

Open Skies and deregulation – The coming revolution

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Introduction

What the European Union does internally often has important consequences for the outside world. Nowhere is this truer than in the area of deregulation. When the EU started in the late 1980s to systematically remove the last national market barriers, it became impossible for Member States to continue their bilateral restrictions on car imports from Japan, or national quotas on banana imports from the Caribbean. Likewise, with EU energy liberalisation, it is becoming impossible for outside gas suppliers like Russia and Algeria to dictate exactly where their gas flows within the EU market.

Now it is the turn of aviation to feel the external consequences of the liberalisation within the EU. The shock will be the greater because, outside the EU, the airline world is still a bilateral one, with traffic rights negotiated between pairs, not groups, of countries. It is an irony of globalisation that airlines, an industry that has arguably done more than any other to tie the world together, should still be so regulated along archaic bilateral lines.

The catalyst for change was the 2002 decision by the European Court of Justice to strike down the bilateral air service agreements that individual EU states have with the US. The court took particular exception to the nationality clauses, limiting these agreements to airlines of the individual EU state in question (in addition to US airlines). This, the court said, discriminated against other EU carriers, and was therefore contrary to EU law. Precisely the same flawed nationality restrictions exist in EU Member States aviation agreements with all other parts of the world. But since these cannot all be renegotiated simultaneously, the EU has decided to make a start with the US, in the hope that whatever is negotiated with Washington will serve as a model for the rest of the world.

As a result of the court ruling, EU governments gave the European Commission in June 2003 a mandate to negotiate an EU-wide agreement with Washington. If and when it is finally signed it would

replace all existing bilateral air service agreements with the US. Negotiations are now under way. A first round has held in Washington in October, and a second round is due in Brussels in December.

The goal is ambitious. The creation of a truly common transatlantic aviation market will have very significant consequences for the airline industries on both sides of the Atlantic. But realising this goal will take time. For the US this will involve opening its domestic market to more competition and dropping laws restricting foreign ownership of airlines in a way that individual European states – through their membership of the EU - have already had to accept.

Resistance from the US is also likely to be greater, because the aviation industry there is, if anything, in a weaker state than its European counterpart, and because protectionist lobbies in the US, notably the airline unions, are stronger and carry more influence with the politicians than is the case in Europe.

However, the backlash against restructuring in Europe should not underestimated either, especially because an EU-wide aviation accord with Washington could trigger greater change in Europe than in the US. Even without such an accord, some kind of shake-out is likely in Europe. The European airline industry already faces general structural problems of over-capacity, rising costs from congestion in the use of crowded airspace and inadequate infrastructure, and the downward pressure exerted on airline revenue and ticket prices by competition from low-cost carriers.

The latter are the creation of airline deregulation. They would never have flourished if routes between, and within, EU states had never been opened up to free competition. The lower fares they offer passengers are the principal justification for deregulation. But the low cost carriers have stirred considerable opposition among established airlines and airports.

One particular target for this opposition is Ryanair, the Irish based no-frills airline that has tripled the number of passengers it carries in the past three years. It has done this partly by exploiting under-used regional airports. They have been ready to give Ryanair discounts on charges and facilities in return for the volume of traffic the Irish carrier can put through their portals. Some of Ryanair's competitors have complained that these discounts amount to unfair state aid when they come from publicly-owned airports that are not subject to the normal disciplines of the market place.

The Brussels Commission is due to rule on a test case involving the discounts that Ryanair has been getting from Charleroi, a publicly-owned airport in Belgium. At a recent European Policy Centre conference, Michael O'Leary, Ryanair's outspoken boss, said the Charleroi decision would be the "Waterloo" for his company and the

industry, because it would make or break competition in European aviation. While that may be going too far, the Commission has acknowledged that Charleroi is the test case, because it intends to follow it up by setting out general guidelines on airport aid to airlines.

These issues, and other problems stemming from EU air liberalisation, were all discussed at a European Policy Centre conference in Brussels on October 23, 2003 – and will be explored in detail later in this paper. But first it is important to set out the significance to future competition in European air transport – of cargo as well as of passengers – of the current negotiations with Washington. The existing air service agreements with the US prevent Europe from fully capturing the cost savings and synergies that should flow from liberalisation, for a series of reasons explained below.

The present EU-US imbalance

Liberalisation – in terms of the freedom for airlines to choose their routes and their prices - started later in the EU (1987) than the US (1978). But in some ways – particularly in terms of reducing state support and control - Europe has gone further.

