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AIR TRANSPORT LIBERALIZATION AND THE ECONOMIC DEVELOPMENT OF THE COUNTRIES

(Presented by the Air Transport Research Society (ATRS))

EXECUTIVE SUMMARY

This paper presents the positive effects of liberalization on the wider economy in order to stress the need to move towards the implementation of a unified liberalized regulatory system that will cater to a sustainable and safe air transport providing economic growth, employment and socio-economic prosperity for all countries and regions.

<i>Strategic Objectives:</i>	This working paper relates to Strategic Objective D — <i>Economic Development of Air Transport</i>
<i>Financial implications:</i>	Not applicable
<i>References:</i>	Air transport liberalization and its impacts on airline competition and air passenger traffic (Oum et al.) An Aviation Strategy for Europe (European Commission, 2015) The Impact of International Air Service Liberalization on Panama (IATA, 2009) Economic Effects of Air Services Liberalization in New Zealand (Ministry of Transport, New Zealand, 2013) Air Transport interview with Dr Fang Liu, Secretary General of ICAO, Dr Temel Kotil, CEO of Turkish Airlines and Pieter Elbers, President and CEO of KLM (ATN, 2016) Airline Choices for the Future: From Alliances to Mergers (Iatrou & Oretti, 2007) ICAO World Aviation Forum (ICAO, 2015)

1. INTRODUCTION

1.1 In 1944, ICAO set the standards by which international air services between countries operates. Bilateral air services agreements (ASAs) have since largely governed the air transport relations between individual States. These agreements have been traditionally restrictive in terms of possible routes, the maximum number of allowable flights, and the air carriers permitted to operate under the respective ASAs. Air transport has been considered to be a strategic sector with countries often aiming for equal sharing of the market between the designated air carriers of both parties, typically government-owned flag carriers.

1.2 During the last three decades, there has been a growing trend towards liberalization of the international air market. In the context of a globalized economy, more and more governments have acknowledged the benefits of allowing market forces to determine and improve the development of air services. Since 1992, the US has successfully pursued so-called “Open Skies” bilateral ASAs under which carriers can operate any route without significant restrictions on capacity, frequency or price. In Europe, the creation of the EU single aviation market in the 1990s put an end to the system of ASAs between EU Member States and profoundly changed the economic and regulatory landscape of air transport in Europe. Progressively, the EU has also developed a coordinated EU external aviation policy and concluded liberal comprehensive EU-level air transport agreements with a number of third countries. This "ambitious external aviation policy [...] with a focus on growth markets" is also a key pillar of the Aviation Strategy for Europe (European Commission, 2015).

2. THE EFFECTS OF LIBERALIZATION

2.1 Some countries, such as the Netherlands and Singapore, achieved rapid economic development by leveraging their liberalized air transport systems. Compared to its European neighbors France and Germany, the domestic market of the Netherlands is relatively small. However, the country has been a first mover in liberalizing its ASAs: In 1992 it signed the first "Open Skies" agreement in the world with the US, which effectively promoted Amsterdam’s Schiphol airport as a major gateway for trans-Atlantic traffic, while facilitating its flag carrier, KLM, to further expand its network coverage in Europe and North America (Oum et al). As Pieter Elbers, President and CEO of KLM said: "For KLM, operating out of the Netherlands, being a small country, access to international markets has been crucial throughout our history. Many historic moments in the development of KLM have been linked to liberalization of the airline industry. KLM benefitted from the ‘Open Skies’ agreement with the US to develop both its own network and its partnerships. Not only did KLM benefit, but we have also seen massive development of Amsterdam Schiphol airport and the country in general resulting in economic benefits and employment” (ATN, 2016).

2.2 The most prominent and comprehensive example of liberalization is the EU single aviation market that resulted in an almost fully deregulated EU single aviation market. Its creation has enabled significant development of the European aviation sector and contributed to a democratization of air transport: European air transport users now enjoy an unprecedented choice of air travel opportunities at competitive prices. The number of both intra-EU and international routes, carrier frequencies, and the number of passengers have increased substantially. All EU air carriers are free to offer their services within the EU single aviation market. This has contributed to the rapid growth of EU low-cost carriers (LCCs), such as Ryanair, Easyjet and Wizzair, which are now amongst the top carriers both in terms of passengers and market capitalization in Europe. European aeronautical manufacturing has been equally strong.

