Aviation: low cost airlines

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The spread of low-cost airlines has been one of the most striking developments in airline competition in Europe during the last fifteen years and one of the most significant for the longer term. The entry of these airlines, such as Ryanair, easyJet and Flybe, into the European air travel market has lead to stimulation of new air traffic and reduced unit costs.

This Note explains the legislative framework in which low cost airlines have flourished and looks at some of the issues associated with these airlines in recent years. Information on other aviation issues can be found on the Aviation topical page of the Parliament website.

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1 Background

At the end of the World War II, many countries had at their disposal a large number of new airplanes and airfields equipped with the latest technology. Within 15 years of the end of the war, using these assets as a starting point, a number of international airlines became major participants in commercial aviation. By 1960, the United States had 58 per cent of the share of world air traffic (in terms of passenger-miles), while European airlines accounted for 24 per cent. An important difference in Europe was that, with a few notable exceptions, most passenger air travel companies that flourished after the war were state-owned and not

privately operated.

The UK, represented by the British Overseas Aircraft Corporation (BOAC) and British European Airways (BEA), dominated European international air traffic after World War II. Following the United States and the Soviet Union, the UK passenger airline industry was the biggest in the world by 1960. After 1945, BOAC inherited dozens of key routes across the British Empire that it had established during the war. Although it was unprofitable during the late 1940s, BOAC eventually gained strength by the early 1950s once it had finished converting its military services to civilian operations. BOAC became the first airline to introduce passenger jet service in 1952.

While BOAC served the UK's international routes, the UK Government assigned BEA all short-haul air transport in Europe. BEA was officially established in August 1946 for that purpose, merging a number of smaller airlines. Both BOAC and BEA dominated British aviation well into the 1960s, although smaller independent airlines continued to exist. In 1974, the two airlines officially merged into British Airways. In February 1987, British Airways was privatised, and soon after, merged with British Caledonian Airways.

Air France was formed in 1933, and by 1952 it had grown bigger than either BOAC or BEA in terms of passenger-miles flown. While Air France was the official French state-owned airline, two smaller private airlines continued to flourish into the 1960s. The French Government distributed routes all over the world between Air France, the Compagnie de Transports Aériens Intercontinentaux (TAI), and the Union Aéromaritime de Transport (UAT). Air France, however, retained its dominant position, and by 1992 it had acquired all the routes of UAT and TAI. Five years later another small airline, Air Inter that had formed in 1956, was merged into Air France. The first German postwar passenger services (both domestic and international) began in earnest in April 1955. Lufthansa was one of the fastest growing airlines in Europe and rapidly expanded its services and aircraft fleet through the late 1950s and 1960s. Alitalia has served as the national passenger airline of Italy since its official formation in 1957, despite being hit hard by international deregulation in the late 1970s.

One of the pioneers of the 'low cost' revolution was Sir Freddie Laker who founded Laker Airlines, a charter airline, in 1966 and Skytrain, a low cost London to New York carrier, in 1971. There followed six years of to-ing and fro-ing with the UK and US aviation authorities. On 1 September 1977 the inaugural Skytrain flight departed London Gatwick for New York JFK. The fares charged at the time were £59 one-way from London and $99 one-way from New York. Skytrain became a financial success in its first year of operation and the service consequently expanded in terms of both new routes as well as additional frequencies. In February 1982, however, Sir Freddie's company went bankrupt and the last transatlantic flight took place that same month.

2   Legislation and regulation

2.1   EU liberalisation

Full details of the liberalisation of the European air transport market can be found in HC Library standard note SN/BT/182, available on the Parliament website.

In June 1992 the European Council of Ministers agreed the Third Aviation Liberalisation Package. The Third Package was the culmination of a gradual process of liberalisation of the Community air transport market to which Member States committed themselves in 1986. The decision to create a single market in aviation formed part of the move to a single internal

market across the whole range of economic activity, as embodied in the Single European Act.