As the result of a series of agreements in 1987, 1990 and 1992, almost all restrictions on routes and fare were swept away in January 1993, and since 1997 airlines have been free to fly purely internal routes in other Member States. Any airline that could show it met financial and safety requirements and had proven EU ownership and control was free to enter this new single market. National flag carriers lost any special status or protection from competition within the EU.

After years of treating airlines more leniently than other sectors, the Brussels Commission has ensured that it is now considerably harder for airlines in Europe to get state aid than is the case in the US. After the September 11, 2001 attacks sent air travel into a temporary tailspin, Congress granted US carriers 5 billion dollars in cash and a further 10 billion dollars in loan guarantees. The Commission has not permitted anything comparable for EU airlines.

Even before that tougher stance in Brussels, few national airlines in the EU benefited from anything like the benefits to US airlines contained in the Civil Reserve Air Fleet programme. Under this arrangement the US government passes all its travel business to US carriers in peacetime, provided the latter promise in wartime to provide the Pentagon with emergency airlift. This “Fly America” programme covers government cargo and post as well as passengers, and is said to be worth around 2 billion dollars a year to US carriers. Non-US carriers can gain access to this US government business, but only if they enter into code-sharing agreements with US carriers; even then, the non-US carrier has to be from a country with an Open Skies agreement with the US. The European Cargo Alliance (ECA) argues that it is

“unacceptable that non-US airlines should have to form anti-competitive alliances with a US carrier in order to qualify to carry [US] public sector business.” Such alliances, the ECA points out, fit far less well into the business model of cargo airlines than that of passenger airlines.

In addition, while no foreigner can own more than 25% of a US carrier, under the third EU liberalisation package that came effect in 1993, individual EU states can no longer prevent companies from other EU states buying up their airlines. In theory this should have led to more cross-border mergers and acquisitions. But its practical effect has been largely blunted by bilateral aviation agreements that individual EU states have negotiated with the US. These agreements are of two types:

- the “open skies” accords that the US has with 11 EU countries and which do not limit frequency of flights.
- the more restrictive deals that Britain, Greece, Ireland and Spain have with the US.

But the common feature of these bilateral agreements is that the liberalisation benefits are only open to carriers from the two countries concerned. For example, a carrier wishing to fly from Germany to the US must be German, and so on. Little wonder, therefore, that Andrew Cahn of British Airways told the EPC aviation conference that the Open Skies agreements “go only a quarter of the way towards proper liberalisation”.

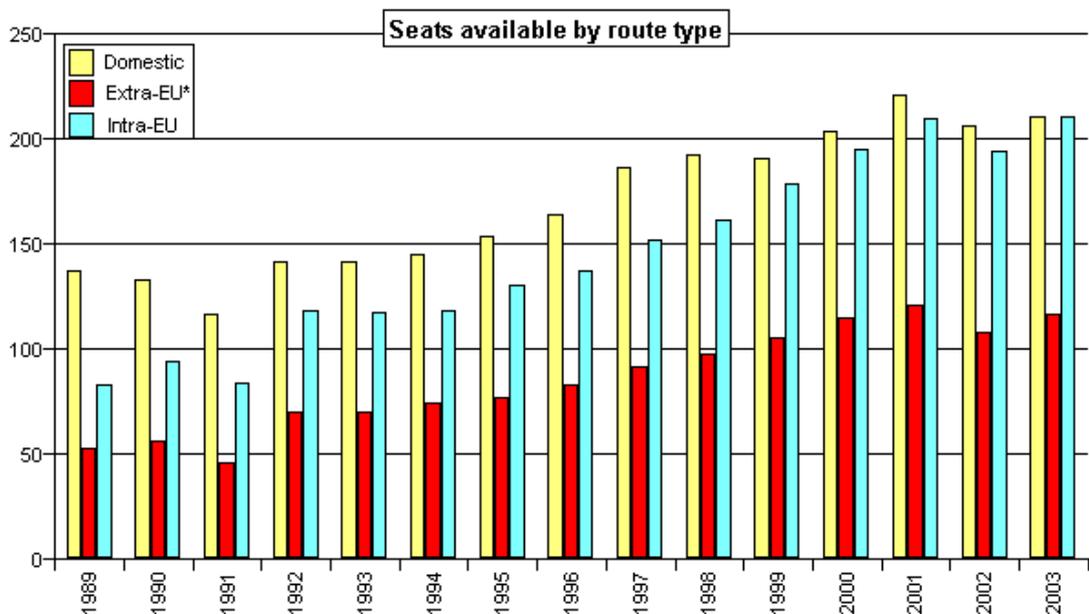
A stumbling block for inter-EU mergers?

