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The impact of Air Service Agreement liberalisation: The case of Nigeria

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ABSTRACT

The positive impact of air transport liberalisation as suggested by economic theories and empirical studies has inspired many developing countries like Nigeria to liberalise some of its Air Service Agreements (ASAs). This paper seeks to examine the extent to which international air service liberalisation has impacted upon Nigeria ten years after it was introduced. The research developed a cross-sectional model with passenger traffic as the dependent variable, while macroeconomic factors (trade and GDP), historical links, distance and ASAs (a proxy for liberalisation) served as independent or predictor variables. The analysis revealed a set of ASA stages in the country's policy-making process (restricted Bilateral Air Service Agreement, Open Skies Agreement and Yamoussoukro Declaration). Further analysis showed that the predictor variables were all significant in explaining passenger demand. The model demonstrated that the liberalisation of market access to the Open Skies Agreement level could stimulate traffic growth by at least 65 percent. The findings can assist in guiding policy and industry stakeholders in future decisions relating to liberalisation and ASAs.

1. Introduction

Air transport regulation has been undergoing structural reform in various countries due to globalisation and the free market economy concept. Consequently, the concepts of privatisation, deregulation and liberalisation of Air Service Agreements, such as open skies agreements, have evolved (Doganis, 2002). The reform was pioneered in the USA in 1978 and adopted by the EU in the 1980's and 90's and is now championed by industry professionals and international bodies such as the World Trade Organisation (WTO) and International Air Transport Association (IATA). In these liberalised countries, the industry has witnessed very significant impacts in the area of traffic growth, competition, air fares reduction, improved cost efficiencies in airlines, and the development of low cost carriers and airline alliances (Button and Drexler, 2006). For instance, the EU experienced increased competition on many routes leading to a 34% decline in air fares, while passenger traffic on certain routes grew by as much as 108% (InterVISTAS-EU Consulting, 2009). In a similar manner, the US airline market grew substantially. These and similar experiences inspired many emerging and developing countries like Nigeria to adopt such reform despite the fear of foreign carrier domination and capital flight.

The Nigerian aviation sector has numerous challenges including low levels of traffic when compared with other peer group countries in Africa, for example Egypt, Kenya, South Africa and Morocco. The low volumes of traffic have led to an underutilisation of aviation infrastructure (21 airports and other navigational aids) with only 2.9 million international passengers in 2010 (NCAA, 2011). Consequently, revenue generation is negatively affected and poses a threat to the sustainability of the country's air transport sector. However, empirical evidence of the impact of liberalisation in other countries has shown that passengers in such markets have benefitted in terms of higher consumer welfare and a higher quality of competitive services (Brattle Group, 2002; InterVISTAS-ga2, 2006). Therefore, a more liberal set of ASAs in Nigeria may bring additional benefits to passengers.

Currently, Nigeria has signed Bilateral Air Service Agreements (BASA) with over fifty countries allowing international air traffic between them. These are mainly restrictive in nature, based on the principle of protectionism (FMOA, 2011). The essence of restricted BASAs is to protect the interests of indigenous carriers in the host country markets (Doganis, 2002). However, Nigeria's air transport sector exhibits a distinctive environment, with weak indigenous carriers that lack the financial and managerial capacity to compete effectively with international carriers. This weakness has provided an opportunity for foreign carriers to take advantage and handle as much as 85% of international air traffic in the market, based on 2010 country traffic data (NCAA, 2011). This suggests that BASAs in the country are only able to safeguard about 15% of international air

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traffic for the privately owned indigenous carriers. It follows that, in the case of Nigeria, there may be even less of an incentive to continue restricting air services and to hypothesize the impact of further liberalisation in these markets.

In 1998, Nigeria adopted reform with the complete deregulation of the domestic market and privatisation of airline and handling companies. Around the same time, international BASAs with some countries were reviewed and partially liberalised. There has been steady growth in the international traffic in recent years which may be attributed to numerous factors including the above mentioned reform. This paper thus seeks to examine the impact of liberalisation on certain aspects of international air transport passenger services in Nigeria, specifically market access and carrier ownership/control. This is achieved by reviewing the country's ASAs to determine the level of liberalisation with the aid of an innovative WTO based index of liberalisation, as well as assessing how changes have affected passenger traffic on a set of Nigerian country-pair markets. The paper also explores the potential impacts of further liberalisation of the country's international routes.

The rest of the paper comprises five sections. Firstly, the theory underpinning the liberalisation concept is discussed along with a review of liberalisation in Nigeria. Secondly, the methodological aspects and the data required for the development of the model and analysis are developed. This is followed by the discussion of the results and estimated impacts of the liberalisation in the next two sections of the paper. Finally, the conclusions are presented in the last section.

