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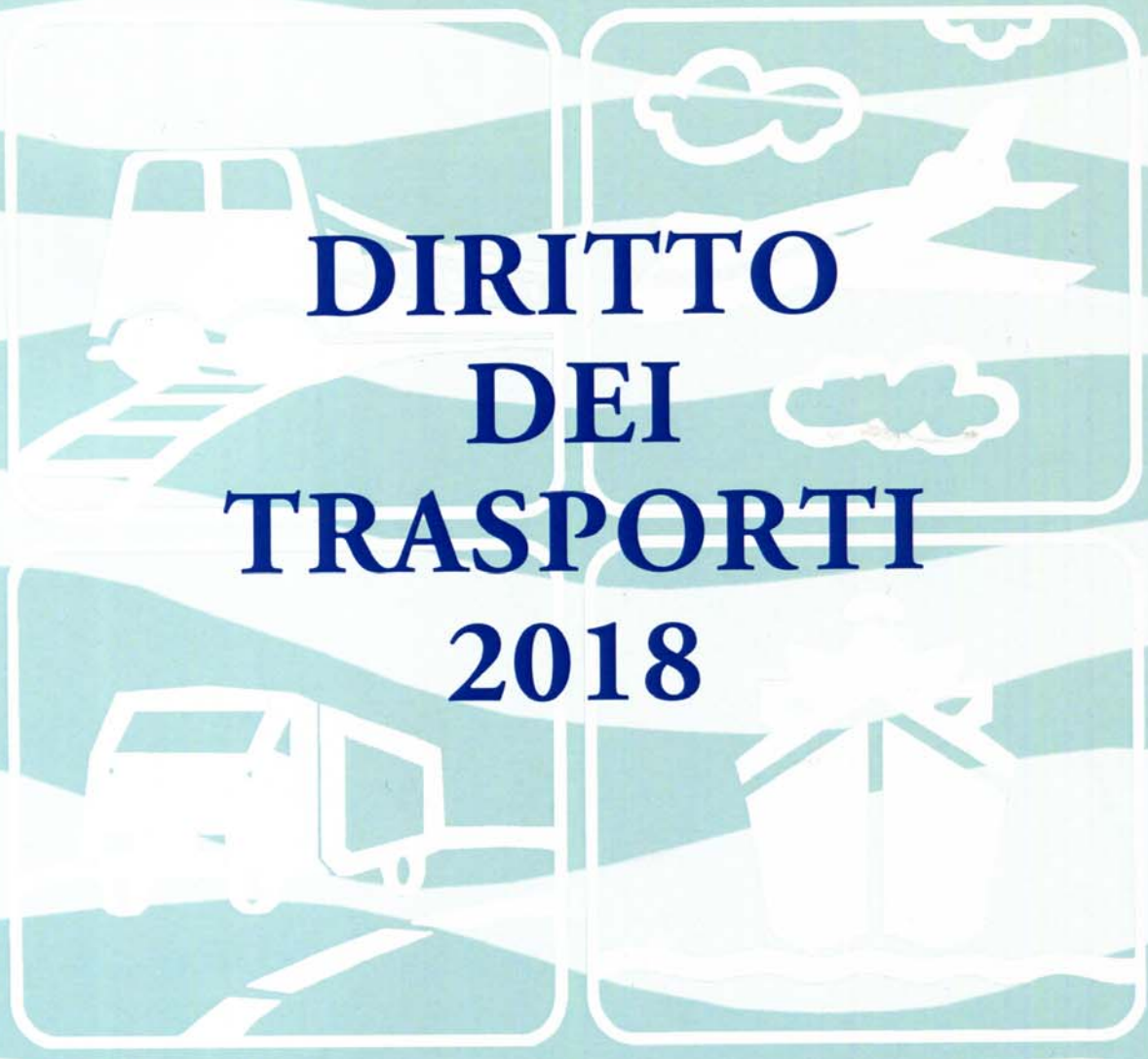

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BILATERAL AGREEMENTS AND AVIATION MARKET EVOLUTION: STATE OF PLAY

Liberalisation is one of the main drivers of the continuous growth of air traffic, market expansion and capital access for air transport. The continued growth of air transport services leads to competitive challenges for most traditional airlines, which are currently facing new players from Asia and the Middle East. This development of the air transport market inevitably leads to tackle old unresolved issues due to the international regulatory framework being unable to keep up with the rapid growth of the sector and make it really global. Among these, the nationality clause and its market access restrictions have characterised, and continue to affect, the Air Service Agreements. In light of the current international air framework regulation — incapable of promoting a level playing field — it should be examined whether a solution for the implementation of 'smart regulation' can be found by ICAO, or by the World Trade Organization, or at regional level, on the initiative of individual states or organisations.

1. *Globalisation and the airline industry* — Globalisation can be described as the process of making the transformation of things or phenomena into global ones that led the world's population to unify into a single society and function together. This process is a combination of economic, technological, sociocultural and political forc-

es. The idea of globalisation is also often used to refer in the narrower sense to economic globalisation involving integration of national economies into the international economy through trade, foreign direct investment, capital flows, migration and the spread of technology ([1]).

Many of these processes have been technology-driven, although facilitated by broad political shifts, such as the demise of the Soviet System, the gradual emergence of international free trade organisations, as the World Trade Organization, and reductions in political tensions. Many of these technical changes have been in transport and the implications of globalisation in its many manifestations have been profound for the international air transport industry.

The above-mentioned implications have to be found not only on the demand side, where the nature and geography of demand in global markets have led to significant shifts, but also on the supply side, where implicit and explicit international coordination of policies by governments have affected the institutional, legal and also technological environment in which air transport services are delivered.

