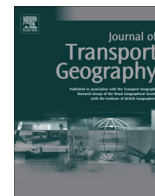




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Four shades of Open Skies: European Union and four main external partners

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ABSTRACT

The Open Skies agreements are in the centre of the European Union's external aviation policy. They form the basis of liberalisation of aviation between the EU and the rest of the world, opening up markets and promoting fair competition. The progress made since the original road map in 2005 depended both on the priorities of the European side and the individual strategy of each external partner. This paper discusses the status of the EU's aviation relations with four important partners: USA, Russia, Morocco and Turkey.

Aviation liberalisation is at a different stage of maturity in the four examples. The evolution of traffic over time can give an insight into the impact that gradual liberalisation had in each case: total traffic grows faster when restrictions are lifted, but new demand is not spread equally across airports on either side. The impact on concentration, measured with the Herfindahl–Hirschman Index (HHI) at airport level, varies significantly between the various markets. Political, geographic, demographic and economic factors influence the airline network dynamics and lead to distinct patterns of expansion. Special emphasis is given to the analysis of the role of airline alliances, ownership limitations and specific obstacles such as the visa limitations and the Siberian overflight royalties.

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1. Introduction

Liberalisation in aviation, as in any industry, can stimulate important structural changes and lead to drastic changes in the patterns of operation of airlines and airports. The liberalisation process that the European Union (EU) has implemented within the EU can be seen in the development of a highly competitive landscape in European aviation. The external aviation policy of the EU, expressed as Open Skies agreements with third countries, is the main expression of liberalisation of international aviation between EU and its external partners.

From a transport geography point of view, it is interesting to analyse how Open Skies agreements can influence the dynamics of aviation activity between the EU and the rest of the world, and explore whether they lead to a concentration or a dispersion of activity in spatial terms. Given the international dimension of the Open Skies agreements, it is of special interest to analyse how competition between airports is affected. Most of the existing literature addresses either competition between airlines at various geographic levels, or competition between airports at regional level.

The methodology and the analysis presented here address the spatial dimension of the impacts of liberalisation and the factors

that influence the patterns of competition between airports at international level. The main research question is how does the degree of liberalisation, in combination with the economic and geographic characteristics of a specific market, influence the evolution of international air transport networks and the degree of concentration in airport traffic shares. While opening up markets are generally expected to have an impact in terms of overall demand, the spatial distribution of the changes in demand may be affected by limitations in supply that have not been fully removed.

Several studies, including Oum et al. (2010) and Goetz and Vowles (2009) argue that liberalisation decreases prices and increases passenger volumes. Removing supply limitations allows new airlines to enter the market or existing ones to extend their offer. The increased levels of competition between airlines press the operators to reduce costs and profit margins. Especially where low cost carriers have an increased presence, lower prices attract higher passenger demand. Button (2009) outlines the type of benefits expected from liberalisation, but also underlines that not everyone is a winner. Non-competitive destinations, airlines or airports may also lose traffic and market share. In addition, establishing a cause and effect link between liberalisation and changes in the market is not straightforward. Pitfield (2009) highlights the difficulty in measuring the real impacts of liberalisation and the need for methodological improvements in order to be in a position to attribute its role in market developments.

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The geographic aspect of low cost airlines and the dynamic evolution of their networks are relevant issues that have been explored in detail by Dobruszkes (2006). While liberalisation is clearly the underlying force that allows the emergence of low cost carriers, full service network carriers still maintain a dominant role in the main European airports. One reason cited is the development of hub-and-spoke networks centred around one or a few hub airports. Low cost airlines prefer point-to-point connection predominantly between secondary airports. Lian and Ronnevik (2011) and Costa et al. (2010) discuss the competition between central and regional airports, in Norway and Brazil respectively, and identify a trend in favour of the central ones. The way each market is affected is explained by a combination of supply (prices and frequencies) and demand (traveller socio-economic characteristics), as well as geographical aspects (distance). Increasing flight distances also favours the development of hub-and-spoke networks (Lin, 2012). Burghouwt and Hakfoort (2001) find evidence of concentration of trans-Atlantic flights in a few hub airports, contrary to the lack of such a pattern for intra-European flights.

