

Transatlantic airline competition

An antitrust perspective

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Agenda

- Introduction
- Alliances and Antitrust - Review and status quo
- Alliances and Antitrust - Prospects
- Conclusion

Introduction

Introduction I

- In 2008, the Open Skies agreement introduced a new age of transatlantic air travel
- After more than 60 years of bilateral restrictions, the agreement allows airlines for the first time to fly non-stop between any city in Europe and any in the United States
- In the aftermath of the agreement, most commentators expect a boost in transatlantic air travel due to increasing airline competition
 - Lower costs through more flexible feeder networks
 - Additional economies of market presence

Introduction II

- Although the effect of the Open Skies agreement on transatlantic competition is likely positive, there are two key reasons to believe that the size of the effect may be smaller than initially expected
 - The new Open Skies agreement leaves several regulatory interventions unchanged such as the cabotage right or the right of foreigners to control US airlines
 - Airlines themselves may have possibilities and incentives to restrict competition
 - Cartelization (e.g. fuel surcharges, cargo rates)
 - Mergers (not feasible)
 - *Strategic Alliances*

Four key questions

1. Does the new age in transatlantic travel needs a rethinking of the socially optimal degree of cooperation between airlines?
2. Is antitrust immunity for airline alliances the socially optimal antitrust response?
3. Can a stricter application of antitrust policy with respect to alliances help to promote competition?
4. Are there possibilities to keep the key benefits of airline alliances for the consumers while promoting intra-alliance competition?

Alliances and Antitrust

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Review and status quo

Antitrust immunity in the U.S.

- Congress has adopted varying types of antitrust exemptions
- These exemptions differ in terms of the scope of conduct exempted from antitrust law and whether some degree of potential antitrust liability remains (e.g., single damages)
 - Some exemptions provide a limited immunity for specific conduct
 - Other exemptions apply to narrow areas but provide a broader immunity - often complete immunity from the antitrust laws
- Examples of broader immunity include international airline alliances and
 - The Charitable Donation Antitrust Immunity Act;
 - The Defense Production Act;
 - The Need-Based Educational Aid Act.

Alliances and U.S. Antitrust Immunity – Statistics

- Most airline alliances have been granted antitrust immunity by the U.S. DOT
- Between 1986 and 2008, the U.S. DOT investigated 39 applications for antitrust immunity by airline alliances (mostly international)
 - 34 were approved, but only 6 without any kind of approval conditions
 - 3 were disapproved
 - American Airlines - British Airways (1999)
 - American Airlines - British Airways (2002)
 - Delta Air Lines - Northwest Airlines - Air France - Alitalia - CSA Czech Airlines - KLM (2006)
 - 2 were dismissed on request by the airlines

Alliances and U.S. Antitrust Immunity – Approval conditions imposed

- Typical approval conditions
 - Filing of any subsequent subsidiary agreements and/or any agreements affecting the alliance;
 - Withdrawal from IATA tariff coordination activities on specific routes;
 - Exclusion of pricing, inventory, yield management and pooling of revenues on specific fares and on specific routes;
 - Exclusion of CRS activities as owners or marketers;
 - O&D survey data reporting requirement.
- There is little variation in the choice of approval combinations over time

Antitrust assessment in the E.U.

- In the European Union, alliances can be investigated either as cartel-type or merger-type form of cooperation
 - Alliances as cartel-type form of cooperation
 - Airlines agree on routes / prices / capacities
 - Airlines have good monitoring possibilities
 - Alliances as merger-type form of cooperation
 - Alliances regularly provide benefits to consumers
 - These benefits may be larger than the costs stemming from reduced horizontal competition
- In case the cartel-type form dominates, an exemption from competition rules needs to be granted
- In case the merger-type form dominates, an application of the merger control procedure needs to assess costs and benefits

Alliances and E.U. Competition Policy - Statistics

- Between 1992 and 2008, the European Commission investigated 24 cases of proposed airline alliances (mostly international)
 - 14 were approved, but only 1 without any kind of approval conditions
 - 0 were disapproved and 10 were dismissed on request by the airlines
- 9 of the 14 approved cases were investigated as an exemption from competition rules
- The remaining 5 approved cases were investigated under the merger control procedure
- The economic analysis does not differ substantially between both investigation types

Alliances and E.U. Competition Policy – Approval conditions imposed

- Typical approval conditions
 - Restrictions on fare levels and conditions on specific routes (including travel agency remunerations and corporate fare products);
 - Surrender and/or releases of slots, ground facilities for other airlines;
 - Restrictions on frequencies/capacity/slots on specific routes/airports;
 - Requirements related to frequent flyer programmes, interlining and special prorated agreements with new entrants;
 - Requirements related to blocked space agreements with new entrants and intermodal agreements with land transport companies.
- There is little variation in the choice of approval combinations over time
- Approval conditions partly differ from the U.S.

Alliances and Antitrust - Prospects

Is antitrust immunity or exemption from competition rules justified?