The breakdown of domestic regulatory structure, starting in the U.S.A. from the late 1970s, provided a successful example and demonstration to be followed by other countries to boost air services and consolidations in the industry. On the other side of the Atlantic, the liberalisation of the air services, which started timidly in 1983 with the Directive concerning the authorisation of scheduled interregional air services between Member States ([2]), culminated with the entry into force of the most triggering measures to liberalise air transport on 1 January 1993 ([3]).

Liberalisation has been one of the main drivers of the continuous growth of air traffic and measures enabling an expanded market and capital access for air transport, leading airlines from far and diverse world regions in economic, legal and cultural terms to com-

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([1]) See R. GILPIN, *The Challenge of Global Capitalism: The World Economy in the 21st Century*, Princeton, 2000.

([2]) Council Directive no 83/416/EEC of 25 July 1983 concerning the authorisation of scheduled inter-regional air services for the transport of passengers, mail and cargo between Member States, OJ L 237, 26.8.1983, 19-24.

([3]) The original EEC Regulations have been recast in reg. (EC) no 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community.

pete in the same international markets ([4]). The International Air Transport Association (IATA), in the «Semi-annual report on the economic performance of the airline industry» published on the 5th of December 2017, attested that in 2017 worldwide passenger departures were more than 4,081 million. IATA expects that a share of 861billion dollars will be spent in 2018 on the airline sector with a rise of 3.1% compared to 2017 ([5]). Meanwhile, the global economy's growth benefits in a significant way from the development of new air services. In 2017 airlines across the world connected a record number of cities, with unique city-pair connections exceeding 20,000 for the first time ([6]). For 2018 IATA forecasted that the value of international trade shipped by air will be $6.2 trillion ([7]).

The continued growth of air transport services lead to, as an inevitable corollary, competitive challenges for the most traditional American and European airlines, which are currently facing new players from the East ([8]). Over recent years a large number of eco-

([4]) T.H. Oum-A. Zhang-X. Fu, *Air transport liberalization and its impacts on airlines competition and air passenger traffic, Transportation Journal*, Vol. 49, No. 4 (fall 2010), 24-41.

([5]) IATA, *Semi-annual report on the economic performance of the airline industry,* Montreal, December 2017, available at: *http://www.iata.org/publications/economics/Reports/Industry-Econ-Performance/IATA-Economic-Performance-of-the-Industry-end-year-2017-report.pdf*.

([6]) The annual percentage increase in the number of city-pairs served was the largest since 2004, and represents a doubling of services since 1996, when there were fewer than 10,000 city-pairs in operation. This increase has reflected the changing economic and industry landscape over time, and has been enabled partly by the new longer-range and more fuel-efficient aircraft replacing airlines' existing fleet, see: *Unique city-pair connections exceed 20,000 for the first time*, 1 December 2017 available at: *http://www.iata.org/publications/economics/Reports/chart-of-the-week/chart-of-the-week-01-Dec-2017.pdf*.

([7]) See: *https://www.iata.org/publications/economics/Reports/Industry-Econ-Performance/Economic-Performance-of-the-Airline-Industry-end-year-2017-forecast-slides.pdf*.

([8]) The 2014 Airbus Annual Report predicted that in 2023 China will overtake the USA regarding passengers carried, becoming the first world market Airbus, *Airbus Annual Report*, Leiden-Blagnac, 2014, available at: *http://company.airbus.com/investors/Annual-reports-and-registration-documents.html*. In 2033 the air services operated in Asia will represent more than the 40% of the global scale air traffic, while, on the contrary, the air traffic in the European continent will account less globally, though the EU and US aviation markets constitute the most profitable for an air carrier AIRBUS, Annual Report 2016, available at: *http://company.airbus.com/investors/Annual-reports-and-registration-documents.html*.

nomic powers and several developing countries (capable of foreseeing the potential of the aviation industry) ([9]) started to recognise the strategic role of aviation in their economic development policies. Several new and highly competitive airlines and airports emerged in the Middle East and Asia, posing a considerable challenge to some American and European airport hubs and air carriers ([10]). The latest, after having experienced a long lasting economic and financial crisis, are no more able to grow at the same rate as the competitors based in the Middle East and in Asia, which appear to benefit also from conspicuous state aids, prohibited under the current legal framework in the U.S.A. and the EU ([11]).

Consequently, a tangible result of globalisation in air transport is undoubtedly a relative shift to areas outside the U.S.A. and the EU, with Asia and the Middle East expected to become the focus of international air traffic flows. This development of the air transport market inevitably leads to tackling old unresolved issues due to the international regulatory framework being unable to keep up with the rapid growth of the sector and make it really global. Among these, the one which has the greatest impact on the market certainly is the nationality clause ([12]) and its market access restrictions that have characterised, and continue to affect, the Air Service Agreements (ASAs).

([9]) On this regard the European Commission remarked that aviation «plays a crucial role in the EU economy and reinforces its global leadership position» in *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - An Aviation Strategy for Europe*, COM(2015) 598 final, 7 December 2015.

([10]) See: *Asia Pacific Commercial Air Transport: Current and Future Economic Benefits*, December 2015, available at: *https://www.iata.org/policy/promoting-aviation/Documents/intervistas-report-aspac-dec2015.pdf*.

([11]) Partnership for Open & Fair Skies, *Restoring Open Skies: the need to address subsidized competition From state-owned airlines in Qatar and the UAE*, 2015. Available at: *http://www.openandfairskies.com/wp-content/themes/custom/media/White.Paper.pdf*. According to this report: «State-owned Qatar Airways (Qatar), Etihad Airways (Etihad) and Emirates Airline (Emirates) (collectively, the Gulf carriers) are the key instruments of these strategies, so their government owners have fueled their operations and their rapid growth with over $40 billion in subsidies and other unfair government-conferred advantages in the last decade alone».

