



International Civil Aviation Organization

INFORMATION PAPER

Information Paper

16/08/06

English only

**ICAO GLOBAL SYMPOSIUM ON AIR TRANSPORT LIBERALIZATION
(Dubai, 18 – 19 September 2006)**

**The Economic Benefits of Liberalising Regional Air Transport
A Review of Global Experience**

(Presented by ComMark Trust)

The attached “Headline Report” is produced by ComMark Trust, which provides an interim summary of a study of the potential benefits of air transport liberalization within southern Africa. The full report, including the results of an extensive econometric analysis currently under way, will be published later this year.



The Economic Benefits of Liberalising Regional Air Transport – A Review of Global Experience

Headline Report¹

Anton Richman and Chris Lyle

November 2005

¹ This report was commissioned by the ComMark Trust to explore the cost to economic growth of the highly-regulated air transport industry within the Southern African Development Community (SADC) and between SADC and other African countries. The Trust is a regional initiative which aims to reduce poverty through improving the legal, regulatory, policy and business service environments in high-growth, pro-poor sectors. It concentrates on three core areas: textiles and apparel, agribusiness and tourism.

Contents

EXECUTIVE SUMMARY	3
1. CATALYSING ECONOMIC GROWTH THROUGH OPENING AFRICA’S AIRWAYS	5
2. THE GLOBAL INDUSTRY	7
3. LIBERALISATION VS REGULATION – THE AFRICAN EXPERIENCE	8
3.1 <i>Southern African regulatory restrictions</i>	9
3.2 <i>Stalled African liberalisation initiatives</i>	11
4. THE EUROPEAN EXPERIENCE	12
5. BENEFITS TO DEVELOPING ECONOMIES.....	13
6. ADDRESSING CONCERNS ABOUT INTRA-AFRICAN LIBERALISATION.....	14
6.1 <i>Achieving economies of scale</i>	16
7. CONCLUSIONS	16

The ComMark Trust

Making Commodity & Service Markets work for the Poor in Southern Africa

PostNet Suite 598 Private Bag X29 Gallo Manor 2052
Tel +27 11 802 0785 Fax + 27 11 802 0798
commark@commark.org www.commark.org

Executive summary

The results of this research indicate that Southern Africa's economic growth and job creation could be significantly higher if governments lift the limits they have placed on airline flights between their countries.

A major focus of air transport benefits for Southern Africa is in relation to the tourism industry. The industry is small business and labour intensive, providing a range of employment opportunities as well as having a multiplier effect through other sectors of the economy. Tourism includes visits for holidays; visiting friends and family; meetings, incentives, conferences and exhibitions (known in the industry as MICE); and visiting for business and retail shopping.

Air traffic within South Africa has surged in the 10 years since liberalisation of the domestic market. However, the regional aviation market between many African countries remains highly regulated, with limited competition, restrictions on flight frequency and / or seat capacity and resulting high ticket prices.

Many countries with weak, state-owned airlines feel the need to protect their airlines from losing money by restricting competition. They focus on the potential impact on the national airline rather than evidence from around the world that the broader economic benefits of cheaper, convenient air travel far exceeds the direct revenue and employment generated by a country's airline. This is all the more so when the operation of the national airline is contingent on direct financial subsidies.

Since the launch in South Africa of low-cost, no-frills airlines four years ago, enabled by liberalisation, the domestic air travel market has grown by more than 50%. On a recent sample of domestic flights, the budget carriers on average charged less than half the price of full-service airlines, and the latter's prices have also come down since the launch of low-cost flights.

This contrasts with constrained routes between SADC countries. For example, the cost per km of flying from Johannesburg to Maputo, a highly constrained route on which only the national airlines of each country are allowed to fly, can be three times the cost per km of flying to Windhoek, a relatively unconstrained route.

The bilateral agreement between South Africa and Angola allows only a single airline of each country to fly the route and only three times a week each, so that there is not even a daily flight between them - this at a time when investment and trade between the two countries is growing rapidly.

The fact that the supply of seats is so restricted can make it as expensive to fly from Johannesburg to Luanda as from Johannesburg to London, three times the distance.

While regulation is intended to protect the smaller national airlines, the air service restrictions actually encourage inefficiency, distort the market and deprive the regulating country of tourism and business spend.

The longer the governments restrict competition in their air traffic markets, the less competitive their airlines become. Small, weak airlines fall further behind as stronger airlines continuously improve their product, efficiency, market reach and penetration.

Air transport regulatory policy should take into account the net benefits to the economy at large, not just the potential impact on the national airline. The economic multiplier effects of the indirect, induced and catalytic impacts of the air transport industry far exceed the direct output and employment generated by a country's airlines.

The cost to economic growth of these regulatory constraints can be readily determined by an econometric study. Air traffic data and up-to-date regulatory information is essential to do this study. Unfortunately we have not yet been able to get access to the required data and information to carry out this research.

