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CABINET

AIRLINE COMPETITION POLICY

Note by the Secretary of State for Transport

INTRODUCTION

This paper seeks colleagues' agreement to the decisions I propose to take on the recommendations of the Civil Aviation Authority (CAA) in their recent report on airline competition policy. It proposes that the Government's response to these recommendations is published immediately in a White Paper.

BACKGROUND

2. Last December, when I announced our plan to privatise British Airways (BA) in early 1985, I also made it known that I was asking the CAA to review the implications of BA's privatisation for competition and the sound development of the British airline industry. The CAA, after full consultation with airlines and others, published its report in July. Its main conclusions and recommendations are summarised at Annex A.

3. I put forward proposals for dealing with some of the CAA's recommendations last month in C(84) 22, which was discussed by a small group of colleagues under the Prime Minister on 11 September. This meeting reached four conclusions -

- a. it felt that legislation to enforce transfers of routes from BA would be undesirably contentious and would arguably be in breach of undertakings given by Sir John Nott, when Secretary of State for Trade, in 1979;
- b. it therefore asked me to discuss with BA a negotiated "route swap" with British Caledonian (BCal), instead of transfers;
- c. it urged me to consider the strengthening of safeguards against predatory behaviour; and
- d. it requested clarification of the anti-trust litigation, to which BA (and BCal) are exposed in the United States.

I am preparing a separate paper on item d. I have now dealt with items b. and c., and the following paragraphs of this paper record the outcome, in the course of describing the response I propose to make to the CAA's report as a whole.

OBJECTIVE.

My objective is, without postponing the privatisation of British Airways, to settle the issues raised by the CAA in such a way as to promote a British airline industry both competitive within itself and strong internationally. To this end I propose a response the key elements of which should be -

- a. to remove barriers to competition in domestic air services;
- b. to seek the designation, wherever we sensibly can, of two or more British airlines to operate in competition on international routes ("dual designation");
- c. to encourage new services, especially by the smaller independent airlines, between regional airports and overseas (especially continental Europe);
- d. to strengthen BCal as a credible competitor and potential substitute for BA on overseas routes both long and short-haul;
- e. to ensure adequate safeguards against predatory pricing and other anti-competitiveness practices by any airline;
- f. to avoid the need for legislation or for excessive interference with BA's present operations such as would delay privatisation.

PROPOSALS

a. Domestic Air Services

5. Here I propose to endorse the CAA's proposals (recommendations 11 and 12) -

- i. that British airlines be enabled to operate scheduled services between any two points in the United Kingdom, other than Heathrow or Gatwick (excluded for capacity reasons), and any other specifically excluded (eg "lifeline" routes, where isolated communities are dependent on a vulnerable air link); and
- ii. to cease regulating domestic air fares (except in so far as is necessary to prevent predatory pricing).

The CAA can implement both these proposals under their present powers.

b. Dual Designation

6. I propose to welcome the CAA's proposals (recommendations 1 and 3) that "additional competition by British airlines on inter-continental routes should be licensed wherever possible" and that it "will seek

to increase the range and market penetration of European scheduled services from Gatwick" (that will be operated largely in competition with BA's services out of Heathrow). I shall also instruct the traffic rights negotiators in my Department to make all efforts to secure the right to dual designation from foreign Governments at an acceptable price.

c. International Services from Regional Airports

7. The CAA proposed (recommendation 5) that "BA's European routes from provincial airports should be taken over by other British airlines". This proposal is contested by regional interests and a number of our supporters there. And it would require legislation to make BA give up any of their regional air services, which would delay privatisation. BA have now made a counter proposal for modest assistance to other British airlines ready to operate new services between regional airports and the rest of Europe -

- i. to pay any airline licensed by the CAA up to £450,000 per route over three years as a contribution to their start-up costs in launching international services from the regions either in competition with themselves or on new routes; and
- ii. to provide them with back-up services (booking, ground-handling, timetabling etc) at the six regional airports BA serve, at cost.

BA's offer would be limited to a maximum of 15 new services, at a total cost of £6³/₄ million over three years.

