The impacts of Deregulation and Liberalisation of Air Transport on Smaller Tourist Markets: The case of Latvia and Estonia

Piotr Niewiadomski
Department of Geography & Environment, University of Aberdeen, Elphinstone Road, St. Mary's Building, AB24 3UF Aberdeen, UK
p.niewiadomski@abdn.ac.uk

1. Deregulation and liberalisation of passenger air transport and the role of the state

Over the last 40-50 years international passenger air transport has been significantly transformed by the neoliberal processes of deregulation and liberalisation. Although deregulation started in the US, initially only with regard to its domestic market, it quickly spread to the international arena when the US started replacing their restrictive bilateral air service agreements (ASAs) with other countries with "open-skies" arrangements based on multiple designation of airlines and no restrictions on routes and capacities (Bowen, 2010; Button, 2009; Debbage, 1994, 2014). Europe followed suit a decade later. In line with the emergence of the Single European Market (SEM), the European Community (which in the meantime became the European Union) implemented three packages of deregulatory reforms – in 1987, 1990 and 1993, with the last one becoming fully effective by 1997 (Bowen, 2010; Debbage, 2014; Duval, 2008; Graham, 1995). Aiming to remove all barriers to intra-community trade, by 1997 the EU had eliminated most regulatory constraints on routes, fares, capacities, frequencies and market entry (Bowen, 2010; Debbage, 2014), thus becoming the most deregulated air market in the world – the European Common Aviation Area (ECAA) (Bowen, 2010; Debbage, 2014; Duval, 2008). Over time, the ECAA also encompassed some non-EU countries (e.g. Switzerland) and, naturally, all new EU member states.

Importantly, the development of the ECAA – a uniform, multi-lateral open-skies agreement – had a critical effect on the role and market position of national carriers in the EU. Namely, the nationality of European airlines serving intra-European traffic ceased to mean anything beyond 'national pride' (Bowen, 2010; Button, 2009; Debbage, 2014, Duval 2008). The privatisation of numerous flagship airlines further undermined the concept of a 'national airline' in the EU, although many governments chose to keep shares in their former flag carriers (Bowen, 2010). While over the 1990s the EU aviation market became similar to the US domestic market, in terms of the 'nationality' of airlines, the EU – as a bloc of countries, rather than a single state – pushed the deregulation of aviation one step further.

Despite the expectations that promoting a competitive environment for airlines would benefit not only the airline industry, but also consumers, and – by means of stimulating passenger flows – also many tourist destinations (Debbage 1994; Goetz and Vowles, 2009; Wheatcroft, 1994, 1998), the processes of deregulation and liberalisation produced a mixed bag of outcomes. As Goetz and Vowles (2009) found with regard to the US, positive effects included the emergence of new entrants (including low-cost carriers, LCCs, as an entirely new concept) and a significant increase in the number of available connections, all of which

intensified competition, thus also bringing lower fares (on average) and a growth in passenger numbers. By contrast, the most important negative outcome was a high turnover in the industry (i.e. multiple mergers, take-overs and bankruptcies) (Button, 2009; Goetz and Vowles, 2009). Importantly, distinct spatial outcomes also could be observed. Many services to small, remote, and less lucrative destinations that could not be economically justified were reduced or withdrawn or, at best, fares on those routes increased (Bowen, 2010; Goetz, 2002; Goetz and Vowles, 2009).

The popularisation of more liberal international ASAs also produced new geographical patterns of accessibility by air at the international level. As such, open-skies ASAs were found to play a crucial role in shaping international mobility and determining access to various tourist destinations (Duval, 2008; Duval and Koo, 2012; Warnock-Smith and Morrell, 2008). Similarly to what Goetz and Vowles (2009) found in the US, the effects of deregulation at the international level were also uneven (Bowen, 2002). With its multi-lateral arrangements Europe was no exception. If Goetz and Vowles's (2009) findings from the US are transferred to the EU context (i.e. an equally liberalised environment, albeit one that is divided into multiple nationally-defined tourist markets), it can be inferred that European equivalents of "small, remote and less lucrative destinations" in the US are in fact entire small states that are positioned at the peripheries of the intra-European networks (i.e. far from the main hubs) and which have a limited ability to generate considerable air traffic by themselves. Thus, the deregulation of air transport in the EU produced new geographies of winners and losers, with accessibility by air being a key measure of success (see also O'Connor and Fuellhart, 2015, for the example of Asia and Australia).

Indeed, similarly to the system of bilateral agreements, where it is often impossible to ensure an equal exchange of rights between states with different domestic markets (Debbage, 1994), in deregulated, multi-lateral environments like the EU, smaller states also often find themselves in a disadvantaged position, albeit for different reasons. While the primary objective for national governments in Europe before deregulation was to protect their national carriers (often at the expense of encouraging tourist visitation!), in the era of deregulation of aviation and the global economic openness, where a "viable airline industry is important to national economic competitiveness, regional economic development, and the 'public interest'" (Goetz and Vowles, 2009, p. 261), the strategic objective is to secure access to the international networks of connections and the flows of capital and people which these networks facilitate (Button et al., 2010; Cidell, 2006; Graham, 1998; Graham and Guyer, 2000; Halpern and Brathen, 2011; Keeling, 2007; Niewiadomski, 2017, 2020; Redondi et al., 2013).

However, in multi-country, deregulated environments like the EU, smaller countries often find such objectives difficult to achieve. First, it is rarely possible for small states to provide a sufficient market to support an independent national carrier (Debbage, 1994, p. 191). Moreover, by contrast to the US, where many smaller destinations have air connections centrally subsidised (Bowen, 2010), the hands of European governments that are willing to support their national carriers in order to overcome their geographical or market-related disadvantages are tied by the EU policies that restrict most forms of state aid (Veebel et al.,

2015). Second, due to the fact that in deregulated environments the provision of air services is a prerogative of airlines (i.e. if a given connection cannot be supported by sufficient demand, it will be instantly withdrawn), many small destinations fall victim to the volatility of airline strategies and their sensitivity to fluctuations in demand (Graham and Guyer, 2000).

Third, the ability of public authorities to subsidise routes operated by foreign airlines is reduced by the same state-aid policies as above. As a result, smaller states often find themselves bypassed by major international passenger flows, to the detriment of their economies and tourism sectors. For all these reasons, many governments of smaller European countries often try to revert to some form of regulatory oversight. Various attempts to maintain the national airline are a common strategy here. The lasting tradition of flagship airlines, which continue to be seen as a valuable national resource (regardless of whether they have been privatised) (Bowen, 2010; Debbage, 1994, 2014), fosters this tendency. The national pride, which airlines are said to reinforce, plays an important role particularly for those countries that (re-)gained independence relatively recently and where national carriers became symbols of national identity (see Bowen, 2010).

