

## 10 YEARS TO 2002 IN RETROSPECT\*

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*What all the wise men promised has not happened, and what all the damned fools said would happen has come to pass. (Lord Melbourne, 1890)*

It is good to be asked to make a valedictory speech on my birthday, just after my retirement following over 40 years in the business. It has been suggested that I ruminate over the past 10 years which have seen some of the greatest changes in the regulation and organization of air services since the Chicago Convention in 1944 -- changes probably greater than in any other 10 year period.

### 1992

Remember 1992. The world was emerging from recession. Germany was united. Eastern Europe was bankrupt, but looking to a democratic future away from the power of the Soviet Union. The Soviet Union was looking increasingly fragile as the various Republics sought greater autonomy. The so-called third world was feeling crushed under the twin pressures of debt and internal strife. The Middle East was then, as now, a powder keg with the Iraq-inspired Gulf War just behind us but the aftermath very much with us.

In this environment the airline industry was suffering one of its worst periods economically. Probably the only area of the world where air transport was buoyant was in the Far East/Pacific region, and even there recession was having its effect. Within the United States the private-enterprise US Airlines were having to react to the economic pressures. The gradual demise of the once great PanAm and TWA was accelerated, and they vanished without trace in the early 1990s.

The US industry emerged from the economic recession, and with the completion of the deregulation process in the early 1990s the US market was reduced to three dominant airlines and some lesser players.

It is difficult to appreciate that in 1992 the European Community States acted separately in international aviation matters, that each of the then 12 members had their own national airline or airlines, and that the majority of these were either wholly or substantially government-owned. Moreover, each of these 12 European States had their own bilateral agreement with the United States with varying degrees of freedom for the airlines of the two sides to operate across the Atlantic.

### THE EC MARKET "COMPLETE"

*Yang Chu, weeping at the crossroads, said "Isn't it here that you take a half step wrong and wake up a thousand miles astray?" (Confucian Hsun-tzu)*

1993 saw the completion of the internal European Community market in aviation when, for the first time, the full force of the Treaty of Rome applied at least to intra-European Community air services and Community airlines. This meant that at last the regulated duopolies which had grown up over the years since the Chicago Convention were thrown open to competitive market pressures. No longer were national, flag-bearing airlines given privileged status in the carriage of traffic to and from their own homeland under the patronage of their national governments. Any airline which satisfied safety and fitness criteria and could be defined as a "Community airline" was free to operate on any route within the Community.

At the same time real force was given to the Treaty of Rome provisions outlawing discrimination against Community corporations or individuals on the basis of their nationality. There could no longer be such a thing as a French or a German or an Italian or a British airline. They were all Community airlines, and ownership was open to any Community national who could secure a stakeholding provided he was not debarred from such a holding by law as unfit.

There was a brief hiatus in 1993 as Community airlines absorbed the full implications of the changes that had been thrust upon them. Most of the States had been resistant in one way or another to this idea of opening up Europe to the full forces of the marketplace,

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\*The date of this presentation happened to fall on Mr. Ebdon's birthday, and he chose to give his view of the future as if he were speaking 10 years hence on the occasion of his retirement. He began by cautioning that his remarks were "a personal flight of fancy" that did not necessarily represent the anticipations of British Airways.

The British, Dutch, and Irish were in the forefront of the move to liberalize Europe from the constraints of the old system in the interests of the travelling public. It was perhaps therefore a surprise that the first airlines to react to this new system were not the supposedly pro-liberal British, Dutch, or Irish but the supposedly reactionary German and French. The two governments concerned announced their intention to sell off their holdings in Air France and Lufthansa, and the two airlines passed into private hands as a unified airline based on the huge Franco-German markets which they had dominated for so long.

Perhaps it was equally surprising that the European Commission permitted this merger to go through unscathed on the grounds that a merged enterprise in private hands would strengthen European aviation for the forthcoming global battle for a share of the world aviation market.

