The Russian Federation

Discussion on «Airline competition»

June 19, 2014

Competition Committee

Formation of the modern airline market in Russia began in 1991. On the background of deregulation of economy, privatization and price liberalization, there was a transition from a centrally planned system to market economic relations within a few years in the airline sector. This transition took place in difficult conditions of prompt reform and, ultimately, adversely affected the development of airline sector services. From 1990 to 2000 there was a sharp decline in the performance of airline sector. Gradually, since 2000 airline market began to recover its positions.

Recent years, air passenger traffic in the Russian Federation has been developed at a sustain level significantly outpacing global growth. Cumulative growth in passenger volume in the period 2007-2013 amounted to 87.9%.

In many ways, these results became possible because of the measures of ensuring the development of competition, among which are:

- Completion of material and organizational separation of the combined airline, providing airport and transport activities in the mid-90s;
- The introduction in the late 90's - early 2000's of antimonopoly body flexible regulation of tariffs for services in airports, that created the premises for the development of competition in this area ;
- Removal of administrative barriers to access to domestic air traffic market in 2007, which existed in the form of licensing route;
- Reduction of the technological and economic barriers to consumer access to services of natural monopolies and infrastructure at the airports by the adoption of the rules of non-discriminatory access in 2009;
- Gradual liberalization (since 2008 to present) of international air service on the space of CIS countries, as well as air services within third countries.

It should be mentioned some structural features of airline market in the last decade:

- High concentration of the market. Today, the activity of passenger and cargo air services carried out by 118 airlines. At that, 15 of them have a share of 85% of total passenger traffic. The top five airlines have a share of over 70% of the total number of passengers;

- Changes in the structure of the market: the share of regional and local directions in overall transport decreased from 75% to 25% in twenty years;

- High concentration of domestic traffic through airports of the Moscow air hub amounted to 75% in 2013.

One of the criteria for the development of competition is the proportion of routes served by three or more airlines. There are not a lot of such routes in the Russian network of airlines routes (currently around 20%). However, exactly these areas account the majority (83.6%) of the total passenger traffic. The share of passengers carried by the airlines operating in a competitive environment has steadily increased in recent years - a steady positive dynamics is observed.

A high level of competition distinguishes main directions, first of all, connected with the Moscow air hub: 5-6 airlines and more operate on such air routes. Competition on these routes determines a pricing policy of airlines: tariffs proposed on them are stably lower than comparable in distance directions with limited competition.

Obviously, the development of the country requires increase in the role of regions in the economy and creation of new centers of active growth. Finding solutions of these problems is impossible without the formation of stable inter-regional and external transport links.

State regulation

Despite the success in the internal liberalization of the market of air services, present legal regulation in the field of international air traffics based on a bilateral inter-governmental agreements on air communication, fixing limits on the number of designated carriers, traffic volumes, frequencies, destinations and agreement of tariffs, it constitutes a serious barrier to access the markets of international communication.

Efforts of the antimonopoly authority are aimed at the liberalization of this sector in recent years. Discussion of the problems of liberalization of air services of CIS countries held in the framework of the Interstate Council for Antimonopoly Policy (ICAP), the participation of the FAS Russia in the Interdepartmental Commission, established in 2012 for the selection of carriers on international routes: proposals and actions of the FAS Russia aimed at the institutionalization of competition as a fundamental principle of market development in the field of air services.

Earlier the concept of liberalization of air space was presented by FAS Russia's ICAP report «About the condition of competition in the air services market of CIS countries» (2008).

The report's conclusions and recommendations, including the correcting of inter-governmental agreements were approved by the Council of CIS's Heads of Government (Kishinev, 14.11.2008)

Among the measures of promoting competition were called the increasing number of appointed carriers, increasing number of pairs of cities for air traffic, removement of tariff agreement between air carriers, coordinate application of antitrust regulation measures to airport services and fuel markets in the CIS countries.

