Open Sky Policy for Developing Countries with Emphasis on the Small Island Developing States (SIDS)

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Abstract

With the advent of globalisation, the world has become a global village. In other words, traveling to other countries has become easy since the travel industry has facilitated economic growth, world trade, international investment and tourism. This paper addresses the future of air travel due to the adoption of an open sky policy by some of the developing countries who are somehow forced to do so as other airlines become too competitive. The first and foremost purpose of this dissertation is to assess the impacts and benefits of regulation and liberalisation on developing countries with a special consideration for the small island developing states (SIDS). Mauritius is a classic example of one such state that has favoured free enterprise for its economic development and has had to give up the quasi-monopoly of its flag carrier. Moreover, the purpose of this paper is to exhibit the benefits of an open sky policy for the government and the consumer. Furthermore the paper also aims at explaining the potential threats that a flag carrier like may face with the advent of an open sky policy. Another objective of this project has been to devise a policy theory that could help airlines of SIDS to develop further strategies within a framework where deregulation and liberalization are bound to become a necessity and inevitable development to reckon with.

Index terms— Deregulation, Liberalization, Globalization, Open sky policies, SIDS.

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Abstract -With the advent of globalisation, the world has become a global village. In other words, traveling to other countries has become easy since the travel industry has facilitated economic growth, world trade, international investment and tourism. This paper addresses the future of air travel due to the adoption of an open sky policy by some of the developing countries who are somehow forced to do so as other airlines become too competitive. The first and foremost purpose of this dissertation is to assess the impacts and benefits of regulation and liberalisation on developing countries with a special consideration for the small island developing states (SIDS). Mauritius is a classic example of one such state that has favoured free enterprise for its economic development and has had to give up the quasi-monopoly of its flag carrier. Moreover, the purpose of this paper is to exhibit the benefits of an open sky policy for the government and the consumer. Furthermore the paper also aims at explaining the potential threats that a flag carrier like may face with the advent of an open sky policy. Another objective of this project has been to devise a policy theory that could help airlines of SIDS to develop further strategies within a framework where deregulation and liberalization are bound to become a necessity and inevitable development to reckon with.

a) The Aviation Sector ir transport has for decades been an important sector for world trade, economic growth and tourism. While in the layman's view, the airline industry has for a long time been associated with excitement, adventure and glamour, for the decision and policy makers is just as important as any economic sectors of a country that requires efficient management and that are subject to all the constraints of business development: competition, costs, energy shortage and economic forces of supply demand. This project therefore focuses on some of the developments that have indelibly marked the industry over second half of the last century.

As a matter of fact, the air transport industry has for many years been viewed as a protected industry. This protectionism stems from the understanding of the Flag Carrier concept. This has Author : University Of Technology, Mauritius E-mail : nmootien@umail.utm.ac.m brought about the state of monopoly situation whereby the national airline was considered as n essential service provider that should have all the support of the state: subsidies, preferential tariffs, accessibility to investment funds and more important the subsiding of routes that are not necessarily profitable.

