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IATA — A Cartel That Needs Reforming

by Professor Hellmuth St. Seidenfus, Münster *

On November 19, 1971, during the 27th annual International Air Transportation Association's — IATA — meeting, a new fare structure on the North Atlantic route was reached. Has this new agreement saved IATA as "a system of freely arrived-at and freely-respected basic rules", or does this new accord only serve to mask, with difficulty, the "pile of debris"?

Operations on the North Atlantic route had become fiercely competitive since charter operators, who only fly when actual need is indicated, began to enter this market. Especially, US supplemental charter flight companies have been active in accelerating this process. Originally, they had been used as civilian carriers to supplement military transport to Vietnam, and they expanded swiftly, achieving load factors of up to 80 p.c. through military contracts. But this dropped to 43 p.c. during 1970 from the time when the engagement of the United States in Vietnam began to fade. From the business standpoint it was only logical that such carriers, once they began to be deprived of their military business, would look for replacement in civilian air transport, wherever it will be ceded to them, and will go on doing so, not withstanding the fact that their policy on prices has so far been incompatible with the principles of sound and viable competitive economics. However, it may be taken for granted that military contracts, which are not usually calculated with narrow profit margins, permitted these operators to write off the value of their planes more quickly than usual. This, very likely, in turn, enabled them to offer North Atlantic flights at uncommonly low rates and still to earn back at least their out-of-pocket expenses on this route.

Yet the conquests of charter operators in markets which, in the past, were the almost exclusive domain of regular air line companies, were not only and simply an effect of the United States' disengagement in South East Asia. It is rather the case that recent developments have disclosed the existence of a structural problem which had been there all the time, and which made especially North Atlantic flights highly attractive to charter operators. This problem is based on the fact that air passenger traffic—which thereby distinguishes itself fundamentally from ocean shipping—cannot be split up into two completely

separate and specialised markets. But only the separateness and separability of such distinct markets permit the efficient and effective operation of a cartel on prices and transport conditions such as IATA tries to be.

True, the charter companies maintain that timetable airline flights and charter operations are not interdependent as markets. They assert that there is no competition between the two, because:

- ☐ airlines and charter companies allegedly serve different groups of clients;
- ☐ charter companies serve as trailblazers for air line traffic.

In the case of North Atlantic flights, the second assertion is obviously invalid, whilst the first one ignores actual facts because the major part of charter traffic, on this route, has been sliced off from the airline market. In this field, "pioneering" activities are neither needed nor at all possible — since there is no scope there, for example, for opening up fresh markets for holidaymakers, nor will charter companies attract special types of new demand. Their competition is simply that of outsiders, whose prices are subject to rules different from those of air line companies.

Dichotomy in Pricing

The market for charter flights permits, on principle, free pricing, whereas IATA companies have tied themselves mutually in regard to their prices and to the quality of their services (even down to the quantity and quality of the sandwiches they may serve their passengers). The reason for this was the knowledge that liner services of a certain given quality cannot be maintained under conditions of keen price competition — which means, in connection with wild fluctuations of profitability. This fact has long been known from the experiences of ocean shipping conferences.

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On average, transport charges of airline companies are also higher than those of charter operators. This is not only due to a less favourable structure of their costs, when their competitors can do with lower expenditure for keeping their airplanes always prepared for flying and can necessarily on average operate with higher load factors. Higher airliner fares are also due to a monopoly of supply, which enables the monopolists to collect part of the consumer rents. The motivation adduced for this policy on prices is the necessity to subsidise liner traffic on routes that are little frequented and could not otherwise be maintained.

In a unified market, it will not be possible to pursue diametrically opposed business policies and different methods of price calculation. In other words, any cartel which is affected by outside competition of such power will not be able to maintain its habitual market policy. The structure of supplies, as it is, does not take account of the fact that the desired division of the market into two independent halves can always be overcome, because the representatives of demand—both persons who travel for business and holiday-makers—are always able to choose between the airliner and the charter flight market, almost without hindrance. Airline companies then tried to counter this development by offering price "differentiations" or rather questionable price manipulations with regard to so-called "affinity groups", a development which could not have come to pass, had there really been two clearly separated markets.

Capacity Problems

The trend towards cut-throat competition would not have operated in so ruinous a fashion, if there had not been surplus capacities pressing upon the North Atlantic flight market, which have not been caused merely by the emergence of charter flight companies, some of which are, as a matter of fact, subsidiaries of air line corporations. It must not be forgotten that this trend developed during a period of swiftly expanding demand.

One major factor which led to over-capacity can probably be seen in technological progress, which brought fast-flying and efficient airplanes into the market during the 'sixties. This had the fatal effect that IATA unified all fares and the quality of supplies and availability of the most advanced planes became mandatory as a special kind of advertising potency. This persuaded the airline companies to inflate their capacities far too rapidly, relative to the size of demand that could be ex-

pected. Their decisions to acquire jumbo-size planes were certainly dictated not only by economic, but also by prestige considerations.

Another adverse influence is that of governmental air traffic policies, which pursue aims of "flag protectionism" and prevent the winding-up of unprofitable national airline corporations, at the same time perhaps encouraging relative unconcern of national airlines about choosing to make big and risky new investments. In the special case of the US Civil Aeronautics Board, its doctrinaire prohibition of capacity restrictions for reasons of obedience to American anti-trust legislation has made, and is still making, this problem worse.

