

# **Deregulation and the Airline Business in Europe**

Selected readings

**Sean Barrett**



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# Deregulation and the Airline Business in Europe

Over the past twenty years air fares in Europe have fallen steadily. New entrant airlines such as Ryanair and easyJet have become the largest passenger airlines in Europe, old national airlines have become commercialised and staff productivity of airlines and airports now compete. The reason behind these changes was the change in policy from protecting national airlines to market competition. This book documents a dramatic change in the economic policy surrounding the low-cost airlines and the airport industry as a whole.

In this fascinating monograph, Dr Sean Barrett provides a full deregulation case study from market control by national airlines through regulatory capture of governments to the transformed competitive market today. The topics covered include the deregulation of Europe's busiest route – London to Dublin, the market entry of Ryanair and its sustainability, the outlook for full-service airlines, the commercialisation of national airlines and the impact of airports on competing airlines.

Through a discussion of controversial issues such as the regulatory capture of government by protected airlines, the dominance of producers over consumers in protected markets and the costs of protectionism in aviation to the wider economy, Dr Barrett's book will be of interest to anyone involved in the airline business, as well as to wider public or competition policy-makers.

**Sean Barrett** is currently senior lecturer at the Department of Economics, Trinity College, Dublin, and is a member of the National Economic and Social Council of Ireland.

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**To Maeve and Melissa**





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# Foreword by Professor Alfred Kahn

I first met Sean Barrett in the late summer of 1989 at an ESRC seminar at Worcester College, Oxford, organised by David Banister and Kenneth Button. The papers presented there were published afterwards in *Transport in a Free Market Economy*, edited by Banister and Button and published by Macmillan in 1991.

Those were heady days. We had succeeded in deregulating the industry in the United States a decade previously, setting off waves of discounting that produced net benefits authoritatively estimated shortly thereafter by Steven Morrison and Clifford Winston at some \$20 billion a year. (It was only a year or so later, in the early 90s, that the industry's historical susceptibility to waves of destructive competition reasserted itself, producing disconcertingly huge multi-billion dollar losses in the four years of the early 90s.)

At the time of our meeting, in 1989, deregulation was still highly controversial in Europe: standard fares remained outrageously high by American standards, leaving the high-elasticity demand to charters. One participant in the conference expressed the view that deregulation in Europe might turn out 'a monopolistic damp squib'. In that atmosphere of scholarly uncertainty, Sean Barrett stood out as a beacon of optimism, with a dramatic story to tell – a fascinating account of the Irish parliamentary revolt in 1984 against legislation to punish discounting of airline tickets by imprisonment and heavy fines, followed by the founding of Ryanair in 1985 and the deregulation of the Dublin–London route in 1986.

The results as he described them then and now chronicles in this volume – with deserved pride – have been almost unbelievably dramatic. Fares on the Dublin–London route fell by 54 per cent on deregulation day and passenger numbers increased by 65 per cent over the first full year. The momentum has been sustained for over two decades. In the last year before deregulation 1985/1986, the protected Irish national airline, Aer Lingus, had 2.2 million passengers; in 2008, four Irish airlines in the deregulated market will have carried some 72 million.

The market leader is that same upstart, Ryanair, whose chief executive, Michael O'Leary, is a former student of Barrett, at Trinity College, Dublin. O'Leary reinvented Ryanair as a low-cost airline in the early 1990s, when it had a little over 1 million passengers. In 2009 it will have 68 million – making it Europe's largest airline – consistently with the lowest air fares and highest staff productivity in the region.

Barrett has become the leading expert on – and enthusiast for – the Ryanair model and its revolutionary impact on aviation in Europe. He also documents in this volume the almost equally dramatic, successful adaptation of Aer Lingus, from the traditional European national carrier to the new deregulated market – in contrast with other former national airlines in Europe that have either left the market or been absorbed by larger carriers. In addition to raising staff productivity to unprecedented levels, Ryanair has both redefined the airline product in Europe to the point-to-point no-frills model and tackled major input costs at airports and in ticketing, sales and distribution.

Most informative to me has been Barrett's description of the growth of competition among airports, of which he has, characteristically, both played a leading role and been the greatest enthusiast/publicist. Europe had large numbers of underused and less congested airports, most of them built for military purposes or by city and regional governments. To my knowledge he was first to analyse the attractions of these smaller, secondary airports for both low-cost airlines – to whom they could offer the 25-minute turnaround time they needed to keep costs down and the ability to expand operations rapidly, without having to acquire slots at high-cost airports.

The decisions to end ticket sales through travel agents in favour of Internet sales and to abolish frequent-flyer points to engage in price rather than non-price competition were also radical in the transformation of commercial aviation in Europe. Barrett has, for decades, advocated the break-up of groups of airports into competing entities, and competing terminals within airports.

As one involved in the political and economic aspects of airline deregulation in the United States in 1978, I find Barrett's work in Ireland both fascinating and a source of personal vindication, admiration, and indeed envy. He has been, along with Clifford Winston and Steven Morrison in the United States, my principal reinforcement, vindicator and chronicler of the results of our efforts.

