

INTERNATIONAL RAMIFICATIONS OF DEREGULATION

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This panel focused upon the following major issues.

- o The special position of aviation and the future role of national governments.
- o The present status of deregulation in domestic markets in and outside the USA.
- o The effects of deregulation in the international and intercontinental markets.
- o The world after deregulation.

The panel discussed, on a qualitative basis, the changes it foresees in the international, and more particularly the intercontinental markets, in the Western world to the year 2000. This period was selected as being sufficiently foreseeable in light of the market development which can be anticipated today.

1. Special Position of Aviation and the Future Role of National Governments

Air transport has always had a very special position in foreign relations not only in the economic, social and military field, but also, and in particular, in the political field.

National governments in all countries have the responsibility for international communications. To date, however, they have kept aviation out of bi-national or multinational discussions dealing with the promotion of international trade. For instance, in the recent negotiations leading to an open market between Canada and the USA, aviation was not discussed.

Governments take the viewpoint that traffic rights must be negotiated against traffic rights. Reciprocity was and still is the basis for international agreements in aviation. Governments refuse to balance aviation against bananas, potatoes or motorcars.

That situation, however, may not last for ever. There are two reasons why the role of the individual governments will be affected.

The first one is the increasing process of the formation of a politically and economically united Europe. The second one is a worldwide process of diminishing governmental interference in the form of denationalization and privatization.

First Europe. It is not unreasonable to expect that sooner or later the authority to negotiate rights will be surrendered by the respective governments to the Commission of the European Communities headquartered in Brussels. That Commission will then have to act and negotiate on behalf of the governments of the large (350 million people) European market and will have to designate carriers. That in itself means lower protection. If the European community becomes a domestic market, and if Brussels becomes the authority, then the bargaining power will shift from the individual governments to Brussels. In

the future this industry may no longer be discussed on the basis of reciprocity between nations but may or will be discussed in a much wider context such as GATT by Brussels, Washington or Tokyo.

The second longterm development is a worldwide process of less government-control resulting in a partial or complete privatisation of industries. This process includes aviation. Giving up the controlling position of European governments will ease mergers, take-overs and acquisitions of airlines. The "flagmentality" in some countries may disappear. It will certainly decrease the special, practically untouchable, position that aviation has at this moment. It will be possible that rules can be applied in the same way as elsewhere in the economic system. Specialization, exploitation of structural efficiency advantages, transfer of labour and capital will take place more and more. This is a development that the USA has already gone through.

That development will go hand in hand with an increasingly dominant role of commercial considerations in the industry. Market forces will take the lead. Innovations in marketing and strategy will be accelerated and governments will become followers instead of leaders although there will be a high degree of interrelationship and dependence between government and industry.

2. Deregulation: Where Are We Today?

Domestic deregulation has been completed in the USA and Canada. Both countries have gone through a quick and turbulent process leading to the formation of a limited number of megacarriers that

- control the market through hub formation;
- control the market through code-sharing agreements;
- control the market through Computer Reservation Systems;
- control the airports through contractual arrangements;
- are increasingly active in the international market;
- have ordered modern equipment that will allow them to operate very efficiently (size and economics) in the international market.

There is some form of deregulation (price competition) in Africa (Nigeria), Australia, Japan and New Zealand. The emphasis is upon "some". It is more "intensified competition on a restricted basis" primarily in the domestic market. (There is no free exit and access in the domestic market in those countries.)

Developments in aviation inside Europe are heavily influenced by the creation of the European market (1991). The Council of the Community has taken steps on fares, on sharing of capacity, on access for air carriers and on legal procedures for the application of the rules of competition for airline companies.

Liberalization in Europe takes different profiles in different countries. Some countries have shown more flexibility and have introduced the system of double disapproval for fare setting and frequencies for intra-European and sometimes for intercontinental services (Belgium and Holland). Other countries have not yet reached that situation for very valid reasons. Increased opportunities in Europe are underlying to the formation of larger companies.

Our panel foresees that the trend towards a more liberal policy in Europe cannot be reversed given the relatively short distances between countries in this continent. The domino effect can be expected.

That process inside Europe will certainly lead to the formation of more powerful carriers in Europe, sometimes through partial cooperation in the field of maintenance, engineering or marketing, and sometimes through direct acquisition.

3. The Effects of Deregulation in the Intercontinental Field

As most of the megacarriers in the USA have expanded heavily in the domestic market, they now place emphasis on intercontinental expansion primarily into Asia and Europe. The long-range trend shows an increasing share of scheduled passengers for U.S. carriers as result of better capacity, more frequencies and more point-to-point services. The number of airlines in the intercontinental field has gone up. The newcomers -- American, United, Delta and Texas Air -- served 48 markets in 1986.

Those airlines are rapidly reaching into markets traditionally served by non-American airlines or by U.S. airlines that by today's standard are not well placed or not well equipped (Panam, TWA).

a. How Will European Airlines React?

