



BREAKING THE SURLY BONDS OF ECONOMIC REGULATION

The issue

Air transport is a global industry whose maturity continues to be denied by arcane economic regulation. The regulatory framework for international air transport, and particularly the transborder restrictions on ownership and control of air carriers, remain an incongruity in a globalized world, placing severe financial and market access constraints on carriers, generating unnecessary complexity, and restraining sustainable growth. Apart from operations within Europe, the process is driven by a network of bilateral agreements based on reciprocity of air services. This concept, associated with protection of “national” carriers, takes precedence in too many countries over a more rational assessment of net national economic and social benefits from tourism and trade.

The disjunct arising from open trade and tourism markets and an outdated and highly restrictive approach to the economic regulation of international air transport, unique to the sector, is a severe constraint not simply on the development of the sector but, more importantly on economic and social development worldwide. There is an increasing need in an era of globalization for the evolution of economic regulatory regimes for air transport, nationally, regionally and globally, which go beyond narrow sectoral interests and provide the optimum overall benefits for the economy, protection of consumer interests and enhancement of competition.

A key issue is that of air carrier ownership and control, which is presently vested in the citizens of single States or, in the case of Europe, a group of States, through national legislation and/or through insertion of provisions in air services agreements. This puts severe constraints on access to capital (in a capital-intensive industry) and on market access (in a transnational industry). It has led to indirect and ultimately unsatisfactory means of obtaining market access such as alliances and code-sharing.

The bilateral straitjacket

International air transport is a quintessential multilateral industry but it is largely locked in a bilateral regulatory straitjacket (or more properly, well over 3 500 straitjackets). It is also the only service sector based on reciprocity and blinkered from the law of comparative advantage. It is difficult enough to envisage a perfect (zero) balance of trade in goods and services for any country in overall terms, and inconceivable that the balance should be zero with each individual country with which that one trades. But that is the concept upon which much of trading in international air transport services is founded. Furthermore, while the general

CONVERGING THE PARALLEL TRACKS OF “SPEED DATING”

The increasing activity of the “Network” and “Routes” events is both relevant and revealing for the regulatory impasse. The focus of the “Routes” events, for example, is a form of “speed dating” on a one-on-one basis at a single location for airlines, airports and, since last year, tourism administrations, to explore, develop or conclude arrangements for new air routes and services. The activity has grown immensely over the years and the annual world event, complemented by several regional ones, encompasses over 2 500 delegates and well over 25 000 one-on-one meetings. At the “Routes” global event in Vancouver last year a number of airlines and airports reported that they had made promising contacts for potential new routes which were presently stymied by lack of traffic rights.

There is now a governmental parallel to “Network” and “Routes”. ICAO has recently established a well-received activity in the form of now annual *ICAO Air Service Negotiation Conferences* (ICAN), which provide a central meeting place for States to conduct their air service negotiations.

Continued ...

“SPEED DATING” ...

By enabling each participating State to conduct meetings with several bilateral partners at the same location, the conferences greatly improve the efficiency of the negotiation process.

ICAN is clearly a welcome activity, but at the same time, by improving the efficiency of bilateral negotiations it may unwittingly be entrenching the bilateral process. The ICAN facility might be used not just for facilitating bilateral negotiations but also for exploring approaches which are broader, in the form of “plurilateralism”, whereby an agreement amongst two or more parties is extended automatically to another party upon its own adherence to the agreement.

There would also seem to be value on both sides by co-location of the Routes and ICAN events. This would inter alia provide great potential for each of the parties to learn about the opportunities and constraints faced by the others, and would hopefully produce some synergy.

terms of bilateral air service agreements are mostly in the public domain, the substantive details, for example of capacities, frequencies, etc, are usually in the form of confidential side notes – the process is by no means transparent.

Within this framework the pace of air transport liberalization, already slow, has been further affected in recent years by economic recession, which has led to a reversion towards protectionism in a number of countries. There has even been retrenchment, including by some major aviation nations, towards limiting traffic rights to third and fourth freedom operations and protecting “national” carriers (even if now privatized), with resistance to service by “foreign” carriers in the absence of reciprocity. In contrast, a few enlightened States, notably in Asia/Pacific, Middle East and South America, have seen air transport as an essential (and successful) catalyst in economic recovery programmes.