2. Liberalisation of Nigeria's international air transport market: theory and practice

Liberalisation refers to the exposure of air transport to free market forces achieved through the removal of most regulatory controls over pricing, entry and exit barriers. Liberalisation recognises that the structure of the transport industry may necessitate the retention of some form of regulation if consumers are to gain long term benefits from the competition promoted by liberalisation measures (Graham, 1995). The common instrument of international air transport regulation between two countries is the BASA which, as Doganis (2002) and Vasigh et al. (2008) have argued, is often designed to protect national interests and provide support for national airlines. Many in the industry have shown concern about ASA policy and its impact on the industry. For instance, Williams (1993) argued that regulation succeeded in creating a scheduled airline industry which was protected from competitive pressures leading to inefficiency, high fares, low load factors, poor profit and poor service quality. Specifically in Africa, Bofinger (2009) claimed that bilateral regulation has held back the development of air transport due to overtly protectionist policies. Therefore, BASAs could be responsible for curtailing a market solution to international air travel with regulation that raises costs to both operators and customers and creates inefficiency in the market. These observations complement several economic and market theories that contest the regulation of air transport.

Meanwhile, Button and Drexler (2006) postulated the theory that BASAs limit capacity and fares in the international air traffic market between countries, while liberalisation policies tend to remove the capacity and fare limitations resulting in an increase in supply of service by the incumbents and emergence of new entrants that create competition. Accordingly, the ensuing route traffic intensity lowers the cost per passenger which in turn lowers the fare and enhances efficiency. They added that further implementation of the policy provokes a more integrated quality of service in the industry such as hubbing, code sharing, interchangeable frequent flyer programmes, common lounges and baggage check-in. Consequently, the increases in service quality at lower costs induce more demand for international air travel. This suggests that liberalisation policies (such as Open Skies Agreements (OSAs) and the African Yamoussoukro Declaration) lead to lower costs of operation and higher numbers of passengers. Whilst the relationship between the degree of liberalisation and traffic volumes appears to be widely accepted from both a theoretical and empirical perspective, its relationship with fare is somehow contestable. Grancay (2009) argued that the relationship between liberalisation and air fares is not a fixed one and depends upon the shapes of supply and demand curves.

There are a limited number of previous studies that have focused on the liberalisation of air transport in Nigeria. Anyanwu et al. (1996) researched the effects of liberalisation on the then national carrier, Nigeria Airways (which is now defunct) but just covered the domestic market which makes little contribution to the current argument of international liberalisation. According to Akpoghomeh (1999), the first deregulation effort with Nigerian air transport was in 1988 when three private carriers commenced scheduled domestic air service operations. However, there was a limit to the number of competitors on routes, where the main routes were restricted to the national carrier and one independent airline. Competition on the basis of air fare and routes was ruled out and the airlines competed only on the level of service quality (frequency, reliability and comfort). Furthermore, Daramola and Jaja (2011) examined how domestic deregulation changed the air connectivity network in the domestic market; the finding suggested that domestic deregulation led to a greater evenness in the overall network connectivity of domestic airline services. Therefore, it is possible that international liberalisation, which is the focus of this paper, could also improve the country's connectivity.

The African Union responded to the global liberalisation effort and formulated the Yamoussoukro Declaration (the new African civil aviation policy adopted in October 1988). The declaration called for the liberalisation and integration of air services so as to pave the way for the continent to participate actively in the globalisation process and regional development. In line with this declaration, the Nigerian government policy was directed towards liberalisation and guided deregulation of the air transport market (Akpoghomeh, 1999; Idrisu, 2004).

The route to liberalisation in Nigeria involved the following:

- Implementation of a new civil aviation policy in 2001 in line with the liberalisation trend, especially the Yamoussoukro Declaration, and backed by law;
- Commencement of the review of existing BASAs with African States, again in line with the provisions of the Yamoussoukro Declaration;
- Deregulation of the domestic aviation market, where several private airlines were granted a license to undertake local, regional and international operations;
- Privatisation of public companies such as Nigeria Airways (liquidated), handling companies and a terminal building concessionaire (Bi-Courtney);
- Implementation of multiple designation with the UK government in 1998;
- Signing of an OSA with the US in 2002;
- Granting of commercial agreements with a number of foreign country airlines. This arrangement permits the airlines of the second party to provide additional frequencies to their agreed BASA.

After ten years (2000–2010) of the implementation of the policy, it is clear that traffic has significantly increased, while many new carriers have entered the market. To support this argument,