EU routes (in billions)	107	244	129%	EU1
Share of Intra-EU ASKs on routes with more than two carriers	42%	52%	+10%pts	EU1
No-Frills Airline share of total ASKs	0.4%	11.6%	+11%pts	EU2
Change in Business Fares on Intra-EEA routes (nominal)	€233	€309	32%	EU3
Change in Economy Fares on Intra-EEA routes (nominal)	€209	€263	26%	EU3
Change in Promotional Fares on Intra-EEA routes (nominal)	€123	€108	-13%	EU3

Notes: (a) "Current" means 2000, except for the no-frills airline share, which refers to summer 2002.

(b) The analysis is based on OAG data and it therefore excludes non-scheduled services.

(c) No Frills airlines defined as bmibaby, Buzz, Debonair, easyJet, Go, Ryanair, Virgin Express

Sources:

AEA Association of European Airlines, January 1993 to February 2000

EU European Commission publication: "Updating and development of economic and fares data regarding the European Air Travel Industry":

EU1 - Summer 2002 update, comparing summer schedule 2000 with summer schedule 1992;

EU2 - July 1992 from 2000 Annual Monitoring Report, Summer 2002 from OAG schedules;

EU3 - Winter 2001 Fares Report, comparing January 2001 with January 1993.