8. This offer is well below the expectations of the airlines concerned, but I believe there would be takers. I believe it is the most we could expect BA to do, short of legislation.

d. British Caledonian

9. Several of the CAA's recommendations (1, 2, 4 and 6) concerned enforced transfers of BA's routes out of London, largely to BCal. As colleagues wished to avoid legislation I have followed up their suggestion, at the meeting on 11 September, of a route swap between BA and BCal, instead of the route transfers, to which BA were opposed. It has been extremely hard to persuade either airline to contemplate a satisfactory swap (ie one that gives BCal sufficiently enhanced profits, without disruption to BA's operations on a scale which would threaten privatisation and be unacceptable to Lord King). With the greatest difficulty I have prevailed upon BA to agree to the offer set out in Annex B, which (on BA's figures) would give BCal about £17 million of extra profit while reducing BA's profit by about £20 million in the short run (more detailed figures in Annex C).

10. Such a swap would involve costs to the Exchequer -

- i. BA's loss of expected profits would mean a reduction in proceeds from the sale (if we sell 100 per cent of the shares) of perhaps £80 million to £100 million;

ii. BA would have to acquire (subject to my being satisfied of the need) about £50 million worth of additional aircraft (probably two Tristar 500s) to operate their new routes (they may be able to lease these); and

iii. as a result of ii. BA's debt:equity ratio at the time of privatisation may be worsened; they may therefore have to retain more of the proceeds of sale.

I believe this to be a defensible compromise between forcing a larger transfer on BA, which would need legislation, and doing nothing to strengthen BCal. But it cannot be effected without the agreement of both.

11. I have told the Chairman of BCal (Sir Adam Thomson) that this offer is in my view a reasonable one, and that his board must either take it or leave it. I expect their answer shortly. The deal would be very valuable to BCal (the airline's pre-tax profit was £3.2 million in 1982-83), and they would be well placed to take advantage of additional dual designation opportunities that my Department may be able to secure for them. Though BCal should make profits in the longer run from more competitive opportunities, some capital investment and other start-up costs would be involved, and new operations would probably involve losses in early years.

12. It now seems more likely, however, that BCal will reject the offer, on the grounds that it would involve their giving up one of their routes in the south-east USA (Atlanta): they have invested heavily in it, and see it as a source of growing traffic and profit. If so I should have to give up the idea of route transfers and swaps to BCal's benefit; and I should have to give to BA BCal's new licence to fly to Riyadh. My discussions with BA and BCal have explored all conceivable options, and I am sure that further negotiations (except about minor details) would not find an agreed settlement, and would put the timetable for privatising BA severely at risk. Such a position on BCal's part should not deter us from early publication of our intentions to seek further liberalisation and more competition opportunities. But BCal's ability to take advantage of them would be limited, and we should be strongly criticised for having failed to strengthen the independent operators. Our defence against this is that we offered a deal which BCal rejected.

e. Predatory Pricing and Other Anti-competitive Practices

13. The CAA draw attention to the need to deal with anti-competitive behaviour (recommendations 9 and 10); and we must indeed have in place effective means of acting against this, so as to protect the smaller airlines against BA's dominant position. I have asked the CAA to pay particular attention to this, and am satisfied that they can act effectively within their present powers. Specifically -

- a. in the charter market, where anxiety is strongest now, the CAA would undertake to monitor prices, and act to limit capacity if any airline was growing too fast through predatory competition; I propose a new back-up role for the Office of Fair Trading (OFT) here;
- b. even after we have freed scheduled domestic services, the CAA would be able to consider charges of predatory behaviour and could if necessary raise unrealistic fares or cut the schedules of any airline found dumping capacity; the OFT already has a back-up role here, which could be further enhanced;
- c. in international services, the CAA can and does consider charges of predation wherever our international agreements allow

The Secretary of State for Trade and Industry agrees.

OTHER MATTERS

14. The CAA made recommendations in two other areas -
- i. Wider licensing powers. The CAA proposed (recommendation 9) "strengthening of its air transport licensing powers in order to promote the sound development of a competitive British airline industry". This proposal has found very little public support. I believe it to be both unnecessary and undesirable, and I propose to reject it.
- ii. Airports policy. The CAA proposed (recommendation 7) that I should "look again at the possibility of increasing available capacity at Heathrow and Gatwick". There is a strong case for a review of airports policy and I am pressing ahead with it; but I must await the report of the Inspector on the Stansted public inquiry and the results of consultation on the operation of the limit on air transport movements at Heathrow.