As its name suggests, there were two earlier packages of aviation liberalisation, the First Package, adopted in December 1987, and the Second Package, adopted in July 1990. Before that time the intra-Community market was governed by bilateral agreements between Member States. These tended to rigidly control route entry and capacity and often allowed airlines to pool their revenues. Many international routes were single designation, so that only one airline of each country was permitted to operate. Fares were almost entirely set by agreement between the airlines under the auspices of IATA: indeed using IATA was a formal requirement of a number of bilateral agreements. There were, however, a few exceptions to these restrictive agreements where the governments themselves had agreed to be more liberal. The first liberal air service agreements in Europe were signed by the UK and the Benelux countries in 1985 and began to bring down fares and introduce competition. This was a model for the First Package which was introduced by the British Presidency of the European Council in 1986.

It is only with the Third Aviation Liberalisation Package that a substantially liberalised internal Community market was achieved. The relevant legislative instruments were as follows:

- Regulation 2407/92/EC (the Licensing of Air Carriers Regulation) provided for common specifications and criteria for the licensing of carriers and the provision of a Community air transport certificate with effect from 1 January 1993. Included in the Regulation was a statutory requirement for air carriers to hold insurance to cover liability in case of accidents in respect of passengers, luggage, cargo, mail and third parties. Governments are not allowed to discriminate between airlines seeking licences to establish themselves on their territory other than for technical or economic reasons such as solvency of financial viability. Any airline which meets common safety, nationality and fitness criteria is entitled to an operating licence anywhere in the Community. The restrictions on charter airlines and limits on the number of 'seat only' sales are abolished. Separate rules apply for airlines operating light aircraft;

- Regulation 2408/92/EC (the Route Access Regulation) set out the rules on access for Community air carriers to intra-Community air routes. From 1 January 1993 airlines would have full access to all routes between Member States and the right to offer services between airports in two other Member States, the so-called seventh freedom of the air. Full, unrestricted access to all routes within the Community commenced on 1 April 1997 for both scheduled and charter services, the eighth freedom of the air (also called 'consecutive cabotage'). Article 6 provided safeguards for new inter-regional services and Article 10 prevented capacity limitations except for environmental and/or air traffic reasons;

- Regulation 2409/92/EC (the Fares Approval Regulation) set down further rules on fares and rates for air services; that from 1 January 1993 airlines would be able to set their own fares on services both within and between Member States subject to the safeguards against unfair pricing (including notification to the Commission);

- Regulation 2410/92/EC amended Regulation 3875/87/EEC regarding the procedure for the application of the rules on competition to undertakings in the air transport sector; and

- Regulation 2411/92/EC amended Regulation 3936/87/EEC on the application of Article 85(3) of the EC Treaty to certain categories of agreements and concerted practices in the air transport sector.

The Licensing of Air Carriers Regulation, the Route Access Regulation and the Fares Approval Regulation were repealed in 2008 and their provisions recast in a single Air Services Regulation (ASR) (Regulation 1008/2008/EC), which came into force on 1 November 2008. Some aspects of the Regulation required secondary legislation to fully implement them in the UK. Chapters I to III of the ASR were implemented by *The Operation of Air Services in the Community Regulations* (SI 2009/41) which came into force on 26 January 2009.

As for public service obligations (PSOs), Article 4 the Route Access Regulation harmonised the procedures for ensuring the operation of lifeline air routes. The PSO provides the basis on which non-commercial but socially and economically necessary air services can be subsidised by national or local authorities, notwithstanding the single market. This has since been replaced by the provisions in Article 16 of the Air Services Regulation. There are three airlines in the UK in receipt of PSOs; they operate 26 services in Scotland and Wales.[1]

2.2   Airport slots

Information on airport slot allocation after 2002 can be found in HC Library standard note SN/BT/488, available on the Parliament website.

It was widely recognised that for the full benefits of the liberalisation of air transport to be realised, the system of allocating airport runway slots at EU airports would have to be revised. The then Transport Secretary, John MacGregor, announced in October 1992 that the UK was using its Presidency to work for a Regulation to allow new airlines access to slots.[2]

It was agreed in 1992 that changes in the allocation of runway slots would have to be tackled at community level if the benefits of liberalisation of air transport were to be realised. Regulation 95/93/EEC ('the Slot Allocation Regulation'), as amended by Regulation 894/2002/EC and 793/2004/EC, was implemented in the UK by the *Airport Slot Allocation Regulations 1993* (SI 1993/1067) and came into effect in May 1993. It is based on the IATA rules but with some amendments. It applies to all airports that have been designated as 'fully co-ordinated', i.e. those airports where there is insufficient capacity to meet demand. The Regulation was extended to include airports in Norway and Sweden in August 1993 and in July 1994 to airports in Austria, Finland and Iceland. In the UK only London Heathrow, Gatwick, Stansted, London City and Manchester are co-ordinated airports.[3] The system for allocating time slots at other airports is based on the IATA system for non-EU airports.

