Air France/KLM merger heralds further rationalisations and job cuts

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Air France has announced that it is to merge with KLM, the Dutch airline. This is the first time that a European national airline has merged with another European flag carrier. It is a response to deregulation, the economic recession, the entrance of the low-cost fliers such as Ryanair and EasyJet—and global overcapacity.

The takeover will create Europe's largest airline, the world's largest airline by sales income, and the fourth largest by traffic volumes after American Airlines, United Airlines and Delta Air Lines. It heralds a new onslaught on the jobs, wages and conditions of workers in the aviation industry, the emergence of a few mega-carriers and ferocious competition with both the other major European airlines—British Airways (BA) and Lufthansa—and the US airlines.

The two airlines will be owned by a Paris-based joint holding company to be called Air France-KLM. Air France, 54 percent owned by the French government, will use its own shares to take over KLM, in effect paying $913 million to acquire 80 percent of the shares in KLM, the loss-making Dutch carrier. This is 40 percent more than KLM's shares were trading at before the deal. KLM will own about 19 percent of the new company. The new holding company will own 100 percent of Air France but only 49 percent of KLM for the next three years at least.

Despite being billed as a merger, the two airlines will continue to operate as separate companies out of their bases in Paris and Amsterdam. They have established this complicated structure rather than a full-scale integration of the two airlines in order to safeguard KLM's international traffic rights under its 1992 agreement with the US aviation industry. Under current rules governing covering routes and landing rights for national carriers, ownership and control must be the same nationality as the aircraft's flag or registration.

While all the other major European national carriers had sought to overcome the restrictions on routes and landing rights by entering into alliances or "mergers without mergers," the Dutch airline made repeated efforts to become part of a larger group.

In 1989, KLM took a stake in Northwest Airlines, the US carrier. Two years later, it started talks with British Airways that were soon aborted when it proved impossible to surmount the regulatory hurdles. Similarly, plans for a merger with Scandinavia's SAS, the now-defunct Swissair, and Austrian Airlines came to nothing in 1993. It had planed to merge with Alitalia in 2000, but pulled out at a cost of $208 million. It then agreed to a merger with British Airways, which pulled out when the US regulatory authorities demanded that it give up some of its landing rights in the US.

By merging with Air France, KLM will join the SkyTeam alliance, paving the way for its US partner Continental Airlines and Northwest, which has a marketing agreement with Delta, to join the same alliance. This would take SkyTeam's share of world air travel from 12 percent to 21 percent, overtaking BA-America's Oneworld alliance and coming a close second to the Star alliance. Of the traditional European flag flyers, only the near-bankrupt Olympic Airline of Greece and the struggling TAP Air Portugal are not part of the three alliances.

At the same time, the Italian government has announced that it will sell part of its remaining 62 percent stake in the loss-making flag carrier Alitalia, which is part of the SkyTeam alliance. It is expected to link up with Air France-KLM and will shortly announce its "recovery" plan that includes major job cuts.

These moves follow the bankruptcy in 2001 of two national carriers, the Belgian airline Sabena and Swissair, and British Airways' recently announced plans to link up with Air Switzerland, the much-reduced airline that has emerged out of the ashes of Swissair.

The deal will require approval from both the European Commission and the US aviation authorities. BA and Lufthansa are known to be unhappy, with BA likely to demand that KLM shed some of its landing slots at its Amsterdam base at Schipol and that the new airline be prevented from exploiting its dominance.

Since the deal will create a five-way transatlantic alliance between the two European and the three US airlines—Northwest, Continental and Delta—this would breach the normal bilateral agreements around which such alliances have been structured thus far and give them a dominant position on the transatlantic routes. If the US Department of Transportation approves the deal, BA may revive its talks with American Airlines and demand that it re-examine the conditions placed on BA's earlier plans for a merger with American in January 2002—the surrender of 224 landing slots at London's Heathrow airport.

Stock exchange reception for the deal has been sceptical. It is instructive to examine the reasons.

The two airlines have studiously avoided mentioning the impact on workers' jobs in order to avoid jeopardising the deal—SNPL, the main French pilots' union, is the second largest shareholder in Air France. They claim that there will be no compulsory redundancies—code for job cuts with union approval. KLM had already announced that it would shed 4,500 jobs from its 30,000 workforce, while a further 13 percent will follow as a result of the merger.

