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Low Cost Carriers, Economies of Flows and Regional Externalities

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ABSTRACT

The emergence of low cost carriers, following air travel reregulation in Europe, has major implications for individual firms and regional economies. Understanding regions as 'economies of flows', this paper explores, largely conceptually, how uneven, fluctuating and fragmentary changes in air travel and connectivity, resulting from the activities of low cost carriers, have had substantial impacts on flows of labour migrants, knowledge, business connectivity/investment, and mobile markets, especially tourism. The resulting modifications to institutions and regional externalities contribute to net changes in the transaction costs of individual firms, regional competitiveness, and the unfolding and increasingly interconnected map of uneven regional development in Europe.

Key Words: Air travel, Regulation, Externalities, Migration, Knowledge, Tourism

Transporteurs à faibles coûts, économies de flux et externalités régionales

Allan M Williams et Vladimir Baláž

RESUME

L'émergence des transporteurs à faibles coûts, après la rerégulation des voyages par avion en Europe, a des implications majeures sur les entreprises et les économies régionales. Assimilant les régions à des « économies de flux », les auteurs explorent, largement sur le plan des concepts, comment les changements irréguliers, fluctuants et fragmentaires qui affectent les transports aériens et les connexions, résultant des activités des transporteurs à faibles coûts, ont eu des conséquences substantielles sur les flux de travailleurs migrants, la connaissance, la connectivité/investissement dans les affaires et les marchés fluctuants, en particulier le tourisme. Les modifications qui en résultent pour les institutions et les externalités régionales contribuent aux changements en matière de coût des transactions des entreprises, de compétitivité régionale ainsi que de déploiement d'une carte de plus en plus interconnectée du développement régional irrégulier en Europe.

Mots-clés : Transport aérien, réglementation, externalités, migration, connaissance, tourisme

JEL : J60, K20, L93, N74

Billigfluggesellschaften, Ökonomien von Strömen und regionale Externalitäten

Allan M Williams and Vladimir Baláž

ABSTRACT

Das Entstehen der Billigfluggesellschaften nach der Neuregulierung des Flugverkehrs in Europa hat sich auf einzelne Firmen und regionale Wirtschaften nachhaltig ausgewirkt. Ausgehend von einer Auffassung der Regionen als 'Ökonomien von Strömen' wird in diesem Beitrag auf größtenteils konzeptueller Ebene untersucht, wie sich die ungleichmäßigen, fluktuierenden und fragmentären Veränderungen im Flugverkehr und in den Flugverbindungen aufgrund der Tätigkeiten der Billigfluggesellschaften erheblich auf die Ströme von Arbeitsmigranten, Wissen, Geschäftsverbindungen bzw. -investitionen und mobile Märkte (insbesondere Fremdenverkehr) ausgewirkt haben. Die sich daraus ergebenden Änderungen an den Institutionen und regionalen Externalitäten tragen zu Nettoveränderungen hinsichtlich der Transaktionskosten der einzelnen Firmen, der regionalen Wettbewerbsfähigkeit sowie der entstehenden und zunehmend zusammenhängenden Karte der ungleichmäßigen Regionalentwicklung in Europa bei.

Key Words:

Flugverkehr
Regulierung
Externalitäten
Migration
Wissen
Fremdenverkehr

JEL: J60, K20, L93, N74

Compañías aéreas de bajo coste, economías de flujos y efectos externos regionales

Allan M Williams and Vladimir Baláž**ABSTRACT**

La aparición de compañías aéreas de bajo coste tras la nueva regulación de los viajes en avión en Europa tiene repercusiones importantes para las empresas individuales y las economías regionales. Basándonos en una comprensión de las regiones como 'economías de flujos', en este artículo analizamos, en gran medida de un modo conceptual, cómo han repercutido significativamente los cambios desiguales, fluctuantes y fragmentarios de los viajes por avión y la conectividad debido a las actividades de las compañías aéreas de bajo coste, en los flujos de los inmigrantes laborales, conocimientos, conectividad/inversión comercial y los mercados móviles, especialmente el turismo. Las modificaciones resultantes para las instituciones y los efectos externos regionales contribuyen a los cambios netos en los costes de transacción de empresas individuales, la competitividad regional y la creación de un mapa cada vez más interconectado del desarrollo regional en Europa.

Key Words:

Viaje en avión
Regulación
Efectos externos
Migración
Conocimiento
Turismo

JEL: J60, K20, L93, N74

INTRODUCTION

A number of measures to liberalize – or, more precisely, to re-regulate – the supply of air travel in Europe since the 1980s have sought to increase competition, with the intention of realising lower prices and welfare gains for air travellers. These aims have been achieved, notably through the spectacular growth of new market entrants, the low cost carriers (LCCs), although there have also been significant innovations in legacy air carriers such as BA and Air France. By 2004, the LCCs accounted for 19% of all intra Western European air travel (DOBRUSZKES, 2005, p39). The outcome has been not only substantial increases in the volume and frequency of air travel but also new geographies of connectivity and accessibility. This paper explores, largely at the conceptual level but also drawing on fragmentary empirical evidence, the implications for uneven regional development in Europe.

The supply of air travel is increasingly recognized as a factor in regional economic development strategies. This is evident, for example, in the focus on airport development in the strategies of UK regional development agencies, notably the Route Development Fund of the Scottish Development Agency (CIVIL AVIATION AUTHORITIES, 2005, p xiv, 97). And, more specifically, BARBOT (2006, p198) emphasises that regional authorities, faced with excess capacity/high unemployment, and willing to subsidise air transport, make 'perfect partners' for LCCs seeking state subsidies to reduce operating costs. Ryanair have pursued this public-private partnership approach with particular enthusiasm, culminating in the landmark European Commission ruling that some subsidies at Charleroi airport were anti-competitive (BARBOT, 2006; FRANCIS *et al*, 2006, p88).

The causality between air transport services (whether by legacy carriers or LCCs) and regional economic development is blurred (GRAHAM, 2003). Does the supply of air services simply follow demand, or does the provision of such services shape and enhance regional

