

INTERNATIONAL AIRLINES

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Introduction

The International Airlines panel identified and discussed 15 issues that are expected to influence the growth of international air travel to and from the U.S. during the next five to ten years. These issues were grouped into the following five major categories (in descending order of importance):

- Demand influences,
- Industry structure,
- Regulatory environment,
- Physical infrastructure, and
- Technology.

Following this review and discussion of issues, the panel reviewed and suggested revisions to the draft forecast parameters submitted by the FAA for the U.S.-Atlantic, -Pacific, -Latin American, and -Canadian transborder markets.

Demand Influences

Macroeconomic Factors

The panel anticipates a slowdown in the U.S. economy during the period 2000 to 2001. Although many forecasts indicate that it should be mild, the panel is concerned that there is significant potential for it to be more serious (possibly a recession). Either a slowdown or a recession would adversely effect the export-dependent recovery in Asia and, to a lesser extent, Europe.

Continental Europe is in the process of recovering from its recession, with the U.K. beginning its recovery. The forecast U.S. slowdown will mildly delay the return to a strong economy throughout the region and will slow the growth of commercial airline traffic. The panel concurs with the FAA's forecast of an average annual growth rate (AAGR) of 4.7 percent in passenger enplanements on U.S.-

transatlantic routes over the next five years.

In Asia, Japan is the major influence on regional air travel. It is expected that the U.S. slowdown will undermine the recovery that has recently begun in Japan, delaying the return of strong air travel growth to and from that country. The Chinese market remains one waiting to be proved. The panel anticipates slower growth in traffic to and from China. South Korea is improving, but political instability in North Korea reduces stability throughout the region. Australia and New Zealand appear to offer stable growth prospects throughout the forecast period. The panel believes the FAA's forecast of an AAGR of 6.1 percent in passenger enplanements over the next five years is high in such circumstances. A 5.0 percent AAGR forecast over the next five years is suggested.

Recent Latin American traffic increases are perceived to benefit from a variety of stimuli, including deregulation and privatization; benefits from these sources are expected to continue through the forecast period. Nonetheless, with a slowdown in the U.S., the FAA's 6.7 percent AAGR forecast of passenger enplanements over the next five years is perceived to be aggressive. A 6.0 percent AAGR forecast is suggested.

The Canadian economy has been showing healthy (3 percent) growth this past year; annual growth in the order of 2.6 percent is expected over the next decade. A combination of this forecast economic growth, increases in real disposable income, continued (but declining) benefits of the open skies agreement with the U.S., and Canada's attractiveness as a destination market for U.S. travelers (because of the favorable exchange rate) is expected to sustain transborder traffic growth. The panel concurs with the FAA forecast of 3.6 percent AAGR in passenger enplanements over the next five years.

Microeconomic Factors

Opportunities are perceived for continued cost reduction,

resulting in lower fares and traffic stimulation. Alliances provide an opportunity for cost savings by allowing the domestic (or larger) partner at each end to undertake sales and traffic support, as well as combined purchasing for the allied airlines. Inefficiencies introduced by alliances are seen as minor compared with the benefits obtained by eliminating these duplications. Slow but steady progress is expected in the reduction of distribution (travel agency) costs to airlines.

Sharp increases in fuel and labor costs are not anticipated in the next five years. Moderate fuel price increases are likely. These will adversely affect all airlines, but U.S. airlines to a greater extent since they currently have lower unit fuel costs. A fuel tax for environmental purposes could emerge in Europe during the next five to ten years.

Aircraft Size

The trend in the 1990s toward smaller average aircraft size in the transatlantic market is expected to reverse itself as more B777s enter the market. A slow growth (about 1.5 percent per year) in average aircraft size is expected in Atlantic markets over the next five years. Replacement of older B747s, DC-10s and MD-11s with B777s and B747s is the major trend foreseen for the Pacific; the net effect will be no change in average aircraft size. Latin American routes are expected to experience very slow growth (0.7 percent per year) in average aircraft size due to the lack of significant infrastructure constraints, the ability to meet increased demand primarily with frequency, and the higher growth expected in the longer-haul (larger aircraft) routes.

Safety and Political Turmoil

Political instability is expected to continue in various parts of the world. Major events like the Gulf War and terrorist attacks can and will have adverse short-term effects. Such events are not expected to affect the underlying growth of demand.

Negative safety perceptions may affect selected national markets but are unlikely to affect as a whole any of the four major regions reviewed.

Industry Structure

Alliances

Alliances have become a part of airline life and are expected to remain through the forecast period. It is recognized that alliances in various forms have come and gone in the past, so although the panel expects the current trend to continue, it does recognize a vulnerability of this structure to changes in the regulatory environment.

The current alliance structure includes the following:

- Star Alliance—built around United, Lufthansa, Air Canada, SAS, Thai, VARIG, and ANA;
- OneWorld—built around American, BA, Canadian, Cathay Pacific, and QANTAS;
- Wings—built around Northwest, KLM, and Alitalia; and
- (Unnamed)—built around Delta and Air France.

A total of four or five alliances are expected to compete during the next five years. As the alliance structure matures, participation in one is seen more as a defensive move (to preserve a competitive position) than as a move to attract new traffic. The stimulative effect of alliances on traffic is seen to be slight—some cost saving is expected and traveler convenience (measured as the number of two-stop or on-line destinations available) is improved.