ComMark therefore concentrated on a comparative review of global experiences with liberalisation of air transport, particularly as pertaining to African conditions.

The experience of other countries, including developing countries, provides evidence of the following:

1. Air transport liberalisation has been successful in a range of socio-economic and geographical environments as a channel and catalyst for increased economic growth and employment, especially related to tourism.
2. Any decline in market share and traffic of the national carrier is likely to be much more than compensated by the benefits to the economy at large from increased air traffic to and from the country.
3. The alternative to liberalisation is likely to prove much more costly to both a national carrier and the economy in the medium-term, with a probably increasing need for public subsidy to the carrier and an increasing opportunity cost for development of the national economy.

This evidence suggests that Southern African governments should:

1. Liberalise the restrictions on airlines entering and growing the air routes between SADC countries and into the rest of Africa;
2. Improve the competitiveness of national airlines on cost, service and product;
3. Allow mergers or alliances between SADC airlines to achieve economies of scale; and
4. Enforce competition rules to prevent unfair competition and ensure that passengers derive ongoing benefit from the liberalisation of air routes.

A combination of these strategies can create a win-win solution for increased air travel, generating benefits in economic growth and job creation, and stronger local airlines.

ComMark also intends to pursue an econometric study to quantify the economic cost of the regulatory constraints of the air transport industry, depending on accessing the necessary data regarding passenger numbers and details of the bilateral agreements between countries.

1. Catalysing economic growth through opening Africa's airways

Air transport liberalisation has been a catalyst for increased economic growth and employment around the world. In a liberalised aviation market governments make sure that airlines are safe and reliable but do not protect them from fair competition on any routes.² They leave it to market forces to determine the number of airlines competing, flight frequency, seat capacity and ticket prices.

The airline industry has grown rapidly in the parts of the world where it has been liberalised. This process started in the United States in the late 1970s, spread to Europe a decade later and has since been implemented to varying degrees in the rest of North and South America, Asia and Australasia. Most African countries have not yet liberalised their air services.

A major focus of air transport benefits for Southern Africa is in relation to the tourism industry. The industry is small business and labour intensive, providing a range of employment opportunities as well as having multiplier effects through other sectors of the economy. The tourism industry includes travel for:

- Holidays
- Visiting friends and family
- Meetings, incentives, conferences and exhibitions (known in the industry as MICE)
- Business and retail shopping.

Economic integration

“Intra-Africa liberalisation would create the appropriate environment for the most proactive carriers of the continent to quickly extend their network and offer air services where they are now missing.

“Free movement of people and goods would be enhanced. Travel time would be shortened, which would definitely accelerate economic integration.”

– *African Airlines Association*
Secretary-General, Christian Folly-Kossi, May 2005

Overall, African tourism into South Africa is on the increase.³ At 4.7 million travellers in 2004, Africans contributed 70% of total foreign arrivals in South Africa, and this channel is growing at 4% a year.

One million people from other African countries visited Johannesburg in 2004 for business and retail shopping, 300 000 of whom travelled by air. Travellers from Africa in the business and retail category spent an average of R3 721 per day, higher than the average daily spend of all foreign tourists in the same category (at R2 636).

The importance of tourism has also been acknowledged by the New Partnership for Africa's Development (NEPAD), which sees it as one of the sectors with the most potential to contribute to the economic regeneration of the continent.

However, the highly regulated nature of regional air travel, which manifests itself in the lack of frequent direct flights and the high cost of travel between African countries, presents a major barrier to growth in the industry and its associated economic benefits.

² However, governments should and do enforce competition rules to prevent anticompetitive practices

³ 2004 Annual Tourism Report by SA Tourism Strategic Research Unit

Air traffic within South Africa has surged in the 10 years since liberalisation of the domestic market. However, the regional aviation market between many African countries remains highly regulated. On routes between many Southern African Development Community (SADC) countries⁴, competition and capacity are restricted, flight frequency is low and ticket prices are high. On two thirds of these routes business and leisure travellers have to be content with an average of one flight every second day.⁵

This study flows from ComMark Trust's focus on tourism as a sector with high potential for strong, pro-poor growth. ComMark's interest is in facilitating economic growth and job creation through the liberalisation of air transport between SADC countries and between SADC and the rest of Africa.

Countries with strong airlines, such as Algeria, Egypt, Ethiopia, Kenya and South Africa want liberalisation. They know their airlines and economies will benefit from increased traffic. They are backed by Cameroon, Ghana, Tanzania and Uganda, among others, which have seen the economic benefit of increased air traffic, even without large airlines of their own.

However many countries with weak, state-owned airlines feel the need to protect their airlines from losing money by restricting competition. They focus on the potential impact on the national airline rather than evidence from around the world that the broader economic benefits of cheaper, convenient air travel far exceeds the direct revenue and employment generated by a country's airline. This is all the more so when the operation of the national airline is contingent on direct financial subsidies.