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2
3 economic development? Without doubt there is an association, expressed by Docherty
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5 (2004, p341) as: 'The most successful regions have class-leading transport and ICT
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7 infrastructure to move goods, services, information and people securely, quickly and
8
9 efficiently'. Moreover, he emphasises the *leading* role of air transport in some circumstances:
10
11 'Particularly for knowledge intensive industries, the presence of direct international air links to
12
13 key global centres of innovation is regarded as critical' (DOCHERTY, 2002, p341). This
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15 paper focuses on the role of LCCs in shaping the regional economic performance as a
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17 whole, and not only knowledge-intensive sectors.
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23 Although there is increasing recognition of links between air transport innovations and
24
25 regional performance and competitiveness, the relationships largely remain a conceptual
26
27 'black box'. Air travel is itself a 'chaotic concept' (SAYER, 1992) in regional economic
28
29 analysis, given it is constituted of multiple flows (of tourists, business travellers, workers and
30
31 tacit knowledge transfers) which are often blurred and multi-purpose (BIEGER AND
32
33 WITTMER, 2006, p 45). The notion of 'economies of flows' provides a starting point for
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35 conceptualising these impacts; as HUDSON (2004, p 462) contends '... economic process
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37 must be conceptualized in terms of a complex circuitry with a multiplicity of linkages and
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39 feedback loops rather than just 'simple' circuits or, even worse, linear flows'. The paper
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41 focuses not so much on predicting regional outcomes – which are necessarily time and place
42
43 specific - as on understanding changes in economic relationships resultant from the
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45 emergence and expansion of LCCs. The reshaping of flows results in institutional changes,
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47 shifts in regional externalities, and changes in firms' transaction costs. However, the outcome
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49 in terms of regional performance and competitiveness will depend on the *net* inflows of
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51 labour, capital, knowledge and mobile markets, and the extent to which LCC flows substitute
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53 for, or are additional, to existing flows via other means of transport. The paper addresses
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55 three main research questions:
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3 a) What are the consequences of LCC expansion, following re-regulation of the supply
4 of air travel, for inter-regional flows of mobile markets, investment, labour and
5 knowledge?
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10 b) How do these shifts in economic flows mediate regional externalities and transaction
11 costs?
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14 c) What are the general implications for understanding uneven regional development in
15 Europe?
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21 THE PAPER IS DEVELOPED THROUGH FOUR SECTIONS THAT CONSIDER A BROAD CONCEPTUAL
22 FRAMEWORK, BRIEFLY REVIEW EUROPEAN AIR TRAVEL RE-REGULATION, EXAMINE THE ECONOMY OF
23 FLOWS, AND EXPLORE THE IMPLICATIONS FOR UNEVEN REGIONAL DEVELOPMENT. WE USE THE TERM
24 RE-REGULATION, RATHER THAN DE-REGULATION, TO SIGNIFY THAT THE PROCESS INVOLVES MORE
25 THAN LIBERALIZATION OR PRIVATATIONS; INSTEAD, IT ALSO INVOLVES THE FRAMING OF A DIFFERENT
26 (EVEN IF MOSTLY, LIGHTER) REGULATORY FRAMEWORK. THE TERM HAS BEEN USED BY A NUMBER OF
27 WRITERS (SEE MAJONE, 1990; EBERLEIN, 1998) BUT LESS SO IN CONTEXT OF THE SUPPLY OF AIR
28 TRAVEL (BUT SEE O'REILLY AND STONE SWEET, 1998).
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41 **CONCEPTUAL FRAMEWORK**

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46 This section focuses on three issues: regulation, economies of flows, and regional
47 externalities.
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51 ***Regulation and local economies***

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57 Regulation is an important determinant of national economic performance differences
58 (ESRC, 2004; HELM, 2001) but air travel supply, one element in the broader regulatory
59 framework, has received scant attention in research on regional economies (see
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3 DOCHERTY, 2004). In part, this is because of difficulties in disentangling the relationships
4
5 between airline re-regulation and regional performance.
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10 a) Regulation is multi-level and, echoing AMIN's (2002) comments about scales, these
11 are 'folded in' on each other . The impacts of re-regulation on production at one level
12 are mediated by regulatory changes, or lack of changes, at other levels. For example,
13 EU directives on air travel supply liberalization, leading to the growth of LCCs, tend to
14 be folded into national level regulations, whilst their impact may be significantly
15 mediated if local land use planning constrains the expansion of air services. This is a
16 source of spatiality and temporality in the unfolding consequences of re-regulation.
17
18 b) Re-regulation is constrained or effected through interlocking spheres of activities,
19 which make its impacts highly contingent on parallel re-regulatory measures. Thus
20 the impacts of the re-regulation of rights of carriage are mediated by the need for
21 parallel re-regulation in other spheres, such as baggage handling, or ticketing.
22
23 c) Re-regulation is shaped by apparently unconnected, or generic, arenas of regulation:
24 for example, by generalized environmental protection or employment laws and,
25 ironically, as argued later, the economic impacts are also mediated by general
26 competitions regulations.
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44 The folding together of different regulatory levels mean that 'geography matters' (MASSEY,
45 1984). Re-regulation does not occur in a vacuum but is place and time specific. For example,
46 LCCs had a different and far more radical impact on the geography of air travel connectivity
47 in the 2000s than in the 1990s (GRAHAM, 1998; FRANCIS *et al*, 2006). LCCs have also had
48 earlier and more geographically widespread impacts on regional economies in, say, the UK
49 and Ireland than France and Germany (UKCAA, 2004). The impacts are also determined by
50 the structures and flows which differentiate regional economies, as DOBRUSZKES (2005)
51 demonstrates, comparing Tours and Charleroi.
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3 Regional 'economies of flows'
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8 This paper is influenced by MASSEY's (1994, p154) view that places are constituted of local
9 and more spatially stretched relationships, being 'articulated moments in networks of social
10 relations and understandings'. In other words, while places are understood as constituted of
11 flows, social and economic relationships are – at least temporarily – locked into particular
12 places (ALLEN *et al*, 1998). Similarly, regional economies can be understood as economies
13 of flows (HUDSON, 2004, p463): '...for the economy to be performable, fluid sociospatial
14 relations and flows require a degree of permanence, of fixity of form and identity – whether in
15 terms of the boundaries of the firm, of national states or of local places'.
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28 Flows, and how they are 'fixed' or articulated in regional economies, are in constant flux, due
29 to a number of incremental and disruptive innovations, which reshape regional institutions.
30 One such disruptive innovation is air travel supply re-regulation – and more specifically the
31 growth of LCCs - which influences factor mobility and key institutions such as labour and
32 product markets (see the parallel arguments about transport infrastructure, JOHANSSON
33 AND KARLSSON, 1994). While probably not the major driver of changing flows of production
34 factors in most regional economies, LCCs can impact significantly on particular places and at
35 particular times.
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48 In terms of regional development, the most significant flows are:
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- 50 a) Trade: particularly where customers are mobile, as in tourism, but also just-in-time
51 deliveries (although many LCCs do not carry cargo, in order to speed aircraft
52 turnaround).
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56 b) Labour migration: the volume of flows, and their changing composition (growing
57 emphasis on circulation and temporary migration), are shaped by changes in the
58 availability, frequency and costs of air travel.
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3 c) Capital: the links between LCCs and capital flows in the regional economy are
4 complex. However, LCCs can shape urbanization economies, business connectivity,
5 and perceptions of regional economies, thereby influencing inward investment.
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10 d) Knowledge: depending on the relative importance of tacit versus codified knowledge
11 (POLANYI, 1966), and the role of face-to-face contacts in knowledge transfers
12 (BUNNELL and COE, 2001), LCCs can influence knowledge transactions across
13 regional boundaries.
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21 The key concept for understanding the impact of LCCs on these flows, for the individual firm,
22 is transaction costs (WILLIAMSON, 1981). These are the full costs incurred by firms in
23 making economic exchanges, including for example search and information costs or
24 bargaining costs. Moreover, the '... critical dimensions for describing transaction costs are
25 (1) uncertainty (2), the frequency with which transactions recur, (3) the degree to which
26 durable transaction-specific investments are required to realize least cost supply'
27 (WILLIAMSON, 1981, p 555). LCC services can reduce transaction costs associated with
28 each of these dimension. Consequently, barriers to extra-regional factor flows may be
29 reduced, mediating the economy of flows. Paraphrasing MASSEY (1994), LCCs have
30 potential to shape 'local and distanced relationships' in respect of each of these flows.
31 Transaction costs are 'flow-specific', so the impact on flows is necessarily uneven. For
32 example, leisure travellers have high price elasticities of demand, and are sensitive to price
33 changes, while business travellers value their time more and are more responsive to costs
34 related to changes in flight frequency and locational convenience (DRESNER, 2006). The
35 regional impacts are complex, not only because individual travellers may have mixed
36 motivations, but also because the *net* changes in flows are critical.
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58 Regional externalities
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3 Shifting the focus of the discussion from the firm to the region, we start with the elusive
4 concept of regional competitiveness (KITSON *et al*, 2004, p991). While recognizing the
5 seminal contribution of PORTER'S (1992) work, we concur with KITSON *et al*'s (2004, p994)
6 view that CAMAGNI (2002) provides a more useful perspective: a region may have an
7 absolute competitive advantage when it possesses 'superior technological social,
8 infrastructural or institutional assets that are external but which benefit individual firms'. Such
9 'regional externalities' influence the efficiency and dynamism of individual firms, and may be
10 positive or negative.
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23 Externalities are generally understood as being effects generated *within* regional boundaries.
24 For example, ALMEIDA and KOGUT (1999, p915) argue, in relation to networks and labour
25 mobility in the engineering industry, that '... externalities are the outcomes of action of
26 skilled labour in spatially defined markets'. However, in the economy of flows the
27 competitiveness of firms is the outcome of their locally and more distanced relationships.
28 Hence, regional externalities need to be understood as incorporating air services (provided
29 by LCCs in this instance) on regional economic institutions, such as labour markets, and
30 knowledge communities. Potentially, this has significant impacts on the efficiency and
31 dynamism of firms, and the competitiveness of regions. Of course, in practice not all firms
32 adjust successfully to the threats and opportunities inherent in the reconstitution of the
33 economy of flows, and the impacts are in any case sectorally specific.
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51 The idealised consequences for regional institutions and externalities are displayed in Figure
52 1. The growth of LCCs changes the prices and frequency of air services, and regional
53 connectivity. These influence key elements in the regional 'economy of flows'. The net
54 changes in flows involve both additionality and substitution effects, in relation to existing
55 flows via other forms of transport (whether by legacy carriers and charters, or by high speed
56 rail or road) . These impact on key institutions in the regional economy. Flows of labour
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3 migrants impact on labour markets, flows of mobile consumers (tourists etc) impact on
4 markets , and flows of knowledge and inter-regional business travel impact on the business
5 environment, influencing investment flows and knowledge transactions. These reshape
6 regional externalities, and hence the transaction costs and performance of individual firms.
7 Moreover, reductions in fares increase real household incomes, a proportion of which may
8 be spent on further travel (as opposed to expenditure on other products/services or being
9 saved). Finally, there are public expenditure impacts: increased expenditure on airports,
10 roads, reducing resulting congestion costs etc are counterbalanced by increased tax yields in
11 a more productive regional economy. Given that externalities are not produced optimally by
12 firms, in this case LCCs, states may be attracted to correct what are seen as market failures
13 for the regional economies, via public subsidies. This, of course, may have deadweight
14 implications, that is subsidising service provision that may have occurred anyway.
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32 Given the difficulties of disentangling the causality between supply and demand – for
33 example, do labour market flows follow or lead changes in labour markets - these are shown
34 as two-way relationships in Figure 1. The productivity and output gains in individual firms
35 may also feedback on LCCs in two ways. Either through increases in average regional
36 productivity levels, and firm incomes, leading to higher demand for LCC services, or in LCCs
37 being able to capture some of the gains in increased regional income (and related tax gains)
38 through negotiating (increased) subsidies from regional governments.
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50 All these changes are, of course, contingent on the nature of existing flows, the structures of
51 regional economies and whether LCCs operate in monopolistic or contested markets
52 (DOBRUSZKES, 2005). These contingencies are discussed further, later in the paper.
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58 AIR TRAVEL SUPPLY RE-REGULATION

