

## INTERNATIONAL AVIATION

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The panel focused on three topics:

- Multinational airlines,
- Open skies agreements between Europe and North America, and
- Intra-European liberalization.

The panel did not attempt to forecast trends in numerical terms. There was general acceptance that the market conditions are so uncertain that quantitative forecasting is very difficult. Instead, the panel focused qualitatively on external forces that will heavily influence the long-term outcome in international air transportation markets. In this context the panel also covered major areas of government regulation affecting international aviation.

There is general agreement that more and more government policies and regulations will come to be driven by market forces. Policy will be made as a tactical reaction to events and crises, rather than as a result of strategic planning.

### General Market Developments

It is clear that the current state of the airline industry is the result of overcapacity in the market. This overcapacity is caused by regulatory exit barriers that not only prevent airlines from leaving markets, but also cause them to retain underutilized or unproductive aircraft and facilities. Aircraft are especially hard to retire. Somehow these exit barriers need to be decreased if market mechanisms are to operate. There was general agreement on the statement that U.S. deregulation has been successful in reducing exit barriers and affords a useful model for Europe and Asia.

Regional liberalization will come before globalization of the airlines. Liberalization creates uncertainty and insecurity for governments and airlines alike, and it will be easier to begin experimentation with free market approaches close to home before attempting to transfer them to a global scale.

Denationalization will precede regionalization, and the combined process will lead to a decrease in the number

of national airlines with global ambitions. As a result the number of international hubs will be limited. Even so, hub and spoke will remain the dominant form of service. There is room for development of nonstop service in some local markets, mainly by new entrants with operations characterized by low cost and high productivity of resources. These new entrants will create greater competitive pressure in the market.

Liberalization and open skies will affect the largest traffic markets first. However, many countries and markets are not mature enough to accept liberalization. Therefore, open skies will take place on a very selective basis.

Two trends can be distinguished. The first is concentration by global carriers in a limited number of profitable city pairs. Some of these city pairs will have a congested airport at only one end, but most of the time both of the airports in the paired cities will have capacity restrictions. This will limit the opportunities for foreign carriers to extend service beyond the hubs. For example, it is very difficult for European airlines to secure feeder traffic at Chicago O'Hare. All the current feeder routes are controlled by U.S. carriers, which also control gates, baggage handling, ticket counters, and service facilities at the hub airports. This will mean that in the limited number of city pairs where global carriers can effect a penetration and be profitable larger aircraft will be needed, both as a way to overcome congestion and as a way to lower their entry costs. This, in turn, will be a driving force to develop and introduce new aircraft with 800 or more seats.

On the other hand secondary cities that are not now hubs have a great potential for nonstop service using regional jets or turboprop aircraft that bypass the major hubs. Because these aircraft will probably have somewhat higher operating costs per seat, service will be provided by low-cost carriers, either new entrants or subsidiaries of the global airlines. British Airways Regional, offering long-haul service from Manchester, is a forerunner of this trend.

Although most of the discussion focused on European and North American developments, the panel recognized that the Pacific Rim still offers the largest growth potential. The difference between the North Atlantic and the Pacific Rim is that most Asian countries are not and will not be ready for liberalization for some time. Bilateral conflicts will have a limited impact as long as the total market is growing as it is in Asia. This is in sharp contrast with the North Atlantic, where the market is virtually mature and competition for market share is intense.

In the near term franchising of airline services will spread because it makes economic sense. Codesharing is essential in negotiation for route rights.

The panel thought it doubtful that new technology such as teleconferencing will negatively influence intercontinental traffic. First there is the problem of time difference. Second, language and cultural differences often require local presence to transact business. The panel did not expect that teleconferencing would have much effect on nonbusiness travel, which is a large and steadily increasing share of the international market.

### Open Skies

Although the report of the National \*Commission to Ensure a Strong and Competitive Airline Industry strongly advocates open skies, it is not clear how the Commission defines it. There are two problems. One is a difference of philosophy between the United States and Europe. The second is the question of how to resolve disagreements on particulars that may arise in negotiations between countries. Essential here is an effective and quick process to reconcile philosophical differences and to settle disputes. The problems are particularly acute on matters such as computer reservation systems, airport handling, security, and frequent flyer programs.

Even if there were international agreement on a definition of open skies, the panel remained skeptical about whether it could be implemented. At the heart of open skies is the question of free market access. If, however, that access is limited by infrastructure constraints on both sides of the ocean, it is doubtful that the principle can be put into practice. A key issue is the right of access to markets beyond the major hubs.

The plea of the airlines is for governments to shift from a comprehensive regulatory approach to a policy of selective intervention on a flexible, case-by-case basis when disputes arise. A rapid system of arbitration would certainly help promote more liberalized market conditions and offer each player equal opportunities. Harmonization of antitrust legislation among countries would be essential.

Because open skies is attractive to different countries for different reasons, the prospects of successful negotiations between blocs and conclusion of multilateral treaties are slight. Bloc negotiations would probably concentrate on protective measures intended to limit access to domestic

markets rather than to enhance opportunities. As a result, the present system of bilateral agreements will be around for a long time to come.

Given the increasing opportunities in the market, there was a general feeling of disappointment among panelists that airlines have so little information on passenger needs and preferences. The panel regretted the disappearance of the Gallup Poll formerly conducted for the U.S. Air Transport Association and strongly recommended a search for alternative methods of market survey.

### **Multinational Airlines**

The motives for formation of multinational airlines are much the same as those for open skies. Barriers to market access due to government regulation is forcing airlines to buy equity in foreign carriers. Remarkably, the interest in multinational ownership is one-directional. European airlines are seeking to invest in U.S. airlines, but not vice versa. The financial state of the airlines on either side of the Atlantic is frequently cited as the reason, but it also appears that U.S. carriers have fewer problems in Europe than European carriers do in the United States.

Equity in itself is not that important. Even a small equity share provides some measure of control over the majority owner. The panel felt that uncertainty of government policies with respect to foreign ownership is a bigger problem than equity participation rules.

The likelihood that a large number of multinational airlines would come into being was considered low, mainly because mergers are difficult to manage successfully. Experience here and in Europe has shown that total integration of two or more airlines gives rise to many unforeseen problems.

There is need for clearer criteria for foreign ownership and more good economic research on the effects that transnational airlines have on national economies. The main focus up to now has been on negative effects (such as loss of employment). The positive effects also deserve attention.

### **Intra-European Liberalization**

The panel thought that the European approach to free markets will be different from that of the United States, largely because of geography. In the United States population densities are highest on the borders of the continent, a distribution that favors hub-and-spoke route structures. In Europe the population is centered in the middle of the continent. Average stage lengths are smaller, and there is strong competition from other modes of transport. As a result formation of new hubs in Europe will be limited, and airlines there will tend to prefer alliances.

### **Conclusion**

The panel agreed that international aviation has great growth potential. However, regulatory barriers will come down slowly. Exit barriers are chiefly responsible for the overcapacity that currently characterizes the industry. Governments will continue to play an important role in the market, but for international aviation to grow government approaches will have to become more flexible and more responsive to market conditions. Regulators will have to learn to follow the market rather than attempt to dictate how the market will develop.