The cost to economic growth of these regulatory constraints can be readily determined by an econometric study. Air traffic data and up to date regulatory information is essential to do this study. Unfortunately we have not been able to get access to the required data for this. Of the SADC governments, only Tanzania and South Africa have responded to requests for information.

This study therefore concentrated on doing a case study of global experiences, particularly as pertaining to African conditions. On the basis of comparative research we believe there remains a strong case for pursuing an econometric study of the benefits of liberalisation between SADC countries as well as to and from other African countries.

This headline report summarises the finding of our initial research, during which a review of liberalisation experiences in different parts of the world was undertaken. It consists of six sections:

- * The Global Industry
- * Liberalisation vs Regulation – The African Experience
- * The European Experience
- * Benefits to Developing Countries
- * Addressing Concerns about Intra-African Liberalisation
- * Conclusions

⁴ The fourteen SADC countries include most African countries south of the Equator.

⁵ Embraer market study September 2005

2. The global industry

Air transport is a major contributor to job creation and economic growth. It has an economic impact exceeding \$2.9 trillion or 8% of global GDP and generates 29 million jobs globally, falling into the following categories:

- Around 5 million are directly employed⁶;
- There are 5.8 million indirect jobs through purchases of goods and services from companies in its supply chains;
- 2.7 million are induced jobs through spending by industry employees; and
- Another 6.7 million direct and 8.8 million indirect jobs are the result of air transport's catalytic impact on tourism.⁷

In Africa, the air transport industry generates around 470 000 jobs and contributes more than \$11.3 billion to GDP on the continent (direct, indirect and induced impacts). If catalytic impacts are included, the jobs increase to 3.1 million and GDP to \$55.5 billion.⁸

Figures from international studies suggest the following multiplier effects for SADC countries:

- Every \$100 of revenue produced by air transport triggers additional average demand of \$390; and
- Every 100 jobs generated by air transport trigger an additional average demand of 565 jobs in other industries.⁹

In addition to tourism, there are other channels through which the air transport network facilitates growth:¹⁰

Trade: 40% of world trade by value is transported by air. It is important between distant markets, for high-value, low-volume / low-weight products and suppliers of time-sensitive goods (eg: perishable products such as flowers, fruit and fish from Southern Africa to Europe). The air transport network is critical to enabling export-orientated growth strategies in developing and transition economies.

Growth through tourism

“Perhaps the major contribution that air services can make to economic development services in Africa is through developing and promoting international tourism.

“Tourism facilitates poverty reduction by generating economic growth, providing employment opportunities and increasing tax collection, and by fostering the development and conservation of protected areas and the environment.

“Economies with high growth during the last decade (eg: Mauritius, Tunisia, Egypt, Ghana) have tended to be those where the tourist sector is key to economic activity.”

– *Oxford Economic Forecasting, The Contribution of Air Transport to Sustainable Development in Africa*, 2003

⁶ 4.3 million people in the airline and airport industry, 730 000 people in the civil aerospace sector (manufacture of aircraft, systems, airframes and engines, etc)

⁷ Oxford Economic Forecasting / Air Transport Action Group, (OEF/ATAG) 2005, *Economic and Social Benefits of Air Transport*. This catalytic impact results from employment and income generated in the economy by the wider role of attracting economic activities, such as inward investment and inbound tourism.

⁸ OEF / ATAG 2005

⁹ Analysis by Chris Lyle, derived from International Civil Aviation Organisation (ICAO) Circular 292, *The Economic Contribution of Civil Aviation* and similar figures published by the ATAG, a coalition of organisations and companies from civil aviation and related industries.

¹⁰ OEF / International Air Transport Association (IATA) March 2005 *Measuring Airline Network Benefits*

Company location/investment decisions: A number of surveys point to the impact of air transport on the location of investment. According to one survey, 56% of companies in Europe consider international transport links an essential factor in deciding where to locate.

Labour supply: The air transport network also helps to improve economic performance by making it easier for companies to attract high-quality employees, improving a region or country's labour supply. This is important for senior staff and professionals, for whom good international links can be an influence on their decision as to where to live and work.

Productivity and market efficiency: The air transport network can enhance the productivity and efficiency of economies by, for example, increasing the potential market in which companies operate, allowing firms to exploit economies of scale and encouraging greater R&D; enabling companies to implement best international business practice in production and distribution (eg just-in-time); and strengthening competitive pressures on companies. Not surprisingly, the high growth sectors of the economy – particularly in knowledge-based industries – are typically among the most dependent on air services.

3. Liberalisation vs regulation – the African experience

A liberalised aviation market is one that has been economically deregulated, such as within South Africa.

Within **South Africa**, the benefits of liberalisation to consumers have been dramatic. Since the launch of low-cost, no-frills airlines four years ago, enabled by deregulation, the domestic air travel market has grown by more than 50%¹¹. The impact on a tourist route such as Johannesburg - George has been even greater, with passenger numbers doubling in the past three years¹².