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3 Air transport in the EU was re-regulated in three stages between 1987 and 1997, with a new
4 system of European regulation replacing national regulations and bi-lateral agreements
5 (O'REILLY and STONE SWEET, 1998). The third package of measures, in July 1992, was
6 the most radical: as of April 1997, all EU carriers had open access to virtually all routes within
7 the EU (freedom of cabotage). The liberalisation measures intended to ensure that 'air fares
8 should normally be determined freely by market forces' (Council Regulation 2409/92).
9 Further liberalisation initiatives targeted the scarcity and cost of infrastructure, a major
10 determinant of the high costs of European air travel. From January 1999, the ground
11 handling market was re-regulated for third parties at Community airports (Directive 96/67),
12 reducing operating costs. The fragmentation of air traffic management systems was
13 addressed through the 'Open European Sky' regulations (Regulation 549-552/2004). And
14 non-discriminatory and transparent use of computerised reservations systems was
15 introduced by Council Regulation 2299/89. PAPTAEODOROU (2002, p384) summarized
16 the competition logic behind re-regulation: 'the presumption of competition working in thick
17 markets and the significance of contestability on thin routes. Under deregulation a
18 multitude of new entrants in popular markets would induce carriers to actively compete'.
19 State aid was also tightly prescribed, a measure which would gain prominence later in the
20 Charleroi case.

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45 The intended competition outcomes were not always realised, not least because legacy
46 carriers initially benefited more than the LCCs. First, competition was often reduced at hub
47 airports (FRENKEN *et al*, 2004, p233), as existing carriers used the new freedoms to
48 increase their dominance over these. Secondly, routes with limited traffic may only support a
49 single (monopoly) carrier (PAPTAEODOROU, 2002). Even where more than one carrier
50 operates at an airport, they may not compete on the same routes, although competition also
51 depends on *all* alternative services, whether at neighbouring airports, or by train. Thirdly, the
52 benefits were realised initially largely by hub airports that increased their connectivity
53 (O'CONNELL, 2006, p60-62; Graham 1998: 90), hardly creating a new economic landscape.