([12]) The nationality clause requires that the airlines are substantially owned and effectively controlled by the home State or its nationals. Needless to say, that the nationality clause hinders not only the possibility for companies to merge, since they would lose the ability to operate in the traffic agreements, but also to create a network capable of operating internationally, in the absence of subsidiaries in the states

2. *Status of the aviation market liberalisation* — Air transport has traditionally always been a highly regulated industry, dominated by the flag carriers and state-owned airports since the role of the States has always been very invasive due to the strategic importance of the sector. This regulatory trend started to change when the U.S.A. decided to deregulate the legal framework with regard to the air transport industry.

However, the most outstanding and relevant example of liberalisation has to be found in the EU single aviation market, where the Member States enjoy all the nine freedoms of the air. Its creation has endowed several and compelling developments in the air transport sector and has contributed to a real democratisation of air transport, since European citizens can currently benefit from an unprecedented opportunity of air services. Through the establishment of the EU single aviation market, all EU air carriers, free to provide their services without any sort of capacity and frequency limitations, had a major and crucial role in the territorial cohesion of the region and in the development within the EU citizens of a shared sense of belonging to the same Community ([13]).

The real engine to the territorial cohesion of the regions has been, in particular, the rapid growth of EU low-cost carriers, such as Easyjet, Ryanair and Wizzair, that increased the competition within the European single aviation market and offered lower fares allowing more and more European citizens to travel both for business related purpose and for leisure. The EU low-cost carriers made full use of the liberalisation of the market establishing airport bases across borders, stimulating traffic volumes and forcing the national carriers to improve productivity and inducing inefficient air carriers

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in which or with whom they intend to operate within the network as is possible to see at European level. A step forward in overcoming these limits could be seen in the possibility for the EU to negotiate horizontal agreements with some non-EU states to replace the nationality clause after the open sky rulings of 2002. This new approach, which undoubtedly favours the European airlines, which can benefit from external traffic rights negotiated by the EC, is incapable even of promoting the development of international networks between airlines of different nationalities. Moreover, the failure of the experiments in Alitalia and Air Berlin, and the difficulties that Meridiana is encountering in relaunching the company after the Qatar Airways acquisition, demonstrate once again the impossibility of creating a real global aviation sector.

([13]) See: *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - An Aviation Strategy for Europe*, cit.

to inevitably leave the market ([14]). A large increase in passenger numbers is predicted in Europe, over the coming years for these airlines, with 40% going to Ryanair, 22% to EasyJet, with another 30% going to other low-cost airlines, with the remainder going to large established airlines.

On the external side, the impact of EU liberalisation has been equally positive since EU-level comprehensive aviation agreements aimed to create new economic opportunities and have boosted air services to neighbouring countries (creating the ECAA) ([15]) as well as to the U.S.A. and Canada.

The positive outcome of the new external aviation policy led to the conclusion of comprehensive global agreements with major aviation powers and with a double purpose of market opening and regulatory cooperation in aviation matters such as safety, security and environmental impact. The first Open Skies agreement was signed by the EU and the U.S.A. in 2007 ([16]) and was later followed by negotiations with Canada which led to a new Open Skies Agreement in 2009 ([17]).

([14]) *EU Air Transport Liberalisation Process, Impacts and Future Considerations*, Discussion Paper 2015-04, OECD, 2015, 14, «*Phase 3: the era of the low-cost carrier (2001-2013)*».

([15]) See Decision of the Council and of the representatives of the Member States of the European Union meeting within the Council of 9 June 2006 *on the signature and provisional application of the Multilateral Agreement between the European Community and its Member States, the Republic of Albania, Bosnia and Herzegovina, the Republic of Bulgaria, the Republic of Croatia, the former Yugoslav Republic of Macedonia, the Republic of Iceland, the Republic of Montenegro, the Kingdom of Norway, Romania, the Republic of Serbia and the United Nations Interim Administration Mission in Kosovo on the Establishment of a European Common Aviation Area (ECAA)*. The European Common Aviation Area (ECAA) came into being in 2006, with EU and Balkan countries as members, in order to expand not only market operation rules, but also traffic, safety and security standards beyond EU territory. The ECAA agreement will create, as envisaged by the EU, new market opportunities due to an integrated aviation market of 36 countries and more than 500 million people. *https://ec.europa.eu/transport/modes/air/international_aviation/country_index/ecaa_en*.

([16]) *Air transport agreement* between in EU and the U.S.A. in the Official Journal of the European Union, L 134/4 dated 25th of May 2007, available on: *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:134:0004:0041:EN:PDF*.

([17]) *Agreement on Air Transport between Canada and the European Community and its Member States*, in the Official Journal of the European Union, L 207/32 dated 6th of August 2010, available on: *https://eur-lex.europa.eu/legal-content/IT/TXT/?qid=1536604948685&uri=CELEX:22010A0806(01)*.

It is undeniable that liberalisation led to an increment of air services, stimulated traffic volume, provided lower fares to passengers and led to a market consolidation through mergers and acquisition. Nevertheless, these positive impacts are not uniform across countries and hinder the chance of having a «smart» regulation in the global aviation industry. Regulations restricting market entry still persist, such as the nationality clause and designation limits, which emphasise the capacity controls, stifling competition, enabling airlines to achieve monopoly profits and other subsidies along with the value chain. These constraints make the air transport market (which is international by definition without, unfortunately, an «international» air company) ([18]) characterised by an unfinished liberalisation.

It does not seem to find a way out by means of the current framework international regulation. The lack of a smart regulation able to implement a common legal framework for the aviation industry represents one of the issues which hinders the growth of air carriers and has, as the major consequence, unfair practices widespread in many areas of the world.