Foundering initiatives

IATA’s “Agenda for Freedom”. With limited headway being made by governments, the air transport industry, led by IATA, has tried to become more active in the government policy-making process. Through IATA’s initiative, eleven countries¹ signed a multilateral *Statement of Policy Principles regarding the Implementation of Bilateral Air Services Agreements*, which has also been endorsed by the European Commission. The primary focus is on lifting national air carrier ownership and control provisions out of air services agreements and agreeing on provisions based on “principal place of business” in one or more of the participating States. However, even this limited venture has quietly been put on the shelf following increasing concern by some western carriers of the “threat” of competition from airlines based in emerging countries, notably Emirates and other Gulf carriers.

Draft Multilateral Convention on Foreign Investment in Airlines. This initiative from the United States would take the ownership and control process forward in a similar way by invocation of the waiver in bilateral air services agreements to requiring designation of carriers by each party limited to those owned and controlled by interests from their territories. The draft deftly sidesteps the overwhelming challenge of altering national legislation and numerous air services agreements by providing a practical and straightforward step forward through its waiver approach. However, its presentation has been low key and there appears to be no focus for promotion and take up.

Regional blocs. The European Commission continues to negotiate comprehensive air services agreements with neighbouring countries, notably in eastern Europe and the Mediterranean region, thereby extending the existing Common Aviation Area, which includes community rather than national designation of air carrier ownership and control. However, such patently positive intra-regional liberalization, while

¹ Bahrain, Chile, Kuwait, Lebanon, Malaysia, Panama, Qatar, Singapore, Switzerland, United Arab Emirates, United States.

under consideration elsewhere, has by no means achieved maturity in other regions. Also of considerable significance is that the second stage of the EU-United States air services agreement last year failed to reach a concluding accord on air carrier ownership and control. There has been some limited movement in Africa, Asia and Latin America to liberalize certain intra-regional air transport services, but with few exceptions the process remains bilateral. All inter-regional services (with the qualified exception of EU-United States) also remain regulated bilaterally and the prospect of liberalized agreements on a bloc-to-bloc basis is a pipedream.

World Trade Organization. The WTO has since its inception in 1995 considered the inclusion of air transport services in the *General Agreement on Trade in Services* but only managed to achieve the insertion, in an Annex, of three ancillary services (aircraft repair and maintenance, computer reservations system services, and selling and marketing) despite revisits every five years. There has been apprehension in aviation circles regarding the GATS and its potential benefits for air transport, essentially predicated on a seeming lack of understanding of the framework. The objective of the GATS is not to deregulate services but to liberalize services trade, and the right to regulate is one of the fundamental premises of the GATS — there is no obligation on any WTO Member to allow foreign supply of any particular service. In any event, larger issues have effectively stymied the development of revised trading agreements (the “Doha Round”) for a number of years and return to substantive address of the GATS Annex on Air Transport Services is not envisioned for the foreseeable future.

International Civil Aviation Organization. After five worldwide air transport Conferences and numerous Assemblies over 35 years, gradually moving from “whether” to liberalize to “how” to liberalize, ICAO has produced a wealth of comprehensive guidance material on liberalization. However, that is just what it is, guidance, with ICAO recognizing that States will move at their own individual, and widely differing, pace. ICAO has no mandate to take the subject any further than providing guidance and the Organization has recently excluded address of economic regulation from its strategic objectives. At the same time, ICAO has decided to convene yet another air transport conference, in April 2013. There might be value in a conference focused on implementation and in particular on lifting air carrier ownership and control restrictions, but the approach at present seems to be leaning towards yet another all-encompassing general overview, which is likely to result in just another political talking shop.

The “threat”

The rising tide of western carrier concern over the rising role of airlines such as Emirates, Etihad and Qatar Airways (with Chinese carriers on the horizon) is natural from airlines which face increased competition but should be viewed by regulators in a larger framework than narrow sectoral interest, namely that of net national benefit. The argument that the Gulf hubs are dominated by sixth freedom traffic hardly holds water in the 21st century. As far back as the 1950’s, in combining third and fourth freedom traffic rights an Icelandic non-IATA airline undercut IATA-agreed fares across the Atlantic and also generated stopover traffic. KLM has exploited Amsterdam as a sixth freedom hub for decades, generating traffic flows well above ones which would be reflective of the Netherlands population alone. Singapore’s hubbing opened up air services between Europe and Australia. Charles de Gaulle, Frankfurt and Heathrow are major transit hubs today. But when a potentially stronger hub competitor, Dubai, emerges on the scene, western air carriers and their regulators balk.