NEXT STEPS

15. Time is now short if we are to hit the target of privatisation early in 1985. We need very soon to begin positive action to get City investors used to an unfamiliar stock. The present uncertainty must first be dispelled. If colleagues can now agree to my proposals and to my announcing them in a White Paper immediately, I believe that, unless there are unforeseen developments - and subject to problems arising from Laker - we can still meet the timetable. At Annex D I attach a draft of the proposed White Paper.

CONCLUSION

16. I accordingly invite my colleagues -
- a. to endorse the response to the CAA report set out in paragraphs 5-12 above; and

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b. to agree to immediate release of the White Paper at Annex D (this is drafted on the assumption that BCal accept the route swap with BA outlined in paragraph 9 and Annex B; if they do not, some amendments will be needed and I shall circulate a revised draft).

NR

Department of Transport

1 October 1984

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SUMMARY OF MAIN CONCLUSIONS AND RECOMMENDATIONS

- (1) There should be some reduction in the relative size of British Airways so that other airlines have adequate opportunity to develop and prosper including at least one airline fit to replace British Airways on any major intercontinental route should the need arise. Additional competition by British airlines on intercontinental routes should be licensed wherever possible (paragraphs 4-14, 25 and 46).
- (2) Specified intercontinental routes should be transferred from British Airways at Heathrow to British Caledonian at Gatwick (paragraph 49).
- (3) The Authority, acting within existing policies and powers, will seek to increase the range and market penetration of European scheduled services from Gatwick (paragraphs 56-57).
- (4) British Airways' scheduled service routes from Gatwick should be taken over by other British airlines (paragraphs 56-58).
- (5) British Airways' European routes from provincial airports should be taken over by other British airlines (paragraph 63).
- (6) The Government should take specific powers to give effect to the reallocation of routes in recommendations (2), (4) and (5) above. These powers should then lapse (paragraph 90).
- (7) The Government should look again at the possibility of increasing available capacity at Heathrow and Gatwick (paragraphs 26-38).
- (8) Provision should be made for access to Heathrow for competing services on those of British Airways' domestic trunk routes where direct competition does not already exist, if necessary by reducing British Airways' frequencies (paragraph 66).
- (9) The Authority would favour a strengthening of its air transport licensing powers in order to promote the sound development of a competitive British airline industry and deal with anti-competitive behaviour (paragraph 88).
- (10) The Authority does not propose any immediate restriction on British Airways' or British Airtours' charter operations but, given a strengthening of its powers, will not hesitate to set a quantitative limit to their penetration of the holiday charter market if it is shown there is abuse of a dominant position (paragraphs 77-78).
- (11) The Authority proposes to introduce, on a two-year experimental basis, an area facility allowing airlines to serve any domestic route other than those specifically excluded (paragraph 93).
- (12) The Authority proposes to cease regulating domestic air fares but will still require fares to be filed with it so that it can intervene to prevent predatory or monopoly pricing. It will consult the Channel Islands and Isle of Man before extending the new arrangements to them (paragraphs 94-95).
- (13) The Authority has decided at least for the present not to amend the general exemption so as to allow the carriage of separate fare traffic on aircraft with ten or fewer seats on any route covered by the area facility (paragraph 96).
- (14) The Authority has updated its Statement of Policies so as to reflect those changes of emphasis that are within the scope of its present statutory powers and duties (paragraph 102).

Proposed route swap between

BA and BCal

BA would give up to BCal its routes to Jeddah and Dhahran in Saudi Arabia (12 services a week)

BCal would give up the following route rights to BA:-

- Atlanta (USA) (7 services a week)
- their south Atlantic route - ie Brazil and, when once more available, Buenos Aires and Santiago de Chile (2 services a week)
- their mid-Atlantic route - ie San Juan (Puerto Rico), Caracas (Venezuela) and Bogotá (Columbia) (one service a week)
- Morocco (not at present operated)

BCal would also undertake not to object to BA's applications to the CAA for licences to serve Orlando and Tampa (Florida).

BA would also be allowed to transfer back to Heathrow from Gatwick its services to Madrid, Barcelona and Lisbon, on condition that it ensured (by transfers of other services from Heathrow to Gatwick, as necessary) that the total package did not bring about any increase of movements at Heathrow.