One consequence of this has been to dampen the incentives for mergers within Europe. BA’s plan to merge with KLM, for instance, foundered on the fact that by merging with BA, KLM would have lost its rights to fly from the Netherlands into the US. KLM has now agreed a tie-up with Air France. But in order for the junior partner, KLM, to protect its flying rights from the Netherlands to the US, its assets are to remain under nominal Dutch control for some years. Thus, Air France and KLM have had to put together what Michel Ayrat, aviation director at the European Commission, calls “a very heavy structure”, simply because of the bilateral agreements with the US. These accords “constrain full deregulation in Europe”, Mr Ayrat said at the EPC aviation conference.

A further asymmetry brought about by individual European deals with the US concerns so-called “fifth freedom” rights, the jargon for the right of an airline from one country to land in a second country and take passengers on to a third. This is permitted under “Open Skies” agreements, but only the US carriers in Europe have any interest in using it, in hopping from one EU country to another. The imbalance arises out of the fact that the EU is a multi-state common market, while

the US is a single domestic market. What EU carriers would like is to fly passengers from one US city to another, but this counts as domestic “cabotage” which is not open to foreigners.

Roland Steisel, a director of the DHL cargo company, explains how the same restrictions hamper the European air cargo business. “The economic reality is that fifth freedom rights in Europe are more equivalent to giving US airlines cabotage rights, not just fifth freedom rights. For instance, FedEx, a US cargo carrier, can transport its shipments from Charles de Gaulle airport in France to Frankfurt on the route between the US-Charles de Gaulle-Frankfurt, whereas DHL or TNT as European carriers, could not transport cargo from New York to Los Angeles on the route Brussels/Liege-New York-Los Angeles. This enables FedEx to organise its European distribution system from its European hub of Charles de Gaulle, whereas DHL and TNT are forced to subcontract their US airlines operations to a UDS carrier”. As a result of this, says Mr Steisel, US airlines will be able to expand operations in the EU with all the economies of scale of their large fleet and US cost base.



A future remedy

The new negotiations with Washington now provide an opportunity to change the fact that EU carriers can only fly to the US from their own country, cannot effectively merge with those not covered by an Open Sky agreement and cannot buy more than a small stake in US airlines. The EU is therefore hoping for the widest possible agreement that will remove these current limitations. Brussels is lured on by a report it commissioned from the Brattle Group, a US consultancy that spelled out the benefits flowing from a broad agreement.

According to the Brattle Group, the cost savings that could be achieved in a Transatlantic Common Aviation Area, could be of the order of 2.9 billion euro or 4.2 % of total combined EU and US airline costs. The report's surprising conclusion is that 80% of these savings would be from intra-EU, as distinct from transatlantic, operations.[1] This is because the deal would facilitate intra-EU mergers, leading to far greater cost savings and synergies than the improved economies of scale and scope that increased transatlantic travel would bring.

How much of the cost savings would be passed on to consumers would depend on the airline unions, and on whether increased traffic would also increase the cost of air traffic control and airport charges. But the Brattle Group estimates there could be a saving to consumers of euro 630 million a year, and possibly up to double that figure.

Part of the savings would come from greater efficiency, stemming from the abilities of US-EU airlines to cooperate more closely. Because of the current regulatory barriers (i.e. nationality requirements), many airlines enter alliances that involve code-sharing or interlining. This allows them to write tickets for more than just one leg of a journey. But not all airlines get the necessary US anti-trust exemption to interline. Those that do and are formally allied typically charge between a fifth and a quarter less than charged by stand-alone airlines. Such efficiencies to the airline and savings to the traveller could be open to all, if the US were to drop its anti-trust restrictions in a common aviation area.

The Brattle study forecasts that passenger volumes would rise by 5-13 % within the EU and by 9-24 % across the Atlantic. Part of this increase would come from an end to the non-Open Sky agreements that the US has with four EU countries – Britain, Greece, Spain and Ireland. In contrast to the Open Sky deals, these four agreements actually restrain output in terms of frequencies of flights.

Ideally, from a EU viewpoint, the coming negotiation should be as ambitious as possible. It should cover not only access to the US domestic market, but also issues of nationality, competition and state aids. Any true transatlantic common market in aviation would surely have to include these elements. However, the more ambitious the goal, the longer it will take to reach it.