This chapter focuses on Latvia and Estonia – perfect examples of small and peripherally-located EU countries whose accessibility by air has been significantly affected by the EU deregulation of aviation, i.e. where major carriers often do not fly and where great hopes are pinned on national airlines – both for pragmatic reasons (i.e. to ensure connectivity) and because of national pride (i.e. nation building since 1991 when both states re-gained independence from the Soviet Union). The efforts which the authorities in both countries invest in inserting their states into the networks of international airlines and securing access to wider tourist flows lie at the heart of this chapter. By comparing both states to Germany, Table 1 illustrates why Latvia and Estonia are considered 'small markets'.

Table 1: Estonia and Latvia as small tourist destinations

(2016)	Latvia	Estonia	Germany
Population (million)	1.95	1.35	82.35
Capital city population (thousand) *	642.89	423.07	3,552.12
GDP (billion US$)	27.69	23.33	3,466.34
GDP per capita (thousand US$)	14.06	17.79	41.90
Air passengers (on scheduled services) (million)	5.38	2.21	200.69

Source: Eurostat (2016) (*https://ec.europa.eu/eurostat/data/database*) apart from * World Population Review (2021) (*www.worldpopulationreview.com*)

As such, the chapter aims to address an important gap in the literature on air transport, i.e. how air transport is shaped "from below" (Niewiadomski, 2017). While most work on passenger air transport focuses on the supra-national level (e.g. the unevenness of deregulation and the spatiality of networks of air connections which this unevenness produces), the impacts of deregulation of air transport on various destinations and how these

impacts are shaped by the various institutional, political and social features of the places which networks of air connections interlink, remain an under-researched issue. Although much research has been done on the implications of an airport's position in wider networks on the respective city/country's accessibility by air (e.g. Bowen, 2002; Halpern and Brathen, 2011; O'Connor and Fuellhart, 2012; Redondi et al., 2013), more work is required on the role of politics and governance at the national level and below, and the different bottom-up strategies which countries and regions adopt to promote themselves to airlines, improve their network position, foster regional competitiveness and open themselves up to business and tourist visitation (Niewiadomski, 2017).

The remainder of this chapter consists of three sections and conclusions. To set the scene, section 2 outlines the development of passenger air transport in Latvia and Estonia after the disintegration of the Soviet Union in 1991. The following section briefly summarises the methodology, whereas the penultimate section discusses the efforts which both countries have been investing in securing a place in the international networks of air connections and gaining access to wider tourist markets. The last section summarises key conclusions.

2. Passenger air transport in Latvia and Estonia after 1991

In 1991 Latvia and Estonia declared independence from the Soviet Union, thus putting an end to the five decades of communist regime. Similarly to many other formerly communist Central and Eastern European (CEE) states, both Latvia and Estonia embarked on a path of transition from socialism to a form of market economy and liberal democracy, with the main aim of dismantling central planning and (re-)connecting with the West both economically and politically (Bradshaw and Stenning, 2004; Smith, 1997; Smith and Pickles, 1998; Sokol, 2001). The complex restructuring which both countries initiated also naturally embraced the transport sector. While both states had to deal with the legacies of the previous system (e.g. legal issues, poor infrastructure, inferior technology, etc.), the processes of privatisation, decentralisation, internationalisation and de-monopolisation – the main components of the desired transition to capitalism (Bradshaw and Stenning, 2004) – fostered both states to develop new organisational structures and seek new cross-border links with the West (Hall, 1993). Passenger air transport was very high on this agenda from the beginning.

Before the dissolution of the Soviet Union, Latvia and Estonia, as Soviet republics, were served by the respective regional branches of Aeroflot – the all-Soviet airline and civil aviation regulatory body overseen by the USSR Ministry of Aviation (Shibata, 1994). Upon re-gaining independence, Estonia and Latvia acquired these branches and converted them into independent flag airlines – Estonian Air and Latavio (also known as Latvian Airlines), respectively (Jankiewicz and Huderek-Głapska, 2016; Shibata, 1994). Concurrently, new civil aviation authorities were established in place of the former Soviet institutions (Shibata, 1994; Sollinger, 2011). There were two main reasons why developing a discrete national air transport system and establishing a flag carrier were of significance to the Latvian and Estonian governments (and nations). First, air transport was expected to play an important role in linking the newly independent states to the global economy, i.e. to facilitate access

to international leisure and business markets and to foster an influx of capital, investment, expertise and goods (Hall, 1993; Jankiewicz and Huderek-Głapska, 2016). Second, since national carriers were seen as symbols of independence, it was also a matter of national prestige (Huettinger, 2006; Shibata, 1994).

Given that the economic restructuring in Latvia and Estonia coincided in time with the deregulation and liberalisation of passenger air transport in Western Europe – a set of processes deeply grounded in the same neoliberal agenda as the post-communist changes in CEE after 1989 – the governments of Latvia and Estonia, similarly to the administrations of the other formerly communist states in CEE, faced a difficult dilemma whether to deregulate air transport and privatise their national airlines or whether to maintain a degree of protectionism. While privatisation could serve as a source of know-how and provide the government with an influx of foreign currency (all of which each CEE country urgently needed), the fear of losing control over the flag carrier to a foreign entity and the risk that the airline might not survive in a market environment were the main reasons why very few CEE states decided to privatise their national airlines without keeping a majority stake (Shibata, 1994). While air traffic to and from both countries continued to rely on bilateral agreements (Shibata, 1994; Sollinger, 2011), Estonian Air and Latavio initially remained in the hands of the state (Shibata, 1994; Sollinger, 2011). It was only in the two domestic markets where some deregulation occurred and new entrants were allowed (although none of them noted any major commercial success).
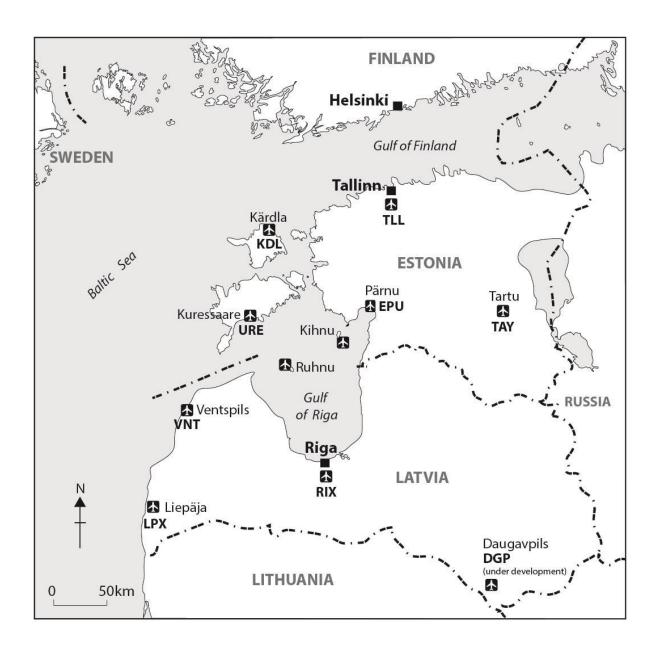
While the protectionist policies remained in place till the accession of Latvia and Estonia to the EU in 2004, significant changes happened in the mid-1990s in terms of airline privatisation. In 1995, the continuous poor performance of Latavio encouraged the Latvian government to open up to the idea of foreign participation. As a result, Latavio was superseded by AirBaltic – a new national carrier of Latvia, established as a joint venture between the Latvian government (51%), Scandinavian Airlines (SAS) (29%), an American company Baltic International (8%) and a couple of Scandinavian banks (12% altogether) (AirBaltic, 2021; Funding Universe, 2021; Huettinger, 2006; Sollinger, 2011). After AirBaltic was transformed into a joint stock company in 1999, SAS bought out the other Scandinavian investors and its stake grew to 47.2% (Funding Universe, 2021; Sollinger, 2011).