Several possible scenarios were discussed.

One is the formation of a group of very strong European megairlines through mergers or equity acquisition between European airlines. Today's cooperation could be a starting point (maintenance agreements, dovetailing of markets, and computer reservation systems could be the initial form for this development). This is what we called "regionalism". That process commences with consolidation of the domestic market (British Airways, British Caledonian). These large carriers will compete against American operators in the same way with the same weapons as their U.S. colleagues. Their rights have to be negotiated by their respective governments and later, possibly, by the EEC.

Another possible form is a cooperative association between airlines on different continents. Through a process of mutual equity acquisition, they come to a merger strategy in order to take advantage of the most effective factors of production and in order to increase market share through worldwide market presence. This form can be described as "multinational megacARRIER". Why should aviation be precluded from possibilities to increase its efficiency and its presence along lines that are generally accepted in other capital and labour intensive industries (oil industry is globalized, the motorcar industry is in that process and so is the shipping industry)? Why can't airlines in Europe, America and perhaps Asia not set up such a construction?

It assumes a change in the present ideas about the essence of having independent Flag Carriers; and it assumes also that the international regulatory system within the EEC will act in a non-discriminatory way against the European airline that goes intercontinental instead of European for cooperation.

In the long run also European megacarriers originating from regionalism will evolve into multinational megacarriers.

Once this trend of European megacarriers (regionalism) or multinational megacarriers has begun, it may go very fast. The potential advantages of synergy becoming apparent to all carriers, airlines will go after each other (as happened in the USA).

Other airlines in Europe for reasons outside aviation may remain independent but have to accept a secondary role.

b. Africa, Latin America and Asia

The panel is of the opinion that Latin America will stick to its policy of tight capacity control to protect their operators. There will be no encouragement of a more liberal policy.

The same can be said about the majority of the African countries.

The group also foresees that the economic reality of today will force/stimulate some countries in those continents to combine their resources and to form an airline that serves intercontinental markets.

Another possibility is to look for adoption by or cooperation with carriers in the developed world.

In Asia, countries like Korea, Thailand, Singapore and Indonesia have become more liberal. The relatively thin market beyond Tokyo makes the necessity to negotiate Fifth Freedom rights an important subject that may be solved within the trade discussions between Japan and the USA.

4. The World After Deregulation?

Cabotage has become an issue as result of code sharing; however, today's legal framework makes this impossible. The panel is of the opinion that in Europe and in the United States vertical integration may be a next step.

Aviation will continue its process of consolidation into the near future. This will occur for financial reasons. The industry in the USA is sliding back slowly towards some regulation as a result of congestion in airways and airports.

It will take a new recession in the USA to again shake up the aviation community. A new industry profile could emerge from such a shock. That new profile could go along with attaching less value to aviation. Attaching lower importance to the aviation industry could be eased by relaxation on sharetrading and ownership by foreign airlines.

As far as Europe is concerned, it can be expected that aviation in that continent will go through a very turbulent and interesting time similar to what happened in the recent years in the USA.

Summarizing the conclusions of our panel, deregulation having its roots in the USA, will have ramifications outside America. The intensity of this impact will depend upon the way airlines will be grouped together in the future. In the long run concentration will ultimately evolve into a globalization of our industry through market forces, supported by an international relaxation of the legal framework.

Discussion

Mr. Nesbit (Airline Forecast Forum, Inc.): Deregulation in the United States effectively destroyed our small charter industry. Do you see deregulation in Europe wiping out the very large developed charter industry in Europe?

Mr. Pronk: As you know the European charter industry is quite important. In fact it carries about 50 percent of the total traffic inside Europe. The leading charter companies are trying to make use of the new legal possibilities that are created within the framework of the European community. Companies in Holland and in the United Kingdom are trying to set up a scheduled service in addition to their charter service. What we expect (now I am talking as a European manufacturer and not as a member of the group) in the long run is that the European charter industry and the European scheduled industry will become very close; and some of the chartering companies will be absorbed or acquired totally or partially by the mother companies.

To give a few examples: KLM is the owner of 50 percent of Martin Aire. KLM is joint owner of Trans Althia. Recently Lufthansa acquired shares in German Air. Recently Lufthansa made an agreement with Spain for the set-up of a chartered airline. That leads to the conclusion that the very strong separation between charter airline industry and industry in Europe will disappear. When it will completely disappear is a question. There are some fundamental structural differences resulting from high utilization and typical seasonality, but clearly those industries are coming closer and closer.

Mr. Griffith (Boeing): A couple of very successful airlines in the world have been built upon the creation of Sixth Freedom rights. What is likely to happen to these airlines if the global environment becomes more liberal?

Mr. Pronk: If the process that we foresee takes place, then those airlines will be faced with more competition and they will then have to compete with the airlines that will form part of what we have called the "multi-national mega-carriers." When they will completely disappear I do not know. But they will be faced with more competition.