However, given the complexity and sensitivity of some of these issues, the EU may have to be satisfied with a two-stage negotiation. The first would involve adapting the bilateral agreements – particularly their nationality clauses - to conform to EU law. The US appears ready to widen the nationality clauses in the bilateral accords to embrace other EU carriers, but under two conditions.

One is the EU state that is signatory to the agreement must assume responsibility for the safety of any other EU carriers benefiting from

the agreement. The other is that carriers from Member States that have not entered into an Open Skies accord with the US should not be able to “free-ride” on the Open Skies agreement of another EU state. This is essentially a dig at Britain, which has always resisted US pressure to get better access for its airlines to Heathrow under an Open Skies arrangement; the three other EU states without Open Skies agreements have airports that are of lesser interest to the US. It is not quite clear, though, how Britain’s airlines can be prevented from “free riding” on others’ Open Skies agreement without at the same time discriminating within the EU against the UK on grounds of nationality.

Clearly, the US might well be tempted to end the negotiations here, and not to go on to tackle all the sensitive issues involved in a second stage negotiation for a US-EU open or common aviation area. Formally, the Bush administration has said it is willing in principle to contemplate a wider agreement. But in practice it is very reserved about enlarging the scope for foreign ownership and control of US airlines, permitting US airlines to lease foreign aircraft and crews for use inside the US, dropping the Fly America policy, harmonising its competition and state aid policies with the EU, and letting EU carriers operate directly inside the US.

Such changes would require legislation, which the US airlines and their employees would work hard to prevent Congress from passing. Jonathan Kessler of the US Mission to the EU thus appeared to understate the case when he told the EPC aviation conference that there was “some resistance” in the US to letting foreign carriers into the US market. One sign of this resistance has come in the air cargo sector, where the US air cargo companies, FedEx and UPS, have gone to court to accuse DHL, now owned by Deutsche Post, of effectively controlling Astar, a US airline, in breach of US law. In July 2003 DHL sold DHL Airways to a US investor group which renamed the company Astar. The contention of FedEx and UPS is that, despite its new ownership, Astar does so much business with DHL as to be under the latter’s effective control. In a tit-for-tat retaliation, Deutsche Post has asked the European Commission to investigate whether UPS’ partnership with Danish airline Star Air might infringe EU law on foreign ownership.

EU governments recently sought to give the Brussels Commission some leverage in its negotiations with the US. They empowered the Commission to impose duties on foreign carriers suspected of unfairly benefiting from state aid, or using unfair pricing policies. This is possible, since the World Trade Organisation (WTO) has not set any rules controlling unfair competition in air transport. It is highly doubtful, though, that Brussels would actually use such a weapon against the US, because it would invite retaliation.

Liberalisation inside the EU –benefits and drawbacks

The past 10 years of a deregulated EU aviation market have brought enormous benefits to travellers, especially in terms of prices and the range and the frequency of flights. However, it is not always easy to judge these benefits. While the market is more competitive, it is not necessarily more transparent. As the Commission said in a paper, “the proliferation of tariffs, over-booking, [lack of information about] the availability of seats at the most publicised promotional fare, the growth in frequent flying programmes, code-sharing and airline alliances can all make it harder to consumers to compare competing offers”. [2]

A major problem is increasing congestion, whether at airports or in the skies above them or even in terms of the increasing tendency of airlines to over-book flights. In the immediate wake of the September 11 terrorist attacks in the US, air traffic fell dramatically in the US and to a lesser extent elsewhere. It has now recovered. Between July and September 2003, the level of flights was back up to a record of just over 25,000 a day from European airports.

The Low-Cost Carriers (LCCs)

Particularly significant in this recovery in air traffic levels has been the growth of low-cost carriers (LCCs). These no-frills airlines are born out of EU liberalisation, and are the fastest growing segment of the industry. This part of the industry is still dominated by LCCs operating out of UK airports, especially the leaders, Ryanair and easyJet operating out of Stansted and Luton. But the habit of no-frills air travel is spreading rapidly. In 2002 continental Europe accounted for 13 % of total business for the LCCs; by early 2003 this proportion had risen to 30 %.

