

THE EVOLUTION OF REGULATION IN THE BRAZILIAN AIRLINE INDUSTRY: AN OVERVIEW OF THIRTY YEARS OF GOVERNMENTAL POLICY

Adalberto Febeliano

Associação Brasileira de Aviação Geral

Alessandro Vinícius Marques de Oliveira

Núcleo de Estudos em Competição e Regulação do Transporte Aéreo - NECTAR

Instituto Tecnológico de Aeronáutica

RESUMO

A presente Comunicação Técnica tem por objetivo efetuar uma breve descrição da evolução das políticas governamentais para o setor de transporte aéreo brasileiro nos últimos trinta anos. Como forma de sistematizar o estudo, é proposta uma divisão histórica composta por seis grandes períodos, desenvolvida sob a ótica das autoridades responsáveis pela indústria, e objetivando permitir uma maior compreensão das questões atuais da política regulatória. Os principais elementos de cada uma das divisões propostas são apontados e brevemente discutidos.

ABSTRACT

This paper aims at developing a brief description of the evolution of the governmental policy for the Brazilian air transport industry in the last thirty years. In order to permit a better synthesis, a historical division with six major stages is proposed, always considering the authorities' perspective, and with the objective of improving the understanding of the relevant issues associated with regulatory reform nowadays. The main elements of each proposed division are indicated and briefly discussed.

1. INTRODUCTION

Since the Brazilian government has sponsored the establishment of five regional airlines under the SITAR Program, approximately thirty years ago, the country's Air Transport Industry has seen many relevant regulatory policy changes, influencing both the domestic and the international markets. Alongside with the macroeconomic environment these policies have, to a large extent, driven the development of the Brazilian airlines, deeply affecting their performance and, ultimately, the entire market development.

This paper aims at addressing these changes, by proposing a historical representation of the evolution of the regulation of the Brazilian airline industry, in order to permit a better understanding of both the recent changes in the regulatory reform under the new government and the recurrent problems associated with the industry.

In order to accomplish that, here we make a proposal of six major stages of regulation since the early seventies, and the main elements of each historical division suggested are identified and briefly discussed.

2. A HISTORICAL PERSPECTIVE OF THE REGULATION IN THE BRAZILIAN AIRLINE INDUSTRY

The domestic air transportation in Brazil is a fast-growing industry. According to the regulator – the Department of Civil Aviation –, there were 26.7 billion passenger-kilometres flown in 2002 against 11.8 billion in 1992, representing a growth rate of approximately seven percent per year, a much higher rate than the country's overall economy. As with most airline industries around the world, Brazilian air transport is rather dependent on both domestic and international economic conditions on account of derived demand characteristics.

In fact this situation is even aggravated by the recurring exchange rate devaluations in the

country, which affect both the demand and the cost sides of the profit equation. Revenues suffer because Brazilians travel less internationally due to higher prices, and foreigners attracted by the country's lower prices tend to prefer their own national airlines, which normally can offer better conditions for touristic purchases.

On the cost side, aircraft lease, aircraft parts and other maintenance costs, and fuel prices increase sharply when the local currency loses its value, leading airlines into recurrent financial crises. Also, airlines face high taxation, with overall rates around thirteen percent, compared with 7.5% for North American and 9% for European airlines, and a much higher fuel tax (Airfinance Journal, 2000). All these factors are usually regarded as explanations for the fragile financial situation in which legacy carriers have been persistently involved.

Until recently, one of the most relevant characteristics of the Brazilian air transport industry was the gradual and continuous process of economic liberalisation that had been initiated in the early nineties by DAC, within a broader governmental program for deregulation of country's economy. Here we provide a synopsis of the path of the governmental policy for the sector by means of Table 1, which summarizes the evolution of the airline regulation in Brazil, considering six main periods in the last thirty years. For a more detailed discussion, see, for example, Tavares (1999), and Guimarães and Salgado (2003); for a discussion of the process of deregulation and its consequences in the United States, for example, see Levine (1987).

Table 1 - Evolution of Regulation in the Brazilian Airline Industry

Stage	1. Regulation with Industrial Policy	2. Regulation with Active Stabilisation Policy Controls	3. Liberalisation with Inactive Stabilisation Policy Controls	4. Liberalisation with Stabilisation Policy Constraint	5. Quasi-Deregulation	6. Re-Regulation
Period	1973-1986	1986-1992	1992-1997	1998-2001	2001-2002	2003-
Economic Policy in the Sector	Regulation	Present	Partially Removed: First Round of Liberalisation	Partially Removed: Second Round of Liberalisation	Removed	Partially Restored
	Macroeconomic Interference	Active	Possible, but not Active	Active	Absent	Absent
	Reference Price	Imposed by DAC	Imposed by DAC	Not imposed by DAC	Absent	Absent
	Price Increase Control	Present	Present, with stabilisation policy targeting	Present, but associated with industry's inflation	Present: mix of stabilisation policy targeting and industry's inflation	Absent
Fares	Registration	Absent	Absent	ex-ante: 48 hours of advance, and automatically approved if no answer by DAC	ex-ante: only in case of more than 65% discount	ex-post: only for monitoring purposes year and ex-ante from 2004 on
	Fare Bounds	Absent	Absent until 1988; [-25% ,+10%] in 1989; [-50%,+32%], from 1990 on (only for discount fares);	Unbounded	Unbounded	Unbounded

