COMPETITION POLICY AND THE
SCOTTISH AIR TRAVELLER

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SUMMARY

This paper starts from the assumption that competition is in the best interests of consumers. Without the competitive element the consumer is likely to be faced with high cost goods and services and a reduced range of choice. Within the civil aviation industry competition is restricted. This is particularly true in regard to scheduled passenger services within the U.K. network.

The need for strict regulatory policies has now been directly challenged in the United States domestic market. Governments and aviation authorities throughout the world are examining their own systems. Britain's Civil Aviation Authority (CAA) has produced a consultation document examining the scope for reduced regulation and increased competition within Britain.(1) The EEC is to produce a white paper in the near future concerned with freer access to important routes for independent airlines.

Because of its size, situation and internal geography, air travel is of vital importance to the Scots and to their social and economic well-being. The Scottish air traveller has two basic needs at present. Firstly, a need for greater choice of airline, aircraft and price competition. Secondly, a need to be certain that routes defined by the CAA as "life-lines" are kept open.(2) The paper argues that whilst there is scope for increased competition, these two consumer needs of increased choice and long term stability of operation can conflict. This conflict is primarily the result of one airline, British Airways, dominating the domestic network and holding a monopoly position on many routes.

This conflict of consumer interest, together with the scope for competition within Scottish air service network, is examined in regard to trunk, feeder and third level routes. Conclusions are reached which indicate that the problem is capable of resolution. Recommendations are set out in the concluding section of the paper.
1.5 The inherent constraints on competition within the airline industry; its susceptibility to trade cycle fluctuations; the limited scope for price competition; the highly regulated structure and the "interference" in its operations by government are well known and documented. The consumer who is looking for pure competition and the free market model of classical economics is doomed to disappointment. As aptly stated by Joan Mitchell,

"...the industry has all the characteristics of an oligopoly writ large. Competition is overtly fierce, but concentrated on marketing and service, with some surreptitious price cutting"(4).

However, the last few years have witnessed profound changes in the airline industry. These changes indicate to the fare paying public that their apparently powerless position in demanding choice and higher standards of service may be a thing of the past.

1.6 In the United States active pursuit of an "open skies" policy and deregulation by the Carter administration has produced a scramble for certain routes, if not necessarily providing greater consumer choice of operator. The regulatory role of IATA concerning tariff levels for international routes has been weakened. Within Europe the EEC is seeking a degree of deregulation. A less cautious Sir Freddie Laker desires to extend the benefits of cut price mass air travel. In Britain, the Civil Aviation Authority has recently published a consultative document which sets out its views on deregulation within the domestic market(5).

1.7 In Scotland the participation of independent airlines in charter work for the North Sea oil industry seems to have resulted in a more buoyant independent sector eager to diversify into schedule passenger operations in competition with British Airways. Or it may be the case that these airlines now face an overcapacity situation in regard to oil charter work and so need to diversify. Airports and airlines throughout Britain report increasing passenger levels despite rapidly increasing fuel costs.

1.8 Within such a climate of expansion and rapid change it is not surprising that the Scottish air traveller has become more critical of the current services on offer and expresses a desire for greater choice, lower basic tariffs and increased competition between airlines. Similarly, it/
2.2 With the increase of Aberdeen-London passenger levels as a result of the North Sea oil industry, consumer discontent has focused on this latter route. At present Dan-Air has applied to the CAA to revoke British Airways licence on the Gatwick route and to operate it in competition with the Heathrow route thus providing the consumer with a choice of airline.

2.3 The reason behind consumer pressure for competing operators to be licenced on trunk routes is clear. British Airways is felt to be a high cost airline, therefore the licensing of a competing independent may provide a lower priced alternative(6).

2.4 A recent judgement by the CAA, resulting from a British Airways application to increase its domestic tariffs by an average of 7½ per cent (heard in London 27.2.79), clearly indicated dissatisfaction at a high cost airline expecting tariff increases on routes consistently in profit. The importance of this "high cost" factor to the consumer is reflected in the fact that Dan-Air on Gatwick-Newcastle makes a profit at a tariff level set below corresponding British Airways fare levels.