A full analysis about the condition of air services markets and the development of competition in various market segments was also conducted in the next report of the FAS Russia which was presented at the meeting of the Government Commission of Transport and Communications in December 2010.

As a result of measures taken for liberalization, air services have grown to more than 2.5 times over the last 4 years. Today, the issues of further liberalization and realization of the «United sky» conception are actively discussed in the framework of the Common Economic Space (Belarus, Kazakhstan, Russia , with the prospect of accession of Armenia and Kyrgyzstan to the EEA).

A number of cases on violation of the antimonopoly legislation according to the Russian aviation authorities in connection with creation of barriers to market access in international transport were examined by the antimonopoly authority. Improvement of situation was achieved after creation of the Interdepartmental Commission for accessing carriers on international routes at the Ministry of Transport of the Russian Federation.

There are some examples of successful liberalization of the market of transport like in Italy (Rome, Venice, Milan), in the UK (on the route Moscow - London), in France (on the route Moscow - Paris). Antimonopoly authority actively supported the output of foreign low-cost carriers (Easy Jet and Wizz Air) on transport markets of the Russian Federation.

The result of intensive efforts of liberalization of international air communication became the dynamic growth of international communication for the last four years, averaged 20%.

For a number of features, civil aviation is a subject of serious state regulation. Meanwhile, according to the FAS Russia, some requirements of regulators are superfluous. According to the FAS Russia, certification requirements for operators on the minimum number of aircrafts should be attributed to them (at least three aircrafts with a number of passenger seats up to 55 and at least eight aircrafts with a passenger seats no less than 55).

The presence of such requirements is a serious administrative barrier to entry the market for new airlines, primarily those who could position itself in the low-fare segment. Antimonopoly authority informed the Government of the Russian Federation about its position.

In recent years there has been a significant increase of low-fare airlines in the global market of air services. Currently, they occupy up to 45% of the European air transport market.

The business model of low-fare airlines present a serious competition to traditional network carriers: The cost of the proposed services of low-cost carriers is averagely in 3-4 times lower than in network companies.

Nowadays, the Russian experience, which is not quite successful, is reborn on the base of subsidiary airline «Aeroflot». And in this respect, of course, analysis of necessary conditions and prerequisites for the development of this sector is very important. Among them are the introduction of "non-return" tariffs (amended accordingly to the Air Code of the Russian Federation), the exception from the tariff the costs for the baggage and flight catering (drafted amendments to the regulations) in order to create the necessary infrastructure, the work for simplifying the certification requirements to the airports is engaged.

Pricing

State price regulation in air transport is carried out in the areas of providing certain services in the airports and, also, in air navigation. Except this, regional administrations have the right for price regulation on local air services. In general, the tariffs for air services were liberalized: believe that free pricing is a necessary condition for the development of competition.

At once, analysis of the airlines tariff policy shows that an established practice in which the value of only carriage tends only to increase, and also to the price supports, regardless of the level of loading of the aircraft. This give grounds that carriers use the opportunity to increase their profitability by attracting inelastic demand.

At the same time the introduction of dynamic pricing in the railway transport, providing demand reduction at low cost services on the eve of the day of departure has led to increased utilization of capacity trains, reduce service costs, traffic growth and increase profitability as a result of the carrier's activities.

According to the FAS Russia, the refusal of carriers from price competition closer to the departure date substantially restricts competition in air services market, lead to the maintenance of price, adversely affect the interests of consumers, contrary to paragraph 1 of Article 10 of the Federal Law "On Protection of Competition".

On April 2, 2014, the FAS Russia, issued a warning to eight airlines dominating on different routes. Among these companies were: «Transaero», «UTair», «Aeroflot», «Siberia», as well as companies included into their group.

Services at airports

As part of the services, securing airlines activities and directly affecting their pricing and market behavior should indicate on the crucial constituent, which is necessary for ensuring healthy competition - providing services at airports. In recent years the situation has changed fundamentally.

