



**International Chamber of Commerce**

*The world business organization*

## **ICC Policy Statement**

### **The need for greater liberalization of international air transport**

Prepared by the Committee on Air Transport

The International Chamber of Commerce (ICC) has since its inception supported the freer flow of trade and investment across national borders. In this context, ICC supports a freer exchange of air services throughout the world, under competitive conditions transparent for all users of the air transport system. With the rapidly changing economic environment brought on by trade liberalization, globalization and e-commerce, it has become increasingly clear that bilateral air service agreements, while they have led to steady improvements, can no longer of themselves meet the rapidly changing needs of airlines, users or the global economy.

The efficiency of air transport would be enhanced by creating more open markets and more flexibility with regard to foreign ownership. Because air transport is so important a facilitator of economic activity, its further liberalization would also allow sectors that make use of its services to become more efficient.

Many national governments are actively seeking more open markets for their air carriers. Regional economic arrangements, such as the European Union (EU), have removed economic constraints on airline ownership and operations within their borders. International agencies such as the Organization for Economic Co-operation and Development (OECD) have become active advocates of air transport liberalization. There is much merit in pooling ideas and seeking a common approach to the issues facing the future of the industry and its users.

This statement proposes options for accelerating the pace of liberalization and for addressing the obstacles that remain.

### **The current situation**

As the primary mode of long distance transport within and between nations, air transport has become a crucial facilitator of economic activity. As such, it plays an essential role in the development of national economies and, by extension, in the health of the global economy.

The international air transport sector has grown under a complex regime of regulations since the conclusion of the Chicago Conference of 1944. Lack of agreement at that time on how the market for air services should be regulated led to the growth of bilateral agreements between countries. These were generally restrictive and they controlled market entry, fares, and service levels. Such a system probably did little to impede the growth of international air transport in the early years, but as technology has evolved and markets have developed, the limitations of such bilateral air service agreements have become apparent.

The rapid deregulation of the US air transport market from 1978 on gave an impetus for international reform of both cargo and passenger air services. Considerable progress has been made since that time in liberalizing international air transport. Some of the changes have come through renegotiation of bilateral agreements to remove many barriers to competition. The Open Skies policy of the US reflected a new approach to international markets. From the early 1990s, it allowed the US and many

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trading partners to sign a liberal template bilateral accord, which has led to a common framework of agreements. The US Open Skies policy is a conspicuous example of bilateral liberalization: 73 agreements have been signed to date.

The EU has taken additional steps which focus on liberalization within the European Economic Area, although individual member States and the EU have also concluded aviation agreements with countries outside the EU. The emergence of an internal European Community air transport market represents a major achievement in creating a liberal regional market for air services. The three packages of reform introduced over a decade from the mid-1980s gradually removed impediments to the free provision of transport services within the EU. An airline substantially owned and effectively controlled by citizens of a country within the European Economic Area (EEA) can now establish itself anywhere within the EEA and can offer services, including cabotage, within the area. There are no tariff controls (except in exceptional circumstances) and there is a gradual movement to liberalize and introduce effective competition in ancillary services.

There are other, more recent harbingers of freer trade areas in air services such as the MALIAT agreement which includes the US, Chile, Singapore, New-Zealand, Brunei, Samoa and Tonga. This development is less extensive than the EU Single Market in air services, but it represents movement forward. The Yamoussoukro Decision reached in July 2000 at the Organization of African Unity meeting in Togo and the 2004 Association of Southeast Asian Nations (ASEAN) roadmap to permit unlimited services between all ten member countries by target dates are also encouraging initial moves towards liberalizing air transport.

### **GATS and air transport**

While other sectors of the economy have benefited from a multilateral trading regime initiated by the GATT and continued within the World Trade Organization (WTO) framework, air transport services have, so far, not followed that pattern. There is difficulty in reconciling bilateral air service agreements with the GATT principles of most favoured nation (MFN) and national treatment, because access to agreed routes is limited to designated carriers of the bilateral parties. Consequently, only three areas of air transport are explicitly included in the Annex on Air Transport Services of the General Agreement on Trade in Services at the present time: aircraft repair and maintenance services, computer reservation system services, and the selling and marketing of air transport services. Leasing as a separate service activity is also covered in the GATS.

