

The Impact of EU-US “Open Skies” Agreement on Airline Market Structures and Airline Networks

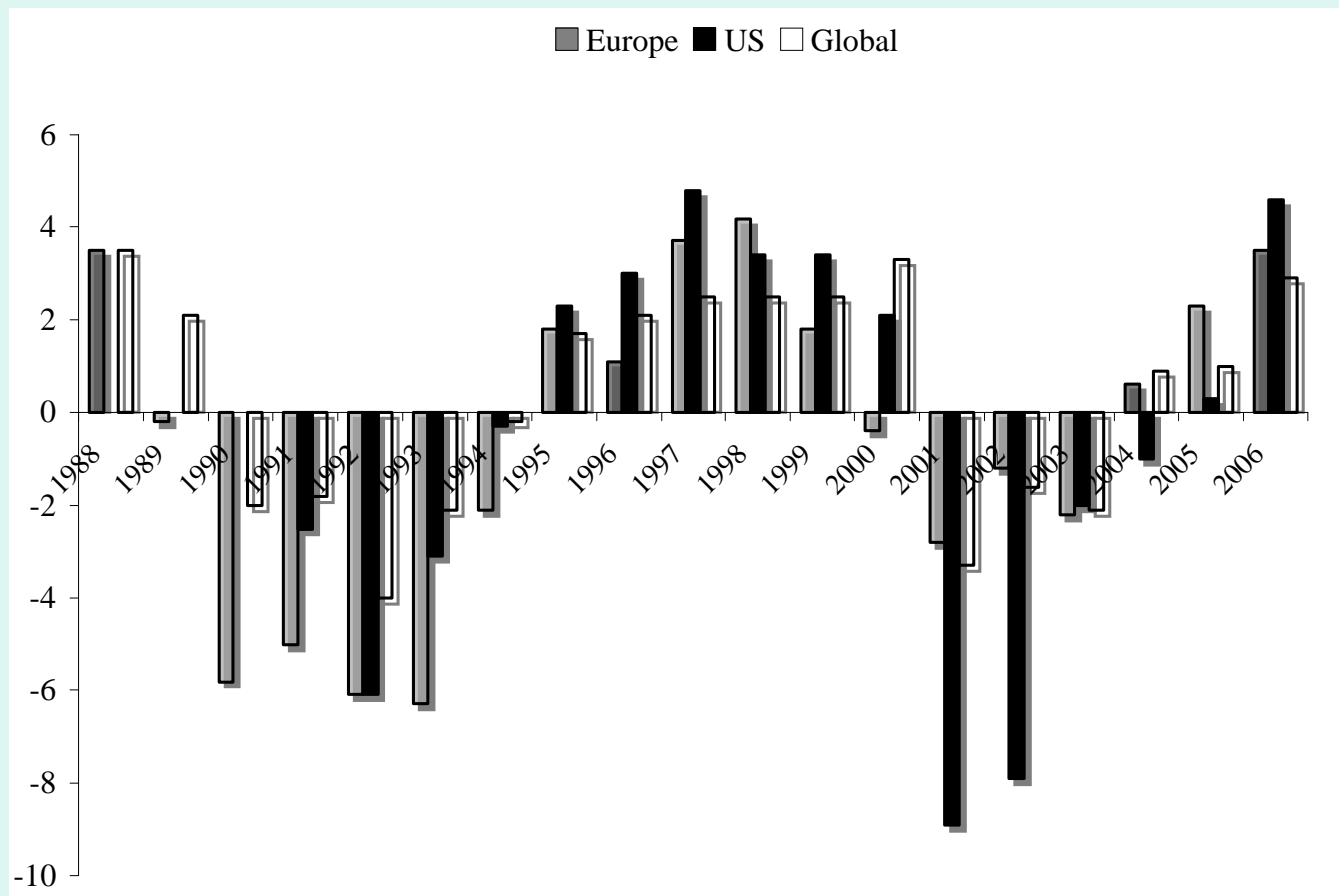
Kenneth Button

George Mason University

Position paper for the 1st Airneth Conference

5th-6th March 2008

Operating margins of airlines (1988-2006)



The economic problems of cost recovery for schedule airlines

The fixed cost problem with competition

- Well recognized in manufacturing - Edgeworth, Viner, Coase
- The fixed of airlines is the committed cost of a schedule
 - UA 946 Washington- Amsterdam on March 2nd 2008 had to fly irrespective of whether it had any passengers or not. That is the fixed cost.
 - Competition keeps from competing carriers prevents full costs being recovered.