EFFECT OF ROUTE SWAP ON BA'S AND BCal'S PROFITS

AS ASSESSED BY BA

(CMO)

	<u>Effect on</u> <u>BCal</u>	<u>Effect on</u> <u>BA</u>
	<u>£m</u>	<u>£m</u>
Saudi Arabia	+ 20	- 20 (1)
Atlanta	- 3	+ 1.5 (2)
Caracas & Bogotá	+ 1.5 (3)	+ 1.5 (4)
Brazil	- 1.5	+ 2
Interest on new capital investment		- 5
	<hr/>	<hr/>
	+ 17.0	- 20.0
Effect on interline traffic on removal of BA's main Iberian services from Gatwick to Heathrow	- 2 (5)	+ 3
	<hr/>	<hr/>
	+ 15.0	- 17.0
	<hr/>	<hr/>

Notes

- (1) Made up of
- | | |
|-----------------------|-------|
| lost route profit | 18.5 |
| lost interline profit | 1.5 |
| | <hr/> |
| | 20.0 |
| | <hr/> |
- (2) BA's revenue gain less than BCal's loss because BA would have to use less suitable equipment (Tristar 500 instead of DC10).
- (3) Loss eliminated.
- (4) BA would serve more economically than BCal by adding sectors once a week to their present Trinidad service.
- (5) BCal's latest figure.

CAP
26 September 1984

DRAFT AVIATION POLICY WHITE PAPER

Introduction

1. The Secretary of State for Transport asked the Civil Aviation Authority in December 1983 to conduct a review of airline competition policy. The Authority consulted widely and published its final report in July 1984. The report is a comprehensive and authoritative analysis of competition policy in an important and complex industry. This White Paper sets out the decisions which the Government has taken on the main issues discussed in the report, and the action it will now take.

2. Airlines are complex businesses, using advanced technology and sophisticated communications and marketing. But the only reason they exist is to carry people and goods. The pattern of services and the fares charged should be decided by the market. The best test of what people want is what they will pay for. Those airlines which provide the right service profitably at the lowest price should thrive. But they should be continuously open to challenge by competitors. The barriers to new services and airlines who can provide a safe and reliable service should be low.

3. Historically most sectors of air transport have been heavily regulated and protected by the State. That is still so in many overseas countries and the Government has to take account of that in its bilateral relations. Regulation is clearly needed in the case of safety where high standards must be mentioned; the case for regulating the commercial activities of airlines is much less clear. The Government will move as

far and fast as it can from a world of regulation to one where airlines compete for the customer's attention. In doing so, it will release the energies of an industry whose growth since the second world war has enriched the lives of many.

The Government's Objectives

4. The objectives of UK airline policy are therefore these:-

First to encourage a sound and competitive multi-airline industry with a variety of airlines of different characteristics serving the whole range of travellers' needs and strong enough to compete aggressively against foreign airlines;

Second to promote competition in all markets: internationally by working to reduce restrictions on services and by making it easier for new airlines to enter the market; and domestically by cutting out controls on new services, and on fares and capacity;

Third to ensure adequate safeguards against anti-competitive or predatory behaviour by airlines, to protect the long term interest of the public through the maintenance of a competitive industry;

Fourth to put the ownership of British Airways into the hands of private investors, including its employees, so as to remove from it both the restrictions and the protection of state ownership;

Fifth to maintain high standards of safety.

5. The Edwards Committee report⁽¹⁾ of 1969 set the pattern for Britain's airline industry over the last decade. The Committee supported the development of a competitive multi-airline industry as the best way to meet consumer needs. Its conclusions are as valid today, as demand has grown and become more varied. There is now a wide range of efficient aircraft, large and small, with which airlines of all sizes can offer services to meet demand of all kinds.

6. The benefits of competition are evident. In the charter market holidaymakers have benefited enormously from the liberal licensing regime within Europe. So too have British independent airlines who have risen to the challenge and now have a major presence in the charter field. Since 1979 the Government has encouraged competition on domestic services as a deliberate act of policy. Travellers on the trunk routes from Heathrow to Scotland and Belfast can testify to the improvement in the quality of service compared with the days when there was only one carrier. Nor can anyone doubt the effects of competition on overseas routes to places like Hong Kong, New York and Los Angeles. In the United States, domestic deregulation has generally benefited the traveller by forcing improvements in the efficiency of airlines previously protected by regulation from the winds of competition.

(1) British Air Transport in the Seventies: Report of the Committee of Inquiry into Civil Air Transport, Cmnd 4018.

Building competition

7. Over the last five years, the Government has taken a number of initiatives to build up competition between British airlines themselves and with foreign airlines. The Civil Aviation Act 1980 was a major step. The interests of users are now given equal weight to those of the airlines when services are licensed. Simple though it was, that change to the legislation has produced significant results. It led directly to the opening up of the domestic market and was a further step towards competition on international routes.