Meanwhile, similar changes also took place in Estonia. In 1996 49% of shares in Estonian Air were acquired by Maersk, a Danish shipping company, while 17% of shares were sold to Cresco (an Estonian investment group), which left the Estonian state with a minority stake of 34% only. However, in 2003 Maersk sold its shares to SAS, which thus made SAS a leading (albeit minority) shareholder in both Estonian Air and AirBaltic (Funding Universe, 2021). The acquisition of shares in both airlines reflected SAS's wider strategy, i.e. an intention to serve the three Baltic states via their local airlines (although its later bid to acquire Lithuanian Airlines proved unsuccessful) (Huettinger, 2006; Matthiessen, 2004). Because of the restructuring and despite the crisis in air transport after the events of 11th September 2001, in the early 2000s both Estonian Air and AirBaltic started generating profits (Funding Universe, 2021). As a result, when the two states joined the EU in 2004, both had well-established national airlines.

By that time, also the structure of the airport sector in both countries had crystallised. Given that Riga (RIX) in Latvia and Tallinn (TLL) in Estonia served the capital cities and were home to the respective national carriers, both countries developed a high level of centralisation. Because of the protectionist policies and the small size of both national markets, between 1991 and 2004 RIX and TLL were the only airports in Latvia and Estonia that served scheduled international traffic. However, a few airports (re-)opened outside the capital cities. Thus, in Latvia, two former Soviet passenger airports were re-developed in the 1990s – Liepāja (LPX) and Ventspils (VNT) (Liepaja Airport, 2021; Visit Ventspils, 2021). Simultaneously, an idea also evolved to convert the former Soviet military base in Daugavpils into a passenger airport (Sollinger, 2011) in order to directly serve Latgale – the most remote region in the country. However, no funding for this proposal was found and, to date, the project has not even commenced (Daugavpils Municipality, 2015). While RIX remained entirely in the hands of the state (Sollinger, 2011), the ownership of the other airport facilities (including Daugavpils) was passed to the respective municipalities. This structure has remained in place to date.

The developments in Estonia were initially similar. In the 1990s, two regional passenger airports were re-developed on the Estonian mainland – Parnü (EPU) and Tartu (TAY). At the same time, the two major airports on Estonian islands – Kuressaare (URE) on Saaremaa, and Kärdla (KDL) on Hiiumaa, as well as the two airstrips on the islands of Kihnu and Ruhnu, continued their operations to maintain connections with the mainland. Although the ownership of these airports initially varied, in 2005 all of them were acquired by Tallinn Airport Ltd. – a state enterprise whose key responsibility was to manage Tallinn Airport. Thus, all airport operations in Estonia were integrated and centralised. As this arrangement has not changed to date, it remains a crucial difference between Estonia and Latvia. All airport facilities in both countries are shown in Figure 1.
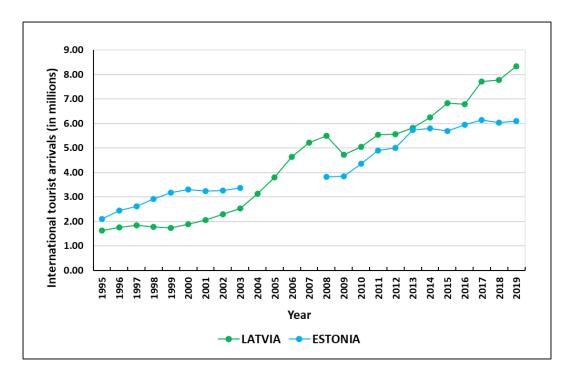
Figure 1: Passenger airports in Latvia and Estonia in 2021
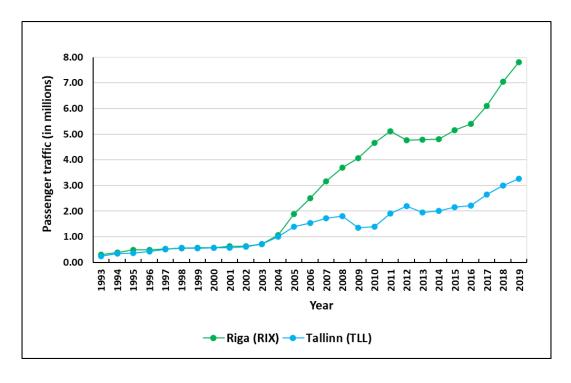

Source: Own elaboration

Overall, before the accession to the EU, passenger aviation in Latvia and Estonia developed slowly (Jankiewicz and Huderek-Głapska, 2016). While the number of international tourist arrivals increased incrementally year by year (see Figure 2), the contribution of air transport to these figures was rather modest (see Figure 3 for the total number of passengers travelling through RIX and TLL in the 1990s, noting that arrivals accounted for ca. 50% of those values). Indeed, most visitors to Latvia came from the neighbouring Estonia and Lithuania by road (nearly 60% in total in 2004) (Druva-Druvaskalne et al., 2006), while every year over 50% of visitors to Estonia came from Finland, mainly by ferry (Jarvis and Kallas, 2006, 2008).

Figure 2: International tourist arrivals (in millions) in Latvia and Estonia (1995-2019)

Source: Own elaboration on the basis of data retrieved in September 2021 from The World Bank – World Development Indicators (*https://databank.worldbank.org*)

Figure 3: Passenger traffic through Riga Airport (RIX) and Tallinn Airport (TLL) (in millions) (1993-2019)

Source: Own elaboration on the basis of data retrieved in September 2021 from Official Statistics of Latvia (*https://stat.gov.lv*) and Statistics Estonia (*https://andmed.stat.ee*)

The situation started changing rapidly in 2004 when, further to the EU accession, Latvia and Estonia adopted the EU-wide open skies policy and joined the deregulated European Common Aviation Area (ECAA), thus also accepting all EU regulations pertaining to aviation. While the dramatic changes in the economic and political landscape presented both states (and particularly their tourist industries) with unprecedented opportunities, the inclusion of both states in the ECAA had a significant influence on both countries' connectivity by air.