- Recommendations by the U.S. Antitrust Modernization Commission (2007)
 - Antitrust immunities should be granted rarely, and only where, and for so long as, a clear case has been made that the conduct in question would subject the actors to antitrust liability *and* is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general
 - In evaluating the need for existing or new immunities, Congress should consider the following:
 - Whether the conduct to which the immunity applies, or would apply, could subject actors to antitrust liability;
 - The likely adverse impact of the existing or proposed immunity on consumer welfare; and
 - Whether a particular societal goal trumps the goal of consumer welfare, which is achieved through competition.

Changing justifications for antitrust immunity I

- Basic justification for immunity of airline alliances (TRB, 1999):
 - Such partnerships can be appealing to airlines because of the constraints on airline entry and expansion imposed by national governments and embodied in aviation treaties as well as national citizen ownership laws
- DOT generally has avored the formation of international alliances, in the belief that the public
 - will benefit from the network efficiencies as well as from the new competition, and
 - will suffer relatively little from the allied airlines cooperatively setting fares and capacity
- In its early approvals, DOT reasoned that immunity would enhance competition in international markets by allowing airlines with small market shares to combine their networks and become more effective in competing against larger airlines

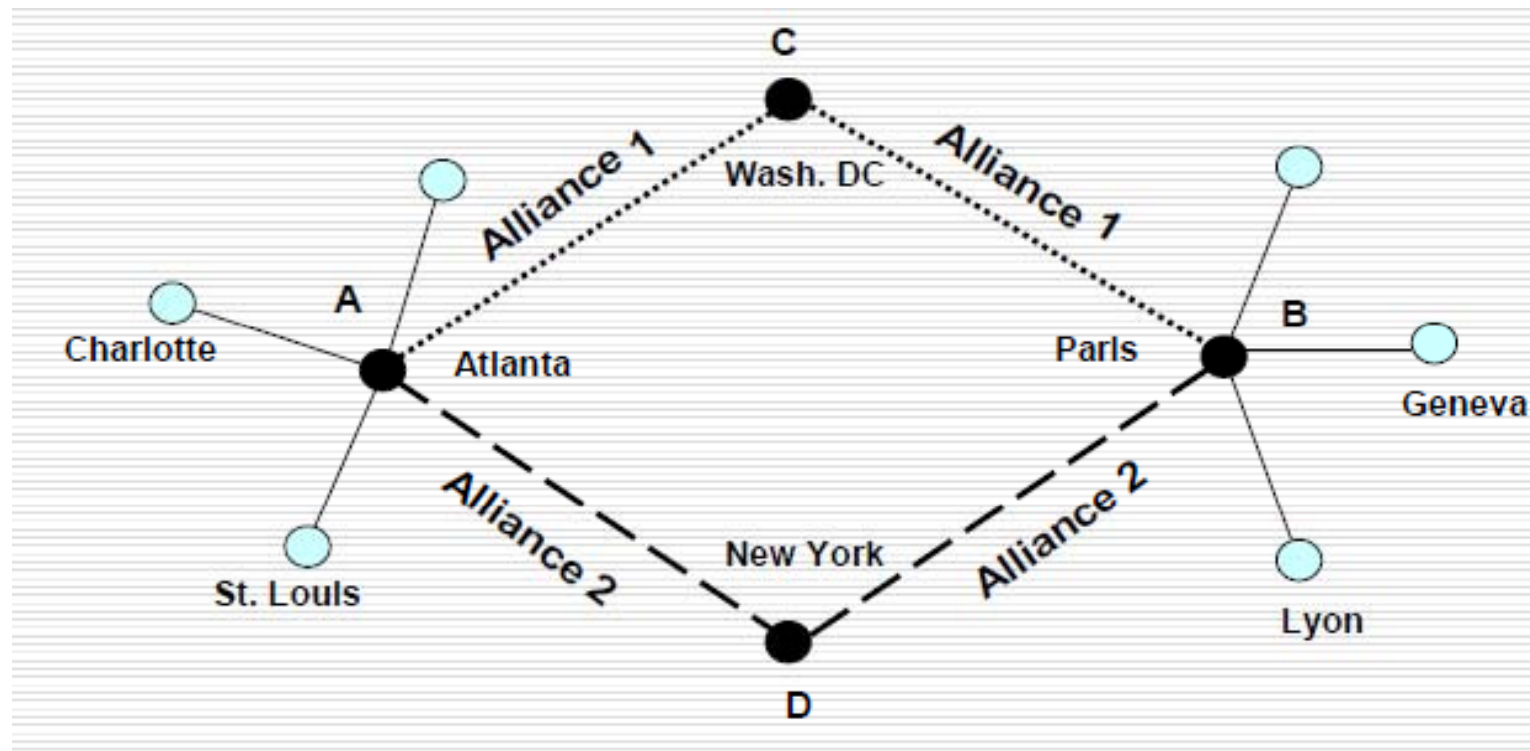
Changing justifications for antitrust immunity II

- In approving later alliances, DOT's emphasis has changed, focusing instead on the benefits of creating alliances that could compete against one another, rather than against individual airlines
- A concern of the TRB is that in advocating international alliances and also granting antitrust immunity, DOT might not have given sufficient consideration to the potential effect of international alliances on the competitive structure of the domestic airline industry
- Furthermore, given the haste with which the alliances were formed, it is reasonable to question whether the intent of immunity requests was protectionist, producing open skies nominally, but with the underlying aim of protecting foreign national carriers from free competition