For the first time ever, rules on the development of competition in ground handling sector in general were set by the Rules of access to services of subjects of natural monopolies in airports (approved by the Decree of the Government of the Russian Federation from 22.07.2009 № 599).

Analysis of application practice of the Rules of access in airports showed that in the sector of ground handling qualitative changes are happened, that are associated with the demonopolization of the area, which is traditionally referred to the sector of natural monopoly. Currently, this document inserts some additional requirements to ensure competition, main of by - the obligatory presence of alternative operators in the airports-millionaire, and also the ability to access not only to the airport services, but to the objects with the use of which these services are provided.

Today we can speak not only about the competition at airports, but also about competition between airports. In 2013, the FAS Russia conducted survey among airports, as well as among consumers (airlines and passengers), which showed that more than half of the respondents among federal airports (30 of 47 airports) consider that they work in a competitive environment, which causes them to improve the quality of their services and to develop new strategies to fight for the consumer. Moreover, all of the questioned regional airports (75 airports) noted that they have competitors (usually among federal airports).

Nowadays airlines as key players in the air services market have a choice within the established «rules of the game»:

- Route traffic (including the Government's decision of abolishment the licensing route in 2007);

- Supplier of aviation fuel;

- Provider of aviation fuel.

However, in the same place, where there are no conditions of competition, the consumer is guaranteed:

- Non-discriminatory access to airports, including TCC
- Regulation of prices (tariffs)

Consolidation and alliances. Antimonopoly regulation

The trend of development of the modern world market of air services are the processes of consolidation, mergers, forming alliances.

Russian airlines are also not remain aloof of this process.

An example of consolidation was the acquisition of the «Aeroflot» company, acquisition of assets of STC «Russia», «Saravia», «Sakhalin Airlines», «Vladivostok Avia».

Consolidation was carried out by instituting control by the «Aeroflot» company over acquired assets.

Decision on consolidation which had been taken by a major shareholder of the company «Aeroflot» - the state, was due by the intention of creating a major player in the market on the one hand, and, on the other hand - to support the companies with precarious financial situation, which had dominated in a certain regional areas.

It must be admitted that the consolidation can reduce the level of competition by means of creating conditions for airlines such as reducing costs, providing access to new markets, improving the efficiency of carriers. This probability is enhanced in case if the route networks of competitors will overcover.

The FAS Russia approved the above transaction and was made an analysis of airline route networks, as well as an investigation of the need to define preconditions related to the possible imposition of reduction commitments on the "Aeroflot" and (or) the release of slots on the routes served by the members of his group of persons. Analysis, conducted by the antimonopoly body showed the inadvisability of putting restrictive requirements in case of availability of service facilities in airports, as well as interspecific competition.

So, despite the fact that on the route Moscow - St. Petersburg, the busiest domestic route, there was a significant enhancement of market power of two airlines as a result of the acquisition of company based in Pulkovo airport STC «Russia» by the «Aeroflot» company, the factor of having strong competition with railway transport was take into account: the opening high-speed railway in this area provided a high relevance of markets of transportation , realized by the various modes of transport. That was evidenced by the analysis of carriers pricing policy and by dynamics of passenger traffic.

However, analysis of the tariff policy of the companies included in the group of companies of «Aeroflot» shows that consolidation reduces competition that came out in the increase of tariffs on serviced routes.

In its activity, the competition authority is also facing problems of discriminatory behavior of market participants. As a rule it refers to economic agents, who have yet combined air transport and airport activities into one legal entity, or major airport operators, experiencing some pressure from the base carriers.

In the first case an example could be the situation connected with repeated denial of the air transport «Saravia» (carrier and airport as part of one legal entity) to the largest carrier – «UTair» in obtaining slots at the airport of Saratov for the flights to Moscow in.

In the second case, the refusal in allocation of slots of airline «Avianova» by the main operator of the airport of Surgut was explained by market participants as latent interests of underlying carrier - airline «UTair».