3 b) Problem Statement

The main problem here is that most airlines of developing countries, including Mauritius, find themselves at a cross-road where they need to make some crucial decisions regarding their future development and survival in a global, more competitive world. Admittedly, most problems of developing countries are of an economic nature. So air transport being one of the vital sectors of economic development together with the linkages it provides for the other important sectors i.e., import-export, industry, tourism and others, it is therefore imperative that the pressing issues are addressed from a purely economic perspective. This study is expected to show the way for the future course of action in a predatory world without barriers or protectionism. It will show the necessity for an open-sky policy with an element of limited and minimum deregulation, especially with due consideration to customer service, safety, pricing policy, and standardisation of products and services. However, the core area of investigation will be the economic impacts of deregulation, liberalisation, globalisation and their effects on developing countries and LDCs (least developed countries) as a result of the emergence of mergers and mega-carriers. This study will also address the very sensitive issue of flag carriers and their legitimate place in a highly competitive industry and in a global world. At the end of this research, countries like Mauritius which have adopted a policy of ?wait and see' or at times given in very reluctantly to political pressure to forgo some of its routes or accepted bilateral and multilateral agreements in a rather half-hearted way will be in a better position to assess what will be the political and economic impacts of the open sky policy on the national carrier itself and in the medium to long-term, what will be the effects on the freight and manufacturing industries and more important still on These are low-lying coastal countries that tend to share similar development challenges, including small but growing populations, limited resources, and remoteness, susceptibility to natural resources, international trade and fragile environments. Their growth and development is also held back by high communication, energy and transportation costs, irregular international transport volumes, disproportionately expensive public administration and infrastructure due to their small size. The SIDS were first recognized as a distinct group of developing at the United Nations Conference on Environment and Development in June 1992. The Barbados Programme of Action was produced in 1994 to assist SIDS in their sustainable development efforts. The UN Department of Economic and Social Affairs lists 52 countries as SIDS. These are further classified in to three geographic regions: the Caribbean; the Pacific; and Africa, Indian Ocean, Mediteranean and South China Sea (AIMS). Each of these regions has a regional cooperation body: the Caribbean Community, the PacificIslands Forum and the Indian Ocean Commission respectively, which many SIDS are members or associate members of. In addition, most but not all SIDS members are members of the Alliance of Small States, which performs lobbying and negotiating functions for the SIDS within the UN system. A list of SIDS countries is provided in the appendix A on page.

4 a) Air Deregulation

Open Sky Policy for Developing Countries with Emphasis on the Small Island Developing States (SIDS) Airline deregulation is a process that started as early as 1978 in the US when the government under the Carter Administration passed the Airline Deregulation Act. This was a process whereby airlines would gradually move out of the International Air Transport Association and devise their own schedules, routes and fares as per the market forces. This was done in two stages with first the domestic air transport within the US and at a later stage the international routes outside the US especially on the European market.

When this concept met with some success in the US, the European airlines were somehow forced to adapt to the situation by starting a similar process which in Europe was termed liberalization. However, the change in term was more or less strategic as the Europeans not only wanted to look as original as possible in their approach but wanted to proceed in phases, hence the packages.

5 b) Deregulation And Liberalization In Their Different

Contexts Deregulation means the elimination or reduction of government control of how business is done, thereby moving towards a freer economy subject to the forces of supply and demand. In other words it is the movement towards a more laissez-faire and free market. Deregulation is the removal or simplification of government rules and regulations that constrain the operation of market forces (Sullivan and Sheffrin, 2002). The stated rationale for deregulation is that fewer and simpler regulations will lead to a higher level of competitiveness, therefore, higher productivity, more efficiency and lower overall prices. Deregulation is different from liberalization because a liberalized market, while having fewer and simpler regulations to increase efficiency and protect consumers' rights, one example being anti-monopoly legislation.

However, the terms are used interchangeably within deregulated/liberalized industries.

6 c) Iinternational Trade And Other Fields Of Operations And Business

Deregulation and liberalization have, since World War II, been on the agenda for international trade. These concepts are not new to trade and aviation. As early as the 1950s, there has been a desire to let Adam Smith's ?invisible hand' determine the course of free trade at home and overseas. This is a situation whereby the market is allowed to be regulated by the forces of supply and demand and without government intervention. This is also referred to as the ?laissez faire' economy and this has worked well for developed countries but not so well for the third world.

7 d) Aviation -Domestic And International Airlines, The Various Stages (Packages)

This section looks at the concept and processes of deregulation as it started in the U.S in 1978 because of the pressure of competition and the antitrust laws. The American air transport industry could no longer operate as per the stiff requirements of the IATA. This new concept changed the American civil aviation remarkably and brought about fundamental changes in other parts of the world especially the European Countries which had also started to question the validity of some of the IATA rigid regulations. However, most European countries felt that there was an urgent need to respond to the changes occurring across the Atlantic. But to be cautious in a venture that had not yet showed positive results, most countries of the then European Community decided to embark on a gradual and progressive process of deregulation which, in order to be somewhat different from the American concept, was called ?liberalisation' which eventually was to ease the European air transport industry in an inevitable process of globalisation.

