

State of the Industry
By Abdul Wahab Teffaha, Secretary General
AACO's 39th AGM

**Mr. President,
Your Excellencies,**

Please allow me first to extend my deep gratitude to your good self, Chairman and members of Executive Committee, CEOs of our member airlines and assistants and to our Industry Partners and sister International and Regional Associations for their support and patronage of AACO's work. I would like also to start by thanking the distinguished speakers and panelists who will enrich this event by their contributions today.

**Mr. President,
Honorable Delegates,
Ladies and Gentlemen,**

We return after 26 years of our last AGM to Kuwait, with an Arab air transport industry that has grown several folds over what it was in 1980, much higher than the average global growth. On the other hand, we return with the same unstable regional environment adversely affecting this industry.

It is true that the Arab air transport industry, in terms of number of passenger-kilometers, freight, fleet, or network is about four times what it was when we last met in Kuwait in September 1980. However, the crises headers are still unchanged: the Israeli occupation of Palestine, the Arab-Israeli conflict which witnessed in 2006 a wide scale attack on Lebanon, the situation in Iraq, terrorism, and other flash points. In spite of all this, 2005 and 2006 have seen growth higher than anywhere else in the world. This growth ascertains the ability of the industry in the Arab world to adjust to the unstable environment, and to mitigate effects to the extent that it was able to grow its global relative size from about 2% in 1980, to about 8% of the industry in 2006.

The annual report of AACO with you today is full of information and figures which shed light on the Arab air transport industry over the last few years, including estimates for the year 2006, in addition to AACO's work last year. But I want in this speech to focus on some of the issues addressed in the context of the report that serve the strategic direction approved by the AACO's General Meetings, and followed up by the Executive Committee.

The key issues facing the Arab air transport industry are the following:

- Air Transport Liberalization
- Ownership and Control
- Alliances and Mergers
- Customer Relations Techniques & Methods
- Managing Costs

No doubt, the issues of air transport liberalization and market access continue to pose the greatest challenge facing the airlines around the world, especially in the Arab World. How stake-holders deal with this issue, forms the foundation of how airlines plan their future, the role they want to play, and identifying their competitive advantage against others. Let us agree at the outset that the concept of government protection of airlines through limiting capacity, setting prices, and frequency is coming to an end. The Arab world is heading in that direction. We may well agree that this issue is a matter of national policy, and that it is an integral part of the economic agenda of each state. The airlines' stance on this issue, through seeking the maximum possible benefits, is not a cause of wonder. In fact, all airlines around the world, including Europe and America, expect their governments to defend their interests. This is neither uncommon nor reprehensible. Otherwise, why carry out negotiations between parties with the longest history of liberalization, as is the case between the United States and the European Union. Both parties try to maximize the benefits of their own airlines and to incorporate such conditions within the framework of the promised agreement to liberalize skies. I intentionally wanted to point out that it is neither unusual nor wrong that governments defend the interests of their national airlines as major economic structures in their respective countries. Unfortunately, some Arab governments believe that the policy of liberalization of airspace through opening market for competition should be done regardless, and I repeat, regardless of the interests of their national airlines. This concept is a strange business practice which we should endeavor to correct with the Governments.

Air space liberalization and the liberalization of markets access is a must. The policy adopted by developed countries is to reform and restructure their national airlines through recapitalization, enacting laws that guarantee equal opportunities, consumer protection, prevention of capacity dumping, predatory pricing and, government operational subsidies. At that point, they open up the market for competition while still playing the role of the regulator in a manner that thwarts monopoly,

guarantees consumer protection, together with the shouldering by the government of social or strategic services costs that are required of their airlines.

In this area, I would like to refer to what is taking place by the European Union to seek amendment of the bilateral agreements between the European Union States and other countries, including the Arab States. I would like to emphasize here that despite the fact that the basis for this request is legal; the implications are undoubtedly economic. We have discussed, jointly with the Arab Civil Aviation Commission, with the European Commission and have drafted an agenda that leads to accepting the amendments provided that they are:

- Part of the process leading to an Arab-European agreement.
- They must not allow European airlines that belong to a country with no bilateral agreement with the concerned Arab state to benefit from traffic rights between that Arab country and other European countries, and
- Not to change the operational status except through a bilateral agreement between the Arab and European countries concerned, and
- Give the Arab country the right to appoint an Arab airline other than from the country in question to operate code-shares with the national airline to the European countries, and
- To implement the agreement with any Arab country that had already signed the amendment requested by the European Commission.