Canada's reaction is a classic example. Air Canada does not fly to the Gulf. And yet it opposes addition to the limited access by Gulf carriers to Canada, primarily on the grounds that the traffic would be sixth freedom, notably from India. Air Canada itself has an avowed policy of exploiting sixth freedom by developing Toronto and Vancouver as hubs for traffic between the US and Asia. Of course Air Canada has a Star Alliance partner in Lufthansa whose hub is Frankfurt (and Air India's application to join the Star Alliance has recently been suspended).....And yet Air Canada stridently opposes a requested increase in the thrice weekly (and regularly full) services of each of Emirates and Etihad to Toronto, or any service by these carriers to Vancouver. Both Toronto and Vancouver have large South Asian populations, with substantial potential traffic which proposed service by Emirates would tap into. As shown by various economic studies, this would both generate new traffic and provide net national economic and social benefits to Canada (taking into account the – essentially minimal – impact on Air Canada). Air Canada has tried and failed more than once to provide a viable service of its own to India.

The position taken by Air Canada, concerned with increased competition, is perhaps understandable. But that of Canada's regulators in not accommodating the larger picture begs belief. Canada's international air transport policy is firmly mired in a third and fourth freedom traffic box and Canada even withdrew from the multilateral *International Air Services Transit Agreement* regarding overflight and technical stop rights. Unfortunately, while Canada is perhaps an acute example of the dinosaur (and a G8 dinosaur at that), such a policy approach is mirrored, if more moderately, by many other regulators worldwide.

If Emirates and its ilk can bring in the tourists cheaper and more efficiently with net economic and social benefit to a country, why not let them? And if they can offer a cheaper fare via a hub why not let passengers have the option?

An oft-used argument is the perception of subsidy for the "foreign" carrier. While some Middle East carriers are arguably given preferential treatment at their home airports, no substantive proof has been offered of this or other subsidy; indeed Emirates, for example, has effectively made its books public to demonstrate the absence of financial assistance. Middle East carriers are State-owned and do have access to sovereign wealth funds for financing aircraft purchase, but other carriers would themselves have much broadened access to capital should national ownership and control provisions be lifted. More fundamentally the host countries of Qatar and the United Arab Emirates offer seamless integration of trade, tourism, infrastructure and aviation policy. Such a holistic approach is not only sadly lacking in most western countries but many of these countries are compounding their shortcomings by imposing unsubstantiated taxes and charges on the air transport and tourism industries.

Ultimately, if there is a net benefit to your country why should you be concerned if a foreign entity is willing to provide a subsidy to help you out? In the past there has been a legitimate concern that the "foreign" carrier may suddenly withdraw its services, but many other traded critical goods and services today face the same situation, and many small countries, which are far more vulnerable than western ones, live with the risk of foreign carrier withdrawal. Perhaps the diktat for the large western carriers should be "If you can't stand the heat get out of the kitchen".

Stepwise progression

So how do we get out of the regulatory cage? A quantum change is highly unlikely given the entrenched positions, and indeed a sudden change might unleash some disorder, but we can and should loosen some of the ties in a progressive way.

At the outset, we have to accept that there are far too many differing policies among the 190 plus governments around the world to achieve a global “solution”, whether through multilateral or bloc-to-bloc arrangements. Instead, accept the concept of **plurilateralism** (ie application of agreed liberalization provisions between a few countries extended in geographic scope as additional countries join in) and associate this with a “**Club of the ready and willing**”.

Such a Club, preferably with membership drawn from several world regions, would focus on two things. First, ratification (or acceptance or approval) by the Club members of the *Multilateral Convention on Foreign Investment in Airlines* – perhaps it could even be a condition of joining. And second, extension of the concept of plurilateralism to embrace other economic regulatory issues, the basic premise being that adherence by two parties to the plurilateral would over-ride the relevant provisions in an existing bilateral agreement between them. Implementation should create a ripple effect, leading to a driving critical mass which outsiders could not ignore.

The Club and its premise would require a champion, preferably in the form of an international third party (the World Economic Forum, for example) rather than an individual State. Prior to formal establishment, exploration by interested parties could take place under the umbrella of the *ICAO Air Service Negotiation Conferences* (see Sidebar), the next of which is scheduled for Mumbai from 17 to 22 October.

A few last words

International air transport is a global industry living in a bilateral or regional straitjacket. Tourism, trade and aviation are the same game, but aviation is played under different, highly restrictive rules.

The Economist newspaper amongst others recently ran an advertisement for a motor vehicle which read: “Designed in America. Built in America. And driven in America”. That vehicle is a Honda. This is an illustration of just how much international air transport is out of kilter with other sectors in the global economy as regards ownership and control.

There is a crying need for impetus towards breakthrough from a regulatory framework which stems back to 1946, before even the beginning of the commercial jet age.

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