Commercial aviation has always been known for its system of government regulation. The general concept has always been that the airline industry, being an important sector of the economic infrastructure and international trade, has to be nurtured, protected and guided; that it has to be cherished as the symbol of independence, sovereignty and nationhood. Governments have always regulated market entry and exit policies of airlines. They have dictated the kinds of services which carriers have to offer. In many cases, they have even gone to the extent of controlling capacity and dictating fares. Since the airline industry has for many years be characterised by financial instability, governments in a number of countries took the view that intervention was necessary to avoid ?wasteful' or ?destructive' competition (Pickrel, 1991; **??**irkby, 1981). The policy was to restrict the scope of competition in a tightly regulated industry. In The single airline, national flag carrier approach began to lose its appeal after 1978 especially in the United States. Since then, many other countries have liberalised airline competition, and though the ?destructive competition' argument still holds in some parts of the world (Dempsey 1995), especially among the developing countries, the consequences of deregulation have been more or less positive for several European countries (Button 1990; **??**orrison & Winston, 1995). The evidence in support of deregulation is possibly leading to the conclusion that developing countries should embrace liberal policies. Nevertheless, it is worth considering whether the benefits of airline competition depend upon factors such as the level of economic development **??**Hooper, 1998).

International air transport has, until recently, been one of the most regulated industries. The Chicago Convention of 1944 laid down the basis upon which a system of international bilateral air service was founded. This was a compromise arrangement that attempted to reconcile the very liberal, free market ideas of the US on the one hand and the more restrictive ones of countries such as Australia (that wanted a single global carrier) on the other (Button, 2009) The Airline Deregulation Act is an example of a deregulatory act whose success has been called in to question (Pfaff 2006) Domestic airline deregulation in the US in 1978 and the liberalization of air transport in Europe, started on a community-wide basis in 1988 with the passage of the first package of measures, brought competition to an industry which had been enjoying a high degree of government support and involvement for so long (Alamdari & Morell 1997).

International air transportation deregulation was generally slower to emerge than domestic reform because of the need for a double coincidence of interests. US policy makers first muted the general idea of bilateral ?open skies' policies to replace the highly restrictive air service agreements as early as 1979, but it took another dozen or so years before the first major one with the Netherlands, was signed. Since that time, a further 60 or so liberal agreements, of varying importance, have been signed between the US and partners. The emergence of the large free trade in air transportation service within Europe from the mid-1990s was another element in freeing-up other international markets by having both knock-out and demonstration effects for regions outside of the European area. Internationally, the initial moves at deregulation can be traced to the initiation of the US ?Open Skies?

policy from 1979. The recent opening up, at least to a substantial extent, of the US-EU transatlantic market is one of the most significant measures of international airline liberalization since the removal of international market barriers within the EU (Button, 2009). US and European carriers have been developing strategies to reduce costs in response to the growing competition in their markets following airline deregulation in the USA since 1978, and liberalization in Europe since 1988 (Alamdari and Morell 1997).

However, since 1984, countries such as UK and the Netherlands began to move towards a more liberal regime by signing more liberalized air services agreements. The airlines' main response has been to the growing competition in Europe has been to reduce costs. The intensified level of international competition from major carriers outside Europe, mainly US airlines, and the need to recover from economic recession which resulted in financial deficits, have also increased the need for the European carriers to reduce costs. (Alamdari and Morell, 1997).