Airport competition is usually analysed in terms of catchment areas, or airport hinterland (Hess and Polak (2005), Luken and Garrow (2011)). Pels et al. (2009) identify the factors that affect airport choice, while Tierney and Kuby (2008) explore the combined choice of airport and airline. In both cases, the trade-off between price and frequency is a determinant of user choices and – as a consequence – defines airline strategies. Fu et al. (2010) explore the mechanisms that lead to changes in aviation traffic flow patterns and suggest that liberalisation stimulates efficiency gains within and across continental markets. This involves the optimisation of airline networks and often leads to the formation of airline alliances. In parallel, the importance of low cost carriers in maximising the benefits from liberalisation is also emphasised. There are, however, several barriers to market entry that strengthen the role of incumbents and their alliances, preventing new operators compete for the market.

Berechman and De Wit (1996) use a network simulation model to compare different airline network options in the context of the deregulated European aviation market. Adopting a hub-and-spoke network with a specific airport as its hub appears to be a strategy that maximises airline profits and deters entry by potential rivals. Alves and Forte (2015) confirm that airline strategies involving alliances may distort competition in trans-Atlantic markets. In the case of flights between Portugal and Brazil, such alliances may lead to market collusion that prevent the appearance of new competitors. Morandi et al. (2014) analyse direct and connecting flights between the EU and USA during a typical off-peak week. Their results suggest that the competition between carriers, alliances and hub airports has led to a decrease in the number of direct transatlantic connections. The increased overall traffic tends to be attracted by the main alliances and their respective hubs. The issue of market dominance by airlines or airports is also discussed in Starkie (2012). A link between liberalisation – aided by new airline business models and new information technology – and decreased level of airport competition is implied.

Koo and Lohmann (2013) compare the impacts of deregulation in Australia and Brazil, explaining the trend for market concentration in Brazil as a result of high policy volatility which posed limitations to the supply side. The more predictable and open policy in Australia helped in keeping the spatial distribution of growth in aviation quite stable. Adler et al. (2014) model the impacts of liberalisation of the transport market in Northeast Asia and expect benefits for both consumers and airlines. The benefits are not, however distributed evenly across or within market players. A main factor that affects the extent and distribution of benefits appears to be airport slot availability. Slot allocation policies can effectively distort the supply side of the market and limit overall

benefits. The impact of supply side policy intervention is also discussed in Calzada and Fageda (2014). Their analysis of subsidies on specific low volume market indicates that such measures on one hand increase passenger volumes and decrease prices but – on the other – drastically limit competition, often to a single airline.

The review of the relevant literature suggests that aviation liberalisation can trigger several changes in the operational model of airlines that affect their network design. Competition between airports is also affected as a result, depending on the specific geographic situation and market conditions. The example of four international aviation markets is used here in order to analyse how these conditions actually influence the spatial dimension of competition in aviation.

2. The policy context

The EU internal aviation market is one of the clearest examples of how European integration can lead to the creation of a single market. Before 1992, the milestone year for the development of the EU Single Market, the EU aviation market was fragmented among the national markets of its Member States, each adhering to a restrictive bilateral agreement with each of the other Member States. After 1992, all national markets of the EU Member States (which eventually became 28) were merged into a single EU aviation market and all national carriers are considered as EU carriers. The immediate effect for the aviation sector was that no restrictions on capacity, market access and pricing were possible. Common rules on aviation were applied across the EU, especially as regards market opening. In particular, investment and airline ownership barriers were removed and common regulations were developed on a wide range of issues (safety, security, air traffic management, travellers' rights, environmental impacts of aviation).

The external aviation policy of the European Union is more recent but largely builds on the success of the internal aviation policy (European Commission, 2012). It follows the guidelines of the Road Map developed in year 2005 by the Council of the European Union and the European Commission (European Commission, 2005). The Road Map was based on three pillars:

- a. Bringing existing bilateral air services agreements between EU Member States and third countries in line with EU law: the Open Skies policy of the European Union implies that bilateral agreements between an EU Member State and a third country are not allowed to include any nationality clauses. Any EU carrier should be allowed to operate between the EU Member State and the third country. This made necessary that about 1500 pre-existing bilateral agreements of the Member States were updated. While more than 900 agreements with 107 countries have been already amended, in the case of 45 third countries the progress was even faster. Horizontal agreements were signed, in practice replacing all the bilateral agreements of the given third country with all EU Member States.
- b. Creating a true Common Aviation Area with the neighbouring countries: as part of its external aviation policy, the EU encourages neighbouring external partners to adopt the EU legislation on aviation rules, initially regarding safety requirements. Successive phases of a potential convergence include market opening and progressive regulatory harmonisation. The European Common Aviation Area, the group of countries sharing the common EU aviation rules can eventually include up to 58 states with a total population of 1 billion inhabitants.
- c. Concluding aviation agreements with key strategic partners: the third important pillar of the EU external aviation policy is the conclusion of aviation agreements with strategic

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