

Is EU's Open Aviation Policy Good for Air Transport?

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International air transport is at a crossroads. The aviation industry's center of gravity has moved toward the East, with main hubs in the Gulf region and ever-increasing passenger markets located in Asia. Long-haul inter-continental low-cost-carriers have emerged. Global alliances and their effects on competition have come into question. These outcomes have led to a reignited interest in the issue of liberalization in aviation: European regulators now need to balance concerns about fair competition with their own decades-long push for the multilateral liberalization of the aviation industry.

The European Union has been at the forefront of market liberalization in international air transport for the last few decades, relaxing the conditions of market access such as airline designation, fare setting, and flight frequencies. After deregulating its domestic market in the 1990s, in 2005 the EU began exporting its open market policies to its neighbors and key strategic partners through comprehensive aviation liberalization packages. With this pioneering approach, individual countries handed over the economic regulation of their international air markets to regional bodies like the EU. This ushered in the era of a potential multilateral approach for achieving global air transport market liberalization.¹

In a recent study, we looked at the economic effects of the EU's external aviation policy with third countries, focusing on 27 countries with which the EU has Air Services Agreements with varying degrees of liberalization.²

Perspectives on Aviation Liberalization

In the last few years there has been renewed interest in air transport liberalization, with a number of studies looking at its impact in many parts of the world and its role in future market developments. A recent

OECD forecast of global air transport demand identified the beneficial and welfare effects of liberalization. But big airlines in the EU and the U.S. are pointing to possible negative effects of liberalization, citing "destructive competition" or "heightened competition" as more and more markets open up.



¹ Other regional approaches to air transport negotiations do exist elsewhere. Notable examples are the 1999 Yamoussoukro Decision which liberalized intra-African air transport market and the 2000 Asian Pacific Economic Community (APEC) Agreement between the U.S., Brunei, Singapore, Chile, Peru, and New Zealand. Recently, the Association of Southeast Asian Nations (ASEAN) has been negotiating with the U.S. and EU to put in place multilateral liberalization. The signatory members of these regional arrangements, however, still maintain greater freedom in the economic regulation of their domestic and international air transport markets compared to EU member states.

² The full report can be accessed at <http://publications.jrc.ec.europa.eu/repository/handle/JRC105822>. It was written during Abate's tenure at the Swedish National Road and Transportation Research Institute (VTI) before he joined the World Bank. Panayotis Christidis is a Big Data Lead Scientist at the European Commission's Joint Research Centre. The views expressed here are purely those of the authors and may not in any circumstances be regarded as stating an official position of the World Bank or the European Commission.

These fears correspond to the expansion of the Gulf region's airlines, the new flights by inter-continental low-cost carriers, and the dominance of global airline alliances.³ The result has been policy uncertainty in major aviation markets such as the EU and the U.S., which endangers liberalization efforts.

Studies have shown that cost structure, cyclical demand, fuel price fluctuations, and infrastructure bottlenecks determine the fortunes of the air transport industry--not "destructive competition." European major carriers usually have a higher cost base, especially in labor costs, when compared with their rivals. Some argue that this high cost base, not liberalization, is making Europe lag other regions in terms of connectivity and airline profitability, to the extent that it is bypassed as a global hub.

Thanks to deregulation, the expansion of low-cost carriers has stimulated cost cuts throughout the aviation industry. The benefits of market forces in the confines of the European Union are well documented. What remains to be seen is whether the EU and its non-EU partners could benefit from a more liberal aviation policy.

The Impact of Liberalization

Over the past 10 years, the EU has concluded or negotiated External Agreements with more than 50 countries, including the open skies policy between the EU and the U.S. in 2008. The EU is the largest regional group that negotiates comprehensive Air Services Agreements on behalf of its members. There are three types of external agreements:

- Horizontal Agreements, which extend to other (European) community carriers the provisions of Bilateral Air Services Agreements that exist between an EU member country and a non-EU member country, regardless of how liberal the provisions are
- European Common Aviation Area Agreements, which are signed with the EU's neighbors
- Key Strategic Partners Agreements, which are comprehensive liberalization packages signed with countries elsewhere in the world

Our study explored whether routes governed by external agreements with 27 of these countries have lower fares and higher service quality and load factors (the percentage of available seats filled or of freight capacity utilized) compared with those governed by traditional bilateral agreements.

We compared the change in passenger flows within a country pair before and after the introduction of the EU's external policy (the treatment group) with the corresponding flows calculated for countries that maintain traditional bilateral agreements with the EU (the control group). The study analyzed traffic flows between EU countries and external partners on four continents where the EU has varying degrees of liberalization, and found that the external policy resulted in up to a 20 percent reduction in fares. These changes in fares spurred a 27 percent increase in demand. Although the external agreements had no statistically significant effect on flight frequencies, carriers that operated in routes governed by an external policy had higher capacity utilization.

The Way Forward

Although the EU has always been considered as the "vanguard" of the movement for liberalized international air transport markets, the progress in terms of agreements actually signed is still slow.

- The progress in negotiations with each of the EU's external partners depends on several economic, geographic, market, or political aspects that often raise concerns about the impact that opening up the market could have on the aviation market of the EU or its partner.
- While the overall policy strategy of the EU is building open aviation partnerships in many parts of the world, its recent emphasis on "fair competition" and "level playing field" has been interpreted by some as protectionist.
- There will always be winners and losers in a competitive air transport market, as in any other industry. There are also legitimate fair competition issues as rivalry between players continues to intensify. Such outcomes are best dealt with by market forces and through general competition policies rather than by direct government involvement in the economic activity of the industry.

Our study provides compelling evidence that the EU's external policy, for the most part, has had positive economic effects. It is crucial that the EU continues its pioneering role by expanding its external aviation policy. Given the well-documented benefits of liberalization, protectionism is neither desirable for a well-functioning airline industry nor beneficial to the society at large, especially for those in much of the developing world where the industry is still tightly regulated.

¹ There are three main global alliances: Star, SkyTeam, and Oneworld. They account for more than 60 percent of the global market share, measured in revenue passengers-kilometres.

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