From the late 1970s, when firs the US domestic cargo market was liberalized followed by the domestic passenger sector, there has been a gradual withdrawal of the state from the specific economic regulation of airlines (Button, 2009) other cases, especially in developing countries that were emerging as independent states, the markets were judged to lack sufficient density to support more than one airline (Bowen & Leinbach, 1995). A common response was to nationalise all and to maintain a single flag carrier to provide domestic and international services. All this has had the effect of eliminating or discouraging public service competition. Such attitudes are now being seriously questioned especially by advocates of free market economies. To fully understand liberalisation and open skies policies, it is imperative to explain the process of deregulation started in the United States in the late 1970s. In fact, this was also called the ?deregulation movement' and ?a veritable revolution in both domestic and international U.S air transport policy'. **??** -To strengthen the competitive position of U.S carriers to at least ensure equality with foreign air carriers, including the attainment of opportunities to maintain and increase their profitability in foreign air transportation -To give air carriers (U.S and Foreign) the freedom to offer consumer-oriented fares and rates -To place the fewest possible on charter air transport -To provide the maximum degree of multiple and permissive international authority for U.S carriers so that they could respond quickly to shifts in market demand -To eliminate operational and marketing restrictions to the greatest extent possible -To integrate domestic and international air transportation -To increase the number of U.S gateway cities -To provide opportunities for foreign carriers to increase their access to U.S points if exchanged for benefits of similar magnitude for the U.S carriers or passengers and shippers -To eliminate discrimination and unfair competitive practices faced by the U.S carriers in foreign air transportation including excessive landing and user fees, unreasonable ground handling requirements, undue restrictions of operations and prohibition against of change of gauge -To promote, encourage and develop civil aeronautics and a viable, privately owned U.S air transport industry (Wells and Wensveen 2004, p554)

Air transport has always been vital for the cohesion of Europe. The continued economic and social development of the EU depends largely upon it. The rules of the Treaty of Rome (1957), including the competition rules, also apply to air transport within the EU. But so far such rules have not been enforced in air transport. Liberalisation which in fact is the European version of American deregulation has been painfully slow in Europe. Members of the European Community have been extremely cautious on the issue. Their strategy has been more or less a ?wait and see' position vis-à-vis the American initiatives.

We have repeatedly heard that Europe is not the USA and that US style deregulation will not work in Europe. Unfortunately, in practical terms and in the immediate future, this is likely to be true, not because European air transport is fundamentally different from the US, but because some European governments are unlikely to give up unilaterally the power they can wield through route licensing, capacity control, price setting and other interference in the industry. Nor are they likely to give up their perceived prestige in having a national, ?flag' carrier. Some 20 years ago, the EU had agreed to a series of measures which should have to liberalise European air transport. But not much has been happening since. The most notable developments have been the negotiations of more liberal air service agreements by the UK government with Germany, the Netherlands, France and Belgium. Within Europe, some competition has already been brought in on a number of routes, and new routes not already flown by the flag carriers have been opened up to new airlines. Some airlines have had difficulty coping with market and/or competitive conditions leading to withdrawals from the market and/or bankruptcy, but the total network has not suffered unduly. Hence within a single nation, competition and scheduled air transport do not seem to be incompatible.

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Much of the analysis of the effects of market change has inevitably focused on domestic liberalizations, with a particular emphasis on the post 178 US market. Not only is this the world largest transport market (Button, 2009) but it was also the main driver of changes in the international market as well as the European tendency to adopt a more liberal approach to air transport.

10 b) Motivations For Liberalization In Aviation

Open skies air service agreements have not only removed restrictions governing rates and fares, market entry and the ways revenues are allocated, but have also permitted the emergence of various forms of business alliances.

11 c) Customer Focus, Costs And Fares

The gradual liberalization of international air transport has largely benefited the traveling public (Button, 2009) The US-EU passenger market is substantial. In 2007 it accounted for 55 million passengers, 385 flights per day in each direction and 235 nonstop citypairs served by 45 airlines comprising 8 from US, 26 from EU and 11 others. Geographically, 32 airports in 23 states were served on the US side and 53 airports in 19 countries in the EU (Button, 2009). The experiences of deregulation (or in Europe, -liberalization?) of air transport markets over the past quarter of a century are generally seen as having produced significant economic benefits (Morrison and Winston, 1995, ??utton, 2004).

There were particular fears in some countries that the US, that had the largest fleet of commercial aircraft at the time and the potential of adding to this by converting surplus military hardware, would dominate any largely market-based outcome an thus an institutional structure emerged that led to piecemeal, and restrictive, practical arrangements (Button, 2009).

Not everyone has gained, certainly some communities have lost services or have seen service quality decline, some airlines have gone bankrupt, and some classes of passengers are now paying higher fares, but for those few that have been adversely affected there are many more who can fly more cheaply, have a greater variety of services to choose from, or have found jobs in the extended air transportation value chain. No positive change occurs without disruption, and that has certainly been the experiences of airlines, but these negative features have been far outweighed by the positive effects.