A review of the operation of the Annex on air transport was begun in 2000 but was terminated in 2003 with no agreement to expand the coverage of the Annex. Due to the poor quality of the commitments entered into by States on the three covered services in 1995, it proved difficult to assess the impact of the GATS. A second review of the Annex will begin in December 2005.

## **The outstanding issues**

### **Bilateral agreements**

The structure of bilateral air service agreements originated in the early days of air transport and has developed since adoption of the Chicago Convention of 1944. It allows countries to retain traditional controls over access to their air transport markets. In practical terms it is a system countries are familiar with, and one in which change is generally straightforward since it does not entail a large number of consenting parties.

However, since the system has tended to focus on individual routes or small sets of routes between pairs of countries, it has led to difficulties in arriving at a high level of efficiency over global networks of air services. Also, the bilateral system has not developed evenly and as a consequence there remain bottlenecks in the overall air transport network. Many bilateral agreements are still restrictive. These introduce impediments that among other things prevent carriers from planning their route networks purely on the basis of commercial considerations.

Although the growing number of liberal bilateral agreements (e.g., US Open Skies agreements) have dramatically improved the situation in some markets, many important issues are still strictly controlled, e.g., ownership and control, cabotage, and the right of establishment. Thus, even the Open Skies model preserves some anachronisms that distinguish the international air transport sector from most other globalized industries. These anachronisms limit free trade in air transport services and optimal capital movement. National differences in the way these market impediments operate also make it difficult in the current bilateral system to bring about their removal.

### **Limits on foreign investment**

Freer trade and movement of capital across borders require open investment policies. In practice, partly due to the need to have 'national' airlines under traditional bilateral agreements, governments restrict foreign investment in airlines. In 1994, ICC advocated the easing of limitations on foreign ownership to airlines, stating that "air transport development should be determined by economic and technical considerations and not by questions of national pride and national ownership." The US, for example, still maintains a limit of 25 per cent on foreign ownership of a US airline, despite proposals to raise the level to 49 per cent. In the EEA, for example, while there are no restrictions on the amount a member country citizen can invest in an airline registered in another EEA member state, there remains a 49 per cent limit on non-EEA shareholdings. As a result, air carriers cannot generally establish themselves outside of their "national" state and cannot take a majority share in, or fully merge with, a foreign airline. There are examples of multi-national airlines such as SAS and Gulf Air, but these are exceptions. Many airlines are still state owned. There remains the strong need for an internationally accepted structure of airline registration to avoid flag of convenience problems, but efficiency in service provision would be significantly advanced by permitting a freer flow of capital in the airline sector. Another issue to be resolved is whether the foreign entity has actual control. The US position is that this term cannot unilaterally set matters related to safety, security, control over corporate governance or national security control, although this position is currently under review.

### **Competence over aviation rights**

The development of free trade areas, and the potential promise of agreements between trade blocs, have raised the issue of the competence to negotiate these agreements. This is the case within the EU, where in June 2003, the Council of the EU granted the European Commission a mandate to negotiate an air transport agreement with the US. This was the direct consequence of the November 2002 Court ruling of the European Court of Justice (ECJ) on the compatibility of eight US-EU countries aviation agreements with Community law. In this instance, the ECJ ruled that some aspects of EU-US bilateral air services agreements infringed EU law. These aspects are fares of United States air carriers on intra-community routes, computerized reservation systems and nationality clauses. On 25 June 2003 the EU and the US agreed to open negotiations for an overall agreement on air transport liberalization and on 1 October 2003, held their first formal round of negotiations. The talks subsided in June 2004 after 5 rounds of negotiations. Informal meetings have taken place since then.

### **Divergent competition policies**

As set forth in its 1997 policy statement, "Convergence of competition law and policy in the field of air transport," ICC, in keeping with its support for a freer exchange of air services throughout the world,

notes the growing number of cross-border alliances, and notes the potential in this context for the unilateral application of competition policy. This creates a lack of coherence between air transport regimes and uncertainty for users and airlines. Accordingly, ICC reaffirms its conviction that efforts should be undertaken to reduce these differences and thus to enhance the stability and predictability of the legal framework within which the increasingly globalized airline industry operates.