We at AACO call upon the Arab governments to adhere to these conditions in the event they sign bilaterally with the European Union countries - until the time when the European Commission obtains the necessary mandate on code-shares. We would like here also to extend our gratitude for the Council of Arab Transport Ministers who decided, by request of AACO, during its 19th session that was held in Cairo, to call on Arab states to support our current negotiations with the European Commission and to call on Arab states to adhere to the conditions of the agenda above if they hold bilateral negotiations with European countries. A recent debate in the European Union is calling for the limitation on the expansion of some Arab airlines in the European markets on the basis that they are subsidized by their governments. AACO, as a matter of principle, is with regulating government intervention, including financial support into a form of capitalization, but not financial support at the operational level. Nonetheless, we find these calls unbalanced, as they overlook the forms of indirect support awarded to some airlines in the

European Union, and in other regions, especially in the area of slots, priority terminals in airports, and sometimes limiting ground services providers in those terminals. We deem it necessary that in the event the issue of government support is brought to the table, then it must include all forms of direct or indirect support, and that it would be balanced and at the same level for all airlines in the world, including those protected under the bankruptcy laws, in order to look into all the issues that lead to unbalanced competitive opportunities.

On the Arab level, we believe that the progressive liberalization and multilateral agreement for liberalization of air transport are essential steps towards creating a single Arab aviation market, paving the way for the development of this market and raising the ratio of passengers to population from 1:3, as is currently the case to the ratio of 1:1 as is the case in Europe and the United States. AACO, which has always called for easing visa restrictions between the Arab countries as a step forward for the promotion of the travel, positively views the efforts of some Arab countries to move towards electronic visas and their speed of delivery, or the cancellation of some visa requirements which has significantly stimulated the market. It is useful in this area to invite Governments to consider the adoption of a uniform visa between all, or some of the Arab countries, along the lines of Schengen visa which would give added value to the Arab tourism market.

With the call on Arab governments to strengthen the growing inter-Arab tourism and the attractiveness of tourism of the Arab region, we believe it is essential that governments adopt a taxation and charges policy on air transport in adherence with the concept of the promotion of tourism. It is unreasonable to ask the air transport sector to increase the competition when taxes and charges on air transport and related services are the highest in the world. Despite the fact that the problem is global in nature, it is crucial in the Arab world that governments revisit these taxes and changes, especially on short sectors where the value of the taxes and duties is almost equivalent to the price of the ticket.

On the other hand, the government ownership and control of airlines is subject to significant challenges. Expanding the base of owners of the airline on one hand, and allowing airlines' access to the capital market instead of locking them in the debt market, are two prerequisites for the development of the air transport sector, and for placing that access under a framework of economic best practices. There is a movement in the Arab world in this direction, especially when the Arab capital is seeking investment areas outside the scope of real estate and banking. We are aware that the issue of airline privatization, its timing and extent of that process represent a key part of the national policy of each country. It

remains that the privatization of airlines and their complete submission to the market conditions should be looked into seriously and promptly.

Currently, three global alliances control over 60% of the global air transport. The adoption of European nationality of airlines in the European Union paves the way for airline consolidation in Europe, and to benefit from traffic rights of merged airlines without operational limitations stemming from national ownership. Moreover, the pressure exerted by major airlines in the industry on their governments to liberalize the terms of ownership and control pushes the air transport industry towards the development of the formula of alliances into one of mergers or exchange of equity. Although we now see it at the European and the Latin American levels, having seen it before in the United States, it is not unlikely over the next few years to see an extension of mergers or exchange of equity across the Atlantic, with Asia, or between three continents. This puts a lot of Arab airlines into a tougher competitive stance. The small size of most of the Arab markets, in addition to the unresolved elements of ownership and future role, have limited the number of Arab airlines acceding to the alliances. In this regard, the initiative for the creation the "Arabesk," in conjunction with the moves towards the establishment of a single Arab air transport market, can significantly enhance the prospects of Arab airlines wishing to join an alliance. We also see the need to consider at the Arab level the adoption of what emulates the European right of establishment for Arab capital, thus opening the door for establishment and ownership of airlines in other Arab countries, and to consider such investment at par with national investment, as is the situation in Europe. It is useful also that the development of the Arab agreement for the Multilateral Liberalization of Airspace in the medium and long term future to include issues such as the right of establishment in the countries that have acceded to the Agreement. The whole air transport industry had demanded governments, through IATA, to ease conditions of foreign ownership and control. Additionally, ICAO stressed during the fifth air transport convention over the need to head in this direction. The Arab air transport industry as a whole cannot continue as an island isolated from what is happening in the global air transport industry in terms of ownership and consolidation. It is because states can ensure strategic and national dimensions in airlines through the laws governing the privatization, we believe that the issue of Arab right of establishment will also open the door, on the medium and long term, for mergers and consolidation between Arab airlines that can reach the volume which ensures a good competitive global standing.