The most obvious area of costs for airlines to tackle has been labour(?) The results indicate that both US and European airlines have been successful in reducing labour unit costs. This was achieved in the US by some reduction in real wage levels (labour costs per employee) and periods of increased productivity (average ATK per employee). European airlines reduced unit labour costs by productivity increases, offset by increases in real wage levels (Alamdari and Morell, 1997).

More intensive competition amongst established carriers and relative ease of entry by lower cost carriers have made the ability to control costs crucial for major airlines' existence (Alamdari and Morell 1997). For example, 15% of the US domestic air travel market is now served by lower cost carriers who offer very low fares (US Department of ??ransportation, 1996) In Europe, a similar trend has been observed with the entry of such carriers such as EasyJet, Ryanair, EBA (now Virgin Airlines), all offering very low fares (Alamdari and Morell, 1997).

One of the major areas of operating costs affected by cost cutting activities is labour expenses. This is because labour costs normally account for between one quarter and one third of airline operating costs (Alamdari and Morell, 1997).

The array of measures to reduce costs that have been used includes: voluntary or compulsory staff redundancy, reductions in wages, introduction of two-tier wage rates, contracting out labour and franchising (Alamdari and Morell, 1997).

There are some parallels between US developments in the US and policy changes in Europe (although) a transformation of European labour costs had not yet occurred (Robinson, 1994) d) Main Factors Driving Airline Operating Costs Airlines find it difficult to recover their full costs in competitive markets. There are clear cycles in the financial performance of the industry that correlate with the largest business cycle. But, in addition, taken overall, the industry has performed badly across cycles. In the US, for example, over the past 20 years or so the operating margins of US airlines has been about 0.4% compared with an average of well over 5% for US industry as a whole. The period has also seen a number of traditional airlines cease operations permanently, namely Pan Am and TWA in the US, Sabena and Swissair in Europe as well as a large number of new entrants and particularly low cost carriers. (Button, 2009). There have been a number of ?events' in recent years that particularly impacted on commercial aviation, adding to the normal market uncertainties of the industry and the larger, temporal trends that are on-going:

There have been unprecedented rises in cost of aviation fuel (kerosene) since 2001. The price of jet fuel has risen from \$30.5 a barrel to 81.9 a barrel in 2006, to \$113.4 in 2007n and is over \$140 in 2008. The result is that for international airlines , fuel costs that constituted13.0% of operating costs rose to 26.0% and has climbed since. This has put financial pressures on the airlines to the extent that some have imposed fuel paid by passengers (Button, 2009). Technically, there is evidence that scheduled air services offered in a competitive market suffer from problems of an -empty core? ??Button, 2005).

The emphasis, however, has largely been on the direct effects of deregulation on the airlines and their customers with rather less on the implications for overall employment, other than narrowly for airline personnel. The broader economic impacts on industrial structure and regional economic development have largely been assessed indirectly through impact studies of the airports that handle the larger traffic volumes. The evidence from this, however, combined with the few impartial studies that have directly sought to link airline deregulation to economic development, is that more commercial sensitive domestic airline markets do facilitate economic growth in regions (Button, 2009).

Unit airline operating costs are affected by input prices (e.g. costs of fuel, airport charges or labour), operational characteristics (eg scheduled/charter or short/long haul) and productivity, which is a measure of the relationship between an airline's input and its output (eg available tonne-kms per employee) (alamdari and Morell, 1997). Input prices such as those of fuel and airport charges are beyond airline management's control and significant cost reduction through productivity or efficiency improvements may take many years to achieve (eg fleet replacement) or could be ineffective (eg airport charges). However labour costs, which account for between 25-35% of total costs, are more amenable to control by airline management. There are many operational characteristics of airlines which can influence performance measures, especially unit costs and labour productivity. However, sector distance, passenger length of haul, aircraft size and the degree of involvement in freight operations have been found to have the most significant impact on airline unit costs (Alamdari et al., 1995).