2.5 British Airways recently made a comparison between its operation and eight other airlines of its own choice using staff productivity as an indicator of efficiency. As measured in available tonne-km per employee British Airways staff productivity was found to be only 59 per cent of its rivals. Other independent studies have indicated that in comparison with independent carriers the state airline is grossly overmanned and that staff productivity is low(7).

2.6 However, it is simplistic to argue that licensing a competing independent on to a route will provide the consumer with choice, lower tariffs and also enable the independent to make a profit. British Caledonian suffers a consistent loss on its Anglo-Scottish routes, usually in excess of £1m a year. Its tariff levels tend to be the same, or slightly in excess of British Airways Shuttle service tariffs. British Caledonian does provide a full meals' service on their flights, but they, in turn, have been criticised by the Air Transport Users' Committee (AUC) for the high cost of this service(8).

2.7 It is also true that the independent was slow to respond to the competitive challenge of a Shuttle type operation. Perhaps this was because the airline/
The current shortage of aircraft in British Airways domestic fleet means, however, that a turbo-prop Viscount is frequently used to the Gatwick destination, rather than the faster Trident.

2.13 Whilst the state airline does have Boeing 737 aircraft on order for its domestic fleet, these are likely to be used in the first instance to replace Trident One and Two aircraft, especially if fuel costs continue to increase. Over the next two year period the Aberdeen traveller to Gatwick may have to accept a seat on a Viscount with a twenty minute increase in journey time at the same fare as for the Trident. This will be with the knowledge that Dan-Air, the potential competitor on the route, will operate BAC 1-11 jets at a tariff level below that currently charged by British Airways.

2.14 The state airline's shortage of aircraft for its domestic fleet increases the disruption to scheduled services caused by aircraft breakdown. A Viscount taken out of service on any sector of the British network produces serious "knock-on" effects on other routes in terms of delays and outright cancellations. Scotland seems to suffer from the results of aircraft shortage more than other sections of the network. The presence of a second airline operating such trunk routes would provide an opportunity for passengers to transfer flights when delays occur.

2.15 British Airways, like its predecessor on the domestic routes, British European Airways, has historically shown a greater readiness to provide a better standard of aircraft type for its passengers after a competitor has provided this first. The state carrier has a tendency to retain its most suitable jets, such as the BAC 1-11, for its more profitable European routes or U.K. routes with European destinations. Only when competition has threatened or consumer discontent reached "dangerous levels", has the state airline redressed the balance and provided domestic passengers with the most modern, comfortable and powerful aircraft types currently available.

2.16 The state airline's domestic market tends to be the poor relation of the European and international networks. Historically, this was well illustrated when BEA's monopoly on scheduled passenger routes such/
regard to the long term operation begin to emerge.

2.21 Competition could be provided immediately on such a route by the CAA allowing an independent airline to operate Inverness-Gatwick or by permitting direct competition into Heathrow. Rapidly increasing congestion at Heathrow makes the latter option improbable. Present traffic levels on the route make it unlikely that the route (and others like it within Scotland) could sustain two operators. The result would be two airlines operating at below break-even point. This would be followed by the probable withdrawal of one and the possible withdrawal of both; leaving the route without an operator.

2.22 A more realistic alternative would be for the CAA to revoke British Airways licence on comparatively "thin" routes such as Inverness-London and to replace the state airline with an independent airline judged to be more cost effective and able to provide a better aircraft type and standard of service generally(9). Such replacement would seem of obvious benefit to the consumer.

2.23 However, the state airline operates a complete network of domestic routes, of which Inverness-London is but one. Within such a network, all sectors have a degree of inter-relationship. The revoking of a British Airways licence on any one route must have a "knock-on" effect on other routes, such as for example, Inverness-Orkney. At the very least there will be a re-allocation of overhead costs to other routes in the network. At worst, piecemeal erosion of the network may leave the original airline with only the loss making routes and with these having to bear sharply increased costs. The benefit gained by consumers on one route as a result of replacement may be obtained to the detriment of consumers on other routes in the network.