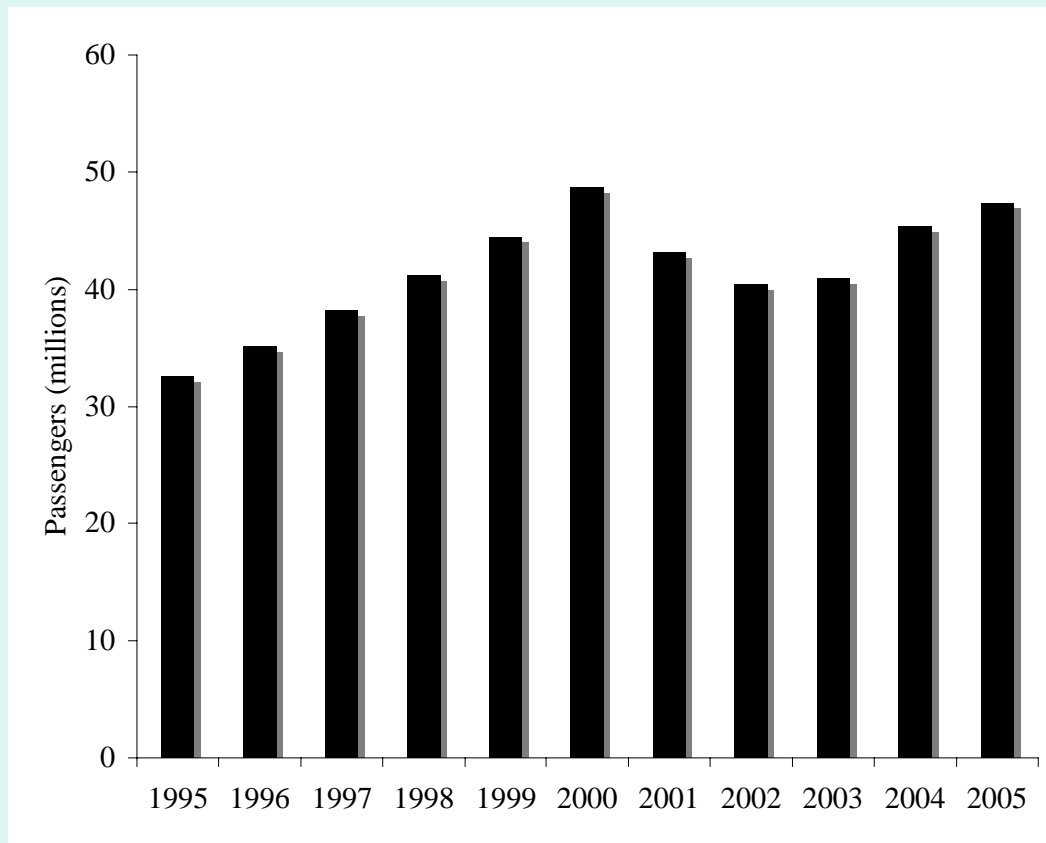
Methods of cost recovery

- Subsidies
- Price discrimination (yield management)
- Loyalty programs (frequent flyer programs)
- Infrastructure control (hub-and-spoke systems)
- Information control (CRS systems)
- Lower costs
- Alliances (cartels)
- Focusing on “protected markets
 - Legal
 - Technical
- Bankruptcy restructuring (Chapter 11 in US)
- Up-line vertical support

The problems with the old approaches

- Subsidies - illegal
- Price discrimination - competition limits this
- Loyalty programs - “Greenshield stamp effect”
- Infrastructure control - “hub busters”/new allocation methods
- Information control - on-line booking systems
- Lower costs - largely exploited
- **Alliances**
- Focusing on “protected markets”
 - Legal - breaking down with Open Skies
 - **Technical**
- **Bankruptcy restructuring**
- **Up-line vertical support**