As an example of discrimination can also be mentioned the conclusion of an anticompetitive agreement between Russia's largest airline «Aeroflot» and the capital's airport «Sheremetyevo», aimed at obtaining unfair advantages to the carrier.

All these cases were the subject of antitrust proceedings.

In the framework of the control of the antimonopoly law enforcement, the principles of which are determined by the Federal Law «On Protection of Competition», antimonopoly authorities consider cases, connected with anti-competitive practices constraint. The main violations by airlines are: abuse of dominant position, mostly in the part of violation of the pricing procedure, setting monopolistically high prices, as well as coordinated actions focused on setting and supporting of price.

In 2013, following the results of consideration of the case about violation of the antimonopoly legislation by Regional office of the FAS Russia, as airline «Aeroflot» was recognized violated in Part 1 Article 10 of the Law on Protection of Competition in setting unreasonably high prices on the route Moscow - Kazan. Nowadays the decision is appealed in court.

In 2012, Tyumen Regional office of the FAS Russia found the violation of antimonopoly laws by coordinated actions of «UTair» and «Yamal», aimed at setting and maintaining prices on the route Sochi - Tyumen. The decision of competition authority was confirmed by the court.

As for global alliances, there are two Russian companies among their members: Aeroflot have entered into alliance with SkyTeam since 2006 and the company «Siberia» («S7») since 2010 is a member of alliance Oneworld.

Alliances have become not just a form of business integration, but in a certain sense a necessary condition for the existence in the market in the context of a globalized economy. However, the association of carriers in alliances, increasing their efficiency by optimizing the structure of the route network and increasing the demand for services offered by members of the alliance, may reduce competition in the markets served by the earlier potential or actual competitors. However, a detailed analysis of the impact of participation in the alliance of «Aeroflot» and «Siberia» on their market conduct, tariff policy, loyalty programs have not been conducted yet.

It should be pointed out that the effect on competition of such forms of cooperation such as agreements of joint commercial operation of flights (code-sharing), of recognition of transportation documents (inter -line) is also ambiguous. If there are established in governmental agreement restrictions on the number of assigned to the air line carriers, the use of code -share mechanism may hinder the development of competition on the transportation route, because the purpose of the route required for both partners, herein, that flight is proceed by one operator company of the flight .

The FAS Russia believes that the main instrument for the development of competition in international transport sector is the improving of the international legal regulation of air traffic, taking into account the special aspects of the current condition of the markets of air services and the changes that they suffer, including changes under the influence of liberalization of international air transport.

In general, for the development of Russian civil aviation it is necessary to implement the system of measures aiming at stable long-term growth of air services. For this purpose it is necessary: the development of airport infrastructure using open transparent procedures to attract investors, involving previously derived airports in economic circulation, airfields, also by simplifying procedures of certification, building norms and regulations; further improvement of tariff regulation (long-term tariff setting and application of policies of comparable prices and tariffs), deregulation in the areas of airport operations, if the necessary conditions of competition are created; combination of state support of regional and local aviation and stimulation of further development of competition on the routes; further development of a competitive market of aviation fuel and securing of aviation fuel; creating conditions of airports activity as business units focused on satisfaction of the growing demand; grading the conditions of the taxation of international and domestic air services, etc.

The FAS Russia believes that the proposed measures will not only promote the sustainable growth of air services, but also lead to a change of the structure of the market of air services. The sustained expansion course of Long haul must be ensured. At that the outrunning growth of regional and local traffic, low-fare airline, business aviation, general aviation, freight services, and services of the regional and local airports should be provided.

Nowadays, generally, such measures are developed and formalized in the Roadmaps, approved by the Russian Government, in particular in the Road Map «Development of competition and improvement of antimonopoly policy», realization of a complex of which has a particular importance for the formation in a slowing conditions of economic growth and the degradation of macroeconomic indicators, the preconditions for the future sustainable growth of air services and economy as a whole.