2.24 This raises the problem of the inter-dependence of many Scottish trunk routes with the services which feed into them from the outlying communities, such as from Orkney and Shetland. Any decision to revoke the state carrier's licence on a route within its Scottish network needs to take into account not only the desires of the consumers on that particular route, but also the affects on consumers throughout the network. This safeguarding of consumer interests is particularly important in the case of adjoining routes which are regarded as essential "life-line" routes.
difficult by the apparent failure of British Rail to act as an effective competitor, even on the Glasgow/Edinburgh-London routes. Despite the faster journey times produced by the electrification of the west coast route and the introduction on the east coast line of the new Inter-City 125 trains, British Rail seems to have been the net loser since the introduction of the Shuttle (10). Even the introduction of the Advanced Passenger Train by 1983 is not expected to change the situation. By that date it is expected that British Airways will have replaced its older Tridents and restructured the Shuttle service sufficiently to have countered current passenger complaints. The much longer rail journey times from Inverness and Aberdeen to London, mean that the air traveller on these routes must discount any competitive benefits as a result of the existence of a British Rail alternative. Competitive stimulus to British Airways will have to come from within the airline industry.

2.30 The options realistically available to increase competition and consumer choice on the Scottish trunk routes thus appear limited. On the Glasgow/Edinburgh-London routes an all jet service and a choice of operators exists at present. However, such a choice does not seem to have restrained either airline in applying to the CAA for frequent (twice yearly on average) tariff increases. It has not produced price competition or a choice of tariff levels. This may be the result of both British Airways and British Caledonian not being cost effective on their domestic operations. However, it does indicate that the introduction of competition on a route guarantees little more to the consumer than a choice of operator.

2.31 The important need would seem to be the introduction of an efficient low cost airline as the competitor for British Airways. Here the announcement by British Midland Airways that it wishes to compete with British Airways on these routes may provide the consumer with more than a choice of airline and type of service.

2.32 On routes such as Aberdeen-London which are profitable and where passenger levels can be expected to increase, it seems obvious that the monopoly position of British Airways should end. An efficient low cost independent should take over Aberdeen-Gatwick if it can provide a better aircraft type and price competition with the Aberdeen/
position was maintained despite the logical response from members of the sub-committee that this relieved British Airways from any effective pressure to reform its cost structure and improve its standard of service. This taken together with the Chairman's comment on the same day that the Authority was unlikely to revoke British Airway's licences for below par services, makes the frustration of the Shetlanders and other Scots served only by British Airways understandable.

2.38 Does this mean that the consumer has no alternative but to accept the present situation brought about primarily because of the imbalance within the British airline industry between a large and dominant state corporation and its much smaller competitors? Additional competition is practical on profitable routes such as Aberdeen-London. However, on "thin" routes replacement of British Airways is the only viable alternative. This, it was noted, does not provide competition or consumer choice and carries no guarantee as to standard of operation. The detrimental effects of piecemeal erosion of these routes on the state carriers overall network and the results for other consumers have been noted; as has the CAA's reluctance to replace the competitive element by setting standards of service on such routes.

2.39 A solution is available to resolve this dilemma. British Airways should withdraw completely from the domestic market and concentrate on its international network. To replace it, a specialist domestic carrier should be created either as a state corporation, or privately funded by interests likely to include British Airways itself. However, it would be essential for the new carrier to be completely independent of British Airways.

2.40 In order to reduce the present imbalance (which may well have restricted the development of the independent sector) within the British airline industry, the new domestic carrier would take over a smaller share of the home network. This would give independent airlines a larger stake and so increase competition in the industry. The new airline would take on the duty of guaranteeing long term operation of socially essential/
2.45 The problem of improving standards of service on the "thinner" non oil routes is more difficult to resolve. The piecemeal parceling out of sectors within this part of the domestic network is not likely to benefit consumers for the reasons given earlier in this paper. However, there does seem to be scope for the CAA to develop a coherent policy concerning standards of service provided on these routes. Where practicable, consumers should have the option of replacement by another airline when these standards are not met over an agreed time span.