### **Fiscal policies**

Air transport is the subject of many taxes aimed at financing general government expenditure. These act to increase travel costs and to reduce mobility. ICC, in its 1997 statement "Taxes on International Aviation: A 1997 Update", urged the reduction of such taxes, making them transparent whenever imposed and limiting authority for their imposition to central governments.

There has been a long tradition of subsidizing certain aspects of air transport for political, social, economic, and strategic reasons. These subsidies are diminishing as air transport becomes more commercially oriented and ICC welcomes this change. Nevertheless, subsidies remain. In many cases they are explicit and direct but in others they come in the form of cross-subsidies applied through mechanisms such as route licensing and state granted monopolies regimes effectively granting home country carriers exclusive rights or monopolies in certain lines of transportation businesses, which enable them to cross-subsidize their competitive operations in foreign markets. Subsidies distort markets and ICC supports their removal. ICC notes that it has already expressed its strong disapproval of state aid in its 1995 statement "State Aid to Airlines" which concludes that "state assistance to airlines, whether direct or indirect, should be deemed to distort the market and to be detrimental to airlines and users." If subsidies are used, for instance for regional economic or social reasons, they should be transparent and phased-out as rapidly as possible.

### **Customs impediments**

International transport by all modes normally involves the need for customs clearance. This can be time consuming and costly for the transport service supplier. It can be a particular cost on air transport where speed and reliability of delivery are important attributes. ICC, the OECD and other organizations have proposed ways of facilitating simplified customs clearance and ICC welcomes the benefits that adopting these measures would have for the air cargo sector in particular.

### **Infrastructure access**

Infrastructure constraints can be a particular impediment to market entry in air transport. Many airports are now operating at their design capacity and the efficiency of the air traffic control (ATC) system is limited by major bottlenecks. Further liberalization of air transport would increase demand, which could lead to further constraints on the capacity of airports and ATC to meet this demand effectively. ICC urges governments to treat the need for improved ATC technology and expanded airport infrastructure as priority issues. Failure to address them effectively will seriously impede economic growth generally.

Local or national nighttime noise closures of airports, particularly in Europe may improperly impede the exercise of basic market access rights. ICC therefore urges governments to implement the ICAO resolution on the balanced approach to aircraft noise management when introducing operating restrictions at airports.

Groundhandling monopolies can also be another barrier to the provision of air services on a commercial basis. Groundhandling should be open to competition, with privatization and divestiture from national carriers.

## Potential paths to further liberalization

The challenge in moving toward a phased-in approach to a multilateral liberalization of air transport is one of choosing an appropriate path. With the trend toward globalization, there is a growing recognition of the limits of the current bilateral framework and the need to launch an initiative toward genuine liberalization of air services. ICAO, which organized its 5<sup>th</sup> Worldwide Air Transport Conference in 2003, promotes liberalization and assists states with its implementation. The OECD and others have also examined the possibilities for furthering reform. Indeed, different paths could be pursued in parallel, and complementary to one another, toward further liberalization of air transport:

- **Liberalization within the bilateral framework** whereby, when bilateral agreements are renegotiated, specific provisions using defined standard terms may be incorporated. Such provisions might include open route exchanges, multiple designation, capacity freedom, pricing freedom, open third and fourth freedom rights, and so on. This type of approach enjoys the benefits of introducing a degree of uniformity into the existing, though disparate, system of agreements without disrupting their basic structure. A challenge would be that there may be few common concepts of practical importance which all or a significant number of countries would accept on a purely bilateral basis.
- **A lead sector approach**, whereby specific markets, such as cargo services, are liberalized first, with these providing a basis for subsequent liberalization of other services. In particular, with the strong growth in air-freight traffic, liberalization of cargo markets could have significant add-on effects. ICC was one of the first advocates, in 1998, of a separate agreement for the liberalization of air cargo. The OECD proposed two alternative paths for further liberalization of air cargo: a protocol to existing air service agreements, liberalizing a number of cargo specific barriers, or a multilateral agreement that would facilitate a more immediate liberalization of air cargo services. Possible advantages of that approach are improving efficiency in fields where there is some common ground for agreement, and demonstrating the benefits for a subsequent widening of the liberalization process.
- **Phased multilateralism (plurilateralism)**. This involves a gradual branching out from a single core of like-minded states that establish fully liberalized air transport markets among themselves. New members either need the agreement of existing participants or can join simply by agreeing to the terms in place. It would allow like-minded member states to come together fairly quickly and avoid forcing reluctant states into a rapid change in policy. The latter could join whenever they feel it is appropriate. Transitional arrangements, without burdensome preconditions other than some basic minimum requirements, would be envisaged to provide for the accession of new states to the multilateral agreement.
- **Full multilateralism**. Here, in every participating country it is possible for an airline to compete for passengers and cargo regardless of its nationality. This would in the long term entail the opening of cabotage to all carriers as well as freedom to supply services in international markets. This is the ultimate free market situation that would yield maximum economic efficiency. Such a situation could be achieved in a number of possible fora, including aviation-specific diplomatic conferences and the WTO. For example, the GATS rules provide clarity and legal certainty to all participants, non-discriminatory treatment and the advantages of the WTO dispute settlement procedure. However, certain issues would need to be addressed, including the application of most favoured nation treatment to air transport services, the availability of reservations, and reciprocity.

## A pragmatic approach

ICC believes in the multilateral liberalization of trade in all goods and services and also believes that, as a general matter, the WTO has proven to be the most effective mechanism for achieving such liberalization. ICC recognizes, however, that the air transport sector possesses particular characteristics that may be seen as complicating the inclusion of direct market access (traffic rights) in the GATS at this stage. Governments seeking the most rapid path to liberalization may feel that the prospects for achieving agreement on including air transport within an agreement as widely subscribed as GATS are too uncertain, and that other, more predictable avenues are preferable – at least in the near term.

Accordingly, ICC recommends that an initiative be launched for the negotiation of an agreement between like-minded countries to liberalize air transport between them. These initiatives would establish a minimum threshold of liberalization beneath which a participating country could not go in the future.

## Summary and recommendations

- ICC is in favour of a freer exchange of air services throughout the world. ICC believes that it is time to move beyond the bilateral system, toward a genuine multilateral liberalization of air transport. Such an environment will facilitate the globalization of air transport markets, to match the globalization of other sectors of the economy.
- ICC also recommends that air transport developments be determined by economic and technical considerations and not by questions of national pride and national ownership. Change will be considerably accelerated if industry pushes for the necessary advances to be made.
- Air transport can only fulfil its economic role if there is adequate and appropriate infrastructure opened 24 hours a day. ICC therefore supports the improvement of ATC technology and the expansion of existing airport capacity as a priority as well as strict adherence to ICAO's resolution on the balanced approach to aircraft noise management when introducing operating restrictions at airports.
- There are many paths to liberalization. The various approaches can be combined with the goal of seamless liberalization. Regional approaches, for example, can be pursued in parallel with further bilateral reforms, or in conjunction with lead sectors such as cargo. These could indeed offer a series of test beds for the development of wider agreements, ultimately within a region-to-region framework. A combined approach also provides for at least some potential improvements in the supply of international air services, while issues holding up fuller liberalization are resolved. Any large scale reforms should be tailored so that they can be extended to countries or groupings of countries that are originally outside of the arrangement but pursuing their own liberalization strategy.

Ultimately, just as in the trade of other goods and services, there must be an underlying legal structure for international air transport. In the short-term, ICC recommends that discussions on existing and potential frameworks be expanded and accelerated, noting that related issues, such as competition policy, must be pursued as an integral part of these discussions. Once a more liberal environment is

achieved, this would create a more favourable context for consideration of a new agreement within a new, aviation-specific diplomatic conference, or existing bodies such as ICAO, or of further GATS coverage of the air transport sector.

**Document n° 304-2/23 Rev.3**

1 December 2005