

Freedom in the skies: Air transport in South Africa

Liberalisation – the background

An international revolution has taken place in the liberalisation of transport markets. Nowhere is this more evident than in the aviation industry. The lift-off occurred in 1978 with the deregulation of the American domestic airline industry under the Carter administration. The repercussions were soon felt throughout the world. The highly regulated US airline industry had had a virtually static regulatory framework for 50 years. Liberalisation led to a surge in the establishment of new airlines and in mergers leading to price wars and increased flight frequencies – all to the benefit of American passengers.

It was not until 1991 that South Africa deregulated the domestic airline industry and today our “open skies” policy is one of the freest – if not the freest – in the world. Anyone can enter the market and operate on any route, subject only to safety, insurance and financial requirements.

Liberalisation – the results

The outcome of this increase in local airline competition has been entirely predictable. SAA has lost market share mainly to Comair and Sun Air – from 95% before deregulation to possibly as low as 50% today. Airlines have entered and left the industry, flight frequencies have increased and prices have fallen. Commercialisation of the nine national airports occurred a few years ago and more recently the airports were partially privatised with 30% being sold to the Rome Airport Company. The Airports Company of South Africa (ACSA) is now much freer from political interference and restrictions and has planned substantial increases in capacity, in order to handle an expected 6,8% annual traffic growth over 30 years. ACSA is profitable which ensures the flow of funds with which it can meet future investment demands. In fact, the airlines argue that it is using its monopoly status to make abnormal profits. This possibly explains why the Rome Airport Company paid so much for a share of ACSA.

Liberalisation – the next step

The aviation industry can be totally liberalised by selling off the rest of the Airports Company and privatising the national carrier. Privatisation of SAA is on the cards. It will soon be split off from Transnet as a separate company and there are a number of suitors, including Lufthansa, KLM and Swissair.

Our domestic aviation policy is fundamentally sound - so much so that the Department of Transport's recently published *Moving South Africa* (1998), which focuses on the problem areas in the transport industry, devotes less than 5% of its space to discussing the aviation sector. This is evidence that current policy is considered close to optimal. With the fundamentals in place, the medium to long-term outlook is good. However, in the run-up to SAA's privatisation, the short-term prospects could be extremely serious for some of the private airlines.

Government condoned unfair competition?

SAA's current behaviour raises the question as to whether to privatise before, after or at the same time as deregulation occurs. International experience over the past 20 years has provided sufficient evidence to allow government to anticipate the most likely consequences of each method. Government can therefore devise an effective strategy that takes into account the probable consequences of its chosen method of liberalisation.

The major disadvantage of *privatisation before deregulation* is that the new owners of a monopoly (e.g. Telkom) or a company that has a major share of the market (e.g. SAA), will try to retain or

regain their monopoly status and so delay the effectiveness of deregulation. Government's often condone such behaviour. Indeed, the outcome is often preferred by governments wishing to maximise the selling price of the state-owned firm being sold. Such a price is higher precisely because the parastatal has a monopoly and is not subject to competition. The monopoly profits (reflected in the sale price) is paid for by the users who have to pay more as customers because there is no competition to keep prices down. This is the least desirable method of privatisation.

Privatisation after deregulation, as in the case of SAA and the South African airline industry, is more desirable as it makes the private sector companies (in this case Comair and Sun Air) firm proponents and supporters of full-blown privatisation. This is because of the inevitable unfair competition that follows from deregulated but still state-owned "competitors". Because of this they put pressure on the government to proceed with privatisation as quickly as possible. However the time period from deregulation to privatisation can take many years. In SAA's case, it will be about ten years – long enough fatally to damage existing suppliers.

Rapid privatisation – in the interests of all

Privatisation at the same time as deregulation is probably the best course of action. An alternative is to include a sunset clause in the legislation which stipulates a fixed and short time period. This would remove much of the uncertainty and allow the private sector to plan accordingly.