On a recent sample of domestic flights, the budget carriers on average charged less than half the price of full-service airlines, and the latter's prices have also come down since the launch of low-cost flights.¹³

Egypt has also had spectacular results through adopting more liberal air transport policies in the 1980s, aimed at exploiting its wealth of heritage sites and coastal assets. Growth in international air passenger traffic and tourist arrivals over the past 20 years has averaged 8% a year (11% a year over the past ten years), despite political uncertainty in the

¹¹ Interview with kulula.com director Gidon Novick.

¹² Airbus market survey 2005

¹³ Comair market research, October 2005.

Freedoms of the air

Air transport is a unique industry in being governed by bilateral and, recently, intra-regional air service agreements negotiated between countries.

International air traffic rights are categorised as "Freedoms of the Air":

- The first freedom allows aircraft of one country to overfly another country without landing.
- The second freedom allows such aircraft to land in another country "for non-traffic purposes". This covers non-commercial landings en route, for example, to pick up fuel or to disembark a sick passenger.
- The third and fourth freedoms provide for aircraft of one country to transport passengers, cargo and mail to and from another country.
- The fifth freedom provides for aircraft of one country to transport passengers, cargo and mail between a second and third country on a flight originating in or ultimately destined for the first country.

The first two freedoms are routinely granted in air service agreements. The third, fourth and fifth freedoms are often limited in the agreements.

region and some major setbacks because of terrorism. This growth has been achieved by a careful co-ordination of aviation and tourism policies.

The market share of foreign carriers has increased but the national carrier, Egyptair, has held its own and maintains an international passenger traffic share of 30%. In 2004, a record 8.1 million visitors earned the country \$6.6 billion in hard currency. This increase is mainly from inter-continental travel.

An African multi-lateral initiative which has succeeded in liberalising air transport is the **East African Community**. This intergovernmental organisation of Kenya, Tanzania and Uganda is aimed at co-operation among the three partner countries in, among others, political, economic and social fields. In July 2005 the aviation bodies of the three countries agreed to harmonise aviation policies and regulations and extend full privileges to airlines licensed and registered in the Community. On a bilateral basis, Kenya and Uganda have already completely opened up air services between the two countries and with Ethiopia.

In general, though, Africa's air traffic growth is being stifled by most African governments resisting liberalisation of the air routes between themselves. Countries with smaller, weaker airlines insist on including constraining provisions in bilateral agreements to limit the level of competition from larger, stronger airlines of other countries.

3.1 Southern African regulatory restrictions

Most bilateral air service agreements between Southern African States permit each country to designate only one airline to operate routes between the two countries.¹⁴

Even where multiple designation of airlines is allowed, frequency and/or capacity limitations usually still apply. This prevents the airlines from meeting market demands and imposes inefficiencies such as two South African airlines being limited to flying a route only a couple of times a week and neither achieving economies of scale on the route.

Most South African airlines are not able to operate as many routes or frequencies as they want to between Johannesburg and the major cities in the other Southern African countries. This keeps ticket prices high, passenger numbers low and constrains tourism spend in the sub-continent.

South African no-frills carrier kulula.com has just launched services on the Johannesburg - Harare and Johannesburg - Windhoek routes. To do this it is cannibalising scarce traffic rights allocated to its sister airline, BA/Comair, as it cannot get more frequencies for itself. Kulula.com has also announced that it would like to fly the Johannesburg – Lusaka route and is working on getting the traffic rights to do so.

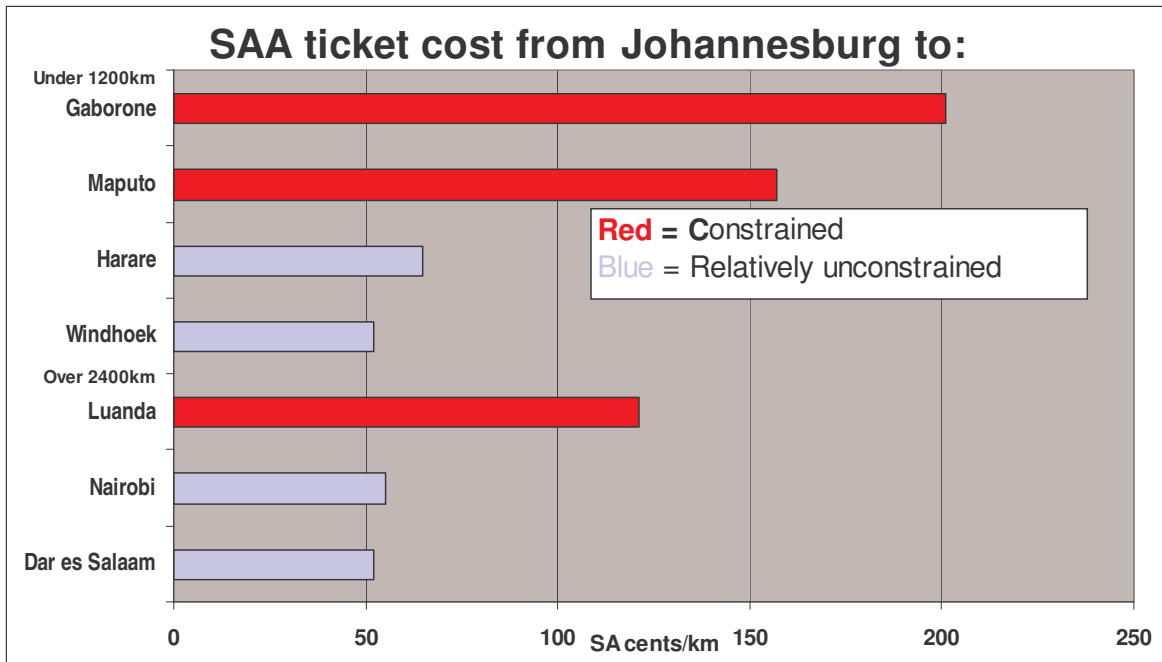
Johannesburg – Luanda would be another prime candidate for increased competition. The bilateral agreement between South Africa and Angola allows only a single airline of each country to fly the route and only three times a week each, so that there is not even a daily