3. *Threats to a fair global aviation marketplace* — At present, unfair practices and discrimination are not addressed by any binding multilateral rules and the vast majority of ASAs fail to provide a full liberalisation with regard to capacity, frequency and traffic rights and to ensure fair competition on the routes subjected to the agreement.

As mentioned above, ASAs fail to address competition related issues since the most commonly used «fair and equal opportunity to operate/compete» clause is not adequate to address unfair practices.

If we focus our attention on an ASA of greater importance which is the Open Skies Agreement signed by the European Union and the U.S.A. we will notice that Article 3, § 6 makes no provision for the cabotage right in favour of the EU airline operators in the US airports. This right is not recognised within the territory of any Member States by the American air carriers. Though the cabotage's reserve is mutual, on closer examination it does not appear to be en-

([18]) The most liberalized air transport markets, such as American and European markets, envisage that, in the first case 75% of the U.S. carriers have to remain owned by U.S. citizens, while in the second case reg. (EC) no. 1008/2008 requires that Member States and/or nationals of Member States own more than 50% of the undertaking and effectively control it (art. 4, let. *f*).

tirely true if we consider the EU as a single entity. According to this provision, the US air carriers are able to perform air services in the European market on the basis of the fifth freedom of the air.

It should also be mentioned that the granting of the seventh freedom of the air right to the EU air carriers is restricted to the cargo service and for the US air carriers includes only the access to third State points beyond the Czech Republic, France, Germany, Luxembourg, Malta, Poland, Portugal and the Slovak Republic.

It is therefore clearly evidenced that an Air Service Agreement worldwide recognised as one of the most liberalized is still constrained by the persistence of a plurality of pitfalls and a barely hidden protectionist purpose imposed by the U.S.A. ([19]). Even among two markets, which are strongly liberalised with highly-advanced legislation to safeguard fair competition, it seems not possible to harmonise regulatory barriers and discourage States from adopting national regulations that hide protectionist purposes.

In this regard, the new Federal Aviation Administration Bill ([20]) seems to create a throwback since it is promoting a partial repeal of the U.S.-EU Air Transport Agreement of 2007. The Bill presented to Congress is along these lines, since the U.S. airlines are no more able to contrast the rising competitivity within the market, failing to create a solid and successful new business model which could be better developed with the support from the U.S. lawmaker.

It is clear that the recent draft is seeking to exclude the «flag of convenience» carriers from access to the U.S. market and it comes to the aid of the U.S. airlines since they cannot offer non-premium services at the same price as their low-cost European competitors ([21]). By restricting access to the transatlantic air routes not only to Norwegian Air, that seems to be the first addressee of this amendment, but also the new low-cost branches of the EU's airline groups, the American air carriers would be able to regain the lost market shares.

([19]) B. Havel-G.S. Sanchez, *The Principles and Practice of International Aviation Law*, New York, 2014, 86 ss.

([20]) House of Representatives of the U.S.A., HR 2997, 21st Century AIRR Act, June 2017.

([21]) T.J. Lynes, *Federal Aviation Administration bill proposes implicit revocation of US-EU Air Transport Agreement,* July 2017, [accessed on 23rd of November 2017], available at: *http://www.internationallawoffice.com/Newsletters/Aviation/USA/Katten-Muchin-Rosenman-LLP/Federal-Aviation-Administration-bill-proposes-implicit-revocation-of-US-EU-Air-Transport-Agreement*.

It is therefore important to bear in mind that the U.S.A. decided to innovate the bilateral ASAs in order to enhance economic recovery of the carriers that were suffering heavy losses and today, after thirty years of the Airline Deregulation Act, the U.S. air transport industry is less competitive with less dynamic growing strategies if compared to the European and Asian air carriers.

4. *Current threats to U.S. airlines and the weakness of the Open Sky policy* — At the present time, the Open Skies policy, strongly pursued in the past by the U.S. Government, is no longer a successful strategy of growth for the American air carriers. This, especially, with regard to the bilateral ASAs negotiated with new air transport faring nations in the Middle East, such as the United Arab Emirates (U.A.E.) and Qatar.

The two Open Skies agreements with Qatar, signed in 2001 ([22]), and with U.A.E., signed in 2002 ([23]), are the most vivid picture of the failure of the Open Skies policy to enforce a level playing field. It is worth noting that Etihad Airways, at that time, did not even exist, while Emirates Airline and Qatar Airways were so small and they did not represent a threat to the U.S. air carriers' operation to the Middle East. In fact, if at first the two agreements with Qatar and U.A.E. had a positive outcome, since they incentivised U.S. air carriers to open new air services, widening their network and accessing new markets, more recently they had a dramatic impact on the U.S. based airlines that were forced to close or reduce many direct routes to the Middle East and Asia ([24]).

This is one of the most striking examples that shows how necessary a «smart» regulation for the global air transport would be. Although the above-mentioned agreements, under Article 11 Sections 1 & 2, provide a specific provision on fair competition, many exogenous factors, such as political and economic interests, prevent en-

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([22]) See: U.S.-Qatar Air Transport Agreement of 3 October 2001, available at: *https://www.state.gov/e/eb/rls/othr/ata/q/qa/114294.htm*.

([23]) See: Air Transport Agreement Between The Government Of The United States Of America And The Government Of The United Arab Emirates of 11 March 2002, available at: *https://www.state.gov/e/eb/rls/othr/ata/u/ae/index.htm*.

([24]) M. Dresner-E. Cuneyt-C. Hofer-F. Mendez-K. Tan, *The impact of Gulf carrier competition on U.S. airlines*, in *Transportation Research* Part A: Policy and Practice, 2015.

forcing these provisions. As suggested by the U.S. Partnership for Open & Fair Skies established by several airlines (and with the support of some unions) ([25]), issues related, for example, to monopolies may constitute subsidies.