The parlous state of all the airlines and the European Union (EU) ban on state aid means that jobs and conditions must go under the knife. The low-cost carriers are offering highly discounted tickets on popular European routes to fill the extra planes they have bought, and the flag carriers have been forced to follow suit. At the same time, the recession, the war in Iraq and the SARS epidemic have eaten into the once lucrative North Atlantic and long-haul flights. Few, if any, airlines will be in the black this year.

Air France and KLM expect profits to increase by $450 million to $550 million after five years as a result of cost savings, rescheduling of routes and improved fleet utilisation. They claim that as Europe’s largest carrier they will be able to grow more rapidly at less expense. While Paris’s Charles de Gaulle and Amsterdam’s Schipol airports rank third and fourth behind London’s Heathrow and Frankfurt International, they have better facilities and possibilities for expansion, being less congested and thus less costly than their rivals. Schipol’s spare capacity is expected to lead to France scrapping its costly plans for a third Paris airport.

But the bourses of Europe are not satisfied with this. While shares in KLM rose 12.5 percent when the deal was announced, shares in Air France fell by 4.2 percent.

According to the *Financial Times*, aviation industry analyst Chris Tarry described the cost savings as “pitiful.” “The proposed cost savings from Air France-KLM are negligible and take far too long to emerge,” he said. “The industry has too much capacity and just putting two airlines together is not enough. You must take capacity and costs out. Instead to make it acceptable to the Dutch state and the unions, you are sustaining the status quo.”

Since the EU deregulation of fares and routes in January 1993 and the privatisation of the former state-owned airlines, numerous smaller European airlines have gone to the wall or been taken over. Of the flag carriers, Air France only survived thanks to a FF22 billion government bailout in 1994 and Sabena and Swissair collapsed in 2001.

Tens of thousands of jobs have been lost, and there has been a huge onslaught on working conditions, provoking numerous strikes throughout Europe. To take but one example, BA—the first state-owned airline to be privatised in 1987—has outsourced key services. Feeder routes are franchised to low-cost carriers who charter their planes and use cheaper non-union crews. Cabin crews are no longer from the home country, but are recruited from bases around the world. Forced to compete with the low-cost carriers, BA is turning to direct sales via the Internet to eliminate the discount given to the travel agents, and to call centres operating in low-wage English-speaking countries such as India. The introduction of new working practices aimed at slashing costs led to a strike among ground staff in summer 2003.

Route structures and prices are anything but rational. Uncoordinated expansion is creating unnecessary duplication of the massive physical infrastructure to support the industry: freight and passenger terminals, runways, transportation systems to connect passengers and freight to the cities and the main land-based transport network, to mention but a few, with huge social and environmental costs. The more isolated towns and cities have seen a decline in services as the privatised airlines close unprofitable routes.

The Air France-KLM merger takes place against the backdrop of the talks between the European Union and the US aimed at a bilateral agreement on “open skies” between Europe and America. They seek a free market in air transport in which the airlines fight for dominance and the extinction of their competitors, at the expense of their workers, passengers, transport and society at large.

“It’s a bet,” says Keith McMullen of the London consultants Aviation Economics, “on the outcome of the EU-US talks on an open aviation area. In fact, it puts some pressure on the EU negotiators to speed up the talks.”

Such an agreement—if reached—would do away with the bilateral national agreements, scrap all restrictions, end ownership rules that limit foreign ownership of national airlines, and provide the European airlines with access to the huge internal US market, and vice versa. Such an agreement would pave the way for full-scale deregulation of the aviation industry. But any agreement on deregulation would only intensify the destruction of jobs and worsen working conditions throughout the industry.

It is, however, far from clear that the two sides will be able to reach an agreement on even the nationality rule that restricts the transatlantic flights of European carriers to travel to and from their home country. This is partly because the US has been pushing for more landing slots at London’s Heathrow airport, British Airways’ home base, to which only two US carriers are allowed access. Given the capacity constraints at Heathrow, any reduction in BA’s landing slots would bring financial ruin. But it is also unlikely that the US airlines, which are expected to take a $5 billion loss this year and are struggling to survive, will want to lose domestic passengers to their European rivals.