But is the success of LCCs sustainable? Nothing in the volatile aviation industry should be taken for granted. Can they continue to cut costs? It is clear that their profitability depends on cutting costs rather than raising fares. Ryanair, for example, reduced its average fares, in the six months between March and September 2003, by 12 % (though part of this was due to exchange rate movements) in order to keep expanding its passenger load. But it is also appears that Ryanair has to maintain passenger growth partly in order to secure ever lower prices from its suppliers, because the way it is able to drive down costs with its suppliers is by promising them an ever increasing volume of business. [3]

How far can wage costs be squeezed? The European Transport Workers Federation (ETF) complains that its member unions are unable to organise employees at Ryanair; the company management’s response to this is that Ryanair employees are free to join a union if they want to, but know that in fact Ryanair gives them a better long

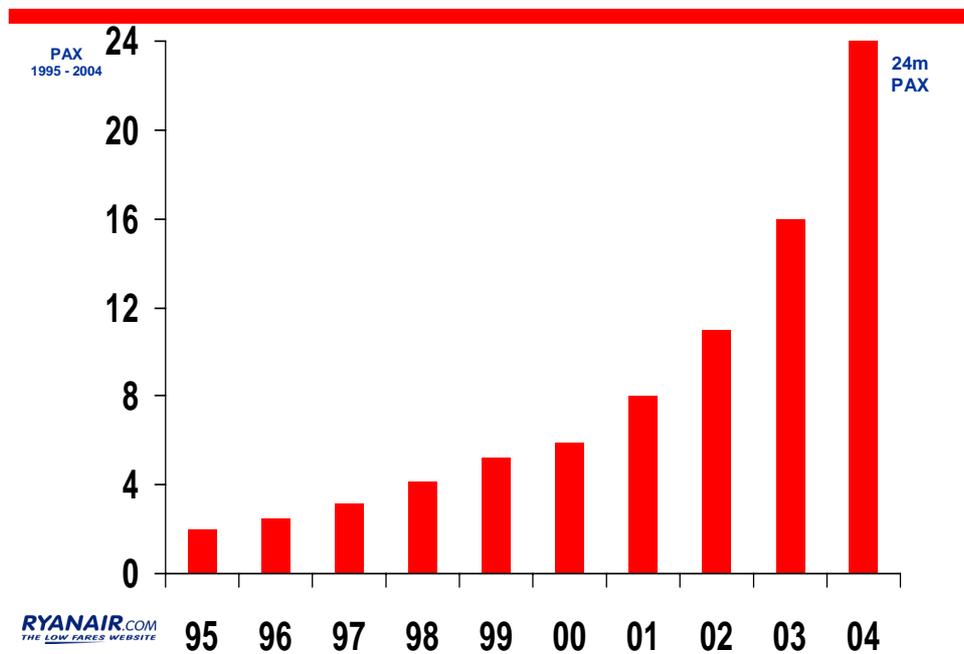
term future than any union can. The ETF also complains that Ryanair largely sidesteps the higher social standards of continental Europe by putting its pilots and cabin crews on Irish or British work contracts. Finally, can the LCCs continue to depend on lower airport charges?

No frills – low costs

While there is no clear definition of LCCs, apart from price, the recipe for getting costs down generally involves buying one type of aircraft, flying them more often and turning them around more quickly than traditional scheduled carriers. As any traveller on a no-frills flight knows, the service tends to be minimal, and has to be paid for. The lack of free catering creates, for the airline, the advantage that cabins can be cleaned quicker and requires fewer crew members.

Another reason for the quicker turnaround of LCCs is that they often exploit Europe's many under-utilised regional airports. These secondary airports are also often willing to offer much lower charges for landing, baggage-handling and office space, in return for the volume of business that a LCC can guarantee. From a public policy viewpoint, offering such discounts at secondary airports may be an intelligent way of diverting traffic away from overcrowded bigger airports, and a more effective way of promoting regional tourism than standard advertising. However, it has stirred complaints from established airports and airlines.

Ryanair's Traffic Growth



Charleroi – the test case

As a result, the European Commission opened an investigation in December 2002 into whether the publicly owned Charleroi airport in Belgium has been giving unfair state aid to Ryanair. This has become a test case for the whole industry. In launching its inquiry, the Commission stressed that it was “not questioning the development of low-cost flights which respond to clear consumer wishes”, but instead “aiming to ensure a level playing field for all airlines”. However, it expressed “doubts” about the reduction in landing fees which the local Walloon government had granted Ryanair, and the financial help which Charleroi airport had given Ryanair in the form of cheaper hotel accommodation, ground handling charges, provision of office space and marketing. In return Ryanair had guaranteed the volume of passengers it would put through the airport.