Once again, the failure of bilateral ASA in creating a level playing field and the removal of technical barriers to trade, led to a widespread uncertainty that could be dissolved only by means of harmonised regulatory framework set up by an intergovernmental organisation, such as the World Trade Organization (WTO) or the International Civil Aviation Organization (ICAO). The WTO excludes from the agreement the largest part of air transport services. Nevertheless, its regime offers an interesting model for liberalisation of the market. Likewise, ICAO in 2013, as we will see later, expressed its willingness to pursue a process aimed at improving fair competition in the market place.

The harmful effect suffered by the American legacy air carriers and the lack of an intergovernmental organisation entitled to ensure fair competition and to discourage States from adopting unfair behaviours led American Airlines, Delta, United Airlines and others to set up a «Partnership for Open & Fair Skies» as mentioned before ([26]).

This new partnership has not yielded practical results. The Department of State, after several demands brought forward by the U.S. legacy air carriers to modify the Open Skies Agreements in light of the White Paper's findings ([27]), opened a formal inquiry on

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([25]) See note 12.

([26]) See: S. Gössling-F. Fichert-P. Forsyth, *Subsidies in Aviation*, 2016, p. 4, available at: *http://www.mdpi.com/journal/sustainability*. «Recent claims by the Partnership for Open & Fair Skies state that the airline Etihad received US$1 billion in interest free loans, and US$1.2 billion in cash in 2013, as well as US$3.504 billion in government shareholder funds in 2014. US$751 million were provided in cash grants for marketing purposes in 2008 and 2010. Subsidies to Etihad totaled US$13.5 billion in the period 2004-2013. Likewise, Qatar Airways was allegedly provided with loans by the government that exceeded US$160 million in the period 1998-2004, and increased to US$742 million in 2008. Notably, according to the Partnership for Open & Fair Skies, loans were forgiven in 2009, and the government continued to provide an estimated US$6 billion in 'shareholder advances' to Qatar Airways in the years 2009-2014. The total amount of subsidies amounted to US$7.76 billion, plus US$618 million in interest, had the loans been acquired on commercial terms. The Gulf carriers deny these claims».

([27]) *White Paper, Restoring Open Skies: the need to address subsidized competition from state-owned airlines in Qatar and the UAE*, January 2015, [accessed on 11th of November 2017], available at: *http://www.openandfairskies.com/wp-content/themes/custom/media/White.Paper.pdf*.

the subsidies received by the Gulf's air carriers. However, the U.S. Government did not intervene to restore fair competition, since it did not find any evidence of the allegations brought forward by the American legacy carriers.

These facts frustrate both the original spirit of the Open Skies Agreement and the implementation of a level playing field, and they prove, once again, the urgency of a harmonised regulation able to prevent unfair practices and regulatory barriers.

In view of the above considerations, an interesting question arising in this respect, is whether the American government will take this opportunity to protect the fair competition principle in order to promote a level playing field. Given the protectionist approach to safeguard the American industry by the Trump Administration, combined with Qatar's isolation, it would be harsher to achieve that result.

In this perspective, American Airlines, while waiting for the US lawmakers to intervene, revoked any code-sharing agreement with Etihad and Qatar Airways. The American airlines considered it unproductive to share the code-sharing's revenues with those air carriers which have distorted competition on the air routes to Asia and the Middle East.

5. *The current threats to EU airlines* — Many concerns, with different approaches, were raised in Europe on unfair competition. Indeed, legacy airlines remain divided on the reasons behind EU aviation problems and the necessary response to competition with third countries.

Lufthansa and Air France-KLM called for strong measures to tackle unfair competition claiming that non-EU carriers are offering unnecessary capacities at non-economical prices. This, with the objective of gaining market shares at the expense of airlines operating under normal commercial conditions.

Some important players, such as International Airlines Group and Alitalia, strongly disputed the claims that alleged unfair subsidies are being provided by Gulf States to their airlines. On the contrary, they stressed that the EU and other national unnecessary regulatory costs and national taxes are ultimately responsible for putting European companies at a competitive disadvantage and hampering the competitive position of EU aviation.

6. *Which role for ICAO in promoting a level playing field?* — In light of the current international air framework regulation incapable of promoting a level playing field, it should be examined whether a solution for the implementation of fair competition principles can be found by ICAO.

The Organisation has, among others, the task of developing international air transport preventing economic waste caused by «unreasonable competition» ([28]). However, in contrast to the matters of safety, security, air traffic management, environment and, in general, technical cooperation, the Chicago Convention 1944 conferred an opaque mandate or, more precisely, envisaged a contradictory mandate to ICAO to act in the area of economic matters. This is because Article 6 of the Chicago Convention provides that all commercial air transport services are forbidden, except to the extent that they are permitted. The idea that ICAO could play a formal role in economic regulation has been debated for many years. Nevertheless, this debate still did not lead to any adoption of standards regarding fair competition.

In any case, despite the limited activity of ICAO in economic regulation of international air services, the existence of a plurality of limitations in order to find a full development of air transportation, has drawn the ICAO's interest for a considerable time.

The ICAO Assembly A/38, which was held in September-October 2013, recognised the importance of fair competition and agreed that: «fair competition is an important general principle in the operation of international air services» and that «ICAO should play a leadership role in identifying and developing tools to promote dialogue and the exchange of information among interested authorities with the goal of fostering more compatible regulatory approaches» ([29]).

The provisions presented by ICAO were meant to be unequivocal and universally applicable in order to draw up binding fair competition clauses to be inserted in every bilateral agreement. Nevertheless, the conference's debate brought up divergent views among States over the issue of competition since, for many of them, competition issues are secondary as compared to the problem of connec-

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([28]) Chicago Convention 1944, article 44.