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3 The CIVIL AVIATION AUTHORITY (2005, p2) summarised why the impact of re-regulation
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5 was initially limited in the UK (as elsewhere in Europe):
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10 First, there was the usual time lag between the removal of regulatory restrictions and
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12 the exploitation of new opportunities by airlines. New entrants or expanding airlines
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14 needed time to build their fleets and to respond to the success of the first movers.
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16 Second, liberalization affected the denser London markets sooner than thinner
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18 regional markets. Finally, it took time for consumers to change their existing patterns
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20 of behaviour .
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26 Competition strengthened in the early 2000s (FRENKEN *at al*, 2004), not least because of
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28 new entrants, the LCCs. The impacts on competition were, of course, variable, probably
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30 being greater for leisure travellers (choosing between different tourism destinations), than for
31
32 business travellers or those visiting friends and families at particular destinations. However,
33
34 in general, there were welfare gains for large numbers of individual travellers, associated
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36 with higher frequencies (on existing or new routes), new point-to-point connections, and
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38 cheaper fares. By 2004 some 60 new entrant and charter/regional airlines had applied low
39
40 fares models in Europe (EUROPEAN LOW FARES AIRLINES ASSOCIATION, 2004). Unlike
41
42 the legacy carriers, LCCs did not establish hubs, but bases, and did not offer connecting
43
44 flights. Instead, they mainly provided point to point flights, often between previously
45
46 unconnected or poorly connected regions, although they also provided services to major and
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48 secondary airports in the leading economic regions. In some cases, LCCs crowded out
49
50 existing legacy carriers, so that connectivity to domestic hubs actually decreased (GRAHAM,
51
52 2003). However, they also provided cross-border links to international hubs: for example,
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54 FlyBe connects Bournemouth to Amsterdam, Paris and Frankfurt. Hence, re-regulation did
55
56 eventually create a new geography of air travel supply and demand, as LCCs transformed
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3 the connectivity of many non-metropolitan regions, initially in a few countries, but increasingly
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5 across Europe.
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10 In summary, re-regulation has reshaped air travel supply and demand within Europe, via
11
12 increased competition for the legacy carriers, and the growth of the LCCs, which accounted
13
14 for more than half the increase in passenger seats, 1995-2004 (DOBRUSZKES, 2006,
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16 p262). Although they pursued different models, LCCs shared key features (DOBRUSZKES,
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18 2006):
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23 • Economies of density (maximizing flying time, and numbers of seats, for each
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25 airplane), which are more important than economies of scale. Turnaround can be as
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27 short as 25 minutes, partly due to using smaller, uncongested airports.
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- 30 • Intensification of the labour process, combing long hours, flexible working practices,
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32 and relatively low wages. This was particularly important given high fixed costs
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34 (DOBRUSZKES, 2005).
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- 36 • High seat occupancy rates, related to pricing strategies.
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- 39 • Additional optimization and cost reduction measures including: standardised fleets of
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41 cost efficient aircraft; standardization of services; bypassing travel agents via direct
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43 internet and call centre sales (accounting for more than 95% of the sales of Ryanair
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45 and Easyjet); and revenues from reservation centres (charging for premium rate
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47 services).
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52 Although their precise business models vary, LCCs mostly focus on minimising service
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54 delivery costs (CIVIL AVIATION AUTHORITY, 2005, p62), especially relating to labour. In
55
56 reality, it is difficult to isolate the exact sources of cost and price reductions, not least
57
58 because there were also favourable concurrent macro-economic shifts (GOETZ and
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60 GRAHAM, 2004): but it has been estimated that a 15 percent decrease in prices per

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3 passenger kilometre after re-regulation in Australia could be ascribed to higher load and
4
5 density factors. LCCs also reduced costs by operating point-to-point schedules between
6
7 regional airports (BARBOT, 2006): the availability of take off slots allowed schedules to
8
9 maximise fleet use; there were reduced congestion costs; and in the absence of
10
11 infrastructure, they could influence the design of new facilities for baggage handling etc. The
12
13 use of secondary airports in metropolitan regions offered similar benefits to LCCs, although
14
15 being dependent on customer trade-offs between prices and time utility. An overview of costs
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17 on intra-European routes suggests that full service carriers operate at about 9 - 12 € cents
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19 per seat-km while LCCs have costs of about 4 - 7 € cents. The main cost differentials stem
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21 from seat density, minimizing station and handling costs, using cheaper airports, offering no
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23 (free) in-flight catering, and eliminating agents commissions.
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34 **LCCs AND THE ECONOMY OF FLOWS**

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38 Although promoting regional economic development was not an original aim of re-regulation,
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40 this was recognized subsequently. Notably, the EU's COMMITTEE OF THE REGIONS
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42 (2004) observed that:
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48 “[t]he availability of regional air services, and in particular low-cost air services,
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50 operating from regional airports improves access to the global economy. This,
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52 coupled with the lower labour costs and facilities costs associated with the more
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54 remote regions, can encourage the business community to locate new economic
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56 investment within the region. Existing businesses in the region could develop their
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58 market share by being able to reach other parts of the Member State, the EU and the
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60 rest of the world”

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5 This is, of course, an uncritical view of air services, which contribute to both inflows and
6 outflows (ie *net* flows are the key issue), whether of tourists, migrants or investors.
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11 The Committee also concluded that regional economic impacts should be considered under
12 four headings: direct, indirect, induced and catalytic. The first three relate mainly to the air
13 travel industry, while catalytic impacts imply to changes in other sectors, inward investment
14 and tourism (see also YORK AVIATION, 2003). Relatively few studies have quantified these
15 catalytic impacts in employment or income terms (but see OXFORD ECONOMIC
16 FORECASTING, 2003 and YORK AVIATION, 2003). Most estimates are produced by lobby
17 groups, providing few methodological details. For example, YORK AVIATION (2003)
18 reviewed studies of employment impacts at 25 European airports, and found that, on
19 average, 2,100 jobs indirect jobs were generated by every 1000 direct jobs. . Even though
20 such estimates are problematic, not least because many studies confuse marginal and
21 average relationships between direct and indirect jobs, or between numbers of passengers
22 and employment, they indicate the substantial regional economic impacts of re-regulation. In
23 another study, HAKFOORT *et al* (2004) estimated the employment income multiplier for
24 Amsterdam airport. While recognizing the importance of forward linkages (creating an
25 attractive business environment), these were particularly difficult to quantify: 'There is no
26 doubt that expansion of airport activity has an impact on the numbers of firms locating in the
27 area, the number of visitors to conferences, the number of tourists and so on, but in many
28 cases it is hard to find a causal relationship...' (p601). Against this background, the paper
29 examines how LCC growth, has impacted on regional externalities and institutions via four
30 main flows.
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58 ***Labour markets***