With the launch of market forces, liberalizing of market access, and expanding the use of regional airports via direct international flights, it is only natural that the region should witness in the future, the expansion of

the low-cost carrier business model. This model has been limited so far to Air Arabia, Jazeera Airways, and Atlas in Morocco. With the expansion of this model, the pressure on the traditional business model, especially on short hauls, will grow more and more. The business model of low-cost airlines has been creative in devising new ways to deal with the consumer using new techniques and lesser costs. Although the network airlines could not clone the same operational model, those airlines should learn from LCCS the innovative mechanisms produced by them.

Dealing with the consumer during the communications and internet revolution has taken on new dimensions, and the arising market transparency has awarded the consumers absolute control over their purchasing options. This role has been traditionally played by travel agents who constituted approximately 85% of the channels of distribution between the airlines and consumers. The air transport industry is moving toward the adoption of new techniques that enable it to manage its dealings with the consumer, and to structure product prices so as to enable the consumers to issue their tickets and boarding passes. It is also moving towards diversifying channels of distribution to the consumer, unconfined by the travel agents and the GDSs.

On the operational level, there is no doubt that the challenge of changing the ways of dealing with customers, and the adoption of new mechanisms to enable the Arab airlines to follow industry trends, and reduce distribution costs at the same time. This issue is a priority in the work of AACO. The current technology used in the reservation, inventory and departure control systems, does not enable Arab airlines to manage the relationship with customers in an optimal manner. We are talking here about the competitive position and not only about information technology systems. These systems would enable the airline to change its ways of distribution in order to compete at par with other airlines.

Thus, the empowerment of Arab Airlines with the use of the technologies used by the major airlines to offer its product to the consumer, sales of seats, the issuance of the tickets, and boarding passes is the adoption of the best practices in the industry. This will also ensure that the Arab airlines product's transparency remains at par with the competitors products that are using this technology as well.

Distribution costs are still high among Arab airlines because of their continued reliance on traditional channels; 18% of our total costs are incurred or issuing tickets and boarding passes. This ratio can be reduced to around 10%, leading to savings of a billion dollars annually to the member airlines. We were working to adopt to what is being done by the air transport industry, to replace the travel agency commission by a service charge paid by the customer, and to focus on the techniques of direct sales and to reduce costs of distribution systems, this objective is

achievable. AACO, is working on those issues, and on negotiations with reservation and distribution systems for that purpose. This knowing that the Arab airlines currently incur much lower costs than other airlines where global distribution systems are concerned by virtue of the collective distribution agreements that have been negotiated under AACO.

AACO has been working on a number of other fronts. On the issue of strengthening the competitive position of the airlines, AACO has concluded the only agreement of its kind in the world to analyze MIDT collectively. On the level of bringing down costs, the Joint Fuel Purchasing Program continues to bring down the fuel bill of Arab airlines by no less than US\$ 20 million at every tender. In 2007, this project will encompass 17 member airlines covering 500 stations. The Ground Services Project continues to contribute to savings. The Regional Training Center has successfully trained more than 10 thousand trainees during the ten years of its existence. With the expansion of the Center's work in 2007, the center will assist members in the implementation of the ICAO program to master the English language, which will become requirement as of 2008. AACO has also supported the IOSA program whereby a decision has been adopted by the Arab Civil Aviation Council "ACAC" upon the suggestion of AACO, calling on member states to require the IOSA certificate as a prerequisite for operations from and to Arab countries. This in addition to the distribution contracts with the Global Distribution Systems that contribute to reducing the costs by around US\$ 110 million annually.

No doubt that the greatest challenge that is facing the Arab air transport industry is the operations in an environment that has most of the conflict zones in the world these days. The instability of the surrounding region also represents pressure factors on the Arab airlines and factors of insecurity to their future plans. The success that is being achieved by the Arab airlines is a testimony of the efficiency and commitment of their leaders and constituents and the customers embrace and appreciation for their highly valued services.

Although it was our fate to deal with an unstable environment, we are nonetheless proud that Arab airlines stand at such high professional competitiveness. May Peace and God's Mercy and Blessings be on you.