([29]) *ICAO Assembly Resolutions in Force*, 4 October 2013, Doc 10022 available at: *https://www.icao.int/publications/Documents/10022_en.pdf*.

tivity and market access. For now, the search for 'smart' regulation must, therefore, be done elsewhere, given the incapability of ICAO to achieve this result.

7. *WTO and air transport: which perspective?* — Could an intervention of the World Trade Organization be decisive in the absence of an effective ICAO action as a consequence of the lack of Member States consensus?

Although the WTO provides a quasi-universal international legal framework for trade relations, air services are governed by a specific Annex of the General Agreement on Trade in Services. This excludes from its scope the largest part of air transport services, namely traffic rights and services directly related to the exercise of traffic rights ([30]).

The three cornerstone principles of GATS, namely, (*a*) the *Market Access:* WTO Members are prohibited from adopting specific measures contributing to limitations on the market access of foreign services and service suppliers; (*b*) the *Most Favoured Nation* (MFN): the rights granted to services and service suppliers of one trading partner are automatically and unconditionally granted to like services and service suppliers of any other GATS' trading partner; (*c*) the *National Treatment* (NT): ensuring that foreign services and service suppliers of any other GATS Member do not receive less favourable treatment than domestic services and services suppliers, and are not applicable to the exercise of traffic rights.

In fact, the GATS Annex on Air Transport Services provides that the Agreement, including its dispute settlement procedures, shall not apply to measures affecting traffic rights or services directly related to the exercise of traffic rights. This is with the exemption of three ancillary services: aircraft repair and maintenance services, the selling and marketing of air transport services and computer reservation system services ([31]).

This exemption of crucial services arises once again from an intrinsic characteristic of the air transport industry, to be found in the bilateral agreements system which grants market access on a recip-

([30]) Annex 1B, General Agreement on Trade Services, WTO.

([31]) See: IATA, *Liberalisation of Air Transport and the Gats*, Discussion Paper Government Affairs External Relations Division International Air Transport Association, Geneva, October 1999 available at: *https://www.wto.org/english/tratop_e/serv_e/iacposit41.pdf*.

rocal basis. As a consequence, the application of the MFN principle would be almost impossible in air transportation. Indeed, it would require extending to all WTO members the best treatment a country grants to any other country with respect to air services, but all of this could be granted on a nonreciprocal basis. In the current air transport scenery this could lead to the problem of «free riders», countries which could take full advantage of the most liberal concessions whilst keeping their markets closed. As a result, the most liberalized countries could not use the concessions made in order to obtain reciprocal treatment.

An example in this regard — to fully understand that the WTO would be not the proper intergovernmental organisation to set a «smart» regulation for global aviation — is offered by the «U.S.A. case». In this example the U.S.A. would be forced to grant to Chinese air carriers the same generous conditions, already granted to the EU airlines (under the U.S./EU Airline Service Agreement), while China, as WTO member, would just have to offer, in order to comply with the MFN principle, the restricted and less liberal ASAs ([32]).

Although, the European Union — together with Australia, New Zealand and Chile — supported the expansion of the GATS to cover air transport during the first review of the GATS Annex on Air Transport Services, very little progress has been made.

8. *State of play: are we forced to coexist with Bilateral ASAs?* — Today, given the impossibility of an effective intervention of WTO and the plastering of the ICAO, the Bilateral ASAs system still represents the dominant, if not exclusive, approach to assess the air traffic rights, capacity and applicable tariffs to access the aviation markets ([33]).

Despite the remarkable growth of the aviation industry in technological and economical terms, the legal framework that regulate

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([32]) B. Havel-G.S. Sanchez, *The Principles and Practice of International Aviation Law*, New York, 2014, 110-111.

([33]) This is because although the Chicago Convention succeeded in creating a standardised system of international air services provisions, it still marked the failure of a possible multilateral exchange of traffic rights. Since the States did not negotiate the Multilateral Agreement and they had to resort to bilateral negotiations to govern the air traffic rights, they created an extensive system of bilateral agreements that became the real tool on which the worldwide air transport relies.

the air services is still based on protectionist logics and it is highly influenced by the States' will to grant the privilege to access their markets on a defensive reciprocity. This is in order to preserve a strategic segment of the national economy ([34]).

In the most liberalized systems, the lack of any sort of harmonisation regarding social and taxation legislations represents a detriment for the airlines that struggle to compete in the air transport industry, not yet definable as air transport single market.

Globally, apart from the successful and unique exchange of traffic rights occurred in the EU with the creation of the single aviation market, which represents the most panoramic exchange of traffic rights in international air transport since in no other region in the world, there was not accomplished a similar result. As a matter of fact, only in the EU single aviation market all Member States enjoy all nine freedoms without any kind of restrictions. In other words, regions where a similar approach was imitated, for example in Asia (within ten-member States of the Association of Southeast Asian Nations, ASEAN), the outcome was totally different. Although the ASEAN members agreed, in the larger context of greater economic integration across all sectors through the harmonisation of trade and investment policies, the negotiation of a series of «staged» accords for comprehensive traffic rights at the sub regional and regional level without a central authority as in the EU (the EU Commission or a legally binding adjudicatory body), has hampered the liberalisation.

The ASEAN Single Aviation Market, that was expected to begin on the 1st of January 2016 by setting up a unified and single aviation market among ASEAN members in Southeast Asia, is facing a strong opposition from Indonesia, the Philippines and Laos who are reluctant to ratify the agreements ([35]). The ASEAN Single Aviation Market would have ensured that all carriers based in the ten-mem-

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([34]) One example is given by the EU-US open skies agreement of 2007 at the time the prospect of meaningful change in ownership restrictions, where foreign ownership limit would be equalised at 49% for both. However, the U.S. has not been prepared to move to this next stage (the union played a relevant role on this regard), so this has not happened, and the EU (already at 49%) has left nothing to push the U.S. up to the same limit. In the past a global leader in the liberalisation of aviation, the EU is now unlikely to make any unilateral move to increase or abolish the foreign ownership limit.