2.46 Also in the short term British Airways will be left with the task of guaranteeing continuity of operation on some of the socially essential routes. The position of these at the very fringe of the domestic network is the main reason why the state carrier needs to retain a viable trunk network. It is significant in this regard that within the deregulated context of the United States the Civil Aeronautics Board is finding airlines wish to pull out of those sectors of their networks which are designated as socially essential for remote communities but are heavy loss makers. Accordingly, the CAA is having to offer airlines special inducements to stay on these routes and keep them open. It is this problem of keeping essential routes in Scotland open, whilst enabling their users to obtain some of the benefits normally provided by competition, that is examined in the next section.

3. THE SCOPE FOR COMPETITION ON SCOTTISH "LIFE-LINE" ROUTES

3.1 The concern in this section is with the routes which converge from the outlying mainland and island settlements into Glasgow, Aberdeen, Inverness and to a lesser degree Edinburgh. At present these services are operated by British Airways and Loganair. The state airline operates:

Glasgow-Stornoway-Inverness
Glasgow-Benbecula
Aberdeen-Wick-Kirkwall-Sumburgh and
Inverness-Wick-Kirkwall-Sumburgh

using a fleet of Viscounts and two HS 748s. Loganair, a specialist third level independent operates:
3.5 Until recently Loganair has operated a standardised Britten-Norman fleet; the Islanders with their STOL capacity being ideally suited to their "island hopping" role. The larger Trislander being responsible for the longer sectors. With expansion into routes such as the two hour Edinburgh-Tingwall, the airline is now using its Twin Otters on scheduled passenger services.

3.6 Though completely separate entities, one a state corporation, the other a private company, both airlines have maintained a close working relationship throughout the last decade. A joint planning group is concerned with the future development of their complementary networks. It was thought in the early 1970s that BEA would absorb Loganair and that a special Scottish Division of the corporation would be formed. This idea has been abandoned and Loganair is a rapidly expanding independent set to branch out beyond third level operations into feeder service work using larger aircraft.

3.7 It is within the sphere of these socially essential networks that the conflict between consumer benefits to be obtained from increased competition and the need to guarantee continuity of operation is at its sharpest. Recently, two of British Airways "life-line" route licences have been challenged by independent operators based in Aberdeen (but not necessarily having their head office there) and primarily engaged in charter work for the oil industry.

3.8 Such airlines are now either wishing to diversify into scheduled passenger services or to extend existing networks in other parts of Britain. In 1978, the CAA received applications from Alidair, Dan-Air and Air Anglia to compete with British Airways on their profitable and oil related Aberdeen-Sumburgh route; this was refused. In May of this year, the CAA convened a public hearing following an application from Air Ecosse to revoke the state airline's Aberdeen-Wick licence and to replace it on the route. The CAA has now revoked this licence.

3.9 Without doubt there has been consumer discontent on both routes concerning standard and frequency of service. Not unnaturally, both consumers and local authorities have looked to independent airlines to provide either an alternative service or to replace British Airways. Discontent has been heightened by the fact that both routes, particularly Aberdeen-Sumburgh/
to applications in an over cautious manner in order to protect an inefficient British Airways from vigorous competitors ready to provide a better service to the consumer on these routes? Or is the CAA right in stating that it must protect consumers from their own natural desires in order to secure the long term future of these "life-line" routes?

3.14 Unfortunately for the consumer the thinking of the CAA at present in regard to "life-line" routes and their guaranteed continuity of operation seems unclear. The judgements in regard to the Aberdeen- Sumburgh and Aberdeen-Wick routes can be regarded as inconsistent. The first ruling that British Airways monopoly must be preserved to protect route users in post oil days seeming to clash with the second that the corporation's licence must be revoked and the route placed with an airline without experience in scheduled passenger service work. This confusion is also reflected in the recent CAA consultative document on deregulation(13). In paragraph 4.20 of this report it is argued that a "life-line" route does not need to be cosseted.