Competition

In Europe, it is expected that some national airlines will be allowed to fail. Sabena, Olympic, and TAP are possibilities. Open skies and European Commission (EC) competition rules will accelerate mergers among European carriers. The panel does not see similar trends in the Pacific over the next five years.

Low-Cost Carriers

Low-cost airlines are not seen as serious contenders in the larger international markets. Carriers with mixed fare classes are seen to have pricing flexibility (in combining high- and low-fare passengers) that will enable them to constrain the effects of low-cost carriers that would need to charge passengers equal shares of total costs. The panel does not foresee any significant downward pressure on yields from such carriers in either the Atlantic or Pacific market.

Regulatory Environment

Open Skies

U.S.-U.K. traffic makes up about 40 percent of the total U.S. transatlantic traffic volume, so an improvement in the U.S.-U.K. bilateral would set a tone for the few remaining (non-open-skies) countries in Europe. In parallel to possible negotiations of this bilateral, the European Commission is seen as slowly moving toward exercising its authority to negotiate external traffic rights for European Union (EU) member states. The panel perceives the likelihood of an EU-

North America common aviation area across the Atlantic in the next five to ten years. Within the late part of this same time frame, some aviation issues might be moved into the WTO process. Either of these latter two developments would put pressure on other regions to liberalize air service.

Ownership

In the EU, 49 percent of airline ownership can be freely traded. The remaining 51 percent can be traded within the EU countries. The U.S. restriction on foreign ownership of a U.S. airline to less than 25 percent is seen as an invalid and anachronistic labor issue. Greater flexibility in the U.S. could lead to changes in the ownership relationships of alliance partners.

Environmental Regulations

Environmental issues are the dominant concern of European governments and airlines, just as safety is the dominant concern of the FAA and U.S. airlines. This concern with the environment will lead increasingly to stringent environmental regulations in Europe. The panel anticipates that there will be a sustained move to a Stage 4 noise standard within the next five years led by European governments.

The panel's major concern is that the U.S.-European dispute over hushkit-equipped aircraft may lead to a trade war. In addition to widespread adverse economic impacts, an aviation casualty in such a war would be the Concorde. Once withdrawn, the Concorde would not be returned to service.

Regional Blocks

There is a possibility that the EU will develop its own (unilateral) rules for aircraft noise and emissions. The U.S. already unilaterally develops standards in the form of safety oversight, security classifications, and crew age-60 rules, which apply to non-U.S. airlines. For a period of time, the Pacific trials of GPS-based navigation systems were conducted multilaterally by the U.S., Australia, Micronesia, and Japan; these were ahead of ICAO's FANS efforts. All these regional-focused activities are seen as disruptive to the standardization of international air transportation regulations and a threat to ICAO's standard-setting role.

It was commented that during the 1980s, the U.S. tended to advance its aviation agenda on a unilateral basis, whereas European nations argued for instituting any changes through the global, cooperative ICAO process. In the 1990s, European nations and the EU appeared to be advancing their aviation agenda on a regional basis, and the U.S. is now arguing for instituting changes through the ICAO process.

Physical Infrastructure

Airports

The London and Frankfurt markets in the Atlantic region and Tokyo in the Pacific region are seen as the major problem areas for traffic congestion over the next five years. However, the emergence of increased point-to-point routing over the North Atlantic should ease the problem there. The traffic-mitigating effects of the recession in Asia and prospects of a slow recovery in Japan suggest that physical airport congestion in Asia, political considerations apart, will not affect the overall regional forecast.

Airspace

Concern is expressed at the inability of the Pacific en-route system to accommodate further increase in demand. Proposed navigation improvements are significantly behind schedule (for political and budgetary reasons, not technological ones). The expected U.S. economic slowdown and a slow economic recovery in major Asian markets will probably defer this problem until beyond the five years evaluated. If not remedied, airspace limitations are likely to be a constraint on trans-Pacific traffic growth within the next ten years. Similar constraints are not anticipated in Atlantic markets.

Technology

New Large Aircraft (A3XX)

In the Atlantic markets, it is not anticipated that conditions will demand the introduction of larger aircraft such as the A3XX until near the end of the next decade.

Customer demand for increased point-to-point service and the lack of major congestion points in the airport and airway system (see separate discussion above) mitigate the need for such an aircraft during the next five years in the Atlantic. Where airport constraints do occur, actions by airport authorities to increase average aircraft size on domestic routes or to encourage passengers to use nonaviation modes of travel for shorter trips are expected to provide sufficient capacity for international flights.

In Pacific markets, slow growth in demand will delay the need for such an aircraft for at least five years. Excess capacity exists in many Asian nations due to recent airport construction; even Tokyo Narita will see some benefit through a slight extension to its (still delayed) second runway.

Mixed concerns were expressed with safety and operational problems of such an aircraft. It is not known how the public would react to a fatal accident involving 700

passengers in a single aircraft (recognizing that similar concerns were expressed about Boeing 747s when they were introduced). It was also noted that the complexities of the boarding process for such large aircraft would have to be addressed.

Supersonic Aircraft

New designs of supersonic aircraft are not anticipated to be operational within the next ten years. Too many environmental problems remain to be overcome.

Communications Substitution

As yet there is no credible evidence that increased communications connectivity (such as through the Internet, videoconferencing, and teleconferencing) has adversely effected air travel. If anything, the panel believes that increased communications connectivity tends to stimulate air transportation demand by facilitating geographically diverse business contacts and meeting arrangements.