8. But before additional carriers can come in to provide competitive services, there must be sufficient opportunity. This does not yet exist everywhere. On some routes for example, both domestic and international demand is probably too low at present to support more than one British carrier; although this does not mean the entrenched positions of inefficient operators will be preserved. Internationally, overseas governments have to be persuaded that they do a disservice to the traveller by insisting on highly protectionist regimes. The long term goal must be to liberalise services wherever possible - where foreign competition is fair and Britain's interests are not prejudiced.

9. Some overseas markets are already fairly open, notably the United States. The European Community offers the best chance for further liberalisation. The Regional Air Services Directive of 1983 was a very limited step in the right direction, allowing smaller airlines more freedom to mount services between the regional airports in the Community.

The Government has welcomed the European Commission's Second Memorandum on a Community Air Transport Policy which should provide the basis for worthwhile liberalisation, though it does not go far enough. The Government is seeking to persuade other member states that the Community should rapidly move to a liberal aviation market.

10. At the same time the Government is seeking to negotiate more liberal bilateral regimes with other member states. The new arrangements agreed with the Netherlands allow any British or Dutch airline supported by its Government to mount new services between the two countries at whatever capacity it thinks appropriate and to charge any fares approved by the country in which the traffic originates. The Government believes other member states will also come to recognise the need for liberalisation.

The Civil Aviation Authority's Review

11. The Government plans to privatise British Airways early in 1985. It has a dominant position in the industry, because of its size and its operating base at Heathrow, the world's busiest international airport. But over the last ten years, the other British airlines have accounted for a growing share of the industry's available output, though their networks of scheduled services include many routes which British Airways has vacated, or are ones in which its interest is marginal. British Airways has in recent years made substantial improvements in its efficiency and financial performance. The independent airlines fear that a more efficient and more competitive British Airways could overwhelm them. These fears would need to be recognised even if British Airways were to remain in the public sector.

12. The Government is concerned to establish as free a market as possible in civil air transport but one in which a multi-airline industry can survive and prosper. It is no part of Government policy to protect the inefficient. But all Britain's airlines have a right to expect a market which is not only competitive - and one in which competition is fair - but also allows them to operate in a stable regulatory environment. It was to meet those concerns that the Secretary of State for Transport asked the Civil Aviation Authority to review the implications of privatising British Airways for competition and the sound development of the industry. The Government is grateful both to the Authority for its detailed and thorough work and to the many interests, airlines and others, who contributed their ideas during the Authority's consultations.

13. The main conclusions and recommendations of the Authority's report were:

(1) There should be some reduction in the relative size of British Airways so that other airlines have adequate opportunity to develop and prosper including at least one airline fit to replace British Airways on any major intercontinental route should the need arise. Additional competition by British airlines on intercontinental routes should be licensed wherever possible.

(2) Intercontinental routes to Saudi Arabia and Harare should be transferred from British Airways at Heathrow to British Caledonian at Gatwick.

- (3) The Authority, acting within existing policies and powers, will seek to increase the range and market penetration of European scheduled services from Gatwick.
- (4) British Airways' scheduled service routes from Gatwick should be taken over by other British airlines.
- (5) British Airways' European routes from provincial airports should be taken over by other British airlines.
- (6) The Government should take specific powers to give effect to the reallocation of routes in recommendations (2), (4) and (5) above. These powers should then lapse.
- (7) The Government should look again at the possibility of increasing available capacity at Heathrow and Gatwick.
- (8) Provision should be made for access to Heathrow for competing services on those of British Airways' domestic trunk routes where direct competition does not already exist, if necessary by reducing British Airways' frequencies.

- (9) The Authority would favour a strengthening of its air transport licensing powers in order to promote the sound development of a competitive British airline industry and deal with anti-competitive behaviour.
- (10) The Authority does not propose any immediate restriction on British Airways' or British Airtours' charter operations but, given a strengthening of its powers, will not hesitate to set a quantitative limit to their penetration of the holiday charter market if it is shown there is abuse of a dominant position.
- (11) The Authority proposes to introduce, on a two-year experimental basis, an area facility allowing airlines to serve any domestic route other than those specifically excluded.
- (12) The Authority proposes to cease regulating domestic air fares but will still require fares to be filed with it so that it can intervene to prevent predatory or monopoly pricing. It will consult the Channel Islands and Isle of Man before extending the new arrangements to them.