"It may be that it is only when market forces fail that any special intervention is required".

Yet in paragraph 4.37 it is stated,

"In a recent decision....the Authority made it clear that its first concern is to avoid undermining the islands' 'life-line' scheduled service links, which were needed before the oil was discovered and will still be needed when the oil has gone".

3.15 These two rulings mirror the conflict in consumer demand between short term consumer gains (Wick judgement) and long term stability of operation on "life-line" routes (Sumburgh judgement). The paragraphs also reflect the two sides of this conflict of consumer interests. Consumers need to examine the case for allowing airlines to replace existing incumbents on the facts of their actual situation. Above all, they should closely examine the long term intentions of airlines wishing to take over and operate their particular routes.
and pilot needs. However logical this argument, it can only raise consumer frustration on these routes, especially those known to be profitable. The initial reaction must be a demand for an independent to take over and operate the routes and to provide a standard of service fitting present basic tariff levels. Such frustration might be less if the state carrier explained why it has only purchased two HS 748s, rather than completely replacing the Viscount.

3.21 Undeniably the Viscount is now a cheap aircraft to operate, in that its historic costs have long been written off. However, the consumer could be forgiven for expecting to see by now the new aircraft in service on these routes for which these replacement costs were intended. It is perfectly clear that the state carrier's domestic fleet replacements are being kept to an absolute minimum, and that the peripheral routes in Scotland have little hope of such replacements. The Viscounts will fly on until their maintenance costs force replacements or until British Airways hand over these routes to an independent airline with suitable aircraft.

3.22 If this is the situation then Shetlanders and Comhairle nan Eilean have a right to be sceptical about recent CAA judgements concerning the need to keep the state airline on "life-line" routes in order to ensure their future. It is becoming necessary for British Airways to spell out its long term intentions in regard to these routes. Further, it is essential that these intentions are made clear to the fare paying public, not just to organisations such as the CAA, local authorities and the Highlands and Islands Development Board. It is the general public on these routes who actually pay the fares and keep the routes in existence.

3.23 The conflict concerning British Airways essential route services has tended to concentrate on whether the licence for a specific route should be revoked in order to allow competition or an improved standard of service by a replacement airline. However, the state airline rightly contends that as it operates an entire network it is wrong to examine radical changes on isolated routes because these are an integral part of the network. As mentioned in the first section of this paper, if one sector's licence is revoked, for example Aberdeen-Wick, there will be a "knock-on" effect from this on to other sectors operated as part of British Airways network.' The result may/
difficult loss making routes with a depleted income. Despite the appeal of new aircraft types and better frequency of service, this is a situation where a new operator takes over an already developed route in which they have not had to invest the development costs themselves. They take over, in fact, a ready made article.

3.28 These peripheral routes in Scotland have been defined as "life-line" routes, hence it is essential that their long term operation is guaranteed. It seems doubtful that such services should be taken on by new operators until they have proved their ability in the scheduled passenger field elsewhere and have an established track record. If the CAA does allow such a takeover, then it is reasonable to expect the new airline to be asked to provide some form of guarantee concerning its long term intentions.

3.29 The fact remains, however, that an independent airline is at present responsible for several "life-line" routes. The activities of Loganair indicate that providing such guarantees of long term operation is not necessarily the prerogative of a state airline.

3.30 There is thus another element of inconsistency in the CAA argument in regard to the need to retain British Airways on these routes. Also, the fifteen or so years of oil production is a long time span in the civil aviation. With the current rate of change in the industry, to state that British Airways will still be there to operate the routes in the year 2000, does seem a rather speculative proposition. As mentioned previously the questions concerning the state carrier's fleet development for these routes seems to indicate that British Airways may intend to shed them well before the turn of the century. The "long-stop" argument is perhaps less strong than either the CAA or British Airways believe it to be.