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3 The availability, cost, skills and flexibility of regional labour markets are mediated by
4 migration. The question is whether migration is significantly influenced by LCC services.
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7 There has, of course, been a long history of labour migration in Europe (mainly south-to-
8 north, 1950s-1970s, but increasingly complex thereafter), which pre-dates air travel re-
9 regulation. However, the nature of labour migration has changed in recent decades (KING,
10 2002), including shifts from longer-term to more temporary migration, sequential migration,
11 and cycles of migration. There has also been an increase in long-distance commuting,
12 involving regular return trips home, whether weekly or at longer intervals. Arguably, LCCs
13 can impact on labour migration in several ways, but mainly through reducing travel costs and
14 increasing accessibility. Effectively, they reduce the costs of international labour migration
15 and, all else being equal, rebalance the costs and returns of migration (SJASTAAD, 1962),
16 leading to increased mobility. This is most likely under particular conditions:
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- 32 a) where costs are a significant barrier to individual air travel;
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34 b) the frequency and convenience of air travel connections are an obstacle to air
35 travel; and,
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37 c) the availability of cheaper, more frequent or more accessible air travel
38 connections makes new forms of mobility (based on more frequent return visits)
39 possible for individuals who otherwise would have been unable or unwilling to
40 migrate.
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50 There are no reliable estimates of the extent to which LCCs have contributed to changes in
51 the scale and nature of labour migration and mobility. However, the CIVIL AVIATION
52 AUTHORITY (2005, p68) argues for causal links:
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58 Low-fare services from a local airport seem to be changing consumers' perceptions
59 about flying generally and consequently are having an effect on travel patterns. As
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3 well as second homes, these services may encourage people to apply for jobs
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5 abroad, or may facilitate working far from home'.
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10 It is not so much that travel costs have been reduced (there were usually previous cheaper
11 alternatives available, such as buses). Instead, LCCs have changed time-space
12 relationships, facilitating changes in the form of migration, allowing relatively cheap
13 accessibility and frequent return visits. This has increased the numbers of potential migrants,
14 by encompassing those who previously had been deterred by earlier time-space barriers to
15 travel.
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25 The impacts on regional economies are even more difficult to assess, even a priori, let alone
26 empirically. The economic outcomes depend on: a) the impacts on labour costs, b) the filling
27 of particular (skills) or generalised labour markets shortages, and c) raising or lowering
28 aggregate skill levels in destination economies. There is considerable research on these
29 issues, relating to human capital theories, mainly at the national level (for example,
30 DUSTMANN *et al*, 2003a; DUSTMANN *et al*, 2003b). However, there is little explicit
31 evidence on regional economic impacts, labour markets and externalities. In part this is
32 because skills transfers via migration is not only a matter of changes in aggregate levels of
33 human capital, but also about the social recognition of skills, and whether migrants have
34 sufficient encultured and embedded knowledge to maximise their embodied and embrained
35 knowledge (WILLIAMS, 2006). But it is reasonable to argue that LCC-induced migration is
36 more likely to have a significant impact on labour markets and firm performance in regional
37 economies with substantial skills gaps (PORTER AND KETELS, 2003). The scale of that
38 impact will depend on whether particular types of labour migrants, in terms of skills, were
39 deterred by the higher transaction costs of migration prior to the introduction of LCCs – which
40 is also little researched. In the USA, the evidence suggests that wage impacts are modest,
41 being greatest at the bottom and top ends of the skills range, while labour migration brings
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3 generalised welfare benefits, either via the impacts of skilled workers on the productivity of
4 others workers, or in filling jobs that are shunned by indigenous workers (PERI, 2006).
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7 However, such impacts are highly regionalised, as well as being specific to national
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10 production and regulatory conditions.

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14 The existence of considerable differences in the skills gap between countries and between
15 regions is consistent with our emphasis on the spatiality of the impacts of re-regulation. The
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18 importance of temporality is also evident. Most econometric evidence for the UK suggests
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21 there is a time lag before workers can maximise the return to their human capital, due to
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24 having to learn about local practices and institutions, or acquire language competency
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27 (DUSTMANN, 1994). There are likely to be similar time lags before the full consequences for
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30 regional economies are realised.

31 32 ***Business travel and tacit knowledge***

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36 Drucker's (1993, p38) widely-quoted conclusion that 'knowledge is the only meaningful
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39 resource today', is of course a gross overstatement. But networks are fundamental to
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42 knowledge transfers, and knowledge transfers are key to the performance of firms and
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45 regional economies. However, there are competing theories of knowledge networking,
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48 including both localised learning (MASKELL and MALMBEG, 1999) and essentially non-
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51 localised networks, for example communities of practice (WENGER, 1998). In reality, most
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54 firms probably draw on several overlapping multi-scalar networks.

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57 The question is whether proximity is critical for establishing the trust that is essential for
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59
60 effective knowledge transfers, and how extra-regional mobility relates to this. AMIN (2002,
p393-4) argues that physical proximity and localized face-to-face contacts are not essential
for trust-based relationships. Instead, intimacy may be achieved, and trust fostered, through

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3 frequent and regular contacts enabled by distanced networks of communication and travel,
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5 and the interweaving of physically proximate and telemediated contacts. In contrast, ALLEN
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7 (2000, p28) stresses that human mobility is important to effect localized networking: ' the
8
9 translation of ideas and practices (is) likely to involve people moving to and through local
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11 contexts, to which they bring their own blend of tacit and codified knowledges'. BATHELT et
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13 al (2004) provide useful guidance on this point, arguing that knowledge is transferred both
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15 through local 'buzz' (various forms of face to face interaction), and along 'pipelines' from
16
17 extra-local sources. There is surprisingly little empirical evidence as to the relative
18
19 importance of proximity-based versus distanced knowledge transfers, or the role of airlines
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21 in facilitating the latter. However, SMITH and TIMBERLAKE (2001) argue there is still strong
22
23 demand for face-to-face business relationships, and that air line route networks are important
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25 in their facilitation. And DENSTADI (2004) argues that innovations such as videoconferencing
26
27 have little impact on business travel (estimated at 7-9% at most in Norwegian studies). In
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29 part, this is because it is used mostly for intra-company contacts, which account for just 4%
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31 of all international business travel in Norway.
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38 LCCs potentially have consequences for the frequency of face-to-face contacts, reshaping
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40 knowledge-sharing networks and the efficiency of knowledge transfers, that is positive
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42 regional externalities. These may be articulated via increased intra- or inter-firm mobility, or
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44 attendances at conferences, exhibitions or other 'knowledge events', as a result of lower
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46 travel costs, more frequent and new air connections. Whether this is significant depends on
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48 assumptions about: a) additional and substitution effects (in relation to other transport); b)
49
50 the importance of face-to-face contacts in specific jobs and industries (see below); and c)
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52 corporate strategies for disseminating and applying knowledge. Where these assumptions
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54 are met, then arguably the growth of LCCs has significant consequences for transaction cost
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56 and firm performance.
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3 The reconfiguration of regional externalities has sectorally variable implications. Air travel
4 use is particularly important for knowledge-intensive activities (BUTTON and TAYLOR, 2000;
5 OXFORD ECONOMIC FORECASTING, 2006). Such activities are unevenly distributed – for
6 example, in the USA, 70% of such employment is located in just 50 of the 321 Metropolitan
7 Standard Areas. Given estimates that employees in the ‘new economy’ are 1.6 times as likely
8 to take flights for business purposes than those in traditional industries, due to greater
9 reliance on personal contacts, changes in travel costs following re-regulation are especially
10 likely to influence such activities. BUTTON and TAYLOR (2000) demonstrate that the
11 expansion of air services stimulated growth in the ‘new economy’ in the USA, with the critical
12 factors being the range of destinations connected, and service quality. Another example is
13 provided by The Recruitment Zone, a recruitment consultancy with offices in Edinburgh and
14 London, amongst other locations. Before the introduction of LCC services, the firm paid up to
15 £350 for return air tickets to London, but EasyJet offered a similar service for under £100.
16 The reduced costs allowed The Recruitment Zone to move staff around their offices for
17 training, or on weekly placements. This similarly encouraged opening a branch in Bratislava
18 (THE SCOTSMAN, 1.06.05).

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40 The fact that knowledge intensive ‘new economy’ sectors have greater reliance on air
41 services means that the growth of LCCs has significant regional implications, that we return
42 to later. But we also argue that knowledge transfer is important to innovation and
43 performance in all sectors, both ‘new’ and ‘traditional’.

