

## **OPERATING SUBSIDIZED REGIONAL ROUTES IN A LIBERALIZED MARKET AS EXEMPLIFIED BY THE NORWEGIAN EXPERIENCE**

(Submitted by Norway)

### **1. INTRODUCTION**

1.1 In a country with a shape and topography like Norway and with a firmly established policy aiming at maintaining settlements in all rural areas, adequate air transport plays an important role and is almost a prerequisite for the economic development of its peripheral regions. With the liberalization of the domestic air transport market it was necessary to ensure the possibility for the State concerned to maintain air services on low-density routes. This possibility is provided for in an EC Regulation adopted in 1992, which sets out the rules for the State to contribute to the financing of Public Service Obligation (PSO) routes through public tenders open to all EEA air carriers holding a valid licence and an Air Operator's Certificate. By means of public tenders, competition is promoted also on low-density routes while at the same time requirements such as number of flights, seating capacity, aircraft size, maximum fares and service continuity are secured.

### **2. BACKGROUND**

2.1 Domestic air services in Norway were previously operated pursuant to a system of licences whereby carriers accepted an obligation to serve a route or routes in return for being granted a monopoly on the same route or routes. The assignment of a set of both "profitable" and "less profitable" routes to each of the carriers concerned ensured a cross subsidisation of the routes to be served. In order to cover the extra costs for carriers, as a result of cross subsidization, passengers faced higher price levels for domestic airline tickets. In addition to this system based on cross subsidization, the Norwegian carrier Widerøe was granted exclusive access - and was subsidized by the State - to a large and complex STOL network comprising 26 airports. Full liberalization of the domestic air transport market (except for the STOL network) took place as from 1 April 1994 and the STOL network was subsequently declared PSO-routes and offered by public tendering three years later as from 1 April 1997. Since then a few other routes have been added to the PSO-routes in addition to the STOL network. The PSO-routes in Norway are now serving 29 regional airports and are expected to carry a total of about 1.5 million passengers in 2002. These routes are thus representing one of the most comprehensive tender invitations within European civil aviation. This would have to be compared to the total of more than 50 Norwegian airports with scheduled air services and a total of approximately 9 million passengers on domestic air services per year. The cost of this program amounts to approximately 400 million Norwegian kroner (NOK) per year.

### **3. DEVELOPMENT SINCE APRIL 1997**

3.1 As mentioned above, the PSO-routes consist, to a large extent, of routes serving STOL airports. The fact that the air carrier Widerøe was subsidised by the State to operate these routes prior to 1 April 1997, gave this air carrier a head start when the route network was offered by public tendering. Nevertheless, a total of 6 air carriers (including Widerøe) submitted tenders in 1996 for the contract period 1 April 1997 - 31 March 2000, and a total of 8 air carriers for the next period of three years.

3.2 For the next contract period running 1 April 2003 - 31 March 2006, the invitation to tender was answered by seven air carriers - of which only five are Norwegian. Of these seven air carriers, four Norwegian carriers and one foreign carrier were awarded PSO-contracts. The awarded contracts amount to a total of 372 million NOK per year and proves that this last competition for tenders thus has reduced the cost of this program for the coming period. In addition to these five carriers, there is a helicopter carrier serving one route with a displaced contract period.

3.3 The introduction of PSO-routes and invitation to tender in 1997 was considered a political success and ensured the same quality of air services at a considerably lower governmental cost. The main reason for that was the incumbent carrier's fear of being outplayed by other competitors, which made the incumbent carrier reduce its costs before submitting the tender.

3.4 Since 1997 a few routes have been withdrawn from the PSO-programme indicating that a route submitted to public service obligation may develop into a commercially viable route. At the same time there is a tendency for routes previously exposed to competition to be subjected to PSO due to the prevailing competition and market conditions. Experience shows that it is necessary to have procedures ready in order to quickly re-instate a PSO-service (or a temporary solution) in case of demise of the operating carrier, or if the service in question is stopped for any other reasons.

### **4. GENERAL COMPETITION ASPECTS**

4.1 On the PSO-routes competition is not considered as a goal in itself. However, as long as invitation to tender is the only way governments may finance air services in a liberalized market, it is necessary to expose the participants to competition in order to attain the most important goal, i.e. to provide transportation services satisfying standards and qualities pre-defined by the State to the lowest possible cost. Consequently, the invitation to tender must be designed to promote competition in order not to lose purchasing power and avoiding the risk of paying higher compensation than necessary. However, this may not always be political feasible.

4.2 One way to enhance competition is of course to split up larger PSO-networks into smaller route areas to facilitate the possibility for also smaller air carriers to submit tenders. In addition, it is most important to provide new entrants with the maximum of available information, since the incumbent carriers will always have the advantage.

4.3 In Norway the experience gained, however, has been mixed. The route areas in question in, e.g. the northern parts of the country put so great technical and operational pressure on the carriers due to severe winters and special geographical conditions, that the number of air carriers with the possibility to submit tenders is reduced considerably. Whether special conditions or not, it seems that a lengthening of the contract period would increase the number of tenders submitted, since carriers would gain more time to write off potential investments made necessary by the contract. In any case, the competition aspect within the PSO-system is to a certain extent dependent on the well functioning of the civil aviation market in general. Air

carriers that have been outplayed by its competitors and lost their contracts must have something to fall back on in order not to be forced out of business.

## 5. REGIONAL ROUTES OUTSIDE THE PSO-NETWORK

5.1 Although a few routes have been withdrawn from the PSO-programme, it seems that both the will and the power to maintain air services exposed to competition have been weakened lately, and pressure is brought on the State to submit routes to PSO. A reason for this is *inter alia* the disappearance of the cross subsidization of routes. Nevertheless, a more efficient allocation of resources can now be seen subsequent to liberalization since the ticket price level on trunk routes has been reduced and capacity increased, while the opposite has occurred on more marginal routes.

5.2 In the long term liberalization is expected to make the civil aviation market in Norway grow, but experience has shown that there is a certain rigidity in the market that may possibly inhibit a sound development.

## 6. CONCLUSIONS

6.1 In Norway the experience shows that liberalization within the framework of the EC regulations has rendered the civil aviation market more efficient. The Community framework and its PSO provisions have generated an environment propitious for competition and resulted in less government spending, without lowering the level of services on the PSO-network.

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