As if in reaction to the threat from the center of Europe, British Airways, which had long had continental hub ambitions, finally consummated its long engagement with Sabena and the Brussels hub. At the same time this new airline established an increased presence in Berlin - - by then the capital of Germany -- to take advantage of the vastly improved airport infrastructure that had been developed since the unification of Germany. Not content with its new-found presence in the heartland of Europe, this enterprise expanded into a hub at Milan in order to develop strategic hub opportunities astride Europe. This operation was to come up against the combined strength of the merged Iberia and Alitalia Airlines, and the scene was set for the emergence of three preeminent European international airlines. It is a matter of history that SAS later took advantage of the enlarged Europe to combine the airlines of Scandinavia and Finland with Austrian Airlines based in Vienna and their shareholdings in the relatively small British carrier, British Midland. However, this enterprise has not so far proved to be as significant a player as the big European three. Close cooperation with Swissair, which has been a feature of SAS over many decades, may signal yet another merger.

#### THE DEMISE OF BILATERAL AGREEMENTS

*All government is evil...The best government is that which governs least.* (John L O'Sullivan, 1837)

These concentrations in the mid-1990s in Europe were presented to the regulators as virtual *faits accomplis*; and, as had occurred earlier in the United States after the 1978 Deregulation Act, the regulatory authorities did little to prevent what many had seen as inevitable.

This concentration of the Community industry put irresistible strains on the worldwide bilateral system, within which the concept of substantial ownership and effective control in national hands had long been seen as a barrier to cross-border mergers. With the catalyst of the European Community and the inexorable pressures of competition, a few short years saw the death knell of the nationality provisions in bilateral agreements worldwide. This is still working its way out in some parts of the world, but the ownership of airlines is coming to be seen as unimportant compared with the need to open up markets for the interests of the consumer in developed parts of the world. There is a continued perception of the need to protect indigenous industries in the less developed world, but ownership is now seen as less significant.

#### THE EUROPEAN COMMUNITY AND THE UNITED STATES

The completion of the European Market and the trend towards Europe-based megacarriers, together with the maturing of US deregulation, created the climate in which a head-on clash between the European Community and the United States seemed inevitable. For some time European airlines and their governments had been concerned that the European market was open to exploitation by US airlines in a way which was not reciprocated within the United States. The concept of cabotage was fiercely protected by jingoistic legislators in the United States and by organized labor.

The argument had always been on two fronts. First, the US market was too valuable to give away, and nobody had anything worth trading. Second, US airlines provided part of the US Government's strategic defense. Even those in the industry like Robert Crandall, president of American Airlines, who advocated changing the law that prevented trading in domestic traffic rights by US administrators, at the same time argued that access to the US market should only be granted in exchange for equivalent opportunities. This contrasted with his attitude on the international front where he sought to ignore the balance of opportunities argument in favor of free and open competition in the interest of the customer. The question of free and open competition in favor of the customer on domestic routes was never fully addressed by the US administration until US airlines found themselves starved for capital, and they began to look at the rest of the world for their capital needs.

Thus, the stage was set for the battle of the giants. The European Community on the one side and the United States on the other lined up for what could have been a war of attrition. Fortunately, as so often happens, the regulators were outflanked by the workings of the marketplace, and the historic merger of American Airlines and British Airways totally undermined the concept of national cabotage.

*Protection is not a principle, but an expedient.*  
(Disraeli 1845)

The emergence of British American Airlines as a fully merged company with shares openly available on the stock markets of the world showed how outmoded was the concept of national cabotage, and the Community and the US Government signed the first truly "open skies" agreement. Under this arrangement European and US-based airlines -- with whatever nationality of ownership -- are free to operate within the United States, within the European Community, and between the United States and the European Community free of bureaucratic intervention.

## MERGER MANIA

The latter part of the 1990s could be characterized as merger mania although many parts of the world still remain unaffected.

We have seen and are still seeing world aviation transform into a genuine multinational industry with government involvement concerned primarily with infrastructure and safety questions, striving for sane continued protection of jobs, and balance of payments rather than the old-fashioned idea of national and government ownership.