The main provisions of the Regulation which affected the practical arrangements for slot allocation were:

- recognition of the long established principle of 'grandfather rights' under which an airline holding and using a slot in one summer season or winter season has first claim on that slot in the next equivalent season;

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[1]   a list of these routes is available on the European Commission website
[2]   DoT press notice, "EC must tackle airport slot allocation", 21 October 1992
[3]   London City was designated as a co-ordinated airport in 2009 following two rounds of consultation by the Government; the document outlining the Ministerial decision is available on the DfT website

- recognition of the secondary rules established by IATA including the period of use of a slot and re-timings of existing slots for specific reasons which are given priority over completely new slot demands;

- the creation of a slot pool into which are placed newly created slots (through increases in hourly scheduling limits); slots returned either voluntarily or under the 'use it or lose it' condition and slots otherwise unclaimed under grandfather rights or the IATA secondary rules;

- allocation of fifty per cent of the pool slots to new entrants[4] unless they request less; and

- a requirement that airlines must use their slots for at least 80 per cent of the period for which they are held or, subject to certain specified exceptions, the slots are withdrawn and placed in the pool.

2.3 UK planning law

Low cost airlines have mostly sought to use airports which have lower charges, such as Stansted and Luton. Indeed, much of the growth of low cost airlines in the UK has been due to the expansion of regional airports outside of London.[5] This has required changes to the planning law, steered through Parliament by both the previous Conservative and Labour Governments.

The *Town and Country Planning (General Permitted Development) Order 1995* (SI 1995/418) grants rights to airport operators to carry out development without requiring planning permission from the local planning authority. However, that right is subject to various conditions, set out in Part 18 to Schedule 2 of the Regulations. The main restrictions are as follows:

> A.1 Development is not permitted by Class A if it would consist of or include—
>
> a) the construction or extension of a runway;
>
> b) the construction of a passenger terminal the floor space of which would exceed 500 square metres;
>
> c) the extension or alteration of a passenger terminal, where the floor space of the building as existing at 5th December 1988 or, if built after that date, of the building as built, would be exceeded by more than 15%;
>
> d) the erection of a building other than an operational building;
>
> e) the alteration or reconstruction of a building other than an operational building, where its design or external appearance would be materially affected.

The 2003 aviation White Paper, which remains the key policy document in this area, states that it is for airport operators to decide how to take forward plans for airport expansion.[6] They will have to meet the requirements for environmental impact assessment, and will also be expected to undertake appropriate health impact assessments. The timing of any

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[4] defined in Article 2 of the Regulation

[5] because of their low cost base, fixed landing charges represent about ten per cent of total costs for low cost carriers, a higher proportion than for full-fare scheduled carriers

[6] DfT, *The future of air transport*, Cm 6046, December 2003, chapter 12

planning applications will be a matter for commercial decision by the operators. A local planning authority is expected to act in line with planning policy guidance and any other national guidelines. These would be considered to include the air transport white paper.[7]

However, in 2008 the Labour Government made changes to the planning system whereby big infrastructure projects, such as the expansion of airports, would be subject to a new planning regime: the Government of the day would publish a 'national policy statement' on airports, upon which an independent Infrastructure Planning Commission would take the final decision on a planning application. As yet, there is no national policy statement for airports, in lieu of which the 2003 White Paper remains the key document. The Conservative party indicated before the 2010 election that it would remove the final say on these types of application from the IPC and return it to the Secretary of State.[8]

3   Airlines

In 1999 the European Commission published a report on the first six years of the single aviation market. This found that between 1993 and 1998 the number of scheduled air carriers in the EU had grown from 132 to 164, and the number of routes between Member States within the EU had increased over the same period by approximately one third. There was also clear evidence that the more competition that existed on individual routes, the cheaper the fares; in particular, the report found:

> the level of fares decreases when the market structure passes from monopoly towards duopoly or routes with more than two carriers. Consumers enjoy fare reductions in a range of 10% to 24%, depending on the type of fare;

> fully flexible business and economy fares are in the same order of magnitude, while promotional fares are half as high.[9]

There are two main reasons why low cost airlines have flourished in the UK more than any other European nation: history and geography:

- UK aviation entered the Single Market in a very different position to that in the rest of the EU. It had more airlines, scheduled and charter, than any other Member State and the highest percentage of overall scheduled output in the hands of airlines other than its major national carrier; and

- The UK (together with the Republic of Ireland) is separated by sea from the rest of Europe. Although this may seem self-evident, it has meant that the propensity to fly of UK residents has traditionally been significantly higher than that of all the other large Member States. Eleven of the 15 densest international scheduled routes between EU and non-EU airports (including five of the six largest) are to and from London;[10] Heathrow is the EU's busiest airport and its most congested.

Figures from OAG Aviation indicate that in April 2009 the low cost sector in the UK experienced a 16.5% drop in domestic services and 16.1% fall in seat capacity year on year. Internationally the low cost airlines scheduled 4,887 fewer flights to/from the UK (down by 11.4%) with an 11.6% reduction in capacity of 853,000 fewer seats. This occurred against a

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[7]   ibid., pp139-140
[8]   full details of these changes can be found in HC Library standard note SN/SC/5041
[9]   COM(1999) 182 final, 20 May 1999, Annex 1
[10]   Eurostat, *EU energy and transport in figures: Statistical Pocketbook 2009*

background of worldwide economic downturn and significant cutbacks in UK aviation. However, worldwide growth in the low cost sector was fairly stagnant over the same period. More recent OAG Aviation figures from February 2010 indicate that growth has returned to the low cost sector worldwide with frequency and capacity up by 11% compared to the same month in 2009 with 40,700 more flights and 6.1million seats. Furthermore, in June 2009 the *Financial Times* reported that in the face of the recession (or perhaps because of it) the low cost carrier Ryanair was now the biggest European short haul carrier, measured by passenger numbers.[11] However, in the second half of 2009 both Ryanair and easyJet indicated that they could see circumstances in which their growth rate would slow or come to a complete halt in the near future.[12]

The fortunes of Europe's low cost carriers have been mixed, as the European Commission, national governments, established and low cost airlines have all battled over access to EU markets and airports. Although the rules governing the Single Market allow any airline operator within the European Community to set up in a Member State, that does not mean that national regulators are always inclined to make it easy. France has proved particularly resilient to the low cost challenge and has taken action to shut-out low cost operations several times. For example, in 2002, COHOR, the French airline authority, restricted easyJet's request for take-off and landing slots. *Les Echos*, the French business newspaper, reported: "They (COHOR) have preferred to serve national carriers that are not very dangerous ... rather than the fearsome low-cost British airlines".[13]

Air France also challenged Ryanair over its £1 million subsidy from the Strasbourg Chamber of Commerce. In August 2003 a French court ruled in favour of Air France and declared the subsidy illegal, prompting Ryanair to withdraw from Strasbourg airport.[14] The Strasbourg judgement was, however, only a precursor to the decision against Ryanair and Charleroi Airport in Belgium. The European Commission's decision to outlaw the 'sweetheart' deal between Ryanair and Charleroi proved controversial; with Ryanair's main competitor, perhaps unsurprisingly, supporting the Commission's decision.[15] According to the Commission, the level of support offered at Charleroi included:

- a 50 per cent discount on landing charges to €1 per boarding passenger;

- a preferential rate of €1 per passenger for ground handling charges instead of the €8 to €13 charged to other airlines, pushing the fee below the cost of providing the service;

- a contribution towards promotional activities of €4 per passenger for up to 26 flights daily and for 15 years; and

- initial incentives of a total of €1.92m (£1.3m) for opening new routes, €768,000 in reimbursements for pilot training and €250,000 for hotel accommodation costs.[16]