The economic and political integration with the EU and the accession of both states to the Schengen Area markedly enhanced demand for air services between the Baltics and the rest of the EU. First, increased flows of investment and trade stimulated business travel to Estonia and Latvia (Dobruszkes, 2009; Jankiewicz and Huderek-Głapska, 2016). Second, because of their rich cultural heritage, both Latvia and Estonia succeeded in promoting themselves to Western tourists as attractive and affordable destinations, which substantially fostered leisure travel to the Baltics (Dobruszkes, 2009; Jankiewicz and Huderek-Głapska, 2016). As a result, distant markets like the UK and Germany, which naturally required convenient connections by air, became strategic markets for the tourism industries of both Estonia and Latvia (Druva-Druvaskalne et al. 2006; Jarvis and Kallas, 2006, 2008). The outflow of Estonians and Latvians looking for employment in Western Europe, which the EU accession enabled, as well as VF&R travel, which it subsequently fostered, became the third key source of demand for air services (Dobruszkes, 2009; Jankiewicz and Huderek-Głapska, 2016). The growth in international tourist arrivals to both countries and the corresponding rise in passenger numbers served by RIX and TLL after 2004 are presented above in Figures 1 and 2, respectively.

Concomitantly, the deregulation of passenger air transport in Latvia and Estonia, which the accession to the EU imposed, significantly reshaped the position of both states in the European networks of air connections. However, despite the considerable rise in demand for air transport, the impacts of those changes were not always positive and therefore not fully welcomed. First, quite typically for newly deregulated countries, Latvia and Estonia saw the arrival of new entrants – mainly LCCs (Alderighi et al. 2012; Dobruszkes, 2009; Jankiewicz and Huderek-Głapska, 2016; see also Dennis, 2005). As Dobruszkes (2009) noted, the number of low-cost connections between Western Europe and "the new Europe" (i.e. the newly admitted EU member states) increased from 118 in 1991 to over 500 in 2008. Both Latvia and Estonia played a part in this increase. Rather unsurprisingly, LCCs addressed mainly the second and the third source of demand for air services, i.e. leisure and work-related/VF&R travel (Jarvis and Kallas, 2006). However, the budget tourists whom LCCs brought were not necessarily the market segment which Riga and Tallinn desired (Druva-Druvaskalne et al., 2006).

Second, although the possibilities were, at first sight, exactly the same for full-service carriers (FSCs), the expansion of FSCs into Latvia and Estonia proved to be very limited. While the relatively small size of both markets and the competitive position of LCCs (Huettinger, 2006) were important factors here, the reluctance of FSCs was also a reflection of the wider changes that were taking place in the deregulated EU environment. Further to the increase in competition, FSCs were forced to rationalise their network strategies in order

to improve their financial performance and survive in the market (Alderighi et al., 2012; Burghouwt et al., 2003; Dennis, 2005). As a result, most FSCs shifted to hub-and-spoke operations, while cutting off less profitable spokes and abandoning smaller destinations (Alderighi et al., 2012; Dennis, 2005; Dobruszkes et al., 2010). Riga and Tallinn experienced this directly. Although some carriers tried to operate routes to RIX and/or TLL, the inclusion of both cities in the networks of major European FSCs was limited. In 2015, Lufthansa was the only major carrier flying to Latvia and Estonia, with Brussels Airlines and SAS flying to Riga only, and with Air France, Alitalia, British Airways, KLM and Swiss either not flying to the Baltics at all or, at best, relying on code-share arrangements with AirBaltic or Estonian Air. Thus, business travel to and from Estonia and Latvia was significantly under-served.

While the above might look like an opportunity for the two national carriers, the competition of LCCs in combination with the limited size of both markets put Estonian Air and AirBaltic in a very difficult situation. Despite lowering their prices and initiating a range of new routes to main EU destinations and hubs (Huettinger, 2006; Jarvis and Kallas, 2006, 2008), both carriers found themselves in dire straits (AirBaltic, 2021; Tammik, 2011; Veebel et al., 2015). However, from the beginning AirBaltic was much more pro-active in dealing with these challenges than Estonian Air. First, to better address the low-cost market, the airline adopted a hybrid, low-cost/full-service strategy, thus becoming a flag carrier with a handful of practices imported from the low-cost model (e.g. market-adjusted fares and point-to-point routes) (Jankiewicz and Huderek-Glapska, 2016; Huettinger, 2006, see also Klophaus et al., 2012). Second, AirBaltic started capitalising on the central location of Riga (relative to Tallinn and Vilnius), which allowed the airline to gradually exploit the links between the three countries and promote Riga (the largest of the three capital cities) as a main hub for the Baltics (Jankiewicz and Huderek-Glapska, 2016; Huettinger, 2006; Ruskulovs et al., 2019). In 2005 AirBaltic adopted Vilnius as its second hub (Huettinger, 2006), which was an additional manifestation of its intention to take over the Baltic market.

However, the unprofitable condition of both airlines within the 5 years after the EU enlargement led to far-reaching consequences. The necessity to inject new capital, which coincided in time with SAS revising its strategy and declaring that it was no longer willing to co-own national airlines in the Baltic states (Roman, 2011), resulted in significant ownership changes. In 2009 SAS sold all its shares in AirBaltic (47.2%) to the airline's management (Baltijas Aviācijas Sistēmas Ltd.) (AirBaltic, 2021). As a result of further investments, by the end of 2011 the Latvian state had acquired 99.8% of the company's shares. Its current stake is 96.14% (AirBaltic, 2021). Similar developments also took place in Estonia. The government's investment in Estonian Air resulted in SAS's stake decreasing from 49% to 10% (The Local, 2010; Roman, 2011; Tammik, 2011). Since the state also acquired Cresco's shares (17%), the Estonian government's stake grew to 90% (Magone, 2009; Reuters, 2009). Over the next few years, it further increased to nearly 98%.

Thus, in 2009-2011 both flagship carriers were effectively re-nationalised. As the main objective was to save them from bankruptcy, both governments provided their carriers with significant amounts of state aid, while also developing restructuring plans and submitting them to the EU to justify the need for financial support (AirBaltic, 2021; Veebel et al., 2015).

While the next section briefly discusses the methodology, the following section analyses the strategies and motivations of the Estonian and Latvian authorities and some of the implications of their actions.

3. Methodology

The discussion in the following section draws from 17 semi-structured interviews carried out between April and August 2015. This included five interviews with representatives of major European FSCs, six interviews with representatives of the air transport industry and local and national governments in Estonia (including tourism- and air transport-related authorities), and six interviews with a similar group of respondents in Latvia. All respondents were recruited via e-mail enquiries. The snowballing method was also adopted whenever a given respondent could facilitate access to other interviewees. All interviews with FSCs were conducted over the phone. In terms of the length, they lasted from 32 to 39 min. (34 min. on average). By contrast, most interviews with Latvian and Estonian respondents took place face-to-face during field visits to both states in June-July 2015. Only one interview in each country took place over the phone after the field visit due to the limited availability of the interviewee. Whereas the Estonian interviews ranged from 41 to 68 min. (51 min. on average), Latvian interviews lasted from 32 to 62 min. (48 min. on average). All conversations were conducted in English and were subsequently transcribed. To keep the analysis below as up to date as possible, the chapter also draws from various documentary sources (including relevant websites and press articles) which were interrogated between January and November 2021.