The Government's response

14. Decisions on the Authority's report are now required. There has inevitably been uncertainty in the industry about the outcome of the review. Airlines have found it difficult to plan for the future and their employees have not unnaturally been anxious. Uncertainties affecting the privatisation of British Airways must be resolved.

British Airways

15. The Government has decided that there will be no forced reduction in British Airways' size relative to the rest of the industry. The independents have grown despite British Airways and should continue to be able to grow, given fair competition, provided sufficient opportunities are available to them and provided they have the resources to take advantage of those opportunities. If these conditions can be met, the independents will be able to grow so as to reduce further the imbalance in the industry.

Competition on European Scheduled Services

16. As this White Paper has already explained, the best prospects for introducing extra competition lie in the short haul routes to continental Europe. Traffic on many of these routes is sufficient to support competing British airlines. It is a major objective to obtain dual designations both bilaterally and as part of the liberalisation of aviation in the European Community.

17. Competition would develop mainly, but not exclusively, between British Airways at Heathrow and British Caledonian at Gatwick. That would

be desirable not only because of its direct benefits but also to help the development of Gatwick as a major centre of international operations. Gatwick has developed rapidly as a major hub airport for London over the last seven years, and now offers a wide range of services. Its development as a major airport will be encouraged further by the strengthening of British Caledonian and by the imposition, from the end of 1985, of a limit of 275,000 air traffic movements at Heathrow. The Government therefore welcomes the Authority's intention to seek, through its licensing decisions, to increase the range and penetration of European scheduled services from Gatwick.

18. The Government considers that the development of Gatwick will be helped if British Airways continues to operate scheduled services there. Removing Britain's largest airline would only diminish Gatwick's stature, curtail competition and prevent British Airways from offering direct services to some points in the USA. The Government is not therefore able to accept the Authority's recommendation that British Airways' scheduled services at Gatwick should be transferred to other airlines. It hopes instead that British Airways will further develop its Gatwick services despite the penalty it suffers from splitting its London-based operations between two airports. [In order to reduce the penalty, the Government is prepared to allow British Airways to move its scheduled services to Madrid, Barcelona and Lisbon from Gatwick to Heathrow on condition that sufficient of its other scheduled services are moved from Heathrow to Gatwick to ensure no net increase in the level of British Airways' air transport movements at Heathrow.]

19. The Authority recommended that British Airways' regional routes to Europe should be compulsorily transferred to other airlines. The main arguments for this are that the smaller independent operators should be given greater opportunities than they now have; that they could develop such services more single-mindedly than British Airways; and that such transfers would be a way of reducing British Airways' relative size without weakening its Heathrow network. British Airways is the major provider of services to Europe from Britain's regional airports, principally from Manchester and Birmingham. Apart from British Caledonian, which now only operates European services from Gatwick, the independent airlines also have a growing role. They have developed routes from a number of airports either on their own initiative or following British Airways' withdrawal from routes. The Government has received strong representations from local authorities and other interests that British Airways should retain its regional presence.

20. On balance, the Government has decided not to accept the Authority's recommendation. A transfer of routes would not in itself increase competition, and there is a risk that without the major airline operating from Manchester and Birmingham both airports would become less attractive. British Airways and the independent airlines should instead compete in the regions. It is open to the independents to challenge British Airways by seeking to replace it on routes if it serves them inadequately, to compete with it on those routes or to develop completely new routes. The smaller airlines may be much better able than BA to operate these routes economically and effectively. But inevitably there are costs in developing both new routes and routes in competition with a large

established airline. British Airways has offered to help the independents by making available to any airline [other than BCal] up to £450,000 per route spread over 3 years to meet some of the development costs and to help them with supporting services. The offer is confined to a maximum of 15 routes supporting services. The offer is confined to a maximum of 15 routes from the 6 regional airports at which British Airways currently operates, whether they are completely new routes or routes on which British Airways itself flies. The Government now looks to British Airways to carry forward its proposals in discussion with any interested airlines who obtain the necessary licences from the Authority.

Intercontinental Scheduled Services

21. In British Airways and British Caledonian the UK has the advantage, exceptional outside the United States, of two airlines capable of operating a network of long haul, intercontinental services. The Government will take all appropriate opportunities to negotiate with the other Governments concerned dual designations and opportunities for less direct competition (such as designating two British carriers on routes to different points in the same country). But, for the reasons explained earlier in this White Paper, progress on terms acceptable to the UK is likely to be slow.