¹⁴ This is according to the records of the International Civil Aviation Organisation. The transport authorities of most Southern African countries have not responded to ComMark requests for updated information on their bilateral air service agreements.

flight between them - this at a time when investment and trade between the two countries is growing rapidly.

The fact that the supply of seats is so restricted can make it as expensive to fly from Johannesburg to Luanda as from Johannesburg to London, three times the distance. High ticket prices, an inconvenient flight schedule and the lack of available seats are likely to discourage both business and leisure tourists from flying between South Africa and Angola.

A sample of SAA's ticket prices from Johannesburg to a range of Southern African destinations shows a stark correlation between constrained routes and high fares.¹⁵



For destinations under 1 200km from Johannesburg:

- The cost per km is 52c to Windhoek and 65c to Harare. These are relatively unconstrained routes where BA/Comair competes with the national carriers and Comair's no-frills carrier kulula.com has just entered these markets.
- This contrasts with R1.57 per km to Maputo and R2.01 per km to Gaborone. Both of these are highly constrained routes where only the national airlines of each country are allowed to fly the route.¹⁶

For destinations between 2 400 and 2 900 km from Johannesburg:

- The cost per km is 52c to Dar es Salaam and 55c to Nairobi. These are relatively unconstrained routes due to a more liberal approach by the governments involved. Although only the national airlines operate the routes at present, competitors can apply to enter these markets.

¹⁵ These were the cheapest return ticket prices excluding taxes for each route quoted by the SAA call centre on 10 November 2005 for travel on SAA from Johannesburg on 14 November, returning on 16 November. A travel agent confirmed that other full-service carriers offered similar prices. Kulula was lower for Harare and Windhoek.

¹⁶ In the case of Gaborone, SAA feeder carrier SA Express operates the route instead of SAA.

- This contrasts with R1.21 per km to Luanda, a highly constrained route that protects SAA and the Angolan national airline TAAG on the route from any competition.¹⁷

Agreements by SADC countries with other African countries follow a similar pattern to the intra-SADC ones. According to International Civil Aviation Organisation (ICAO) records, most only permit designation of a single airline and constrain flight frequency and/or seat capacity.

3.2 *Stalled African liberalisation initiatives*

In the 1980s there was concern that the bilateral structure in Africa was impeding air transport development, leading to poor quality and quantity of services, weakness of some airlines and a disjointed network. This led to a meeting of African Ministers responsible for civil aviation in 1988 in Yamoussoukro, Côte d'Ivoire, at which an Africa-wide air transport policy was adopted.

In the light of limited implementation of this policy, the Ministers met again in Mauritius in 1994 and in Yamoussoukro again in 1999.

The latter meeting produced the Yamoussoukro Decision, which was given more binding force by a meeting of the Heads of State and Government of the (now) African Union in July 2000.

The Decision calls for gradual Africa-wide transition towards multiple designation of airlines, no regulation of frequency or capacity, and complete liberalisation of non-scheduled and air cargo operations.¹⁸ The Decision should take precedence over any bilateral or multilateral agreement on air services between state parties which are incompatible with it.

It is now six years since the Decision was adopted and few African countries have implemented it.

In an attempt to break the regulatory log jam and speed up liberalisation, South Africa hosted a meeting of African Ministers responsible for air transport at Sun City in May 2005.

Yamoussoukro Decision

The May 2005 meeting of African Ministers responsible for air transport in Sun City failed to agree a timetable for implementation of the Yamoussoukro Decision. However, for the first time the countries agreed to report to the Monitoring Body on their status of implementation and to include a plan of action for giving full effect to it.

