



# International air transportation and economic development

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## Abstract

Legislation in 1977 and 1978 effectively deregulated the US domestic air cargo and air passenger transportation industries. International air transportation, largely as the result of the 'Open Skies' initiative from 1979 has also gradually been liberalized but progress has been geographically and temporally uneven. This study is concerned with extending the Open Skies concept and in accessing the benefits to the US economy of removing the remaining impediments to the provision of free market services involving, in particular, the full transatlantic market. It initially reviews some of the previous work that has looked at links between industrial location and the quality of international air transportation. It develops a modeling framework to examine the implications of further liberalization on the economies of US regions that currently have limited international services. The work involves a macro-analysis of the impact of European international services for 41 Metropolitan Standard Areas. © 2000 Elsevier Science Ltd. All rights reserved.

## 1. Introduction

A major criterion for measuring the success of our air transportation system should be our ability to use air travel as a competitive advantage in a global economy. The ability of Americans to transport their goods, services and themselves to markets wherever they exit should be an important goal of US public and foreign policy. (National Commission to Ensure a Strong Competitive Airline Industry, 1993)<sup>1</sup>

As exemplified by the above quote from the National Commission to Ensure a Strong Competitive Airline Industry, international air transportation is not only a major industry in its own right but more importantly it is of considerable significance as an input into a rapidly growing international and global economy.<sup>2</sup> International air transportation is an essential ingredient for

the success of tourism in many countries and regions. It is also an important input into the successful development of many, non-leisure-based industries where interpersonal communications are important. It is not only passenger air transportation that is vital to many of these latter industries. Many such firms also rely on a range of air freight services to provide quality service to customers and to operate just-in-time production management.

World trade has historically been the subject of regulation and control by participants. Trade in international air transportation services has been no exception in this. Nations often wish to protect their own commercial air fleet for reasons of national security but the motivation has also frequently been one of economic protectionism. In recent years, there has been a movement away from this as blocks of nations, such as those in the European Union (Button et al., 1998),<sup>3</sup> have developed multilateral free markets between themselves. Further, the structure of bilateral agreements between countries governing the terms on which air services are traded have in many cases been liberalized. The US, with its Open Skies policy has been at the forefront of this latter trend. A number of barriers to free markets in air transportation, however, remain. One of these is the only partial removal of

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<sup>1</sup> At about the same time, but on the other side of the Atlantic, the European Union's, Comité des Sages for Air Transport (1995) was making similar pronouncements.

<sup>2</sup> The US Department of Transportation Office of Airline Information provides periodic assessments of the sector. The latest was in US Department of Transportation Office of Airline Information (1995).

<sup>3</sup> There have also been more limited attempts at liberalization within the APECC states and within South America.

institutional constraints to free trade in international air transportation. The US's Open Skies policy of the post-1979 era has, for example, led to considerably more openness in many international markets but controls still remain over significant parts of the global network.

This was recognized by the National Commission when it pointed to the existing bilateral system of air service agreements as being, "...no longer sound or sufficiently growth-orientated in the global trade environment". The issue extends beyond this, and simply negotiating more Open Skies agreements, although desirable in themselves, provide only part of the solution. For air transportation to be truly global and for the skies to be cleared of market impediments issues such as allowing full cabotage, the expansion of foreign ownership rights, and less restricted access to many airports still need to be addressed in many countries.

The aim of this paper is to examine some of the benefits that US air transport enjoys from having liberal international air transportation and, hence, the potential gains from further liberalization. It focuses on the economic benefits (largely in terms of employment generation) that communities can enjoy from having direct access to international air services. The airports at the core of the study are medium sized international airport although for comparative purposes it is also necessary to embrace some smaller and larger airports in the analysis. The essential hypothesis examined is that the introduction of international services can benefit the economy of an area, that there are accelerated benefits from having a wider range of international services but that these benefits of additional services are largely exhausted when the number of international destinations served becomes very large.

To make the work tractable, the study primarily concerns itself with North Atlantic services. This is because it is a large and important market and one where significant institutional constraints still remain. It is also an air transportation market that serves an important link between two major trading blocs, the European Union and the North American Free Trade Area. The empirical analysis looks at a range of US airports and makes use of a wide variety of data sources to normalize for factors other than air service availability that affect employment growth in any particular area. It concentrates on employment in industrial categories where there are location choices (e.g. not extractive industries) potentially influenced by the quality of local transportation services. It uses the shorthand term 'new economy' to describe these industries although in reality they embody a much wider range of industries than those considered at the cutting edge of the new economy. The analysis uses employment as the key economic variable of interest because it is a relatively robust and measurable indicator of a region's economic success. International services are defined largely in terms of European destinations served by di-

rect flights but other supplementary indicators will also be used, for example to indicate quality of service and network effects.

## 2. The international regulatory regime

The modern structure of international air transportation controls can be traced back to the failure in 1944 of the Allied powers at the Chicago Convention to reach an agreement on how the post-Second World War air transportation system should operate. The subsequent structure of bilateral agreements that emerged as the de facto institutional framework for international air transportation has taken time to change and to begin to meet the contemporary needs of industry and travelers.

At the 1944 Chicago meeting there were conflicting views on how the international market should be regulated. Discussion at the Convention was dominated by governments claiming absolute sovereignty over the airspace above their territories. Opinions ranged from having a single, global carrier under a single authority to a completely free, competitive market. The hope was that those signing would grant to all other signatories freedom of access to this airspace and to airports beneath them. To this end certain freedoms of the skies were identified.<sup>4</sup>

The convention also gave rise to a United Nations agency (the ICAO) that is largely concerned with safety, technical standards, the collection of statistical data, etc., rather than detailed economic regulation although it has become more involved in this in recent years. It did not make much progress on traffic rights because the commercially important third, fourth and fifth freedoms were not, with some minor exceptions, settled on the hoped for multilateral basis. Instead bilateral deals were brokered.

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<sup>4</sup> The 'Freedoms of the Skies' are:

- *1st freedom*: The right of an airline of one country to fly over the territory of another country without landing.
- *2nd freedom*: The right of an airline of one country to land in another country for non-traffic reasons, such as maintenance or refueling, while en route to another country.
- *3rd freedom*: The right of an airline of one country to carry traffic from its country of registry to another country.
- *4th freedom*: The right of an airline of one country to carry traffic from another country to its own country of registry.
- *5th freedom*: The right of an airline of one country to carry traffic between two countries outside of its own country of registry as long as the flight originates or terminates in its own country of registry.
- *6th freedom*: The right of an airline of one country to carry traffic between two foreign countries via its own country of registry. This is a combination of third and fourth freedoms.
- *7th freedom*: The right of an airline to operate stand-alone services entirely outside the territory of its home state, to carry traffic between two foreign states.
- *8th freedom*: The right of an airline to carry traffic between two points within the territory of a foreign state (cabotage).

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