Predatory pricing – in the interests of none

SAA's actions are currently under review by the Competition Board at the request of Comair, Sun Air and Nationwide. SAA's behaviour is under attack because it appears to be trying desperately to regain the market share it has lost since deregulation while it has the luxury of not having to make profits before it is privatised. It appears to be simultaneously increasing capacity and reducing prices on the major routes and this is unusual economic behaviour when there is no significant increase in demand. However, this behaviour would be perfectly acceptable if SAA was a private company with limited shareholder funds. In the case of a parastatal with limitless taxpayer funds, the behaviour is not acceptable. Predatory pricing represents unfair competition when it is carried out by a parastatal, with access to unlimited taxpayer funds, which is competing with the private sector. It is this type of action that must be stopped by the Competition Board, the relevant Ministers and the Cabinet if SA is to have a healthy airline industry capable of handling the future business and tourist demand.

In 1991, the Government set out the position of how SAA should act in terms of the new domestic air transport policy. The main conditions were that SAA should operate on a commercial basis, that profits on international routes should not be applied to subsidise domestic losses and that there should be no cross-subsidisation between SAA and Transnet. It appears likely that Transnet and SAA are not complying with these conditions.

SAA has a dismal profit record. Over the past 30 years SAA has run up enormous losses and it is expected to lose a further R200 million in the financial year ending March 1999. Since the commercialisation of Transnet, SAA has not reported a profit, even ignoring the effect of the publicised shortfall in the pension and medical aid funds. It has been showing losses on its domestic operations since 1991. It does not make sense for any government in the world to subsidise airline passengers, especially when the beneficiaries are the wealthy. This surely cannot be the government's objective and it is highly unlikely that the authors of the RDP ever intended redistribution to be to the rich.

Once SAA is completely privatised it should be free to compete as aggressively as it wishes but it is extremely unlikely that shareholders would agree to face annual losses of up to R200 million. The

sooner SAA is completely privatised the better it will be for all concerned, including SAA. SAA's share of the domestic market is likely to decline further unless it becomes much more efficient which it is trying to do by shedding over 1 000 jobs. The task will not be easy as it has an ageing fleet of aircraft of various types which burden it with high maintenance costs.

SAA's bright future

All is not doom and gloom for SAA. Many nationalised airlines have turned losses to profits in the run-up to privatisation. British Airways, once a large burden on the British taxpayer, is now one of the world's most profitable airlines. This year will see the privatisation of Air France, Alitalia and Iberia, all three now turned from loss-making concerns into profitable airlines. The latest indications are that SAA will also become profitable this year – making it more attractive to its suitors.

Another major force affecting the airline industry is globalisation. Alliances are being established to create global networks of seamless air travel. Economies of scale are being achieved through joint purchasing arrangements and maintenance agreements. Four competing global alliances are likely to result from current international industry changes: the Star Alliance with Lufthansa and Singapore Airlines; Wings with KLM, Alitalia, Air France, Air China, Continental and Northwest; Oneworld with BA, Cathay Pacific, Qantas and American; and Qualiflyier with Swissair, Austrian Airlines, Sabena, Turkish Airlines, TAP Air Portugal and Delta. When SAA chooses a partner for 30% of its equity, it will consequently also be deciding which global alliance to join which will have a significant effect on its long-term future. As the dominant airline in sub-Saharan Africa it will be in a strong position when it makes this choice.

Whether domestic airfares are increased or not depends on a number of factors including the certainty that SAA will have to operate commercially in future. This, together with the fact that domestic airlines currently earn average yields lower than worldwide averages will tend to push airfares up. However, if SAA focuses on profitable international and domestic routes and increases its efficiency significantly, then the current low level of airfares could be continued. On balance, this is unlikely and air passengers will no longer enjoy subsidised air travel. Whatever the outcome, users will be paying the true cost of air travel.

Further Reading

Moving South Africa: Towards a transport strategy for 2020 (1998). Discussion draft. Department of Transport, Pretoria.

O'Malley, Thomas (1998) *Privatisation: A UK success story*, FMF Monograph 21, Johannesburg.

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