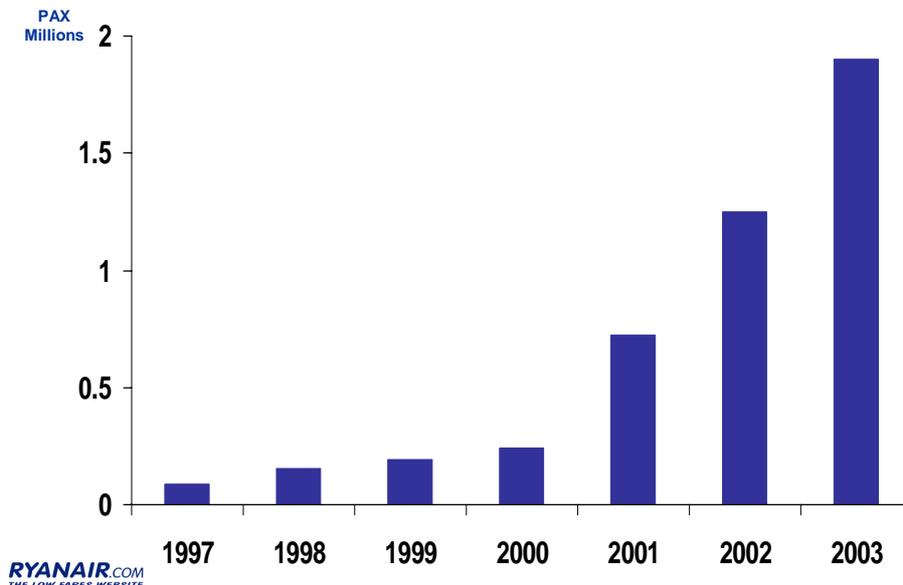
The Commission investigation turns, among other things, on whether a) the aid was non-discriminatory in the sense of being potentially available to all airlines, and b) whether publicly owned airports offer bigger discounts than private airports because they are not subject to the normal disciplines of the market. For his part, Michael O’Leary, the Ryanair Chief Executive, gave a robust defence of his case to the EPC aviation conference. He did not regard the aid as a subsidy. “We are paying it upfront, and then getting some of it back” in terms of hotel rooms or marketing support, “because it is our money”, he claimed. In return, Ryanair could help increase the number of passengers going through Charleroi from 2 million to 10 million a year in the future.

Mr O’Leary claimed the arrangement was not exclusive, because it had been offered to other airlines. Indeed he said Ryanair would benefit if more airlines did use Charleroi, which “being empty for 80 % of the day” had plenty of spare capacity. On the issue of whether the publicly-owned Charleroi airport was behaving like a rational private investor in a way that the Commission could approve of, Mr O’Leary said five other nearby airports (three private and two public) had offered Ryanair discount deals, and that the one offered by Charleroi “was not the cheapest”. But it was “crucial for public airports to be able to compete with private airports” for airline business, he stressed. In this way, he said he was seeking to replicate on the continent the position in Britain where “there is real competition, not only because the airlines generally hate each other but also because the airports compete with each other.”

The outcome of the Charleroi case is expected to determine the fate of complaints against Ryanair elsewhere at other French airports like Strasbourg and Pau. It is clear the Commission has a love-hate relationship with a low cost carrier like Ryanair and an outspoken entrepreneur like Mr O’Leary. On the one hand, it has clear misgivings about the opaque nature of the discounts he has been getting from Charleroi and elsewhere. It would like future airport/airline

arrangements to be openly advertised and tendered for, and for such arrangements to be non-exclusive and shorter in duration. On the other hand, they clearly want Ryanair and Mr O’Leary to succeed, and do not want to do anything that would damage his business model.

Brussels Charleroi – Traffic Growth last 7 years



Congestion

Airspace

Liberalisation and the consequent increase in air traffic have put new strains on air traffic management in Europe’s crowded skies. The decline caused by the September 2001 attacks in the US, and to some extent the outbreak of the SARS disease, has now been reversed. The period of July-September 2003 saw the highest average number of daily flights across Europe. At the same time, average delays related to air traffic management were 58 % down between July and September 2001, previously the busiest period on record.

This is partly due to improvements introduced by Eurocontrol, Europe’s air navigation safety organisation that has operated since 1960 and that now has 31 countries as members. One such improvement came at the start of 2002 with the reduction in the minimum vertical separation of aircraft from 2,000 feet to 1,000 feet. This has created new flight levels, allowed more aircraft to fly at lower and therefore more fuel-efficient cruising altitudes, and has led to a 15 % increase in capacity.