Benefits and costs of airline alliances

- The following key benefits and costs of airline alliances need to be considered
 - Benefits of airline alliances
 - Eliminates double marginalisation
 - Enhances network effects through scheduling of connecting flights and coordination of gate location and baggage handling
 - Allows cost reductions through facility sharing
 - Facilitates inter-alliance competition
 - Costs of airline alliances (Reitzes and Moss, 2008)
 - Eliminates horizontal intra-alliance competition (higher fares and reduced choice on certain routes)
 - Provides incentives to foreclose non-alliance rivals from providing interlining services at alliance hubs or to otherwise raise their costs
- A further assessment is needed to decide whether alliance benefits are typically larger than alliance costs

Competition between airline alliances I



Source: Reitzes and Moss (2008)

Early studies of the effects of airline alliances

Study	Alliances	Period	Findings
Gellman Research Associates (1994)	BA/US Air, KLM/NW	1994	Profits increased for all parties with BA and KLM gaining more than their partners
Youssef and Hansen (1994)	Swissair and SAS	1989-91	Increases in flight frequency; variations in fare levels; the strongest service levels had the lowest fare increases.
US General Accounting Office (1995)	KLM/NW, USAir/BA, UAL/Lufthansa UAL/Ansett, UAL/BMA	1994	All carriers enjoyed increased revenues and traffic gained at competitors' expense, not industry growth.
Dresner et al (1995)	Continental/SAS, Delta Swissair, KLM.NW	1987-91	Mixed successes with traffic volumes; in general alliances did not benefit partners
Park (1997)	KLM/NW, Delta/ Swissair/Sabena	1990-94	Traffic increases at the expense of rivals. Complementary alliances lowered fares while parallel alliances increased fares.
Oum et al (2000)	Star Alliance, oneWorld Skyteam, KLM/NW	1992-1994	Increased traffic on alliance routes
Brueckner and Whalen (2000)	US international alliances	1999	Fare are some 18% to 20% lower on international alliance, inter-lining routes

Recent studies of the effects of airline alliances

- Code sharing and immunized alliances are found to have significantly lower prices than traditional interline (multicARRIER) service, but the effects are smaller in magnitude than previous results (*Whalen, 2005*)
- SkyTeam fare increases of 4-5% on certain gateway-to-gateway routes involving U.S. and France (*Reitzes, Robyn, Neels, 2005*)
- Update of DOT data show 12-15% increases in fares in Open Skies markets (*Reitzes and Moss, 2008*)
- Since the approval of the Delta/Continental/Northwest codeshare alliance, formal empirical analysis of the alliance's effects on price and traffic levels fails to support collusive behavior for approximately 64% of the codesharing between the three airlines (*Gayle, 2008*)

Conclusion

Conclusion I

- Antitrust immunity for international airline alliances has traditionally been granted although the degree of cooperation (routes, prices, capacities) is pretty high compared to other industries
- The justifications for antitrust immunity changed over time (following unexpected industry developments)
- It is difficult to identify a particular societal goal that trumps the goal of consumer welfare and justifies complete antitrust immunity
- A key motivation and benefit of airline alliances, promoting open skies agreements, is lost at least for the transatlantic market
- In addition to a possible reduction of the benefits, some key cost components may have increased such as the loss in horizontal competition or a consolidation in the number of alliances

Conclusion II

- As a consequence, antitrust immunity should be abandoned completely and replaced by the application of existing merger guidelines
- A less drastic policy reaction would be to grant limited antitrust immunity more cautiously by imposing more effective approval conditions (*Ex-post evaluation?*)
- Due to the potentially adverse effects on travelers in mainline, gateway markets where the partner airlines had been rivals, the carving out of overlapping routes from the immunity agreements might be a suitable option which could be applied more often
- Allied carriers still could share codes and coordinate other activities on the carve-outs, but would not have immunity for highly coordinated pricing, inventory, and yield management
- More econometric work is certainly needed to get a better picture of the net effect of airline alliances in the transatlantic market and to base policy conclusions on more robust foundations

The general issue is not only relevant in transatlantic markets ...



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Attn: Aviation/travel writers

ACCC denies authorisation to Air New Zealand, Air Canada's Cooperation Agreement

The Australian Competition and Consumer Commission has denied authorisation to Air New Zealand and Air Canada to give effect to a proposed Cooperation Agreement.

Under the agreement, the airlines would share the revenue from Air Canada's direct Sydney Vancouver route and Air New Zealand's direct Auckland-Vancouver route, and would jointly promote the flights.

"The ACCC is concerned that the agreement would reduce competition between Air New Zealand's indirect flights and Air Canada's Australia-Canada direct flights, since Air New Zealand will receive revenue from the direct flights," ACCC Chairman, Mr Graeme Samuel, said. "The ACCC can authorise such an agreement where it meets a public benefit test but the ACCC considers that the test has not been met here."

Many thanks for your attention!

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