The resolution, which was subsequently endorsed by the Executive Council of the African Union, also called for:

- The long-awaited African Air Transport Executing Agency to be established under the auspices of the African Union;
- The role of the Air Transport Monitoring Body created by the Yamoussoukro Decision to be strengthened and clarified;
- This Monitoring Body to harmonise and implement the various competition rules established by Regional Economic Communities on the continent; and
- Implementation of the Yamoussoukro Decision to be included in the African Peer Review Mechanism of NEPAD.

¹⁷ This is based on SAA's full economy fare as the airline was fully booked on the route for the week of 14 November as well as the following week.

¹⁸ In addition to no limitation on the first four freedoms of the air (involving overflight and technical stops in any African country, as well as commercial air traffic rights of the airlines any African country to and from another African country), the Decision grants "fifth freedom" traffic rights for the airline of any African country to provide onward air services between a second and third African country.

Although aspects of the Decision were clarified at the meeting (see box on previous page) unfortunately no timelines were agreed for implementation, effectively reducing it to a voluntary initiative which will only be implemented by African governments who believe they will benefit from liberalisation.

Other governments will move on liberalisation only when they see the benefits for their own economies. But the longer they restrict competition, the less competitive their airlines become. Small, weak airlines fall further behind as stronger airlines improve their product, efficiency and market reach.

4. The European experience

The European Commission pursued a comprehensive multinational agreement fully liberalising aviation services and investment within Europe over the period 1988 to 1992.

The Commission's liberalisation measures essentially removed all commercial controls on aviation services and investment within the European Union member countries, as well as Iceland, Norway, and Switzerland, which adopted the measures without joining the European Union.

Airlines from member States of the European Common Aviation Area can operate with full traffic rights and no capacity restrictions on any route within the Area. Perhaps most significantly, European nationals or companies from any member country can buy or set up an airline in any other member country. This right of establishment has enabled, for example, British Airways to own and operate Deutsche BA as a German company in Germany.¹⁹

European air traffic surged following liberalisation. Between 1992 and 2000, the number of scheduled airline routes between European countries increased by nearly 75%, the number of flights increased by 88% and the number of seats offered more than doubled.²⁰

Liberalisation allowed more competition and the number of international scheduled routes with three or more carriers increased by more than 250% in the following eight years.

Increased competition also resulted in lower ticket prices.

In real terms, published normal economy air fares decreased by 5% and published promotional fares fell by about 30% from 1992 to 2000.²¹ Overall, average ticket prices fell by more than 15% in real terms over this period.²²

¹⁹ *The Economic Impact of an EU – US Open Aviation Area*, December 2002, prepared by the Brattle Group for the European Commission's Directorate-General Energy and Transport.

²⁰ *The European Experience of Air Transport Liberalisation*, 2003 report to ICAO by the European Civil Aviation Conference, European Community and European Commission.

²¹ 2003 EU report to ICAO

²² There is no comprehensive data in Europe on the proportion of passengers buying the different types of fares and how these proportions have changed over time. However, Association of European Airlines data indicates that average yields in the European area increased by 1% in nominal terms compared to inflation of 19% cumulative over the eight year period.

Oxford Economic Forecasting (OEF) has found that the catalytic impact of the expansion of air services has boosted European GDP by 4% over the past decade.²³

Part of the reason for this is that improvements in the air transport network encourage increased business investment. OEF found that increased air transport usage in Europe accounts for over one-third of the growth in business investment over the past decade.²⁴

The European Commission engaged the Brattle Group in 2002 to conduct a major study on the economic effects of creating a single, open market in aviation covering Europe and the US.²⁵ The study found that air travel would surge and fares would drop if existing restrictions were lifted. It concluded that an EU-US “Open Aviation Area” would:

- Increase transatlantic travel by between 9 and 24%.
- Boost intra-EU travel by between 5 and 14%.
- Increase direct employment by 1-3% in the EU and US aviation industries
- Create about €5.2 billion a year in consumer benefits through lower fares and increased travel, with more than half of those benefits going to transatlantic passengers. Of this, the lion’s share (€3.1 billion to €3.8 billion annually) comes from gains to consumers that do not involve any reduction in airline profits
- Increase economic output in directly related industries by \$3.6 billion to \$8.1 billion a year.²⁶

To estimate the impact of replacing these restrictive bilaterals with an open aviation area, the consultants used regression analysis to calculate the impact of the 1990s Open Skies agreements between the US and other EU countries, which replaced similarly restrictive agreements.

Their analysis, the first rigorous assessment of Open Skies agreements, shows that these agreements led to a 10% increase overall in transatlantic passengers.

5. Benefits to developing economies

While most air transport liberalisation studies focus on developed countries which have liberalised and the benefits for their economies, an increasing number of developing countries have benefited from liberalisation.