4. Research findings: securing connectivity for Latvia and Estonia

4.1 The shortage of full-service connections

The accession of Latvia and Estonia to the EU in 2004 opened both countries to international tourist flows, to the benefit of both states' tourism sectors. The adoption of the EU-wide open-skies policies and the deregulation of passenger aviation also increased the role of air transport in bringing visitors to Latvia and Estonia (as Figures 2 and 3 also show). However, despite some positive developments, the configuration of the provision of air services that developed in both countries after 2004 was not considered sufficient to the needs and aspirations of both national economies. While leisure and work-related/VF&R traffic were served relatively well (mainly by LCCs), the shortage of full-service links, which were perceived critical in bringing business travel and attracting foreign companies, quickly became a concern. The peripheral location of both states (relative to the rest of the EU) and the small size of both markets were the main reasons why most European FSCs showed little interest in Latvia and Estonia:

> "The Baltic states as such, unfortunately, are of minor importance within our company. We used to fly [there] (…), but we decided that it was not feasible for economic reasons to continue to operate at that point in time."
> *(Respondent 2 – a European FSC)*

[A European FSC] is not interested, but at least they are talking to us, at least they are talking… Today they are code-sharing, but they are not active, they are not promoting flights to Tallinn, they are just selling. But [a different FSC] is extremely arrogant, they are refusing to talk to us, saying: 'Come back in five years. I have no time to talk to you because this is not our market. Goodbye.'."
(Respondent 13 – Estonia)

Furthermore, the unappreciative (or even dismissive) perception of both markets by major European FSCs also derived from the aforementioned wider need to rationalise their EU networks and abandon less profitable destinations. One of the respondents explained it:

How to convince airlines to fly to Tallinn, this is our problem! (…) So, for example, even if British Airways (…) want to have a night stop in Tallinn, they have (…) so many bigger places, so many guaranteed business places before Tallinn. So, when we start to count… 'OK, let's fly to Tallinn and back, it's occupying our aircraft for seven hours – seven hours of aircraft for somewhere in Eastern Europe. During that time, we could fly a few times to Paris.'. So then, if you are an aircraft owner, you fly to Tallinn or three times to Paris. This is the answer and this is where the problem is!"
(Respondent 15 – Estonia)

However, the negligible interest of FSCs in the Baltic countries contrasted starkly with the importance pinned on air transport by both national economies and the respective tourism industries – particularly for business tourism. A respondent from Latvia explained it perfectly:

"Just think of Latvia as an island. If you travel from Riga, any direction in the car for 8 hours, you still reach only less than 2% of the European GDP. If you travel the same way from Prague or from Brussels for 8 hours in any direction, you reach almost 40% of the European GDP, by car. So basically here, anywhere you go, you can't even go, you don't have proper motorways, you don't have a railway, you don't have a ferry… (…) You have to fly. It's basically like an island. So that's why air transport makes a difference."
(Respondent 10 – Latvia)

Another important factor that naturally discouraged FSCs from flying to Estonia and Latvia was the existence of the two national airlines who – despite their limited resources – were obvious competitors for FSCs, albeit only at the local level and on selected routes:

"[Local carriers] are competition for one-day destinations. (…) Serving those markets from their home bases, they always have the morning flight. The other carrier, from the other end, would have to have a night-stop operation there which is quite costly because you have to park the aircraft, (…) you have to pay for the crew hotel, (…) so there is a lot of operational costs attached to a night-stop. And this of course gives them a product advantage."
(Respondent 1 – a European FSC)

Thus, a significant disjuncture evolved after 2004 between the interests of major European FSCs and the needs and ambitions of the Latvian and Estonian economies. While it was extremely difficult to attract major FSCs, even when some FSC connections were initiated, in most instances they proved to be short-term anyway.

4.2 The flag carriers in Latvia and Estonia – strategic importance, national pride and local rivalry

Since attracting FSCs proved difficult, the only way to insert both countries into the networks of air connections of major FSCs was through the respective national airlines reaching out and developing links to the hubs of those FSCs themselves. Indeed, as discussed previously, both flagship airlines set up a range of routes to key destinations in Europe (Huettinger, 2006; Jarvis and Kallas, 2006, 2008), including the hubs of major FSCs which they often served on the basis of codeshare agreements with the respective airlines. This, in turn, was usually also a good arrangement for those FSCs:

> "[Major European airlines] sometimes don't realise that this [the Baltics] is a specific market, a very thin market and they need extremely low cost that they cannot typically afford. That's one of the reasons why the big ones (…), they all fly to Riga, but do you know what? They fly to Riga, but you never see their aircraft here. Why? Because this is AirBaltic flying and they are only selling their tickets (…), because this is so much cheaper for them. They cannot afford it themselves, so they fly AirBaltic."
> *(Respondent 10 – Latvia)*

While at first sight, the whole situation might look like a win-win solution both for the two national carriers and for major European FSCs, and a satisfactory arrangement for both economies (and both tourism sectors), in practice both national carriers found it difficult to achieve profitability. The fact that the revenue from codeshare agreements between larger and smaller airlines is rarely shared in a way that is favourable to small carriers exacerbated this issue further. The financial difficulties that both airlines experienced created a three-fold challenge for the authorities and the aviation industries of both countries. The first challenge was to save the flag carrier (with national pride as one of the key drivers), which in the absence of foreign FSCs was to be the main means of achieving the second challenge, i.e. to ensure a sufficient level of connectivity by air. This, in turn, was to help achieve the third, ultimate challenge, which was to facilitate business travel and attract firms and investment from those industries where convenient air connections are a key locational factor.

As a result, both national governments offered their flag carriers considerable financial aid, which coincided in time with (and perhaps fostered) the withdrawal of SAS from both airlines and their almost entire re-nationalisation. However, the outcomes of those actions differed between the two countries. While AirBaltic survived the problems, achieved profitability by 2013 (earlier than expected!), had their restructuring plan (and state aid) approved by the EU in 2014, and developed further to become the best performing airline within the group of the new EU member states (AirBaltic, 2021; Jankiewicz and Huderek-Glapska, 2016), the

state aid for Estonian Air was deemed illegal by the EU, which instantly led to the airline's bankruptcy in 2015 (Veebel et al., 2015). Two main factors shaping this divergence can be identified.

