Evaluating International Air Route Liberalisation: A New Calculus for a New Environment

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Theme

- **Balance of economic benefits and costs from liberalisation changing due to a changing environment**
- **This affects the net benefits to a country from liberalisation**
- **In both directions, but mainly positively**

Outline

- The benefit cost approach to evaluating air route liberalisation
- Ownership changes
- Regional (EU) negotiations
- Existence of LCCs
- Tourism benefits
- Role of 6^{th} and 7^{th} Freedom carriers
- Conclusions

The CBA Approach

- Growing acceptance and use since 1990s
- Benefits and costs of liberalisation could be extensive, but:
- Main costs and benefits accrue to passengers and airlines
- Lower prices, changes to profits
- Plus effects on frequency, connections, time taken etc, jobs
- Consumers gain from lower fares
- Airlines lose in the SR from lower profits, but may achieve productivity gains
- Objective to determine overall impact on welfare

Structure

- Take a home country, foreign country perspective
- Evaluate from the perspective of the home country
- Home airline is 100% home owned
- Starting point a bilateral agreement- restrictive (realistic until recently)
- Suppose liberalisation- more capacity, less fare regulation, multiple designation etc

Liberalisation

- Home passengers gain, home airline loses
- Evaluate the net position from the home country perspective
- Not always positive- e.g. if home airline has a high market share, and high proportion of pax are foreign
- Liberalisation positive for overall welfare though
- E.g. Australia Japan route

Policy Relevance

- Reports in Australia, Canada, Germany take a CBA perspective
- Implicit- UK, US?
- Informs the policy stance taken by countries
- Other factors, such as interest group lobbying, are still relevant
- Move away from the “reciprocity” view
- When a country loses, this poses an issue of whether compensation is possible, and could induce it to liberalise

The Changing Environment

- **Airlines ceasing to be 100% home country owned**
- **Regions moving to regionally based negotiations- EU**
- **LCCs affecting the competitive balance**
- **Tourism benefits and costs more explicitly recognised**
- **More carriers operating on a 6^{th} and 7^{th} freedom basis**

Ownership Changes

- Previously government owned airlines
- Privatisation opens up ownership
- Restrictions exist- eg requirements for 50% home country ownership
- Many airlines now have substantial foreign ownership
- Corporate taxes still go to the home country
- Now, only 70% (say) of the profits of a 50% home country owned airline accrue to home country
- Mergers also dilute the home country interest (e.g. KLM-Air France)

Ownership Implications

- **Only a proportion of the reduction in profit due to liberalisation accrues to home country- shared with foreign investors**
- **Home country may have a share in the profits of the “foreign” airlines**
- **Cost of liberalisation to the home country is reduced**
- **Makes country more prepared to liberalise**

Other Implications

- **Countries may be less insistent on seeking access for home carriers if the gains they achieve are shared**
- **Countries, through their airlines, gain when there is improved infrastructure**
- **E.g through less airport congestion**
- **Gains from these sources are now shared more widely**

Regionalisation

- **Now there are examples of liberalisation within a region- e.g. EU+**
- **Now relations between the region and other countries is on the agenda**
- **Horizontal agreements in the EU- now countries negotiate on behalf of EU airlines, not just their own**
- **Moving towards regionally based negotiations-e.g. EU with the US**

Horizontal Agreements

- **Suppose a liberalisation proposal on a route- e.g. more capacity**
- **Some capacity may go to non home EU carriers**
- **Home airline loses profit from lower fares, and from loss of market share**
- **Liberalisation thus less attractive to the home country under the horizontal agreement than before**
- **However the gains to the region as a whole may be greater from liberalisation**

Regional Negotiations

- Cover a broader group of interested parties than before
- Regional pax and regional airlines
- The negotiating entity captures a greater share of the total benefits and costs
- Probably means that the regional entity is more likely to pursue liberalisation than individual countries
- However, the regional negotiator still has to take implications for individual countries into account

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Example

- **Illustrative example only**
- **Home country A is part of a regional bloc; foreign country B**
- **Consumer benefits and airline profits are affected by liberalisation**
- **Non home regional passengers travel- in horizontal case, non home regional airlines fly**

Nationality Based Negotiations

	A	Rest of region	B
Passenger benefits	100	30	100
Airline Profits	-80	0	-80
Net Benefits	20	30	20

Horizontal Negotiations

Passenger Benefits	A	Rest of Region	B
Passenger Benefits	105	31	105
Airline Profits	-110	30	-80
Net Benefits	-5	61	25

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Impacts of LCCs

- **LCCs now well established in US, Europe and Asia**
- **Operate with lower costs and fares**
- **Now seeking international routes (esp in Asia)**
- **Often held back by restrictive ASAs**
- **Can affect the balance of benefits**

LCC Entry

- **Bigger impact on competition, fares, than old FSA entry**
- **Existence of other LCC airlines means that multiple designation now can have real meaning**
- **Costs fall with entry- larger gains from liberalisation**
- **Foreign LCC entry- has a bigger negative impact on home airlines profits than FSA entry**
- **Country without home LCC entry less likely to benefit from liberalisation**

Tourism Benefits and Costs

- **Liberalisation encourages tourism flows in both directions**
- **Countries gain from increased foreign tourism expenditure**
- **Net gains less than extra expenditure- need to provide goods and services to tourists, at a cost**
- **Depends on the economy- scope for stimulation; existence of unemployed persons**
- **Also, by implication, outbound tourism creates a cost**

Implications for Liberalisation

- **Results of evaluations now less sensitive to % of home country passengers on the route**
- **Tourism benefits are normally smaller than the benefits or costs to passengers and airlines, but they can sway the casse**
- **Route liberalisation asymmetry:**
- **Impact on inbound (generated and diverted) tourism > impact on outbound (generated only)**
- **Tourism benefits likely to be positive for most route liberalisation decisions**

6^{th} and 7^{th} Freedom Traffic

- **Increasing presence of 6^{th} and 7^{th} freedom carriers**
- **Significant share of some route traffic; seeking new markets**
- **Implications depend on nature of liberalisation**
- **E.g, more capacity to 3^{rd} and 4^{th} Freedom carriers- 3/4 th freedom carriers gain at expense of 6^{th} and 7^{th} carriers**
- **Liberalisation more attractive than without the $6/7^{th}$ freedom carriers**
- **Liberalisation which allows 6^{th} and 7^{th} freedom carriers to enter- less attractive because they gain profits at the expense of the home carriers**

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Summary

- **Ownership changes diluting the importance of impacts on airline profits-encouraging liberalisation**
- **Home country horizontal agreements less likely to be liberal, but regionally based agreements more likely to be liberal**
- **Presence of home based LCCs increasing the gains from liberalisation**
- **Tourism benefits affecting the balance, usually in the direction of liberalisation**
- **Presence of 6th and 7th freedom carriers affecting the balance in both directions**

Thank You

Implications for the CBA Approach to Evaluating Air Transport Liberalisation

- **Several changes taking place in the airline environment**
- **Model still very relevant, but the parameters have changed**
- **This affects the balance of outcomes**
- **In both directions, but more often in the direction of making liberalisation more attractive to home countries**