



**ASSEMBLY — 40TH SESSION**

**ECONOMIC COMMISSION**

**Agenda Item 32: Economic Regulation of International Air Transport — Policy**

**REGULATORY ENVIRONMENT FOR A SUCCESSFUL AIRLINE INDUSTRY**

(Presented by the Hermes Air Transport Organisation)

**EXECUTIVE SUMMARY**

Decision-makers should consider the benefits from creating a regulatory environment that will allow airlines access to the capital necessary to effectively compete in the industry. This may include relaxing ownership and control restrictions. States should consider acting in concert with like-minded states to develop the environment needed to support aviation growth. Although ownership and control barriers may remain in certain regions, a new multilateral approach to airline regulation can emerge under the auspices of ICAO.

<i>Strategic Objectives:</i>	This working paper relates to Strategic Objective — <i>Economic Development of Air Transport</i> .
------------------------------	--

<i>Financial implications:</i>	Not Applicable.
--------------------------------	-----------------

<i>References:</i>	Not Applicable.
--------------------	-----------------

**1. INTRODUCTION**

1.1. Air transport is a major contributor to the world economy characterized by solid growth. To accommodate this growth, it is forecast that about 37,500 new passengers and dedicated freighter aircrafts at a value of US\$5.8 trillion will be needed over the next 20 years, compared to the current fleet of around 26,000 aircrafts. These immense capital requirements are intensified by the need of airlines to fund other processes including investments in big data analytical systems, product customization and baggage handling.

**2. OWNERSHIP AND CONTROL ARE BARRIERS TO AIRLINE FINANCING**

2.1. Securing airline financing is faced by severe difficulties. These difficulties are confounded in the airline industry by ownership and control restrictions that inhibit the ability of airlines to finance their operations. As in every industry, including other parts of the air transport supply chain, investors are expected to carefully balance expected returns against risks. Small markets and inability to

reap economies of scale and scope may significantly discourage investors who also prefer to avoid funnelling money into fragmented sectors characterized by hyper-competition. Moreover, complexities in the regulatory environment and legal uncertainties create further disincentives for investment. These regulatory barriers may limit market size; allow inefficient carriers to remain afloat; and raise investment risks from a legal perspective. In fact, these barriers may significantly inhibit financial/portfolio investors, while the inability to effectively control an airline may discourage strategic investors and deny potential synergies emerging at the airline level.

### **3. CIRCUMVENTING OWNERSHIP AND CONTROL BARRIERS ARE HELPFUL BUT NOT THE SOLUTION**

3.1. There seems to be empirical support that effectively dealing with ownership and control clauses may have a positive impact for the airline sector. The European Union has created new industry dynamics by substituting national with community ownership and control clauses thus encouraging *inter alia* the development of low fare airlines and allowing consolidation through mergers and acquisitions among network carriers. In Latin America, LAN has successfully engaged in transnational acquisitions, creating among others LATAM, while Australia and New Zealand have also adopted a liberal stance *vis-à-vis* international ownership and control of their carriers.

3.2. It is of interest also to note that even in parts of the world where national clauses in ownership and control are powerful, alternative market responses are also possible. The establishment of the three strategic alliances (i.e. Star, SkyTeam and Oneworld) among network carriers is certainly a success story in terms of creating a global network experience. Similarly, low fare airlines such as Air Asia/JetStar and Air Arabia have managed to establish a solid presence in Australasia and the Middle East/North Africa respectively by establishing local subsidiaries.

3.3. Yet, these circumvention efforts, irrespective of how successful they may prove in the short and medium terms, add costs, raise complexity and create legal uncertainties. Thus, they fall short of achieving the benefits of full integration offered by a relaxation of ownership and control clauses. Even the community clause introduced in the European Union may face legal challenges on international routes and markets when third (i.e. non-EU) countries are reluctant to accept it in the renegotiation of their bilateral agreements.

### **4. AIRLINES MUST ACCESS CAPITAL TO BE SUCCESSFUL**

4.1. In any case, financing will flow to the airlines that investors believe are most likely to be successful. Successful airlines will be the carriers that have the lowest operating costs and/or the greatest ability to generate revenues. For example, airlines that can best use customer data to develop ancillary revenues may be able to gain market share, since the ancillary revenues will allow the carriers to lower base fares.

4.2. We see the future industry as one dominated by carriers pursuing cost leadership and/or revenue generation models that extend beyond national boundaries. These carriers will have the access to private financing necessary for fleet acquisition and will be able to gain market share over carriers that are more reliant on government financing. Clearly, the industry will require a shift from a nationally-based industry to a market that better allows for international growth.

**5. CONCLUSIONS: REGULATORY REFORM CAN HELP  
THE AIRLINE INDUSTRY BE SUCCESSFUL**

5.1. Decision-makers should consider the benefits of being proactive in creating the environment that will allow airlines access to the capital necessary to effectively compete in the industry. This may include relaxing ownership and control restrictions within a regional context. States should consider acting in concert with like-minded states to seek regional solutions to develop the environment needed to support aviation growth. Moreover, regional blocs should develop a dialogue with other regional blocs to facilitate aviation growth for the benefit of their populations and economies.

5.2. The successful airline industry that will emerge will be well-managed, attract investments, benefit travellers and drive GDP growth. Regulatory barriers, such as ownership and control, are obstacles to the movement towards this emerging industry, but are not insurmountable obstacles. The barriers can be lifted by governments or circumvented by airlines. However, the barriers may remain in certain regions of the world due to the political will and priorities of the countries in those regions. Ultimately, a new multilateral approach to airline regulation will only emerge under the auspices of ICAO.

5.3. Although ownership and control may not appear as a major problem to some governments and airlines given the advent of alliances and the other workarounds employed to facilitate air transport, it may be the case that the states that are proactive in developing policies that facilitate aviation financing and growth will produce the winning airlines in the long run.

— END —