In a recent (2008) response to a seminar in Boulder, Colorado on 'Deregulation Revisited', I said that

it was precisely the failure of the industry under regulation to provide travellers of modest means with a choice of economy over comfort that constituted both the need for deregulation and the essence of its success. The experience wonderfully illustrates the principle that cartelization of a structurally competitive industry – in particular the prohibition of price competition – sets off all sorts of other forms of cost-inflating competition, substantive and non-substantive, the fatal flaw of which is that it denied customers the choice of low-priced service without those amenities.

European air fares, then the highest in the world, had farther to fall than in the United States. The results of deregulation in Europe have been correspondingly dramatic. The gains from policy entrepreneurship by Sean Barrett, his disciples and his supporters in promoting and achieving the deregulation of European aviation have been immense. This volume chronicles that historic process.

## **References**

Kahn, A. (2008) 'A Grateful response and supplement', presented at the Seminar on Deregulation Revisited: A Tribute to Fred Kahn, University of Colorado, 5 September 2008.

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## About the author

Dr Sean Barrett is uniquely placed to write on the transformation of the regulation of European aviation. He was an early advocate of deregulation both in academic journals and in the public media. He has been a board member of the *Journal of Air Transport Management* since its foundation. He has served on the Air Transport Users Committee of the Chambers of Commerce of Ireland and represented Ireland on the Council of the Federation of Air Transport User Representatives in the European Community. He is a Government of Ireland nominee on the National Economic and Social Council which advises on economic and social policy and has served on review bodies dealing with industrial policy, ports policy and financial controls in the health service. As a director of the Irish Tourist Board (1984–1989) he advocated deregulated access transport in order to stimulate an important but then stagnant sector of the economy.

# Preface

## Regulating Europe's skies

Almost 117 million passengers travelled on Europe's low-cost airlines in 2006. The market leader in this segment is Ryanair with 29.9 per cent. The other airlines with a market share above 5 per cent are easyJet with 25.9 per cent and Air Berlin/Nikki with 11.8 per cent. For the year 2008 Ryanair and easyJet combined passenger numbers are estimated at over 100 million. Ryanair exceeded 1 million passengers for the first time in 1993. easyJet was founded in 1995.

The UK Civil Aviation Authority report (2006) entitled 'No Frills Carriers: Revolution or Evolution?' found that between 1996 and 2005 international passenger traffic between the UK and the EU increased from 69.1 million to 123.7 million. Low-cost airlines increased from 3.1 million to 51.5 million and accounted for 89 per cent of the increase in passenger numbers compared with 9 per cent on full-service legacy airlines and 2 per cent on charters. The CAA also noted that 'since 2000, both charter and full-service carriers have seen flat or declining demand'.

Ryanair, the largest and longest established low-cost airline in Europe, is based in Ireland. With a strong tradition of support for its national airline, Aer Lingus, Ireland was an unlikely candidate to provide the market leader in low-cost aviation in Europe. A dramatic parliamentary rejection of legislation to fine, imprison and withdraw the travel agent's licence of those discounting airline tickets in 1984 led to the market entry of Ryanair in 1985 and its entry on the major Dublin–London route in competition with Aer Lingus and British Airways in 1986.

The structure of this book is as follows. Chapter 1 deals with the defeat of regulatory capture. It describes the defeat of the Air Transport Bill in 1984. Legislation to protect national airlines was defeated by a rare parliamentary revolt in Ireland. This led to the establishment of Ryanair, and its entry to the Dublin–London route in 1986. It became the market leader on the busiest international route in Europe and was the first new entrant airline in Europe to carry more passengers than the previous national airline. Chapter 2 describes the European aviation system under the regime of one national airline per country, fare collusion or co-ordination and market sharing agreements. Chapter 3 describes the impact of new market entrants to the Dublin–London route in 1986 over the initial three years. The route is the busiest in Europe with 4.3 million passengers in 2006. Chapter 4 describes the development of Ryanair, the dominant new entrant on the Dublin–London route, in

the 1990s. British Airways left the Dublin–London route in 1991. Ryanair became the market leader in 1995. Aer Lingus was then in financial difficulties and required a government rescue plan in agreement with the EU. Chapter 5 describes the continued development of Ryanair after 2000. Its anticipated 58 million passengers in 2008 will be almost six times the number carried by Aer Lingus. Chapter 6 analyses the difficult market faced by full-service airlines in competition both with low-cost airlines and legacy national airlines. It is based on Cityjet, a full-service airline now owned by Air France. Chapter 7 is a case study of the commercialisation of Aer Lingus from regulatory dominance and capture through to privatisation in 2006. Chapter 8 illustrates the growth of airport competition in the deregulated European aviation market in response to low-cost airlines. Chapter 9 examines the problems of dismantling a national airport monopoly and promoting competition between and within airports. Chapter 10 summarises the impact of deregulation on European aviation market in 2008.

Sean D. Barrett



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