Table 1 (Cont.) - Evolution of Regulation in the Brazilian Airline Industry

Stage	1. Regulation with Industrial Policy	2. Regulation with Active Stabilisation Policy Controls	3. Liberalisation with Inactive Stabilisation Policy Controls	4. Liberalisation with Stabilisation Policy Constraint	5. Quasi-Deregulation	6. Re-Regulation
Period	1973-1986	1986-1992	1992-1997	1998-2001	2001-2002	2003-
Entry	<i>New Firms</i>	Not allowed: "4 nationals & 5 regionals" policy	Not allowed: "4 nationals & 5 regionals" policy	Allowed, both in national and regional levels	Allowed	Allowed, but stimulus to increase in concentration
	<i>Regional Monopolies</i>	Present	Present	Absent, with the exception of SAP routes	Absent	Absent
Competition	<i>Authority's attitude</i>	Avoid	Avoid	Stimulate	Stimulate but with antitrust controls	Avoid overcompetition and excess capacity and antitrust controls
	<i>Among Nationals and Regionals</i>	Absent	Absent	Allowed, with the exception of SAP routes	No Distinction	No Distinction
Capacity and Infrastructure	<i>Frequency, Airways and Aircrafts</i>	Controlled based on load factors; requests needed ex-ante authorisations to CLA	Controlled based on load factors; requests needed ex-ante authorisations to CLA	Ex-ante authorisation (CLA); no economic control; priority to existing airlines	Ex-ante authorisation (COMCLAR); no economic control; simpler and faster process	Ex-ante authorisation; economic controls restored
	<i>Airports and Terminals</i>	State-owned enterprise; Infraero	State-owned enterprise; Infraero	State-owned enterprise; Infraero; equal access to airport facilities and terminals.	State-owned enterprise; Infraero; some congested airports causing problems of access and entry.	State-owned enterprise; Infraero; codeshare TAM-VRG claimed to inhibit equal access to facilities.

The most representative stage of the regulatory period was from 1973 to 1986, where regulation was performed along with mechanisms of development policy (**1. Regulation with Industrial Policy**). In fact, the government accomplished a framework of "four national airlines and five regional airlines" (including the SITAR Program) in order to both regulate and promote industry's development, in a policy completely enacted by 1976. Prices were fixed by authorities, entry was banned, and the country was divided into five main monopolies for regional airlines. Besides that, competition between regionals and national (trunk) airlines was virtually absent.

From 1986 to 1992, the government started being more intrusive in terms of macroeconomic interference in the industry, especially with respect to inflation stabilisation targeting (**2. Regulation with Active Stabilisation Controls**). This policy was remarkable in terms of interfering in the pricing of all infrastructure industries in the country and led to artificially low real fares, which airlines still claim have caused them great losses.

Liberalisation effectively started from 1992 on, although some measures of deregulation were already present since 1989 (fare bounds, for example). During this First Round of Liberalisation (**3. Liberalisation with Inactive Stabilisation Policy Controls**), regionals' monopolies were abolished, with exception to the airport-pairs linking city centres of four major cities – São Paulo (CGH), Rio de Janeiro (SDU), Belo Horizonte (PLU) and Brasília (BSB) –, called "special" airport-pairs, SAP. Furthermore, the policy of "four nationals & five regionals" was abolished, and newcomer's entry was stimulated by the regulator, which has led to a tide of new small airlines into the market.

Also, there were now reference prices and bounds from -50% to +32% of the main value, in substitution of price fixation, and price competition was seen as "healthy" for the industry, and was encouraged; fare bounds were conceived only as temporary instruments for enhancing price rivalry. This can be regarded as a period of inactive stabilisation policy control, as there was no need for the macroeconomic authorities to interfere in the market and lower instability in the costs side, as –exchange rates were stable during most of the period.

In the late nineties the aviation authorities decided to remove two relevant regulatory devices still remaining: the fare bounds and the exclusivity of rights for operating SAPs by regionals. This generated the Second Round of Liberalisation (enacted in Dec/97-Jan/98), which triggered much strategic interaction by airlines, with intense price and frequency competition. For a description of the resulting price wars of this period, see Oliveira (2002).

Another relevant characteristic of the period was the strong instability of exchange rates, especially the high devaluation of January 1999, which represented a major increase in all airlines' operational costs. As the pressures for price increase throughout the economy were strong, macroeconomic authorities (Ministério da Fazenda, MF) started interfering in the industry again (**4. Liberalisation with Stabilisation Policy Constraint**). This has represented a relevant constraint to the airlines' strategies, as they could not increase prices as desired, but instead had to wait for previous authorizations from both the DAC and the MF. Besides that, antitrust authorities were now closely monitoring the market.

In 2001, most of the remaining economic regulation was removed, as well as the macroeconomic interference. All airlines could then set their prices freely – a "quasi-deregulation" period, as entry, price and frequencies were also almost entirely liberalised (**5.**

Quasi-Deregulation).

Finally, in 2003, Brazilian aviation authorities, following directives of the new federal government, started implementing some procedures of re-regulation, aiming at controlling an alleged excess capacity and over-competition in the market (**6. Re-regulation**). New aircrafts imports were banned, price competition controls were put in practice once again, and strategic movements increasing market concentration, such as the code-share agreement between the two major airlines, Varig and Tam, were neither disallowed nor discouraged.

3. CONCLUSIONS

The main purpose of this paper was to propose a representation of the evolution of the regulation of the Brazilian airline industry for the past thirty years, by making use of six major stages. Such description can be certainly regarded as useful in permitting analysing the recent disruption in the liberalisation process, in which the industry was involved since early nineties, as well as in pinpointing the sources of the recurrent crises usually associated with this relevant industry.

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