22. The Civil Aviation Authority proposed then the Government should take new statutory powers to transfer certain solidly profitable intercontinental routes from British Airways to British Caledonian. The aim would be to strengthen the latter as a potential competitor, direct or indirect; and to make it better able to replace British Airways on a

major international route, should the need arise. While the Government agrees generally with these objectives, it considers that the Authority's proposals for compulsory route transfers would be excessively disruptive to British Airways and went further than necessary to enable British Caledonian to take advantage of new competitive opportunities likely to be available. Instead of compulsory transfers, the Government favours a reciprocal arrangement to strengthen BCal financially, under which each airline would withdraw from routes which the other might then take up.

23. The two airlines have agreed to such an arrangement. British Airways has agreed to withdraw from Jeddah and Dhahran in Saudi Arabia. The Government is ready, subject to the licensing processes, to designate British Caledonian as a British carrier in place of British Airways on these routes and to negotiate with the Saudi authorities to obtain rights for it to serve Riyadh. For its part, British Caledonian proposes to withdraw from Atlanta in the USA and from its South American routes. It will surrender its licences to Morocco, which it currently does not use. In addition, British Caledonian will not oppose British Airways' licence applications to serve Orlando and Tampa in the USA. The Government is ready, again subject to the licensing processes, to designate British Airways under the relevant Air Services Agreements. It will now be for the airlines to apply to the Civil Aviation Authority in the usual way for the licences they require. The effect of these transfers would be to strengthen British Caledonian with increased annual profits estimated at around £15m. The reduction in British Airways' profits would be of the same order.

24. Inevitably, an exchange on these lines would mean that the Exchequer and the taxpayer would receive less on the privatisation of British Airways than would otherwise be the case, other things being equal. But the Government considers that some reduction in the proceeds of sale is justified by the benefit to the consumer from strengthening British Caledonian as a competitor to British Airways on international routes, and the benefit to the economy of keener and more efficient competition with foreign carriers. This agreement should prove of advantage to both airlines, and should avoid undue disruption for their networks and the staff concerned. The Government looks to both airlines to smooth the transition, so far as possible, for the travelling public and for the staff concerned.

25. Though an exchange on these lines would not in itself increase direct competition, it will place British Caledonian in a strong position to take advantage of the further opportunities for dual designation of British airlines on European and long haul routes which the Government is committed to seek. But competition need not be solely between British Airways and British Caledonian. The Government welcomes too the emergence on suitable routes of specialist carriers who can provide an extra challenge to the established airlines.

Domestic Services

26. The United Kingdom is the only significant market in which there is the freedom to liberalise air transport without the constraints imposed by agreements with other countries. This White Paper has already pointed to the benefits of competition on domestic services and for that reason the Government strongly endorses the Authority's proposal to introduce, initially as an experiment for two years, an area licensing facility allowing airlines to fly, subject to certain exceptions, between any two points in the UK. This will be an important step allowing our domestic airlines to develop services based on customer need. The Government also welcomes the Authority's proposal that domestic fares should no longer require specific approval.

Charters

27. Within Europe, the charter market is already virtually a free market in which airlines can compete unhampered by Government regulation. Despite the concern expressed by the charter airlines about the impact a privatised British Airways could have on their activities, the Government is reluctant to initiate measures which directly restrict the present level of competition. The Government therefore agrees with the Authority that to ban British Airways from whole plane charters, or to require British Airtours to be disbanded or sold separately would not benefit competition or the consumer. In the Government's view abuse by any airline of a dominant position in the charter market is best dealt with by specific safeguards against anti-competitive behaviour. Provided the safeguards are effective, the Government believes there is no need to single out charters for special treatment.

Safeguards against anti-competitive behaviour

28. Civil Aviation Authority's report drew attention to the need to deal with anti-competitive behaviour. The Government agrees that it is essential the Authority is able to do this. The Authority will remain the main regulator of the civil air transport industry and therefore the principal bulwark against airlines acting in a predatory fashion towards their competitors. However, the Government is satisfied the Authority already has sufficient powers to act against anti-competitive and predatory behaviour in the industry. Through the licensing system, the Authority can attach appropriate conditions to an air transport licence in the interests of users. It can refuse lower prices to an airline where they can be shown to be predatory; increase prices which are being frozen, regardless of rising costs, with predatory intent; and cut back capacity and frequencies designed to force out rival airlines. The Government is asking the Authority to use its powers accordingly.