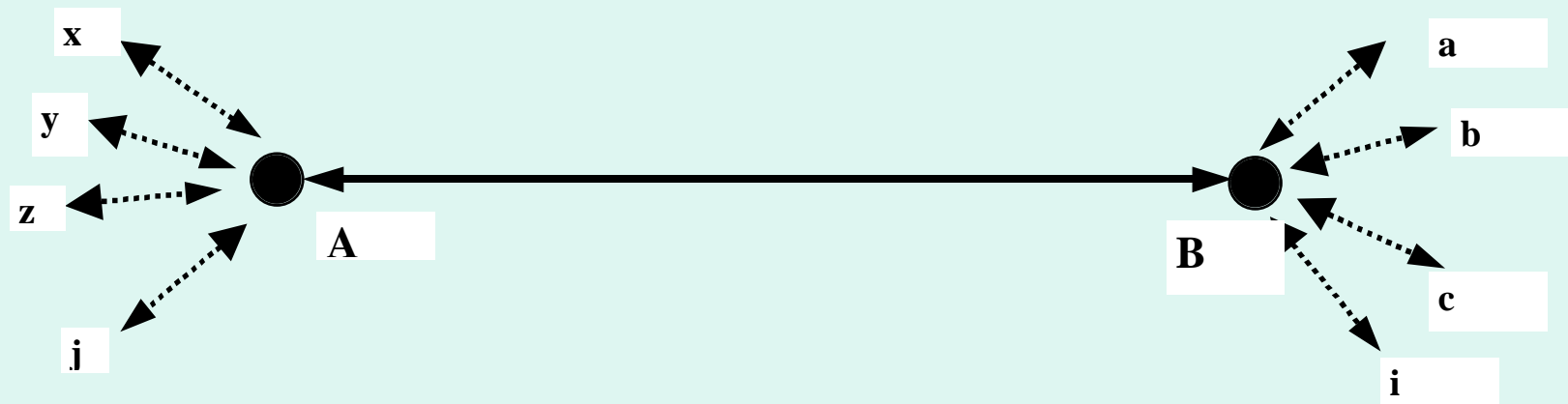
EU-US transatlantic air passengers



The European based “Open Skies” initiatives (passenger services)

Netherlands	In Force	10/14/92
Belgium	Provisional	3/1/95
Finland	In Force	3/24/95
Denmark	In Force	4/26/95
Norway	In Force	4/26/95
Sweden	In Force	4/26/95
Luxembourg	In Force	6/6/95
Austria	In Force	6/14/95
Czech Repub.	In Force	12/8/95
Germany	Provisional	2/29/96
Italy	Comity and Reciprocity	11/11/98
Portugal	In Force	12/22/99
Malta	In Force	10/12/00
Poland	In Force	5/31/01
France	In Force	10/19/01

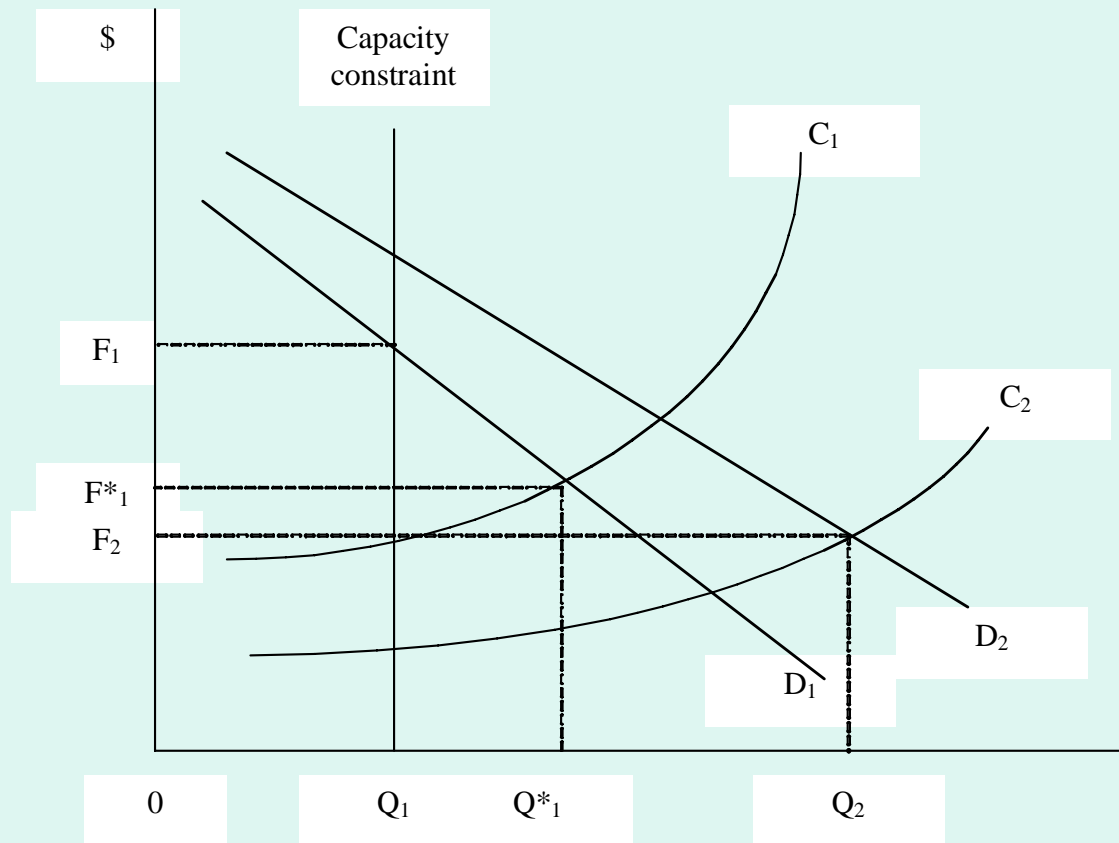
The “dog-bone” international hub-and-spoke network