([35]) See: A. Tan-K. Jin, *Clear take-off* on *ASEAN Open Skies*, 2013, Straits Times.

ber States enjoyed unlimited operations under the third, fourth and fifth freedom of the air within the region. However, protectionism won out another time on liberalization ([36]). In fact, if we bear in mind that Indonesia and the Philippines are ASEAN's two largest Members by population, their decision not to ratify the agreement hinder any chance of having the ASEAN Single Aviation Market to be in force within the region anytime soon. At the same time, it is important to point out that the ASEAN Single Aviation Market liberalisation agenda remains relatively modest if compared to the outcome of the EU single aviation market and of the EU Common Aviation Area (ECAA).

In addition, if we analyse the agreement in greater detail, relevant limitations arise since, as already underlined, third, fourth and fifth freedoms of the air are considered only, while the seventh freedom ([37]) and the right of cabotage are not provided by the agreement.

In view of all this, up to the present date, there aren't immediate and international options to the situation. A global solution is strongly needed but, as we have seen, the international bodies entitled to do so are not able or ready to provide any effective solution.

9. *What is going on in the meantime?* — In the light of the above, it is clear that up to the present date no immediate international solutions are available and no transnational bodies are able to provide a remedy. Meanwhile, what is going on? Which solutions are carried out in the most liberalised region of the world to curb the issues arising from the absence of an international regulation? What is the approach of the most liberalised regions in the world to contain the problems arising from the absence of a global framework?

The States, fully aware of the impossibility of finding a solution at transnational level, are pursuing unilateral approaches such as the EU is presently doing.

([36]) See: *Asia Pacific Commercial Air Transport: Current and Future Economic Benefits*, cit. p. 71.

([37]) Seventh Freedom of The Air: «the right, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State».

10. *Regional solutions: The EU approach* — It is realistic to say that the EU represented a global leader in the liberalisation of aviation but is more realistic to admit that the EU is now unlikely to make any unilateral move to increase or abolish the foreign ownership limit and therefore to go beyond the constrains associated with this rule. One of the most important of these constrains is the issue of fair competition. It can't be forgotten that in the European Union the principle of fair competition is an intrinsic part of the internal market. For this reason, the absence of a multilateral solution cannot leave unresponsive one of the most advanced aviation markets, where it has become essential to ensure that fair competition is guaranteed both by European carriers and by non-European carriers.

In other words, because the issues on fair competition — which is one of the unresolved issues most affecting European airlines — are not properly addressed at bilateral or multilateral level, the EU adopted, in recent years, a further approach to prevent and counteract any possible unfair practices and discrimination harming EU air carriers.

11. *The EC Regulation 868/2004 to prevent anti-competitive behavior* — In this regard, it was not the first time that the EU decided to step in and to protect its air carriers since already in 2004, the European law maker adopted the reg. n. 868/2004 ([38]). With this Regulation the EU intends to safeguard its airlines from practices considered unfair and discriminatory.

The Regulation was adopted as a response to the U.S. Aviation Insurance Program ([39]) and further measures qualified as State aids under the EC law, which, after the terrorist attacks of the 11th of September 2001, the U.S. air carriers were benefiting from ([40]).

([38]) See reg. (EC) No 868/2004 of 21 April 2004 concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community, Official Journal L 162, 30/04/2004 P. 0001-0007.

([39]) It was part of a package of measures providing USD 5 billion direct compensation and USD 10 billion in subsidising loans and loan guarantees. It was extended in 2009 and 2013 and will expire in 2018. [accessed on 15th November 2017] available at: *www.faa.gov/about/office_org/headquarters_offices/apl/aviation_insurance*.

([40]) J. BALFOUR, *EC Policy on State Aid to Airlines Following 11 September 2001*, in *Air & Space Law* 2002, 399.

The U.S. Government granted its airlines 5 billion US dollars in direct grants and an additional 10 billion U.S. dollars in loan guarantees to compensate for the closure of the U.S. airspace for four days. The government financial support enabled U.S. airlines to sell underpriced tickets on the transatlantic routes between Europe and the United States, seriously distorting competition and harming European air carriers. The U.S. lawmaker's action drew the attention of the latest which were calling for a similar approach in Europe. The U.S. legislator approach was not transposable into the European legal framework, since the U.S. Aviation Insurance Program granted extensive discretionary powers to the U.S. Secretary of Transportation and would have breached the «one-time, last-time» rule.

Europe reminded Member States, wishing to adopt a similar approach, that such aid would be required to be duly notified and strictly regulated ([41]). Due to the objective extraordinary situation, restricted aid would have been allowed under Article 107 (2) (b) and the EC would have approved time-limited aid to cover extra-insurance costs.

The EC legislator chose a different approach. As clarified in March 2002, in the Explanatory Memorandum accompanying the proposed Regulation, bilateral agreements often lack the necessary mechanism to provide swift and comprehensive protection against subsidisation and unfair pricing practices. In that Memorandum, the Regulation «concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community» seemed the best solution to these problems ([42]).

This is the main reason why the focus of Regulation 868/2004 is on unfair practices as set out in Article 1, since the objective of the Regulation is to establish a procedure to be followed to provide protection against injury to the Community industry from subsidisation and other unfair pricing practices of third countries in the supply of air services.

However, the approach of the EU lawmaker has proved to be entirely impractical for the air transport sector which is characterised

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([41]) Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ 244 (2004), 2.