44 45 46 47 48 49 50 51 ***Inward investment, business connectivity and business travel***

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56 The CIVIL AVIATION AUTHORITY (2005, p65) argues that business passengers, as well as
57 leisure travellers, seek lower fares as well as reliability: ‘No-frills airlines have created this
58 expectation and have removed the perception that business air travel, or indeed travel on
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3 regional routes, or even scheduled flights generally, has to be expensive.’ Consequently, ‘the
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5 distinction between no-frills and the existing full-service airlines has now become more
6
7 blurred’. The utilization of LCCs for business travel is evident in comparative data on legacy-
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9 carriers and LCCs (CIVIL AVIATION AUTHORITY, 2005, pp65-6). For example, the
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11 proportion of business travellers is 39% on BA’s Manchester – Amsterdam route, compared
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13 to 34% on Easyjet’s Liverpool – Amsterdam route; and 44% on BA flights, compared to 39%
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15 on Easyjet flights, on the Gatwick to Edinburgh route. Of course, there may be substitution
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17 effects, with LCCs partly providing a low cost substitute for flights that would otherwise have
18
19 involved legacy carriers. But there is also evidence of additionality effects: a passenger
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21 survey at Budapest airport found that 8% of outward, and 5% of inward, business
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23 passengers would not have travelled in the absence of LCC services (KPMG, 2005).
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25 Although a minority, this is a significant additionality effect. MASON’s (2001) survey, of short
26
27 haul business travellers on legacy carriers and LCCs in the UK, provides similarly useful
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29 insights, demonstrating that both large and SME companies use both types flexibly.
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31 However, SMEs are relatively more likely than larger companies to use LCCs because the
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33 latter often have corporate agreements with particular airlines or travel agents. And -
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35 providing further evidence that LCCs can create significant regional externalities - MASON
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37 found that a small proportion of SME business travellers had never used legacy carrier
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39 services for business purposes.
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48 How does air travel supply re-regulation impact on regional economies in this context? Most
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50 obviously it reduces business travel costs (and transaction costs), and CARSON WAGONLIT
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52 TRAVEL (2003) argue that LCCs had a maximum of about 8% of the European business
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54 travel market, bringing 56% cost savings on average to travel between the city pairs they
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56 served, resulting in net total saving of 3-5% in corporate travel budgets. This is a relatively
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58 small average saving against total transaction costs, but will be more substantial for
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3 particular companies and regions (see also OXFORD ECONOMIC FORECASTING 2006 for
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5 similar evidence in relation to investment in airports).
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10 Beyond this, LCCs may attract inward investment in two main ways. First, LCC services may
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12 change the image of a regional economy, enhance external awareness of its business
13
14 environment, and generate inward investment. The CIVIL AVIATION AUTHORITY (2005, p
15
16 ix) argues this is significant: '... as realization of low cost travel potential increased so the
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18 profile of the airlines, airports and regions concerned also increased'.
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23 Secondly, LCCs can influence the search spaces of potential investors (and their search
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25 costs) for whom minimum levels of accessibility (in horizontal or vertical linkages) are
26
27 important locational factors. OXFORD ECONOMIC FORECASTING (2006) report that a
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29 quarter of firms surveyed considered that access to air services influenced their location
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31 within the UK. Air passenger services were considered more important than either air freight
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33 or air express services, and it is the former which LCCs specialise in. They can also mediate
34
35 the linkages of existing firms. As noted earlier, these effects are sector specific. BUTTON
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37 and TAYLOR (2000) found that the availability of direct international services was the third
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39 most important factor in the location decisions of firms in Atlanta. Moreover, there had been a
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41 sharp increase in inward foreign investment from specific countries after the introduction of
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43 non-stop flights to these. They also report that air transportation was the third most important
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45 factor in the location decisions of companies surveyed in Europe. Studies of particular firms
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47 in Amsterdam and Zurich have also established the importance of air connectivity for their
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49 operations. YORK AVIATION (2003) reports a survey of businesses in Hamburg that
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51 demonstrates that 80% of manufacturing firms considered that air service connections were
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53 important for accessing their key customers. And SkyEurope's Bratislava-Paris link helped to
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55 persuade PSA Peugeot Citroen to build a car assembly plant in Trnava (Slovakia). Prague's
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57 new air connections were also a key factor in DHL's decision to build an IT centre in the
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3 Czech Republic in 2004 (FINANCIAL TIMES, 9.12.05;
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5 <http://firstnews.com.ua/en/trans/trans.html?id=136090>).

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10 Although both effects are potentially important, neither should be exaggerated. Arguably,
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12 reliance on low cost rather than legacy carriers may signal a region's position in the second
13
14 tier of regional competitiveness. Moreover, LCCs have a calculating and functional approach
15
16 to new services: if they do not quickly show a positive return, they may be axed, and
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18 potential regional investors will know this risk. Hence, the regional externalities they generate
19
20 are blurred by uncertainties to some extent. And the impacts of LCC services will depend not
21
22 only on their exact nature (destinations served, frequency and diversity of services etc) but
23
24 also on the 'receptive capacity' of the regional economy, that is on the ability of firms to take
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26 advantage of changing regional externalities. Additionally, the CIVIL AVIATION AUTHORITY
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28 (2005, p2) recognized that:
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34 While an enhanced network of air services from a region would be likely to be
35
36 conducive to economic growth, it is unlikely *alone* to be an effective tool for driving
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38 economic development. It can, however, make a particular city or region more
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40 attractive, at the margin, than another as a location for business.
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45 Nevertheless, inward investment has important implications for regional competitiveness in
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47 two ways. First, the entry of new firms is instrumental in increasing aggregate productivity
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49 levels, and LCCs arguably may increase numbers of new entrant firms in a regional
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51 economy. And OXFORD ECONOMETRIC FORECASTING (2006) report that analysis of
52
53 panel data for European countries demonstrates a positive link between air transport usage
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55 and connectivity, and investment levels, although the causality is not clear. Secondly, there is
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57 a long-established argument that foreign investment has higher productivity because it
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3 necessarily has knowledge, and other, advantages (HYMER, 1960), which yields an absolute
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5 ownership-specific advantage over host country firms.
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8 9 ***Mobile consumers and markets***