Since **Chile** liberalised its international air transport in 1979, traffic has increased at well-above regional and world average rates, with the original national carrier LAN (formerly LAN Chile) maintaining and, for many city-pairs, increasing market share. Over the past 20 years arrivals by air in Chile of non-resident visitors have increased at an average annual rate of 8%, with tourism receipts in US dollars rising at a greater rate in most years.

²³ OEF / ATAG 2005 p 13. The analysis is based on ten years of data from the European Union countries.

²⁴ OEF / IATA 2005 p 6

²⁵ Although the US had negotiated "Open Skies" agreements with 11 of the then 15 EU countries, the US and Europe continues to maintain substantial restrictions on transatlantic competition and investment in aviation.

²⁶ Brattle Report 2002

In **Costa Rica**, as a result of liberalisation, the number of tourist arrivals in this Central American State has more than quadrupled over the past 20 years (an average annual increase of 10.5%), the number of air carriers serving the country has risen from nine to 26 and the points directly served in the US has risen from one (Miami) to 12 (four of which are served by Costa Rican carriers).

Overall, South America has seen strong double-digit traffic growth in recent months, and some start-ups such as GOL in Brazil are prospering as low-cost carriers.²⁷

The World Travel and Tourism Council (WTTC) predicts that many of the developing countries which have liberalised air transport will experience travel and tourism growth above the world average predicted for the next ten years.

For example, Chile, Costa Rica, Egypt, South Africa, Tanzania and Uganda are expected to show an average annual percentage increase of 5.5% in travel and tourism demand compared to a world average of 4.6% in real terms from 2005 to 2015.

The Egyptian government plans to attract an extra one million tourists each year to Egypt for the next decade, more than doubling the present total to 18 million by 2015.

The WTTC recently released a study showing that further liberalisation of air transport by Egypt is a prerequisite if these targets are to be met.²⁸

The study estimates that by the year 2011 further liberalisation could provide incremental increases for that year of 2.4 million international arrivals and a \$1.6 billion contribution to the economy, increasing overall GDP by 1.8% and employment by 223 000 jobs.

6. Addressing concerns about intra-African liberalisation

The preceding analysis clearly indicates that air transport regulatory policy should take into account the net benefits to the economy at large, not just the potential threat to the national airline.

Going Global

“The need for structural change is critical if we are to be viable and sustainable industry. In many ways, governments must play catch-up with the industry.

“Airlines compete in a global market, but without basic commercial freedoms that other industries take for granted. Airlines need the freedom to serve markets where they exist and to merge and consolidate where it makes business sense.

“In short, we need progressive liberalisation with governments setting a level playing field and regulating safety and security. After that they need to get out of the way and let airlines get on with the business of turning growth into profitability,”

– *Giovanni Bisignani, CEO of the International Air Transport Association, 31 October 2005. IATA represents 265 airlines comprising 94% of international scheduled air traffic.*

²⁷ The Economist 10 November 2005

²⁸ WTTC special report commissioned by the Egyptian Tourism Federation (ETF) and released 31 August 2005. The estimates are based on WTTC's 2005 Tourism Satellite Accounting (TSA) research, launched in April 2005, which is produced with Oxford Economic Forecasting (OEF).

If overall air transport to and from a country grows as a result of liberalisation and the national carrier loses some passengers to the increased competition, the net economic impact is invariably a positive one due to the beneficial multiplier effects associated with a growing tourism industry.

Nevertheless the concerns of African governments about the threat of liberalisation to their national carriers need to be addressed.

In the rationalisation process following liberalisation in the US and Europe, many legacy carriers from the regulated era struggled to adjust to free competition and some major airlines went into bankruptcy.

Other legacy carriers have adapted and thrived in the new environment, borrowing from the low-cost business models of new competitors, and new entrants have not only taken up the slack but, through innovation and low costs, have generated a tremendous growth in passenger numbers.

There is no reason, other than scale, why an African carrier should not be competitive with other carriers. Scale advantages can be gained from governments allowing alliances and mergers of airlines, subject to the application of competition rules to ensure that passengers benefit from the arrangements.²⁹

While profits may be reduced (or losses increased) in the short term through more competition, reduced fares will lead to increased traffic volume which can be turned into an overall increase in both revenue and profitability.

There is no doubt that, as in the developed economies, the transition from protected legacy carrier to a restructured, more flexible and more efficient airline able to thrive in a competitive environment is not easy. Government assistance might be required to support such restructuring, as was the case with many European carriers prior to privatisation.

Essential service and tourism development routes

The Essential Service and Tourism Development Route (ESTDR) concept is based on principles for essential air services pioneered in liberalised markets within Australia, the European Union and the United States.

In the globalising, liberalising marketplace, international “poor country” routes are socio-politically equivalent to thin traffic domestic routes in developed countries that are supported by essential air service schemes.

