



Sectoral Study on Competition on the Airline Passenger Transport in Latin America

Aldo Gonzalez
University of Chile

This sectoral study was commissioned by the Regional Center of Competition for Latin America (CRCAL) and it addresses the main issues related to competition in the airline industry in the region. The report is intended to provide useful concepts and methodological tools to address the most common problems on competition in the airline industry. The practical applications of the principles developed in this report are illustrated by cases that have been examined by antitrust agencies in Latin American countries.

The introductory part of the study provides an overview of the aviation industry in the region. Major air carriers and their respective hubs of operation are identified. Traffic statistics and concentration for both domestic and international routes are also reported.

The document also delves on specific regulations of the aviation market that have an impact on competition in the region. The main constraints on the operation of airlines are the system of freedoms of the air and limits on foreign ownership of airlines. Latin America, unlike other economic areas, such as Europe or the United States, does not have an internal deregulated market. Most countries in the region severely limit the granting of freedoms that would allow foreign airlines to operate in their airports. These restrictions preclude airlines to exploit the benefits of operating as a network. Constraints on entry and foreign ownership have forced the major regional airlines, such as Avianca-TACA and LAN - to create subsidiary companies in different countries as a means to penetrate domestic markets.

As international experience and the case of Latin America show, the slots or time schedules for takeoffs and landings are the critical inputs to operate at congested airports with extremely high traffic. The scarcity of these inputs may constitute a serious barrier to entry for new carriers. In the region, Brazil and Mexico have specific regulations for administration of slots at airports that can be defined as saturated. However the region must work towards new schemes that foster more competition.

The essential facility character of airports suggests that the best option is the separation of two activities: airlines and airports. Airports are difficult to replicate. Therefore, if an airline owns the infrastructure it can exclude rival airlines by monopolizing the market of routes that are connected through the airport. Several countries in the region limit the degree of integration between airlines and airports, either through explicit rules or by rulings from competition agencies.

Similarly to other economies, the airline industry in the region has passed through a consolidation process. Mergers and acquisitions have been the vehicle employed by major regional airlines to overcome entry restrictions in domestic markets.

One of the key aspects in merger control is the definition of the relevant market. In the airline industry the market is generally defined as the pair origin/destination. However, there are some controversial issues in whether to consider other modes of transportation as close substitutes, if indirect flights compete with direct flights or if flights originating or ending in the same city, but in different airports, can be considered the same relevant market. The study discusses some of these dilemmas that may arise in competition agencies while conducting an investigation.

Another crucial component of merger control is the implementation of mitigation measures, also known as remedies. The international experience shows that mergers with a likely anticompetitive impact on routes are generally approved subject to various remedies. The article reviews the remedies most frequently applied in mergers in the aviation market. In Latin America there seems to be a preference for structural rather than behavioral remedies. This entails that the most used remedy is the reallocation of slots at congested airports, which serve as a mechanism to facilitate the entry or growth of competitors in the affected routes. Behavioral remedies such as tariffs or flights control are only applied exceptionally and on a temporary character, given their inherent imperfections.

Alliances arise as a way to expand the network of services offered by the airlines or reduce exposure to the risk of a company to offer a new service or develop a new product. These agreements provide competitive advantages to the partners and may accrue a benefit to passengers. After air liberalization processes observed in different continents, there has been a trend towards different types of agreements and the formation of global alliances. Today most of Latin-American carriers belong to one of the three major alliances: OneWorld, SkyTeam and StarAlliance. Since alliances involve cooperation among direct or potential competitors, they tend to raise competition concerns. Agreements also create network effects, which in some circumstances may exclude competitors from the market. Therefore the study also discusses some of the implication of creating/belonging to an alliance.

Finally, the study also describes briefly some of the most commonly used econometric techniques to predict the impact of the merger on prices on the routes affected by the operation. Based on the literature and the experience on antitrust cases in many jurisdictions, the document provides a detailed description of the barriers to entry in the airline market. The regulatory barriers in the airspace in

Latin America, both in domestic and international routes, severely limit the entry of new airlines in case of abuse of market power by the merged airlines.

In short the latest development of the airline industry in the region provides very important challenges for aviation and economic regulators. The purpose of this work is to serve as a reference tool for the competition agencies of the region to analyze antitrust practices arising in this highly dynamic industry. A preliminary version of the report can be found at www.crcal.org