First, it can be inferred that the Latvian (air transport) authorities, as well as AirBaltic more directly, diagnosed the problem much earlier, i.e. straight after the EU enlargement in 2004, even though more radical measures had not been taken until 2009-2011. The adoption of a hybrid strategy after 2004, and the expansion to Vilnius to take advantage of the Lithuanian market, was a solid start (Jankiewicz and Huderek-Glapska, 2016; Huettinger, 2006; Ruskulovs et al., 2019). The substantial help offered by the national authorities was also a decisive factor here:

> "It was basically a combination of the government changing its aviation policy and investing in (…) Riga Airport, which is the only international airport in Latvia, (…) and also the investment from the shareholders of AirBaltic, both private and the government. So, it was gradual investment by the state and the private investors (…), and also the change of the political concept."
> *(Respondent 10 – Latvia)*

Unfortunately, despite the good intentions and the financial help offered by the Estonian government to Estonian Air, the same could not be said about the Estonian authorities:

> "At the same time Estonia and Lithuania did nothing like that, so of course they are suffering now from years of under-investment. And that's the result – not the strength of AirBaltic, but the weakness or absence of their political will and strategic decisions."
> *(Respondent 10 – Latvia)*

> "We cannot actually see very much what they've done in order to support our local connections, our local airline. We can see that they are saying it's important, but we don't see too many actions. It's even the same with the EU discussion: we can see that the Latvians were a lot more active in lobbying and trying to get decisions through to support their airline. When it comes to Estonia, they [the government] haven't been so active in that respect."
> *(Respondent 15 – Estonia)*

Second, the Latvian authorities as well as the Latvian air transport industry skilfully and strategically capitalised on the geographical location of Riga – its central location relative to smaller Tallinn and Vilnius on the one hand, and its convenient location between Europe and Russia (and other Eastern states) on the other. Quite understandably, the geographical location of Riga was a useful springboard for AirBaltic's further expansion into the neighbouring states. Thus, further to the adoption of Vilnius as its second hub in 2005 and the successful restructuring of the airline from 2009 onwards, AirBaltic took advantage of Estonian Air's difficulties and adopted Tallinn as its third hub from which it also initiated several direct connections (including some of the routes simultaneously served by Estonian

Air). Such a multi-hub strategy that relied both on operating lucrative point-to-point routes from all three airports and on re-directing some of the remaining traffic from Tallinn and Vilnius via RIX was a promising path to significant market advantage.

> "It's Riga that is taking the biggest share. They already developed very well, they developed the airport itself, they developed very good marketing activities."
> *(Respondent 5 – a European FSC)*

> "All neighbouring countries are trying to grab passengers from Tallinn – Fins, Latvians, all of them! (…) They [AirBaltic] are just the biggest and I can tell you that Latvia is two times bigger and that Riga Airport is two times bigger than Tallinn. (…) This is what they have thanks to AirBaltic, which is an aggressive and good company, that's it. (…) [We can overcome this problem] only when we have a proper national airline which generates at least a little bit of transit traffic and learns how to bring people to Tallinn – exactly what other neighbours are doing: Finn Air or AirBaltic."
> *(Respondent 13 – Estonia)*

Simultaneously, Riga Airport – as AirBaltic's hub – started aspiring to become a gateway to the East. While Estonia prioritised its economic and political relations with Scandinavian states, Latvia seemed more willing to recognise its potential to connect the East with the West. To help develop East-West routes (and bring more transit traffic to Riga) was another strategy of AirBaltic and RIX that relied on Riga's geographical location. Uzbekistan Airlines, which had a stop-over at RIX on their way to the US (a route operated on a code-share basis with AirBaltic), can serve here as the best example.

> "The Baltic states are still small. What the Baltics need to win in this situation, as I see it from my perspective, is that they need Riga as their transit hub between Europe and other countries. They are serving Scandinavia, but they also need to become a hub to East – to the Former Soviet Union countries. So that's where I think they have the right policy."
> *(Respondent 5 – a European FSC)*

> "The understanding of the Eastern cultures, the understanding of the neighbour to the East, several neighbours to the East – it's a huge market of two hundred million people – these are the legacies that AirBaltic commercialises on and capitalises on. These are productive legacies and they benefit from these and turn them into their favour, both politically (…) and also commercially. (…) So, they know how to operate in these Eastern markets and they make money out of this."
> *(Respondent 10 – Latvia)*

Rather unsurprisingly, even though AirBaltic initiated direct routes from TLL (thus partly addressing the problem with connectivity which Estonia started experiencing), Estonians did not fully welcome AirBaltic's expansion. As *Respondent 6 (Estonia)* explained, because of

their traditional (economic, political and cultural) links to Finland, Estonians always had a preference to fly from Helsinki if there were no direct flights from TLL. Only people from southern Estonia (i.e. Pärnu or Tartu) might pick Riga due to its geographical proximity (although the only international route available from Tartu in 2015 was in fact Helsinki!):

> "Show me Estonians that say Riga is the centre! Of course, looking from the outside, I can understand that we are a very small region, even if you put the three countries together. And Riga is in the middle and, if we talk about airports, then Riga Airport of course has a lot more connections than Tallinn Airport. So it might seem like that. But definitely, if we talk about the wider context and the economy, as such, and the identity of the countries then Riga does not represent Estonia. And probably I guess also the Lithuanians do not think like that. We try to be strongly independent. (…) So, probably, Air Baltic has a bigger customer group. But for people who need to take a business trip from Tallinn, at least the people I work with, Air Baltic is not our first choice."
> *(Respondent 6 – Estonia)*

Importantly, apart from national pride, Riga's and AirBaltic's advantage were also not appreciated by Estonians for economic reasons:

> "Well, sure, the location clearly helps. But historically, well, the dominance of Riga wasn't so evident in the past. We can see that a lot of business has actually moved from Tallinn, and potentially also Vilnius, to Riga because of the fact that it's in the middle. But it's also highly supported by the connectivity you can see in Riga. And historically, Western companies, when coming to the Baltics, would set up their headquarters in Tallinn instead of Riga. But now we can see more and more that they are actually being moved down to Riga. Sure, there can definitely be also other reasons for that when you look at the cost of labour or also different legislation or taxation environments. But connectivity is nevertheless one of the most important factors here."
> *(Respondent 15 – Estonia)*

It is also pertinent to acknowledge that the rivalry between RIX and TLL, and between AirBaltic and Estonian Air, was not solely a reflection of the small size of the Baltics as a market or the competition between the two states at the local level. The relative shortage of market space for both airports and both airlines is also symptomatic of the wider problems with European aviation and the overall level of saturation of the European market:

> "I think, however, a general European (…) aviation problem is the number of companies serving one market. I think we have way too many too small carriers in Europe. (…) Compare the US, which is naturally a more saturated aviation market, to Europe. You have far, far less carriers serving almost the same amount of people. (…) So, I think in general the smaller carriers have it rather tough right now."
> *(Respondent 2 – a European FSC)*

This, in turn, links to one of the contested issues across the Baltics as far as air transport is concerned – whether Estonia, Latvia and Lithuania should follow SAS (which serves as a national airline for Denmark, Sweden and Norway simultaneously) and develop one airline representing all three states. Apparently, such an idea emerged as early as 2005 when a 'Baltic Airlines System' was proposed as a merger of Estonian Air, AirBaltic and Fly LAL – the Lithuanian flag carrier at that time (Huettinger, 2006). The concept, however, sparked varying reactions and, as such, it did not materialise.