2.3 The impact of EU aviation policy on countries outside of the EU has been equally positive: EU-level aviation agreements aim to "create new economic opportunities", "ensure market access, promote investment opportunities, [and] facilitate air travel" (European Commission, 2016). The EU has put in place a closely-aligned Common Aviation Area with neighboring countries and is negotiating EU-level air transport agreements with a number of key partners. Since the signing of the EU air transport agreement with the Western Balkan States, the number of passengers has almost tripled. In the case of Morocco, this number has doubled since the liberal agreement was signed. The agreements with US and Canada have led to a combined growth of more than 3 million passengers between EU and these markets (European Commission, 2015).

2.4 Thus, it is undeniable that liberalization has contributed to increased air service levels and lower fares, which in turn has stimulated traffic volumes and led to economic growth and employment. There is a link between increased air traffic and growth in employment and GDP. A 2006 study estimated that each 10% increase in international air services has led to a 0.07% increase in GDP (IATA, 2009). A study examining the impact of liberalization in New Zealand warned that limiting the ability of foreign carriers to offer services to New Zealand routes could ... potentially diminishing the benefits from liberalization (Ministry of Transport New Zealand, 2013). Finally, as the CEO of Turkish Airlines, Dr. Temel Kotil, stated, "The international business between Africa and Turkey has increased from nonexistent to 20% thanks to Turkish Airlines flying to several points in Africa," and that, "the growth of the Turkish Airlines has helped the Turkish economy by being a multiplier of the economy" (ATN, 2016).

3. CONCLUSION

3.1 Liberalization has led to substantial economic and traffic growth. Such positive effects are mainly due to increased competition in the aviation market, which reduces price and stimulates traffic growth, producing efficiency gains as a result of carriers' ability to optimize their network and pricing strategies. In addition, the increased competitive pressure forces airlines to improve productivity and induces inefficient carriers to leave the market. Moreover, there arise positive externalities to the overall economy from liberalization, including stimulation of growth and employment opportunities, trade promotion, and better transport and logistics services. Although these impacts are not uniform across countries, there has been an increasing number of States progressively adopted liberal air transport policies, suggesting widespread benefits from the liberalization of air transport.

3.2 Liberalization allows carriers to better structure their networks to cover intra/intercontinental markets. However, optimal benefits will only be achieved if ownership restrictions are eased, allowing optimization across borders, as has been achieved in Europe. Hub-and-spoke networks are extensively used by airlines to achieve cost advantages in production (economies of density) and revenue. Research by Iatrou and Oretti (2007) has found that strategic alliances have led to revenue increases for member carriers, allowing airlines to achieve "second best" network connections in markets, especially where bilateral agreements are restrictive. If ownership / citizenship restrictions are relaxed, market consolidation via mergers and acquisitions in a liberalized environment would allow airlines to further strengthen their networks and market positions and optimize their networks. This will best take place in a marketplace with a unified, liberalized regulatory structure that can ultimately replace the current bilateral framework.

3.3 The emergence and growth of low-cost carriers, made possible through liberalization, has brought significant positive impacts to the airline industry. The fast growth of LCCs has led to increased competition and reduced fares in liberalized markets, such as Europe. In the EU, LCCs have benefited

from the liberalization of beyond rights by establishing airport bases across borders. On the other hand, existing regulations on route entry, ownership and effective citizen control have constrained the expansion of LCCs in many markets, thereby, preventing the associated benefits from being fully realized.

3.4 The ICAO World Aviation Forum has called on States to include aviation in their national development plans and to position aviation as a strategic priority for the development of their countries. This is because aviation stimulates employment, trade, tourism and other areas of economic development at the national, regional and international level (ICAO, 2015). This economic development, however, can only best be achieved in a liberal environment. ICAO has stressed liberalization as an important goal for air transport. Liberalization will enhance connectivity and promote the economic benefits that connectivity affords. Furthermore, a liberal environment will best lead to the sustainable development of international air transport.

3.5 Liberalization of the aviation system has achieved significant progress, as exemplified by the emergence of strong and competitive carriers, airports that are more user-friendly, optimized airspace, the sustained growth of air traffic, and enhanced connectivity between States and regions. Most importantly, liberalization has allowed for greater choice and more competitive prices for the travelling public, according to Dr. Fang Liu, Secretary General of ICAO (ATN, 2016). As a result, the ATRS calls upon States around the world to continue to liberalize their air transport systems in order to further promote economic development and prosperity.

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