But pressure on the system is inexorable. With the number of flights expected to rise an average 4 % a year, total air traffic will double from now and 2015. So wider structural changes have become the order of the day, rather than just technical fixes. The biggest of these changes has involved the entry of the EU – though in its *communautaire* guise of the “European Community” – into Eurocontrol. In October 2002 the EU as an entity joined Eurocontrol alongside individual EU states. In a sense this amounts to a takeover of Eurocontrol by the EU whose membership will next year expand to 25 of Eurocontrol’s 31 members.

Still, it is a takeover that suits both parties. The EU gains the resources of a 3,000-strong organisation that has dealt with civil-military airspace issues for more than 40 years, an area in which the European Commission (which has only a dozen officials dealing with air traffic issues) has had neither legal competence nor technical expertise. For its part, Eurocontrol will gain from the legal framework and mechanisms of the EU. In theory, Eurocontrol’s decisions, once taken unanimously, are binding on its members, but in practice implementation has often been slow because the organisation lacks the EU system of courts and penalties.

The spur for the EU move on Eurocontrol came from the very serious air traffic delays that developed in 1999 when, at a time of strong aviation activity, the NATO bombing of Yugoslavia put a large part of Balkan airspace off limits to civil aircraft for several months. Regardless of this, however, it was inevitable that something would have to be done to bring together the 73 flight information centres and 35 separate air traffic systems that exist across Europe (excluding Russia); this compares with 18 flight information centres operating under a single system in the US.

As a consequence, in 2001 the European Commission came up with legislative proposals to create a “Single European Sky” [4] to be adopted first by EU Member States and then to be spread to all Eurocontrol members. These proposals, which are the subject of final negotiations between the EU Council of Ministers and Parliament, include:

- a) Harmonised conditions for air traffic controllers, despite their different status in their various countries. Only a few years ago all EU air traffic controllers were central government civil servants. Now this is only the case in France and Greece. In all other Member States air traffic control has been spun off into autonomous public bodies, while in Britain it has been privatised.
- b) Reorganisation of civil and military airspace. The dispute here is over the degree to which the Commission should have the power to group the airspace of individual countries together into “functional blocs”, and to shift military airspace away from Europe’s more crowded air corridors to more peripheral areas. Predictably, the

European Parliament would like the Commission to have more of such power, the Council less. But the need for action is there. To date, Europe's only "functional bloc" consists of the airspace of the Benelux countries and part of Germany, and managed by Eurocontrol's Maastricht centre. A similar Vienna-based centre is planned for 2007-8 in order to serve Austria, northern Italy and six central European and Balkan states' airspace. The airspace that European air forces use for training also needs re-locating; with the end of the Cold War, there is no longer any need for them to practice defending or attacking central Europe.

- c) Interoperability of national systems, technical standards and procedures.

Slots

On the ground, congestion takes the form of competition for landing and take off slots. Some bigger airports, like London's Heathrow, Amsterdam's Schipol and Frankfurt are approaching saturation, and have very few new night slots to offer airlines. But the lack of new slots obviously frustrates the aim of encouraging competition with new entrants into the market.

The long term answer to this problem is to increase the number of runways and terminals so that airports can accommodate more aircraft. In the shorter term, as George Paulson, the director of Eurocontrol told the EPC aviation conference, there are a number of airports – though not Heathrow – where for the price of relatively minor investment far greater use could be made of existing facilities. Nonetheless, the European Commission has suggested that currently available slots could be allocated better by a market mechanism such as auctions, rather than being handed out by airport or civil aviation authorities. Such trading of slots would correspond to the fact that the value of slots to airlines changes with their fluctuating fortunes or strategies.

In fact, secondary trading of slots at particularly congested airports like Heathrow is developing. It is a curious market, in the sense that no one has really established who owns slots, which boil down to the right to use a runway for an average of 47 seconds and the additional time it takes for aircraft to taxi to and from airport gates. Traditionally, airlines simply have slots, on a so-called "grandfather" basis, because they have used them in the past, although nowadays some provision is usually made for new entrants which have a right to some of any unused slots.

At Heathrow, British Airways has been buying up slots from airlines which have been willing, for a price, to swap slots and shift their operations to Gatwick, and from airlines that have needed to raise the money. Recently United Airlines, the ailing US carrier, put up some of its Heathrow slots for sale on the internet, and BA bought them. This

prompted a complaint from Continental Airlines, another US carrier, that BA was “ruthlessly” tightening its “iron grip” on Heathrow. However, Continental’s proper grievance should have been with the existing US-UK air services agreement, which prevents it from operating at Heathrow. If it had been able to fly into Heathrow, it could have competed for the United slots, and outbid BA.