At the international level, ESTDR is based on the premise of external support to air carriers or tour operators for achievement of the specified level of service. Such support would normally be in terms of supplemental funding, by government or tourism entities in the receiving market, by bilateral aid from the originating market, or by third-party aid from development institutions.

Such support could take the form of public-private partnerships involving governments, tourism entities, air carriers and airports.

A key feature of the ESTDR concept is that it is route specific and any subsidy would be direct, distinct and transparent. The airline serving the route would be selected through a competitive tendering/bidding system having clearly-defined criteria and equally applicable to all the eligible airlines. The eligibility of an airline would depend on the air services agreements governing the route concerned.

The selection of the airline would be based on either the tender requiring the lowest financial compensation or the overall best tender.

²⁹ The SADC Civil Aviation Committee approved competition rules for air transport services on 27 May 2002

However, the alternative to liberalisation is likely to prove much more costly in the medium-term, with an ongoing and probably increasing need for public subsidy and an increasing opportunity cost for development of the national economy at large.

Another reason for the reluctance of some countries in Africa to embrace the liberalisation process centres on the reliability of international air services to less popular and therefore less commercially viable destinations.

In recognition of this, ICAO, at the instigation of and in collaboration with the World Tourism Organisation, has just completed a study of an Essential Service and Tourism Development Route (ESTDR) scheme. (see box on page 15)

6.1 *Achieving economies of scale*

A major inhibition to airlines of smaller countries achieving economies of scale is the traditional regulatory constraint requiring that airline ownership and control be vested in the citizens of a single country. This is an anachronism in the global economy and is circumvented mainly by major airlines through code-sharing and alliances. Airlines of developing countries are often excluded from these alliances because they don't conform to entry standards.

The ICAO air transport conference of 2003 adopted a recommendation to encourage progress towards loosening the controls, based on "principal place of business" rather than national ownership³⁰.

African airlines, with appropriate regulatory support, should pursue regional alliances, bearing in mind a possible long-term goal of consolidation into unified carriers. Given the relatively small size of African markets, such consolidation is even more pressing than in the developed countries where it is increasingly taking place.

7. Conclusions

The available evidence suggests that inter-government limits on airline flights between the countries in the region are holding back Southern Africa's economic development.

On air routes between many SADC countries, competition and capacity are restricted, flight frequency is low and ticket prices are high. While intended to protect the smaller national airlines, the air service restrictions encourage inefficiency, distort the market for potential investors and deprive the country of tourism and business spend.

Air transport regulatory policy should take into account the net benefits to the economy, not just the potential threat to the national airline. The economic multiplier effects of the indirect, induced and catalytic impacts of the air transport industry exceed the direct output and employment generated by a country's airlines.

The benefit of liberalisation could be substantiated by an econometric study, which could predict the net economic benefit of Southern African air transport liberalisation.

³⁰ Doc 9819, *Report of the Worldwide Air Transport Conference*, 2.1: Air carrier ownership and control.

For this study the following information would have to be sourced:

1) From the SADC governments:

- An accurate and up-to-date list of the restrictions contained in the bilateral air service agreements with each African country,
- The nature and date of any liberalisation of these bilateral agreements or provisions in multilateral agreements which have changed the bilateral regulatory situation.

2) From the airlines, airports or computer-based reservation systems:

- Historical data of passenger numbers for each air route studied (average prices paid would also enhance the study).

Meanwhile, our review of liberalisation experiences around the world leads to the following conclusions:

- Air transport liberalisation has been successful in a range of socio-economic and geographical environments as a channel and catalyst for increased economic growth and employment, especially related to tourism.
- Any decline in market share and traffic of the national carrier is likely to be much more than compensated by the benefits to the economy at large from increased air traffic to and from the country.
- The alternative to liberalisation is likely to prove much more costly to both a national carrier and the economy in the medium-term, with a probably increasing need for public subsidy to the carrier and an increasing opportunity cost for development of the national economy.

Therefore, if overall air transport to and from a country grows as a result of liberalisation and the national carrier loses some passengers to the increased competition, the net economic impact is invariably a positive one due to the beneficial multiplier effect.

African governments are grappling with how best to grow tourism and business travel while developing sustainable competitive airlines on the continent.

Governments in general do not want powerful foreign airlines to overwhelm their local carriers and thus be left without airlines whose economic interests are tied to their economies.

The industry debate is usually framed as local airline protection versus more and cheaper air travel. This implies an inevitable trade-off between the two, which need not be the case.

A better combination of strategies would be to:

- 1) Liberalise the restrictions on airlines entering and growing the air routes between SADC countries and into the rest of Africa;
- 2) Improve the competitiveness of national airlines on cost, service and product;
- 3) Allow mergers or alliances between SADC airlines to achieve economies of scale; and
- 4) Enforce competition rules to prevent unfair competition and ensure that passengers derive ongoing benefit from the liberalisation of air routes.

A combination of these strategies can create a win-win solution for increased air travel, generating benefits in economic growth and job creation, and stronger local airlines.