Given that over time AirBaltic developed a dominant position in the Baltic market, the question of "a Baltic airline" evolved into a question whether the role of representing all three Baltic states should be passed to AirBaltic. The fact that in 2015 Lithuanian Airlines (a Lithuanian carrier that superseded Fly LAL) went bankrupt, and the same was already expected of Estonian Air, underpinned this debate significantly. Unsurprisingly, the idea divided Estonians and Latvians further. While such a concept looked obvious to Latvians, Estonians rejected this idea both on the grounds of national pride and for economic reasons:

> "[We have] a preference to have AirBaltic as an airline for all Baltic states but the neighbours do not like the idea. (…) I think it would be best for all Baltic states and this airline would become more competitive. And bigger and stronger."
> *(Respondent 9 – Latvia)*

> "I would prefer that we would have our own airline because then we have certain choices, I think, that we can make as a country – we have more freedom, we can open [links] with destinations that make sense for Estonia and we will have the possibility to make these decisions ourselves. If we only have a company that is owned by one country then, well, these questions would arise: what would be our choices, (…) would there be a difference in quality serving Latvia, versus serving Estonia or Lithuania? Plus (…), it is sort of a question of national pride as well, to have our own airline. I understand how a central airline would be more convenient in many ways, but (…) it would be a bit more fair as well if we didn't have one dominance in the region.
> *(Respondent 12 – Estonia)*

However, the inability of Estonian Air to be profitable in the competitive EU environment, further exacerbated by the EU's decision to deem the state aid for Estonian Air illegal, forced the Estonian carrier to declare bankruptcy in November 2015. As Veebel et al (2015) discussed it, there were three key reasons why the decision was unfavourable to Estonian Air. First, due to the fact that the aid was provided in a few instalments, the "one time, last time" principle was infringed. Second, connected to the first, the EU Commission was not convinced that the carrier would survive without further aid. And third, the EU Commission was notified about the aid and provided with a restructuring plan only after a proportion of aid had been transferred (see Veebel et al., 2015, for a more in-depth discussion).

Despite the fact that the request for permission to grant state aid to Estonian Air may not have been administered in line with the EU regulations (notwithstanding the fact that the

case for help might not have been strong enough anyway), the EU's negative decision sparked a lot of resentment amongst Estonian air transport stakeholders, which led to a negative perception of the deregulation policies at the EU level. The following comments, obtained in the summer 2015 when an unfavourable decision from the EU was already expected (although it had not arrived until November), illustrate it perfectly:

> "We are not allowed to support our airline. Why??? The others are not flying here! If KLM, Air France, British and Lufthansa are flying to this capital city twice a day, then no-one cares. But today, when no one is flying and we're struggling, why can't we pay our airline to make the service? We would be happy to do it, but we can't. This is all (…) nice for the big airlines in the middle of Europe but, 'Hey, look at us! We are here, a little "island", what can we do?'."
> *(Respondent 13 – Estonia)*

However, the bankruptcy of Estonian Air and the negative feelings towards the EU regulations did not discourage the Estonian authorities from pursuing their ambitions of having an independent flag carrier as the best means of securing connectivity for the country:

> "The biggest parties are still confident that Estonia is lacking connections and the best way of actually having good connections is having somebody based in and operating them from Tallinn."
> *(Respondent 15 – Estonia)*

> "I think there will always be an independent airline in Estonia. Just because we have to have it."
> *(Respondent 11 – Estonia)*

Indeed, shortly after Estonian Air went bankrupt, the Estonian authorities set up an entirely new, fully state-owned carrier Nordica, whose main goal was "to ensure availability of the flight connections that Estonia needs" (*www.nordica.ee*, 2021). On the back of its partnership with Adria Airways (and later with LOT Polish Airlines) Nordica became fully operational within one year, which allowed it to expand its network of connections and even achieve profitability by 2017, i.e. only two years after it was set up. Although many of these routes proved over time to be unprofitable and Nordica decided to focus on operating flights for other airlines (including SAS), in 2021 – after the state aid offered to the airline to help it deal with the effects of the pandemic was approved, the airline reverted to own operations (*www.nordica.ee*, 2021). While AirBaltic's position remains unchallenged, it has yet to be seen how successful Nordica will be.

4.3 Implications and consequences at the sub-national level

However, it is useful to recognise that the increasing dominance of AirBaltic across the Baltic states as well as the superior position of RIX at the level of the Baltic region were not achieved at no cost. Since the central government's commitment to supporting RIX and

AirBaltic left very little space for promoting regional airports in Latvia (Liepāja and Ventspils) or supporting the development of new facilities (e.g. Daugavpils) either politically or financially, the success of AirBaltic and RIX arguably came at the expense of regional interests. As some interviewees confirmed, the structure of ownership in the Latvian airport industry (with each regional airport owned by the respective municipality) also contributed to this. As the central authorities did not co-own any regional airports, not only were they not obliged to offer support, but, supposedly, they also did not consider it strategically beneficial (see Niewiadomski, 2020 for a similar situation in Poland). As it can be implied, the assumption was that direct international connections from regional airports would diverge some traffic from Riga.

> "Daugavpils, Ventspils, Liepāja … these are our regional airports but for the country of two million population having more than one [international] airport is quite hard. (…) In Latvia we have a three-hour drive… up to four hours to Riga from every corner of the country, so I think it's enough to serve just one airport. And one third of the population lives in Riga or around so that also makes it viable for one big airport."
> *(Respondent 6 – Latvia)*

Moreover, as *Respondent 6 (Latvia)* confirmed, none of the regional markets in Latvia is large enough to justify another international airport and none of the regional airports has potential to create a new market for themselves. Even though *Respondent 16 (Latvia)* confirmed that direct international routes to Latvian regional airports would boost regional tourism and spark a dispersal of tourists away from Riga, *Respondent 9 (Latvia)* stressed that as of 2015 the central government had no plans to invest in regional airports or reshape the structure of airport ownership. In this respect, as the aforementioned case of Daugavpils illustrates, the hands of regions and regional airports were tied. As *Respondent 8 (Latvia)* confirmed, not only could municipalities not count on support from the central authorities, but, because of the small size of their markets, it was also impossible for them to obtain funding from other sources, e.g. the EU. The ability of Latvian regions to foster leisure tourism or to use aviation as a means of bringing business passengers and attract foreign firms was limited and, hence, the level of disappointment with the central strategy was often high. Indeed, apart from Riga-Liepāja flights which AirBaltic ran for a short time in 2007 and then reinstated in 2019 (AirBaltic, 2021) (allegedly not to lose the local market to the Lithuanian airport of Palanga, a seaside destination for LCCs, just 60 km from Liepāja across the border, as opposed to 222 km to Riga from Liepāja), no other Latvian regional airport enjoyed any scheduled air traffic after 2004.