But there is opposition to auctioning slots. Some incumbent airlines jealously guard their slots, and may not want to sell. Some of the poorer regional airlines fear that they will not have the money to compete in an auction for additional slots. And there is a problem of matching any internal EU market for slots with the system of slots for international flights that is still administered by national authorities.

Re-regulation

There is a risk that some of the benefits of deregulation could be undone by ill-conceived legislation. The one example of this to which people can point so far is the new measures that the EU agreed in 2003 to protect passengers who have been denied boarding, or had their flights cancelled or delayed. These problems have not increased much with liberalisation. The European Commission figures showing that some 250,000 people are denied seats every year through over-booking or cancellations appear to be fairly constant. But there is a perception that the problem has increased with deregulation. It *is* true that the worst over-bookers are the established national carriers, who are willing to allow passengers to make several bookings on the same high-priced, refundable ticket. This kind of passenger is all the more valuable these days because the revenue they provide allows the established carriers to lower the prices of other seats in order to compete with the low cost carriers.

At all events, the new consumer protection measures for passengers go far beyond the previous regulations dating back to 1991:

- for the first time, they cover unscheduled and charter as well as regular flights, and passengers arriving in the EU (from a third country) as well as leaving the EU. If, however, the third country has similar traveller protection, then *its* regulations apply rather than the EU’s.
- the new system will require airlines, which have over-booked flights, first to call for volunteers to surrender their seats in return for some compensation. Only if there are insufficient volunteers would the airline be allowed to bump people off a flight. If and when they do that, the bumped passenger is entitled to compensation, set deliberately high at 250 euro for flights of less than 1,500 kilometres, and more for longer flights.

- reimbursement in cases of cancellations or even long delays (defined as five or more hours).

Not surprisingly, the most vociferous complaints have come from the LCCs. At the EPC aviation conference, Mr O’Leary complained the new penalties neither bore any relation to the price of the ticket paid, which in the case of Ryanair was far lower than 250 euro, nor would be applied to alternative forms of transport like trains. However, the view of the Commission was, in the words of Michel Ayrat, its aviation director, that “competition cannot be allowed to develop to the detriment of the consumer.” He also said that the Commission would soon propose similar measures for train passenger compensation.

Conclusions

Clearly, the EU needs to be careful to avoid any heavy-handed re-regulation of the airline industry that would cost its citizens some of the benefits that air liberalisation has brought. There is, too, probably an irreducible amount of state intervention that is justified to maintain minimum public service on air routes to distant or less populated parts of the EU.

Such intervention is allowed under a 1992 regulation that permits Member States to grant temporary exclusive licences, or monopolies, to ensure a regular service on certain routes for which the market does not offer an adequate service. These exclusive licences are often supplemented by government aid. The routes on which such monopolies are granted or subsidies paid are generally within EU states, and therefore within the bigger EU states. However, some countries make more use of them than others. Britain and Spain, for instance, take a minimal view of such public air services, seeing them as justified only where no other transport “life line” exists for remote communities. France and Germany, on the other hand, see such support for air transport as a valuable form of regional development, and therefore use it more extensively.

This is part of the wider debate the European Commission has raised in its recent Green Paper on the role of regulators in all the recently liberalised sectors of the EU economy, and the degree to which regulators should identify and protect “services of general interest”, or public service obligations [5]. In this context, one could argue, and this paper has suggested, that aid paid to airlines like Ryanair by regional airports like Charleroi might – if provided in an open and non-discriminatory manner – be an intelligent way of promoting regional development, and be more effective than standard tourism advertising.

In the wider cause of creating a transatlantic common aviation area, it would be nice to enlist an entrepreneur like Mr O’Leary. Someone of his energy and his populist skills might be just the person to sell the benefits of transatlantic liberalisation to the politicians and the public

in the US; the focus of Mr O'Leary and Ryanair, however, are for the moment solely on Europe.

Nonetheless, for Europe, the benefits of reaching the widest possible agreement with the US are very clear. Not only would such an agreement end the imbalance in the US favour. It would at last allow Europe to reap the full fruits of its own liberalisation.

References:

[1] The Economic Impact of an EU-US Open Aviation Area published by the Brattle Group, 2002, page 5.

[2] The European Airline Industry: from Single Market to World-Wide Challenges, a Communication from the European Commission, Com (99) 182, published 1999, page 18.

[3] See Financial Times, 4 November 2003, p.17.

[4] Creation of the Single European Sky, published by the European Commission, COM (2001) 123, November 2001.

[5] Green Paper on services of general interest, published by the European Commission, Com (2003) 270, May 2003.