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14 LCCs also change access to markets, either via air freighting goods or transporting mobile
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16 markets (notably tourists) to firms. Air freight is more likely to be significant in deliveries of
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18 highly perishable goods, or high-value, low-weight goods, and in just-in-time deliveries. The
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20 resultant reduction in inventory costs, or the reduced search/bargaining/enforcement cost of
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22 serving markets, can significantly reduce transaction costs, contributing to enhanced firm
23
24 performance. However, because LCCs rely on rapid turnaround of aircraft, they are not
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26 significant in transporting goods. Re-regulation may have influenced the costs and availability
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28 of specialised air transport services, or legacy carrier services, for this purpose, but LCCs
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30 have only a minor role.
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36 Therefore, in many –perhaps most – regional economies, the main trade impacts are
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38 associated with mobile markets. These have several forms, including transporting customers
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40 to personal service providers in another region or country. For example, LCCs have
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42 generated a fly-to-dentist market from Northern to Eastern Europe, in response to total cost
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44 differentials (FINANCIAL TIMES, 9.12.05). However, the main role of LCCs is their
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46 contribution to increasing tourism flows (both inwards and outwards), through reducing travel
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48 costs and increasing accessibility. 'Tourism demand is quite price elastic, and aviation
49
50 liberalization has brought down fares, thus increasing tourism overall, and often, altering
51
52 patterns of tourism' (FORSYTH, 2006, p3). The overall regional net effect depends on: a) the
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54 balance between tourist inflows and outflows ; and b) additionality and substitution effects.
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3 There are three potential economic consequences, related to changes in regional
4 externalities. First, the overall outcome is a net increase - or decrease – in market size in any
5 one region, which may impact on performance via scale economies, or stimulating new
6 (higher productivity) entrants to the sector. Secondly, changes in the composition of tourism
7 flows and market segmentation may lead to net increases or decreases in tourist spending.
8 Increases in higher spending tourists would – all else being equal - lead to higher sales per
9 employee in existing tourism firms, or to the entry of new (higher productivity) firms to serve
10 expanding markets. Thirdly, LCCs may change the temporal distribution of tourism arrivals
11 (EUROPEAN LOW FARES AIRLINES ASSOCIATION, 2004, p26): their flights are mostly
12 year round compared to the more seasonal services provided by charters, and they also
13 incentivise mid-week travel. As a result, they provide a more secure and more temporally
14 constant flow of tourists and income to tourism establishments, reducing their effective
15 transaction costs. This is critical in an industry where services are highly perishable (tourist
16 bed nights or theme park rides can not be deferred or stocked) (SHAW and WILLIAMS,
17 2004, pp21-24).

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38 Given these potential impacts on competitiveness, the key issue is the additionality effects of
39 LCCs. The CIVIL AVIATION AUTHORITY 2005, p ix) argues that there is a positive circular
40 relationship between supply and demand: provision of low cost services generates demand,
41 which further stimulates increases in supply. This EUROPEAN LOW FARES AIRLINES
42 ASSOCIATION (2004, p26) similarly argue that LCC services have increased the number of
43 new tourist destinations directly accessible by air, boosting inter-regional tourism, as leisure
44 passengers are generally reluctant to use connecting flights through congested hub airports.
45 The same report quotes research that demonstrates that an estimated 42% of LCC
46 passengers (for whatever trip purpose) are new, of whom almost three quarters would not
47 otherwise have travelled. Although this figure seems rather high, a survey by KPMG (2005)
48 at Budapest airport found that about one quarter of outbound leisure travellers on LCCs
49 would not have travelled otherwise: 21% of those visiting friends and relatives, and 33% of
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3 those on holiday. The comparable figures for inbound leisure travellers on LCCs were 14%
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5 and 16%. Finally, BIEGER and WITTMER (2000, p41) argue that LCCs increase overall
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7 tourism, via stimulating particular market segments, such as short-stay city tourism and
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9 second home tourism. There are, therefore, substantial additional effects for destination
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11 regions, which – as argued earlier – reduce transaction costs and enhance economic
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13 performance. Whether there are corresponding negative effects for other regions is more
14
15 complex: is the new holiday (using the LCC) in place of a holiday that would have been taken
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17 in the home, or another region? And even if not, has the additional expenditure incurred been
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19 diverted from alternative consumption or from savings. These complexities underline the
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21 spatiality of the economic consequences of LCC growth.
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27 **REGIONAL ECONOMIC IMPACTS: OVERVIEW**

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31 The causal links between air transport and regional development are complex, shifting and
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33 often circular, but we concur with KNOWLES (2006, p 408) that 'Transport innovations
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35 enable specialisation of production and the division of labour to occur, widening market areas
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37 and enhancing opportunities for trade'. The classic view is that transport innovations
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39 contribute to time-space convergence (JANELLE, 1968), implying greater regional
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41 convergence, but in reality this is highly uneven and some places may become relatively less
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43 accessible. Therefore, the key question is whether LCCs contribute to a spiral of metropolitan
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45 advantage with supply tending to follow demand (JOHNSTON, 1973), or whether they
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47 realign regional externalities so as to mediate existing patterns of uneven regional
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49 development (KNOWLES, 2006).
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58 Table 1 provides a deductive and suggestive overview of the impacts of LCCs on regional
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60 externalities, emphasising their temporality, both in relation to time-lags and duration. The
impacts are evident in potentially increased flows of labour migrants, tacit knowledge,

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3 business travel, inward investment, and mobile markets (especially tourism). These are
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5 outcomes of shifts in regional externalities which follows changes in air services, while also
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7 contributing to shaping externalities through their impacts on regional institutions. For
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9 example, lower travel costs lead to increased tacit knowledge transfers, adding to regional
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11 knowledge and learning capacity, which in turn enhances further inflows of tacit knowledge
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13 transfers. We contend that increases in business travel and tourism were realised relatively
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15 quickly, while there were longer time lags for labour migration flows, reflecting slower
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17 learning and adjustment to changing costs and uncertainty. The duration of impacts is also
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19 variable but we contend that the comparative advantages of regions in terms of inward
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21 investment could be expected to decline relatively quickly over the medium term, due to
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23 competition from other regions and the hypermobility of international capital. In contrast,
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25 increases in knowledge, access to mobile markets, and labour are likely to be longer term,
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27 being underpinned by new networks. Finally, we have added congestion costs to indicate
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29 that not all the outcomes of LCC expansion have positive externalities.
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35 The impacts of LCCs are also spatially variable. Not all regions benefit from LCC services,
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37 the services are highly differentiated, and there are several contingencies to note. First, there
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39 is additionality: whether LCCs create a new geography of accessibility and connectivity
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41 compared to legacy carriers. Table 2, based on DOBRUSZKES (2005), provides empirical
42
43 evidence on the regional distribution of LCC activity in Europe. To some extent, service
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45 provision is demand led, with metropolitan regions accounting for 43% of the total. However,
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47 the *relative* impact of LCCs - the proportion of air services provided in each regional type – is
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49 strikingly different. Their impact on metropolitan and central regions is relatively modest (11%
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51 and 14% respectively) compared to the intermediate, peripheral and especially the sub-
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53 central regions (17%, 20% and 47%). They also account for more than half of the growth of
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55 air services in the sub-central and intermediate regions. Therefore, they do modify the
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57 traditional concentration of air services in metropolitan regions, and potentially bring
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3 disproportionate positive regional externalities to other regions, especially sub-central
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5 regions.
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10 Secondly, the reshaping of regional externalities depends on critical threshold levels. There
11 are considerable differences between having a single point to point connection (for example,
12 between a medium sized city and an important tourism destination) and a range of LCC
13 services to multiple destinations. DOBRUSZKES (2005) illustrates this in a comparison of
14 Tours and Charleroi. The former has a single Ryanair connection, providing relatively
15 minimal additional connectivity, and an already substantial tourism market, so overall
16 economic impacts are relatively modest. In contrast, Charleroi is a Ryanair base, with flights
17 to 12 destinations in 2004, offering significant direct connectivity where virtually none had
18 existed previously. Hence, the regional economic impacts are highly differentiated, even
19 within the zones that seemingly have benefited most from realigned regional externalities.
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33 Thirdly, LCCs – although operating different business models – tend to be opportunistic and
34 potentially unreliable providers of air services. While enhanced regional externalities do
35 generate increased air travel supply in the medium term, LCCs often undertake minimal
36 market research and quickly abandon a route if deemed unprofitable. The associated risks
37 for companies which are particularly reliant on specific routes are considerable. Moreover,
38 because the generation of regional externalities is almost entirely incidental to their
39 operations, LCCs under provide these. That is why (sub) state interventions have been
40 prominent, in order to ameliorate market failures in relation to regional welfare: hence, route
41 development costs often accrue in whole or part to regional authorities, but ironically that
42 means LCCs have relatively low sunk costs, adding to the uncertainty surrounding new air
43 services. Moreover, many new air services attract travellers from an extensive hinterland, as
44 in the case of Charleroi (DOBRUSZKES, 2005), which means that it is difficult to localize the
45 benefits resulting from regional subsidies.
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3 Finally – as noted earlier – the impacts are sectorally variable, and knowledge intensive
4 establishments are most likely to benefit, yet these firms are relatively weakly represented in
5 many non metropolitan regions. However, there are also benefits for labour intensive
6 industries (drawing on enhanced labour migration), those serving inbound tourism, and
7 SMEs compared to transnational corporations. But such generalisations need to be
8 tempered by an understanding of the contingent nature of these impacts.
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18 CONCLUSIONS