By contrast, partly because of the central ownership of all airports in Estonia, partly because of the necessity to offer public service obligation (PSO) connections to Estonian islands, and partly because of the overall aviation policy (somewhat different than that of Latvia), Estonian secondary airports did not have strong reasons to feel left on their own. Indeed, as *Respondents 14 and 15 (Estonia)* said, for some time after 2004 many regional Estonian airports enjoyed direct connections operated on a commercial basis by Estonian Air – both international (from Kuressaare, Pärnu and Tartu to Helsinki and/or Stockholm) or domestic

(e.g. from Tartu to Tallinn). They were accompanied by a network of PSO routes which were also initially operated by the Estonian flag carrier. Although most commercial services had to be terminated over time for economic reasons (i.e. the only international connection available from any other Estonian airport than TLL in 2015 was the Tartu-Helsinki route), the PSO links between the mainland and Kuressaare, Kärdla, Kihnu and Ruhnu remained in place (although the operator had to change several times in the meantime):

> "We have to have in mind that Estonia has a lot of islands and very often aircraft is the only connection to the island. We have all islands basically connected with ferries, but still, in very bumpy times, in autumn, spring, winter, the aircraft is the only connection." *(Respondent 13 – Estonia)*

5. Conclusions

The chapter has examined the efforts which the Latvian and Estonian authorities invested in inserting their states into the networks of international air connections after 2004 in order to secure a sufficient level of connectivity by air for their respective national economies and tourism industries. While the EU-wide deregulation and liberalisation of air transport produced numerous benefits (e.g. lower fares, more connections, fewer regulatory restrictions), it also gave rise to new geographies of accessibility by air, which in turn re-shaped the spatial patterns of international tourist flows, often to the detriment of smaller, more remote and peripheral destinations. In a multi-country context like the EU, this often applies to entire states – mainly the smaller ones that are not able to generate significant demand for air services themselves, and the remote ones that are located far from main hubs. Estonia and Latvia served here as the best examples.

While the accession to the EU and the adoption of the EU's open-skies policies in 2004 opened both countries to increased leisure and business visitation by air and, generally, stimulated demand for air services in both states, both Estonia and Latvia found themselves largely bypassed by international business-related passenger flows carried by full-service carriers (FSCs). Since many major FSCs were not interested in flying to Latvia and Estonia due to the need to rationalise their networks and abandon less profitable routes, Estonia and Latvia fell victim to their small size and relative peripherality and undertook various initiatives to overcome this problem.

Although further to regaining independence from the Soviet Union in 1991, both countries' aviation industries followed a very similar trajectory and had a similar starting point in 2004 when they joined the deregulated European Common Aviation Area, they responded to the new circumstances with a different degree of success. While both Latvia and Estonia remained committed to saving their flag carriers (AirBaltic and Estonian Air, respectively) as a means of maintaining vital connections with key European destinations in the absence of major European FSCs in Riga and Tallinn, their decisions and actions produced different outcomes. The well-organised financial and political support which the Latvian authorities provided to the Latvian air transport industry (i.e. AirBaltic and Riga Airport) in line with the EU state-aid rules, was a decisive factor. The strategic reliance on the central location of

Riga (relative to Tallinn and Vilnius), which served as a springboard for AirBaltic's expansion into the neighbouring states, significantly facilitated this process.

Meanwhile, despite the good intentions, the Estonian authorities not only reacted too late, but also not decisively enough. The poorly managed provision of state aid to Estonian Air (deemed illegal by the EU in 2015) inevitably led to the airline's bankruptcy. Although the main goal was to ensure sufficient connectivity for Estonia (partly to boost its tourism industry, partly to attract business visitation and foreign investors, and partly because of national pride), in the deregulated environment the case made by the Estonian government was not strong enough. However, the Estonian persistence to have a national carrier anyway resulted in the development of a completely new flag airline – Nordica.

While the Latvian government successfully helped its aviation industry to overcome the problem of small size and peripherality of the Latvian market and secure sufficient connectivity for the country, the success arguably came at the expense of regional interests. The Latvian authorities' "all-eggs-in-one-basket" approach, which implied a strong centralisation of efforts and investments, left regional airports within the country underdeveloped and/or unconnected (although no intentionality should be suspected here). Meanwhile, despite its strong commitment to neoliberal, pro-market principles since the beginning of post-communist transformations (Jansen, 2008), Estonia adopted an exceptionally strong interventionist strategy to keep the country connected at the national level, while also trying to moderately support its regions (e.g. through the central management of all airports and through the PSO connections which kept remote regions connected to the mainland).

The above analysis leads to three important reflections on the EU-wide deregulation and liberalisation of aviation and its effects on various countries and how these effects are shaped and mitigated "from below" by national and sub-national institutions. First, despite the deregulation and liberalisation of passenger aviation in the EU since the 1990s, the cases of Estonia and Latvia illustrate that the state continues to mould international networks of air connections, thus largely influencing geographies of aviation and international tourist flows by air (see Mathiessen, 2004; Dobruszkes, 2009, for similar observations). More attention is therefore required to how political and socio-cultural features of the places which networks of connections interlink shape the mosaic of international air connections and what role various patterns of multi-scalar power and governance play in these processes.

Second, the above analysis fully confirms Graham's (1998) findings from before the EU enlargement that there is a clash between the deregulation policies and the EU's emphasis on regional development. Whereas the regional policies aim to foster convergence and cohesion, alleviate economic backwardness, and facilitate sustainable economic growth (with transport often being a critical means to achieving these objectives), the processes of deregulation of air transport are rather found to enhance demand on pre-existing routes instead of minimising regional disparities through connecting more peripheral places (Graham, 1998). As the EU has since expanded to include a number of new, less affluent

countries and regions, Graham's (1998) observations seem to be even more valid than before.

Third, as Veebel et al (2015) discussed it, even though state aid can in theory serve as a useful tool for attracting investment to peripheral regions, reducing economic inequities, and addressing various market failures, the EU's state aid rules restrict its applicability to small, under-served and peripheral aviation markets with relatively weak flag airlines. While the primary aim of these rules is to ensure undistorted competition at the EU level, they do not account for individual countries' diverse abilities to compete, and a range of geographical, historical, political and cultural factors that determine these abilities (Veebel et al., 2015). Although some exceptions exist, the small size or the peripheral location of the market do not count, even with regard to such strategic sectors as aviation that are essential for the realisation of national interests (Veebel et al., 2015). While the case of Latvia illustrates that it is possible to overcome such problems (even though it may happen at the expense of regional interests or the interests of neighbouring states), the case of Estonia clearly exposes the negative consequences which a uniform application of deregulation policies and state aid rules at the EU level may lead to.

Acknowledgements

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