The longer the average sector distance or passenger haul the lower the unit cost of operations, all the other things being equal. Similarly, the larger the aircraft size the lower the unit costs. The higher the percentage of freight carried, the lower the unit costs, particularly when an airline operates all-cargo aircraft. The cost of flying a tonne of freight is considerable less than the cost of flying an equivalent volume of passengers, who demand numerous additional services both on ground and in the air. (Alamdari and Morell, 1997).

Increases in productivity and efficiency are the key to cost reduction, particularly for large and well established carriers.

Efforts to reduce costs and bring about stoppages, most of short durations, affected SAS (ground staff), Austrian Airlines (flying crew), TAP Air Portugal (all staff), Air France (all staff) and Alitalia (pilots).

12 e) Controversy

The deregulation movement of the 20 th century had substantial economic effects and engendered substantial controversy. The movement towards greater reliance on market forces has been closely related to the growth of economic and institutional globalization between 1950 and 2010. There are a significant number of risks associated with economic liberalization and deregulation which may require some forms of protection against the distortion of the market but continues to encourage competition. Much of the analysis of the effects of market change has inevitably focused on domestic liberalizations, with a particular emphasis on the post-1978 US market.

Such changes in the airline regulatory environment affected many aspects of the aviation industry. Established US airlines faced significant competition from new entrants, particularly in the initial period following deregulation in 1978. These new airlines were generally not unionized, and operated with labour costs which were well below those of the large incumbents. They also achieved higher productivity and more flexible work practices. (Alamdari and Morell, 1997). Progress since the development of concepts such as -Open Skies? in the late 1970s as an alternative to the restrictive bilateral air service agreements that had effectively controlled most international transport since the mid-1940s has been uneven and spasmodic (Button, 2009) encouraged such a trend. It is wrong however to assume that the development in EU airlines' staff levels is entirely due to increased competition in the EU countries. However a survey of 18 airlines revealed that almost two thirds of surveyed carriers believed that EU liberalization measures affected their policy in relation to staffing **??**Cranfield, 1997).

The macro-economic conditions of the late 1970s (?stagflation'), combined with background pressures generated in part by a series of academic studies, led to a sea-change in policy thinking. The US initially legally removed most economic regulation from its domestic market in 1978 and other countries, either through de jure reforms or de facto actions, gradually loosened theirs. The move towards greater economic and, to a lesser degree political, integration in Europe in the 1990s brought with it the creation of a Single European market, including that for air services.

Strategic alliances now dominate the international air transportation. Although not all have been successful in a commercial world, there were inevitably failures, they have allowed wider network economies of scope, and density on the cost side, and economies of market presence on the demand side to be exploited (Button 2009). Deregulation and liberalization are both here stay for many more years to come. As mentioned earlier, this is now an irreversible situation. This is a process which all future development will have to reckon with. It is obvious that this is a situation where the fittest will continue to survive. Operators will venture to change threats in to opportunities and weaknesses in to strengths. The developing countries will continue to lag behind and if they cannot beat the situation, they will continue to pull resources with the mega carriers. Mergers and acquisitions will continue with some airlines moving out to make way for new entrants with new technology and new management methods. This paper has endeavoured to show that the concepts of deregulation, liberalization and globalization in international air transport are phenomena that nations will have to reckon with in the decades to come. The propensity for protectionism in the developing countries and the SIDS and the obsolete approach to the industry will have to change. Although we no longer speak of first, second and third world anymore, as far as air transport is concerned it is a fallacy to believe that because of globalization, freedoms of the air, bilateral and multilateral agreements, all countries are on a level playing field. Airlines of developing countries and the LDCs will have to deregulate in a progressive way and go in to mergers with the big airlines that are still willing to carry them to greater heights. [1] [2] [3]

Figure 1: ebruaryF

o Creating a level playing field and ensuring competition
o Maintaining quality standards for services
o Protecting consumers
o Ensuring sufficient provision of information
o Preventing environmental degradation
o Guaranteeing wide access to services
o Preventing financial instability and protecting consumer savings (Cali et al., 2008)
f) Roles Of Stakeholders And How They Change Regulated Environment To A Deregulated One

Figure 2:

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liberalization formally started from 1988 with the passage of the first liberation package (Crans, 1992, AEA Yearbook, 1993).

Figure 3:

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