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[11] "O'Leary looks to skies as he keeps throttle open", *Financial Times*, 3 June 2009
[12] "Economic downturn grounds easyJet's ambitious growth and fleet size targets", *The Times*, 30 July 2009; and: "Ryanair chief sees end to growth", *Financial Times*, 2 November 2009
[13] "Challenge of 'fly-by-nights' that fly all over", *The Times*, 10 April 2002
[14] "Ryanair flies into turbulence over France," *The Times*, 27 August 2003
[15] "Ryanair talks of disaster but the low-cost revolution flies on," *Financial Times*, 7 February 2004
[16] European Commission press notice, "The Commission's decision on Charleroi airport promotes the activities of low-cost airlines and regional development", 3 February 2004

The Transport Select Committee of the House of Commons published a report on passengers' experiences of air travel in July 2007. This looked at several aspects of the low cost airline experience and had a mixed view of the low cost sector, praising some operators for opening up air travel to the less well off while criticising others for 'sharp practices' and low standards of service. For example, on the general benefits of low cost airlines, the Committee said:

> There is no doubt that low cost airlines have been in their way one of the strongest democratic forces of the past decade or so. UK citizens on low and fixed incomes can today travel to mainland Europe for as little as £20 or £30, something they could not have dreamed of a quarter of a century ago.[17]

It did, however, criticise the lack of transparency as regards online booking and ticketing:

> For passengers to have confidence in online booking, it is vital that airlines put additional taxes, fees and charges up-front in their online advertising and on their booking pages. As it stands, there is the danger that customers are being duped into choosing a carrier on the basis of inaccurate fare information presented on the Internet. This is unfair both on the passenger, who might never know that a better fare was available, and on those airlines who are honest about their fare structure on their websites. This is not a problem which is confined to the UK: non-UK operators who carry significant numbers of passengers to and from the UK are engaged in this kind of hucksterism. We recommend that the Government make representations to the European Commission on the issue of online advertising of air fares. There must be a level playing field across the whole of the deregulated European market.[18]

In 2006 Simon Calder published an updated version of his 2002 book *No Frills: The Truth Behind the Low Cost Revolution in the Skies*. He summed up the impact of the low cost airline industry as follows:

> The journey to a low-cost revolution in the skies – and, now, on the seas and the surface – has been anything but smooth, encountering political turbulence and the adverse winds of protectionism. Vested interests still control a vast proportion of world aviation. Europe's skies, for example, have officially been open since 1997. But leading airports remain effectively closed to newcomers because of the shortage of available slots. Heathrow is the world's most desirable, and hence most difficult, place in which to land a plane. The present state of freedom of the skies can be roughly stated as 'you can fly anywhere toy like within Europe, as long as it doesn't include Heathrow; Gatwick, Stansted, Frankfurt and Amsterdam are tricky, too'. There is simply not enough room in the skies or on the runways for all the flights that wish to be airborne at peak times. And in parts of Europe, obstructive governments act in collusion with 'flag carriers' to constrict the freedom of the skies. Many countries regard an airline as an essential component of a nation's identity, in the same way that dud teams from dwarf countries get to play in European soccer tournaments, where they are customarily knocked out in the opening round.

> With some ostrich-like exceptions, the no-frills revolution has forced the flag-carrier airlines to cut fares and, equally importantly, restrictions. The rule that all cheap flights must involve a Saturday night stay, enabling traditional airlines to keep fare levels punishingly high for decades, has all but disappeared on routes where no-frill competition exists.

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[17] Transport Committee, *Passengers' experiences of air travel* (eighth report of session 2006-07), HC 435, 26 July 2007, para 129

[18] ibid., para 20

The no-frills airlines, and the Internet, have empowered many potential customers to organise their own tailor-made holidays – often at a lower price than in the holiday brochures – and, more crucially, to change their lifestyles. I bet you know at least two or three people who have bought property in France or Spain in the last few years, and who commute to and fro using a low-cost airline. Ryanair and easyJet have helped to revitalise waning communities abroad (though not all the locals see it like that). One of the most profound effects of the no-frills revolution has been to open up Europe, forcing the traditional airlines to slash prices and do away with mind-bogglingly complex fare rules. Thanks to low-cost airlines, second home ownership abroad has rocketed. Lifestyles have been transformed, and long-distance relationships formed, thanks to a newly affordable Europe. Ryanair and easyJet have done more for European union than any amount of EU propaganda.[19]

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[19] Simon Calder, *No Frills: The Truth Behind the Low Cost Revolution in the Skies* (2006), pp6-7