


# Airline Liberalisation

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 Further liberalisation of international air transport is essential. The liberalisation of operational and ownership restrictions is not an easy process, but it can be a very beneficial one. Experience from other industries demonstrates the positive impact it can have for both consumers and producers. A modern, commercial and global airline industry requires modern, commercial and global rules.

International air transport is governed by a 60 year-old set of rules, the bilateral system. It was designed for another age. Bilateral Air Service Agreements contain restrictions on the number of airlines and frequency of services on many international routes, while many countries have limits on airline ownership and control by foreign nationals. Airlines have built an industry that is safer, more accessible and more efficient than ever before. Now we need governments to bring policy in line with the changes airlines have achieved. The future success of the industry rests on greater commercial freedom to serve markets where they exist and to merge and consolidate where it makes business sense.

## LESSONS FROM OTHER INDUSTRIES ON THE IMPACT OF LIBERALISATION

IATA worked closely with consultants OXERA to analyse the impact of operational (i.e. product market) and ownership (i.e. capital market) liberalisation in four different industries: retail banking, energy, telecoms and media. The parallels of these industries to air transport are close: strategically important, network oriented and customer-focused. Each industry also has a definitive point in time at which liberalisation was undertaken. The analysis looked at the impact of liberalisation for both consumers and producers through its influence on competition, efficiency, costs and the strategic responses of firms. A copy of the full report is available from: [www.iata.org/economics](http://www.iata.org/economics).

### LIBERALISATION PROVIDES BENEFITS FOR CONSUMERS

Further airline liberalisation can provide significant benefits for consumers. Experience in the other industries shows that liberalisation can:

- **Lower Prices.** For the EU countries that have liberalised their energy markets, electricity prices are 10-20% lower and gas prices 35% lower than they would have been without liberalisation. In Korea and Japan, liberalisation of the telecoms industry has also seen the cost of long-distance calls fall by up to 50% as new entrants engage in price competition with incumbents;
- **Increase Output and Choice.** Liberalisation of TV and radio markets has increased the available output and increased the number and diversity of options, including specialist channels for different consumer tastes (e.g. Indian TV, New Zealand radio);
- **Improve service quality.** For example, relaxing ownership restrictions in the US banking sector has increased both service quality and the ease of access to it. Customer service quality has increased, as shown through satisfaction surveys. Service fees have risen to cover the extra costs involved but consumers are willing to pay for higher quality.

### IT CAN ALSO PROVIDE BENEFITS FOR PRODUCERS TOO

Full liberalisation that provides firms with the full commercial freedoms to respond to increased competition can:

- **Improve capacity utilisation** towards its optimal level (e.g. UK energy markets).
- **Increase productivity** for both incumbents and new entrants (e.g. telecoms in Japan). Firms also look to compete over the longer-term through innovation.
- **Transfer best practice.** It helps to transfer managerial and technological knowledge and best practice (e.g. New Zealand media sector).
- **Increase investment.** It can increase investment in the sector (e.g. telecoms) and lower the cost of capital as firms have access to more efficient sources of finance.
- **Improve profitability.** It can help firms to lower costs, improve efficiency and to develop economies of scale – resulting in improved profitability (e.g. EU banking).
- **Increase a firm's market value.** It allows for a greater potential for takeovers and hence for shareholders of target companies to benefit from the significant share price appreciation that characterises such activity (e.g. Nestlé)

## STRATEGIC RESPONSES TO LIBERALISATION

In the industries analysed, firms have typically reacted to liberalisation through the following strategic responses:

- **Expansion into new markets.** Liberalisation can lead to greater competition in a firm's main market, but can provide significant opportunities for firms to expand into new geographical markets too. However, if liberalisation is not introduced at a similar pace (e.g. EU energy markets) it may not provide a level playing field for firms to compete.
- **Diversification into new products.** In response to increased competition, some firms have looked to offer a wider range of product choice (e.g. Indian media sector), helping to attract a wider customer base.
- **Specialisation in niche products.** Liberalisation can lead firms to concentrate on where their competitive strength lies, ensuring that a core customer base is retained and revenues are maximised among these clients (e.g. US banking).
- **Market exit.** Incumbents may be forced to exit some markets in response to competition, but new entrants have also found that they are unable to gain a foothold in some markets when faced with efficient incumbent firms or a culturally-different customer base and are forced to exit (e.g. German TV sector).

## KEY LESSONS FOR THE AIRLINE INDUSTRY

### 1. Liberalisation is not a seamless process, but it is possible.

Lessons from the other industries show that full liberalisation is often not a seamless process. Liberalising markets over different timescales or removing restrictions on operations without removing those on ownership can create distortions and reduce the potential benefits that are available. However, a discussion paper produced by the UK Civil Aviation Authority<sup>1</sup> shows that a clear pathway to full liberalisation for the airline industry, that is consistent with optimal safety and security standards, does exist.

### 2. Full liberalisation is required to maximise the potential benefits.

The benefits of liberalisation are maximised where both operational and ownership and control restrictions are removed. The structure of the airline industry means that removing operational restrictions can lower barriers to entry to the industry. But it will not maximise the potential benefits to customers, airlines and the wider economy unless ownership restrictions – and the barriers to exit or to adjust capacity – are also removed.

### 3. Further liberalisation can provide substantial consumer benefits.

Further operational and ownership liberalisation can protect and enhance the consumer benefits, in terms of greater choice and lower fares, already obtained from liberalisation so far in the airline industry. It can also widen and expand these consumer benefits to new regions and routes that currently have highly regulated markets. Therefore, it can continue to provide benefits for airline users, while also providing significant benefits for the wider economy. For example, a recent study by Intervistas<sup>2</sup> found that liberalising some of the current major restricted country pair routes could increase traffic by 63% and generate an additional \$490 billion of GDP.

### 4. Greater commercial freedom allows airlines to improve productivity and efficiency.

Liberalisation can create the freedom for airlines to operate on a fully commercial basis. This will allow them to allocate capital more efficiently, to respond better to changes in demand in markets and to improve productivity. It provides a platform for the airline industry to expand or rationalise capacity and ownership in accordance with customer needs. It can also improve the return on capital invested that is earned by the airline industry as a whole.

### 5. Liberalisation can provide benefits for a flexible and efficient firm.

In a fully liberalised market, the key for firms is to recognise where its competitive advantage lies and to focus on it. Liberalisation provides opportunities for expanding into new markets as well as threats to existing markets. There will be winners and losers from liberalisation. However, experience from the other industries has shown that firms who are efficient, flexible and responsive to customer needs – regardless of their size – are best placed to benefit.

### 6. A multilateral approach to liberalisation is preferable.

A multilateral approach is likely to have more substantial and positive implications for both consumers and airlines. Bilateral negotiations remain the main forum for discussion and a useful mechanism for reform, but the rationale for more supranational leadership is strong. Globally brokered agreements (e.g. through ICAO) are desirable but face practical difficulties. Therefore, at least for the short-term, co-ordinated bilateral and/or regionally focused negotiations can offer the best way forward.



Governments must now provide the leadership that the airline industry needs. Governments will not all be able to liberalise markets at the same pace. But it is important that they all recognise the need to move in the right direction. Reform is now necessary to support the long-term health of the industry.

<sup>1</sup> See CAA (2006), "Ownership and Control Liberalisation: A Discussion Paper", [www.caaerg.co.uk](http://www.caaerg.co.uk).

<sup>2</sup> See Intervistas (2006), "The Economic Impact of Air Service Liberalisation".