29. Although the Government regards the Authority as the primary instrument for acting against anti-competitive behaviour, the Director General of Fair Trading also has a back up role. The Government intends to expand this and to bring civil aviation more into the mainstream of the competition rules as they apply to industry generally. Under the Competition Act 1980, the Director General can already investigate and seek to remedy anti-competitive conduct in domestic air services. Under the Fair Trading Act 1973 the Director General can refer monopoly questions to the Monopolies and Mergers Commission, subject to the

Secretary of State for Trade and Industry's veto, with a few exceptions including civil aviation. The Government proposes to give him the power to investigate charters under the Competition Act 1980 and to refer monopoly questions concerning both charter and domestic services to the Monopolies and Mergers Commission under the Fair Trading Act. He will have no such powers in relation to international scheduled services but the Government will retain its present powers to refer any aspect of civil aviation, including international scheduled services, to the Commission. The Government will lay the necessary Statutory Instruments before Parliament to extend the Director General's powers. The Director General will then be able to give more substantial support to the Authority in its role as the first line of defence against anti-competitive behaviour.

The air transport licensing system

30. Where the other governments concerned choose to favour their state airlines by subsidising them or restricting competition it will be impossible to liberalise international scheduled services. Nor will it be possible to deregulate domestic services completely given that there cannot be free access to all the UK's airports. The Civil Aviation Authority will need to continue regulating entry to many of the routes airlines wish to fly.

31. The Authorities favour a strengthening of the powers and duties in order to provide the sound development of the industry. The present statutory framework has, however, proved sufficiently flexible and adaptable to allow the competitive development of airline services and will in the Government's view be sufficient to implement the policies in this White Paper. After very careful consideration the Government has concluded it is neither necessary or desirable for the Authorities to be given a duty to promote the sound development of a competitive British airline industry.

32. As this White Paper has made clear, the Government believes it is in the consumer's interest to ensure there are a number of efficient and profitable British airlines strong enough to compete with each other directly or indirectly where the opportunity occurs, irrespective of whether there is a competing foreign airline. It will not be possible to secure direct competition between British airlines on every route. Even then, the Government considers the existence of a British airline indirectly competing on other routes, and able to take over a particular route if the airline operating it should withdraw, is a spur to efficient service and

a market-orientated approach by the incumbent airline. In the Government's view, the Authority can generally achieve all this through the licensing system with its present powers.

33. Appeals from a licensing decision by the Authority are determined by the Secretary of State for Transport. Although he must recognise that the Authority has primary responsibility for licensing decisions, he will consider each case referred to him in this way on its merits. Before directing the Authority to reverse or vary any of its decisions, he is bound by the Civil Aviation Act 1982 to have particular regard to the Authority's own statutory duties. Nevertheless, he may form his own judgement on the merits of the issues facing the Authority in the light of his own responsibilities and against the background of this White Paper. He will not lightly substitute his own judgement for that of the Authority, but the Secretary of State is free to do so where, consistently with the statute, there is in his opinion a substantial reason for directing the Authority to reverse or vary any of its decisions.

Airports policy

34. The Civil Aviation Authority recommended that the Government review its airports policy, particularly in order to give airlines more opportunities of using Heathrow for domestic services. The Government has reaffirmed the intention announced by its predecessors to impose an annual limit for environmental reasons on air transport movements at Heathrow, when Terminal 4 comes into operation next year. Consultation is at present in progress about the way in which that limit will be administered, and the Government will take careful account of the Authority's views in deciding that question.

35. The longer term provision of airport capacity in the London area will depend on the report of the planning inquiry into the applications to develop Stansted or alternatively a fifth terminal at Heathrow. The Inspector's report is still awaited. Until the Government has had an opportunity to consider it, it cannot make any changes in the present policy for the London area airports.

CONCLUSION

36. This White Paper marks out the the way ahead for the air transport industry. It provides a stable framework for the foreseeable future. Within it, Britain's airlines can and must take advantage of present and emerging opportunities to compete on fair terms. Only competition will ensure a flow of innovative ideas, and new management and marketing methods which is essential for Britain's airlines to keep their place in the world, and serve the traveller well.