3.31 Even the argument concerning development costs lacks consistency. British Airways did not, of course, pioneer these Highland routes. This was done by such people as Gandar-Dower and Fresson in the interwar years. The routes they created/
operate the Prestwick feeder service, a route considered non-viable previously by several airlines. Again, a new aircraft type is to be used, the Shorts 330, giving the airline a larger capacity aircraft as part of a diversified fleet.

3.35 The contrast with British Airways on their remaining routes is a clear one. It is an independent airline which has safeguarded the long-term future of routes shed by the state operator. It is the independent operator which has then gone on to revive dormant routes and pioneer new ones. More significantly still, it is the independent airline which has gradually extended its fleet as its network expanded. Unlike the state carrier, Loganair is now planning to phase out its Trislanders as having served their day to be replaced by new aircraft. For an active airline, a specialist third level operator, there is some justification in believing that it should be protected from having profitable routes "creammed off" especially by new arrivals. This is true when such an airline is still pioneering new services such as the proposed Inner Hebridean.

3.36 There is a strong case for British Airways shedding more of these peripheral routes to proven independents with established track records. It is obvious that these services are at the bottom of the corporation's "pecking order" in regard to the provision of modern suitable aircraft. Consumers on routes such as Glasgow-Benbecula are well aware that their tariff reflects one of the highest cost per mile routes in Britain for what is generally agreed to be a very inadequate level of service. Consumers are also aware that the promise of long-term continuity of operation by the state airline carries with it the likelihood of few basic improvements. They are further aware that it is the independent operators which are investing in new aircraft types for the domestic market, not British Airways.

3.37 Recently, the state airline indicated that it was aware of the extent of consumer discontent on these routes by attempting to provide extra capacity and frequency on the Aberdeen-Wick route. The proposal was to jointly run the service with Loganair, with the latter providing additional rotations with a Trislander to the Viscount currently on the route.

3.38/
Kingdom, or to setting up within British Airways a separate U.K. division, independent in choice of staff, fleet and method of operation.

4.2 That in the long term the U.K. scheduled passenger service network be so arranged as to permit easier access by independent airlines to major trunk routes.

4.3 Where consistent with present and projected passenger levels, early action be taken to permit low cost independent airlines to compete with British Airways on routes where the state airline is the monopoly operator. Preference should be given by CAA to airlines able to provide price competition in addition to service competition.

4.4 The CAA should set out clearly defined conditions of service and criteria for setting tariff levels to be met by operators of routes which cannot sustain a competing airline. These conditions to be monitored by the CAA.

4.5 The CAA should clearly state how future developments on "life-line" routes will take account of the two basic and potentially conflicting consumer needs:

(i) the short term benefits usually obtained as the result of price and service competition;

(ii) guaranteed continuity of operation of the route over the long term.

4.6 British Airways should publish information regarding its long term plans in regard to the "life-line" routes it operates.

4.7 New operators of "life-line" routes, especially these serving the island communities, should be required by the CAA to guarantee continuity of operation over a considerable time span (not less than five years).

4.8 Any successor to British Airways should qualify for subsidy funding on unprofitable but socially essential routes on the same basis as independent operators. The type of subsidy should be such that it encourages reasonable tariff levels and high standards of service and also encourages other operators to act as potential replacement airlines if the conditions set out in 4.4 are not met by an incumbent.

GLASGOW
June, 1979.
REFERENCES


5. CAP 420.

6. The recent judgement by CAA in refusing an application from British Airways for tariff increases on several domestic routes (hearing 27.2.79) specifically drew attention to what it considered to be an unacceptable level of costs on profitable routes.

7. Air Transport Users' Committee evidence to House of Commons Trade and Industry Sub-Committee enquiry into domestic air fares.

8. AUC (as above).

9. Currently British Airways operate one jet and one turbo-prop aircraft on the Inverness-Heathrow route.


13. CAP 420.