It is early yet, but it seems inevitable that the next 10 years will see still further concentrations and upheavals in the airline industry as the international market becomes more and more open and competitive.

## THE CUSTOMER

*If you open that Pandora's box, you never know what Trojan 'orse will jump out.* (Ernest Bevin)

When the US Government proposed deregulating the US domestic market, one of the great debates was

whether the customer (passenger and shipper) would benefit. The early expectation by the founding fathers of deregulation (like Alfred Kahn) believed that this so-called deregulation would result in the emergence of a large number of competing airlines fighting for the customer's business -- with resultant pressure on costs, improvement in efficiency, and benefit to the customer. Initially it appeared to work in this way. New airlines emerged and submerged; and in the end, as we have seen, the US industry consolidated into a small number of large players with their associated feeder airlines and niche operators. The same thing happened in the European Community.

It is a matter of fact that airlines, throughout the decades since modern aviation began, have failed to generate the funds necessary to support their operation - - including the replacement of assets and investment in necessary computer technology. Airlines throughout the world have been supported by government subsidy, both open and hidden, and there were those who believed that aviation was not an industry which could be left to the vagaries of the marketplace.

The marketplace is proving to be made of sterner stuff. Faced with ever increasing subsidy bills and increasing customer dissatisfaction, governments throughout the world have become increasingly unwilling to underwrite the debts of their chosen flag carriers. Privatization became the "in" thing, but private capital is no more willing than government to invest in loss-making enterprises. A shake-out became inevitable.

We now see, 10 years after the completion of the European Market, few airlines in the developed world remaining in government hands. Those in private hands are forming the alliances and mergers which must inevitably result in a concentration of the world air transport industry into a smaller and more rational number of competing enterprises, as is the norm in most other industries.

At last the air transport industry appears to be coming of age. At last a more rationally organized international industry appears to be capable of earning profits adequate to fund its operation and replace its assets without being underwritten by government subsidy or guarantees.

Those who believe in the free enterprise system also believe that by this means the customer -- whether passenger or shipper -- will benefit in the long run from a more efficient and consumer-responsive industry. It requires that governments stand aside and stop meddling in the affairs of the industry except to the extent necessary to counter any continuing tendency of other governments to interfere in the free play of the marketplace.

## INFRASTRUCTURE

Any consideration of the last 10 years would be incomplete without addressing the problem of the infrastructure. It seems inevitable that the air transport industry will be bedevilled with shortage of airport facilities and inadequate ground access to airports and that successful airports will find demand tending to outstrip supply. Concerns about the impact on the environment have meant that airline customers have had to accept less than optimum provision in congested areas as planning authorities have had to balance the advantages to the community of adequate air transport service and the disadvantages to the environment which they inevitably produce.

It is fortunate indeed that the concentration of the industry in the United States and Europe has relieved the strain on scarce resources at the key airports, which otherwise might have encouraged the regulation-minded governments to interfere. This has resulted in the use of larger aircraft that make less demand on runways and air traffic control. Once again the marketplace itself has produced solutions to what looked like an intractable problem in the early 1990s.

## ENVOI

Problems are still with us. Governments continue to have a significant role in ensuring that there are facilities adequate for the needs of the traveller and shipper. The last decade has been one of upheaval in the structure of the industry, particularly in the area of ownership and control of airlines and the involvement of governments in their day-to-day regulation. This conflict between the regulation-minded official and the free market proponent is likely to remain with us, but I believe that the lessons learned over the past decade will ensure that we never again find ourselves in a period when the Granny in Whitehall in London or on the Hill in Washington believes that he or she is better at anticipating the customers' needs than the marketplace itself.

*You ask me what it is I do. Well actually you know,  
I'm partly a liaison man and partly PRO.  
Essentially, I integrate the current export drive.  
And basically I'm viable from ten o'clock till five.  
(Sir John Betjeman, Executive)*