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22 In 'economies of flows' (HUDSON, 2004), the growth of LCCs has effectively redrawn the
23 map of accessibility and travel costs across Europe, although the outcomes are highly
24 uneven both spatially and temporally. Similarly to other recent transport innovations, such as
25 restructuring of legacy carriers or introduction of high speed train services, these potentially
26 impact on flows of labour migration, mobile markets (especially tourism), business
27 connectivity/investment and knowledge, which modify regional economic institutions.
28 Although there is a dearth of research on the relationship between lower cost air travel and
29 regional competitiveness, the exploratory analysis in this paper has identified several issues
30 for further analysis.
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45 First, re-regulation has increased absolute levels of accessibility in many European regions,
46 even if relative differentials have widened. There is some evidence available from LCCs, and
47 from consultancy reports, on the impact of low cost air travel supply on passenger volumes
48 and different market segments. LCCs are leading contributors to changing travel habits,
49 generating additional travel, rather than merely substituting for flights with legacy carriers.
50 They contribute to a new geography of air travel supply in Europe, distinguished by lower
51 costs, new connections, and new service frequencies. These are mediating the proximate
52 versus distanced relationships that distinguish economies as spaces of flows, especially in
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3 respect of labour migration/mobility, knowledge transactions, business connectivity, inward
4 investment, and mobile (tourism) markets. The outcome is complex but, generally,
5 metropolitan regions (with hub airports) were the initial winners, while non-metropolitan
6 regions (especially those which became bases for multiple point-to-point connections) were
7 the longer term winners (GRAHAM, 1998; BOWEN, 2002; DOBRUSZKES, 2005). This is
8 contributing to a new geography of air travel connectivity, although the major metropolitan
9 areas still occupy dominant positions in this respect.
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21 Secondly, the criteria which determine airlines' prospective route selection are critical: cost
22 minimisation; availability of efficient but appropriate facilities; geographic, demographic and
23 strategic considerations; and numbers of regional businesses in the early growth phase
24 (RYANAIR, 2005). Those regions deemed 'not prospective' by LCCs may lag in the changing
25 map of accessibility, and this may reinforce existing, or create new forms of, regional
26 inequalities amongst non-metropolitan regions. But precisely because the generation of
27 external economies is not the priority of LCCs (as with private companies, generally), they
28 under-produce these in relation to the optimal functioning (competitiveness) of the wider
29 regional economy. Moreover, the lack of sunk costs in many routes, reduces their
30 commitments to these, increasing the uncertainty costs for users. Regional authorities seek
31 to rectify such market failures, but are constrained both by limited budgets, and by the EU's
32 competition regulations which made these regional externalities possible in the first place.
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50 Thirdly, there is persistent non-contestability on some routes, where travel costs remain
51 relatively high. However, a single carrier providing a link may be preferable to no link, whilst
52 the proximity of neighbouring airports, offering similar services, may also reduce non-
53 contestability. However, PAPTAEODOROU (2002, p387) argues for new forms of re-
54 regulation to counter non-contestability, and ensure economic gains are realised: 'to avoid
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3 the side effects of the previous system, price regulation should explicitly provide productivity
4 incentives'.
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10 Fourthly, while evidence on the realignment of economic flows is limited, even less is known
11 about their regional economic impacts. While there have been estimates of the aggregate
12 effects on employment, spending or investment, there have not been – to the best of our
13 knowledge – any attempts to analyse systematically the outcomes in terms of regional
14 externalities and institutions. Therefore, this paper has been limited to discussing key issues
15 relating to regional externalities in relation to disaggregated flows. Assuming additionality
16 effects in each case, or at least reductions in the transaction costs of existing flows, critical
17 issues have been highlighted relating to the volumes and levels of labour skills, tacit
18 knowledge transactions, inward investment and foreign ownership, and the balance between
19 inbound and outbound tourism. The overall impacts depend on the resulting net flows.
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34 Finally, the paper has not sought to identify or predict the impacts on specific regions. Flows
35 are locked into particular places (ALLEN *et al*, 1998) so that their impacts are determined by,
36 for example, existing economic structures and institutions and the potential to realise
37 dynamic gains through micro changes in individual companies – not to mention broader
38 social and cultural relationships. These complex changes in externalities and institutions, and
39 the interfolding of different levels of regulation, require substantial empirical research which,
40 given the paucity of secondary statistics, presents substantial challenges for primary data
41 collection. Ideally, such research should be longitudinal, focussing on a period of significant
42 change in LCC services and regional economies. Given the growing emphasis on the role of
43 air travel, both supply and demand and airports in regional development strategies, the need
44 for such evidence based policy recommendations is pressing.
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Table 1: Generalised impacts of LCCs on regional externalities for individual firms

Impact on flows	Regional externality	Timing of delivery		Duration term	
		Sooner	Later	Medium	Long
+Increases in labour migration	Labour market costs, flexibility and skills supply		X		X
+Increases in tacit knowledge transfer	Knowledge and learning capacity		X		X
+ Increases in business connectivity	Access to markets and suppliers, and inter-regional networking potential	X			X
+ Increases in inward investment	Knowledge capacity, and regional image		X	X	
+ Increases in mobile markets (tourism)	Access to markets	X			X
- Overall increase in travel leads to congestion	Reduced accessibility		X		X

Table 2: Distribution of LCC services by regional economic type: Europe, 2004

	% of all LCC services	% of all regional services	% of recent growth due to LCCs
Metropolitan	43	11	34
Central	15	14	37
Sub-central	17	47	87
Intermediate	9	20	64
Peripheral	16	17	43
Non-localized	1		22
TOTAL	100	15	42

Source: DOBRUSZKES (2005)

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Figure 1 Re-regulation, flows, externalities and performance