Keen competition by outsiders coupled with surplus capacities are at present the main determinants of conditions on the North Atlantic route. At the same time, it is feared that South East Asian traffic may be affected by complete chaos in fare arrangements, after the British government has granted far-reaching privileges to a number of charter companies for serving connections with Thailand, Malaysia and Singapore. The expected conflict will become more acute through six independent European charter companies having joined up, in the summer of 1971, with the same number of US-based firms to form the International Air Charter Associations—IACA— as a counterweight to IATA, in order to push their interest within the international bodies of civil aviation and tourism. IACA has already appealed to the governments "to dismantle all artificial obstacles which discriminate against those persons who choose to fly with the planes of charter companies." The outsiders are now closing ranks. Has IATA still a chance to survive, in the face of this situation?

Chances of Reforms

The first thing that has to be stated is: as it has been established that there are not only shifting borders between the markets for airline and for charter traffic but that the two markets are frequently overlapping—which means that there are, in fact, not two but there is one single market—the following measures are useless for bringing about effective and lasting reforms:

- ☐ price reforms of the airlines, taken in isolation;
- ☐ other measures affecting airlines only, which fail to re-shape completely the composition of the services offered in themselves.

That is why the compromise worked out at Honolulu for one year can hardly be described as a reform. To drop the APEX tariff, to introduce a special tariff for winter excursion flights, and to

keep special tariffs for affinity groups in being, whose definitions, however, can neither be controlled nor adhered to, will, on the whole, have no more than marginal effects, in the same way as all other extra-seasonal discounts. Such measures do nothing to change the different points of departure for airline and charter flight business, and they will not have any noticeable impact on capacity policies of the two groups.

Tasks of Airlines and Charter Traffic

It has been stated that it would be a "logical reaction to American charter flight policies" to cut down drastically the fixed timetable flying programme on North Atlantic routes, or to scrap it completely. It is, however, abundantly clear that this would not adequately adapt things to present conditions. For once, as long as it is true that less frequented connections have to be subsidised from the profits earned over the North Atlantic (as it was at least in former times), airlines would also have to give up gradually flying over routes that are cursed by persistently lower load factors. To shift planes from timetable to charter work would not change this fact at all, and such drying-out and shrinking of the permanent flight network would be highly adverse to the worldwide division of labour. It would then be more than likely that a price war could not fail to break out over the North Atlantic, with further undeniable disadvantages for worldwide integration.

It would make more sense to homogenise the services which are being offered, by:

☐ granting airlines the right to operate charter flights at freely calculated fare prices, within certain limits;

☐ to impose on charter companies the binding obligation to offer fixed timetable traffic at generally fixed fare levels, also within certain limits.

The crucial difficulty, naturally, will be the definition of "certain limits". At the outset, it will be necessary to use different yardsticks for the two different types of operators, which means: charter companies will have to offer relatively fewer fixed timetable services (measured, perhaps, in passenger/kilometers) than airlines are obliged to offer, and airlines will be conceded relatively fewer charter services than typical charter companies.

Policy of Price and Capacity

It will probably still be indispensable for fixed timetable operations to enforce agreements which forbid fierce fare fluctuations. But, on the other hand, fare differentiation will have to be probably even steeper than that practised now. For example,

if quantity discounts can be practised to their full limit, it will probably not only be possible to fix floors and ceilings for fare tariffs and thus to make prices fully responsive to the elasticity of market demand but it may even be conceivable that the interests of both charter and airline companies become mutually similar or even identical. (It goes without saying that it is a basic condition for such a reform that the two types of operators are treated equitably by public administration and governments.)

More elastic fare policies will produce the fewer risks of long-lasting cut-throat competition, the more it becomes possible to make agreements on capacities which enable operators to take part of available capacities out of the market for limited periods. Without such agreements, it is very unlikely that a long-term market equilibrium could be achieved in intercontinental traffic, because—apart from accidental external influences on the supply position, as were caused, for example, by the US pulling out of Vietnam—there will always be the problems of technological progress, which lead to sudden jumps in the size of supply. Thus, the introduction of jumbo-size airliners, with their unprecedented facilities for mass transport, has produced a capacity explosion. Development of novel airplanes enforces, through quality competition, investments by all companies engaged in civil aeronautics, which will reproduce again and again new disequilibria in the air transport market, and thus long-term dangers for price stability.

The structure of supply will have to be homogenised by enforcing, in the first stage of a needed reform, similar and later, identical conditions of supply, lest air transport services are to suffer a breakdown in quality, which has to be kept to the level of fixed timetable liner conditions. This, however, necessitates a fundamental change in the attitude of the CAB and close cooperation between IATA and IACA, with the agreement of interested governments, eventually leading to a merger of the two organisations, perhaps under the name of IAA.

All other attempts at overcoming present difficulties, perhaps through subsidising airline services, or through formation of a super-cartel for prices, conditions, quotas, and regions of operation—national defence mechanisms against charter operators without changing present arrangements of airline organisation—are all prone to fatal weaknesses. They would lead to fractionisation of markets, make it less necessary for operators to adapt themselves to actual market conditions, and thus do harm to worldwide exchanges and trade.