“Open Skies” and “Open Markets”

- Open Skies
 - Focus entirely on the final services provided (fares, airlines, services, etc)
- Open Market
 - Focus entirely on the entire air transport industry and includes factor markets (investment, labor, etc)

The simple economics of Open Skies policies



Extent of Open Skies coverage as a result of the 2007 agreement

Originally Covered	Now
Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, and Sweden	UK, Bulgaria, Cyprus, Estonia, Ireland, Greece, Hungary, Latvia, Lithuania, Spain, and Slovenia

The wider impacts

- Airlines - short term financial respite
 - Slot controls in Europe
 - Power of alliances
 - Regulation and competition policies
- Economies - benefits in terms of jobs and industrial restructuring
- The Environment - adverse tempered by new aircraft and traffic diversion rather than creation
 - New aircraft types
- Safety/Security - minimal implications

The main US and European airlines that are part of the major strategic alliances

Star Alliance	oneWorld	SkyTeam
United Airlines Lufthansa bmi TAP Portugal Finnair Lauda Air LOT Polish Airlines Spanair SAS Scandinavian Airlines Austrian Airways Tyrolean Airlines	American Airlines British Airways Aer Lingus Air France Iberia	Delta Airlines Continental Northwest Alitalia Air France/KLM CAS Czech Airlines

Brattle Group's estimates of the direct employment effects for Europe of an Open Aviation Area (in thousands of employed)

	Airline employment	Airport employment*	Airport employment**
Low bound scenario			
Pricing synergies	600	188	481
No output-restricting ASA bilaterals	1587	436	1092
Total	2178	624	1573
Low bound scenario			
Pricing synergies	3523	1124	2820
No output-restricting ASA bilaterals	1578	436	1092
Total	5101	1560	3912

Market share of passengers by airline at European's largest airports

Airport	Carriers 1	Carrier 2	Carrier 3
London Heathrow	British Airways 41.6%	bmi 12.1%	Lufthansa 4.8%
Frankfurt	Lufthansa 59.4%	British Airways 3.6%	Austrian 2.9%
Paris Charles de Gaulle	Air France 56.6%	British Airways 5.15%	Lufthansa 4.9%
Amsterdam	KLM 52.2%	Transavia 5.5%	easyJet 4.3%
Madrid	Iberia 57.0%	Spanair 12.7%	Air Europa 7.1%
London Gatwick	British Airways 55.1%	eastJet 12.8%	flybe British European 5.6%
Rome	Alitalia 46.2%	Air One 10.0%	Meridiana 3.9%
Munich	Lufthansa 56.8%	Deutsche BA 6.6%	Air Dolomiti 6.5%

Conclusions

- The Transatlantic Open Skies will:
 - Benefit consumers and enhance economic growth
 - Offer short-term financial gains for the main alliance airlines
 - It will have some, but not significant effects on the environment
 - It will be additional strains on infrastructure until that is treated in an economic manner
 - There are minimal safety/security concerns
 - Provide on-going challenges if a genuine Open Market is to be developed.