([42]) Explanatory Memorandum COM (2002) 110 final, Brussels Mar. 12, 2002, 2.

by a specific and dynamic pricing system for several reasons. Firstly, the Regulation was modeled on tools used in anti-dumping for goods and proved not to be adaptable to the specificities of the air transport industry. Indeed, the EU lawmaker used directly the concepts and definitions that were drawn from the provisions used for defence of trade in goods. This approach does not address properly the difficulties in the air transport sector to determine the existence of unfair pricing practices. The Regulation requires proof that third country airline's fares are offered sufficiently below fare levels of EU air carriers. This, ignoring the fact that, unlike other industries, the air transport industry pricing system heavily depends on many factors and conditions. Price levels are subjected to rapid modifications which happen also in function of demand and competitors' practices.

Secondly, the narrow scope of the unfair practices — together with the ineffectiveness of the redressive measures, inappropriate for the needs of an efficient defence structure of air transport — urged the need for a new instrument to safeguard fair and open competition in the EU external relations.

Lastly, Regulation 868/2004 makes it even harder to lodge a complaint since it limits the right to complain to the European Commission to the «Community industry». More specifically, with regard to the Community industry's definition, the European Commission pointed out that, in order to comply with it, a valid complaint would need to be filed by the European air carriers whose collective share constitutes a major proportion of the total Community supply of those services.

Therefore, in the current legal framework, Member States and single air carriers are unable to file a complaint in their own right. In this respect, it is worth noting that, under Regulation 868/2004, a complaint proposed by both Air France-KLM and Lufthansa Group, would not have complied with the «Community industry» requirement.

12. *Toward a new EU Regulation on safeguarding competition in air transport* — The above-mentioned situation — that led to significant losses of important parts of EU air carriers' revenues on routes towards certain countries in favour of competitors benefiting from alleged subsidies and unfair practices — highlights the urgency to

amend Regulation 868/2004, in the absence of more effective measures at international level.

In fact, without significant changes to the material substance and logic of the Regulation, it would be very unlikely that its current structure would be able to have an effective impact on market behaviour re-establishing a level and fair playing field. Therefore, in the absence of an effective legislative tool, the EU air carriers, would not have ensured the necessary protection against possible unfair practices by non-EU operators.

As noted by the European Commission in the Proposal for a new Regulation on safeguarding competition in air transport repealing EC Regulation No 868/2004 «the liberalisation and deregulation of international air transport has fostered unprecedented competition within the Union market and globally. […] However, in the absence of an international framework that sets out the conditions governing competition among air carriers, practices regarding the treatment of air carriers may differ from one country to another and affect competition. […] Indeed, unfair practices, if they are allowed to persist, may lead in the longer run to dominant or even monopolistic situations in the aviation market, meaning less choice, less connectivity and higher prices for EU citizens». Hence, this has given rise to the Commission's proposal to address the fair competition issues since when the EU's connectivity and competition are at risk «the Union must be able to act effectively to ensure an open and competitive market» ([43]).

Previously, the Council on 20 December 2012 adopted conclusions in which it called for a more ambitious and robust EU external aviation policy, based on the principles of reciprocity and open and fair competition in a level playing field. For the Council, Regulation 868/2004 is not able to safeguard open and fair competition, so it encouraged the Commission and Member States to «use their bilateral and multilateral relations to actively support the establishment of a level playing favoring open and fair competition in international air transport». Also, the European Parliament called in several resolutions for the revision of Regulation 868/2004, firstly in its resolution of 2 July 2013 where it considered that bilateral ASAs are not the most appropriate solution to prevent market restrictions or

([43]) Proposal for a Regulation of the European Parliament and of the Council on safeguarding competition in air transport, repealing reg. (EC) No 868/2004, 8.6.2017, COM(2017) 289 final, 2017/0116(COD).

unfair subsidies (44). In this context, the EU Institution pointed out that a more coordinated Union approach should be applied to establish fair and open competition and called on the Commission to propose the revision or replacement of the Regulation.

Later, the European Parliament's 11 November 2015 resolution on aviation emphasised the ineffectiveness and inadequacy of the Regulation urging the Commission to revise it in order to safeguard fair competition in the EU's external aviation relations. Lastly, in its recent resolution of 16 February 2017 on aviation strategy for Europe, Parliament welcomed the Commission's proposal to revise Regulation but also stressed out that «neither an unacceptable trend towards protectionism, nor, on their own, measures to ensure fair competition can guarantee the competitiveness of the EU aviation sector».

13. *The proposal for repealing EC Regulation 868/2004* — This is the background which has given rise to the Commission's proposal to address the fair competition issues since when the EU's connectivity and competition are at risk «the Union must be able to act effectively to ensure an open and competitive market».

The proposal to amend the current Regulation is in accordance with the Commission Communication on the EU's External Aviation Policy (45), which emphasises the importance of the EU's ability to act internationally to safeguard the competitiveness of EU airlines against unfair competition and other practices that arise (46). The scope of the proposal, therefore, goes beyond the existing Regulation 868/2004 which aimed to provide protection only against subsidisation and unfair pricing practices; we have seen that, in accordance with its provisions it is very difficult to give evidence of such pricing practices (47).

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(44) European Parliament resolution of 2 July 2013 on the EU's External Aviation Policy, Addressing future challenges (2012/2299(INI)).

(45) European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *The EU's External Aviation Policy, Addressing Future Challenge*, COM(2012) 556 FINAL.

(46) The legislative process required before final adoption of the Commission's proposal has not yet commenced and therefore it is not excluded that the final version of the regulation may be different from the proposal examined here.

(47) See U. Schulte Strathaus, *Is the European Commission fulfilling its ambitious aviation strategies?* in *Air and Space Law* 2017, 517.

A new major element of the proposal is that it takes into account the obligations contained in international air transport or air services agreements with third countries, while Regulation 868/2004 failed to provide for a dedicated European internal procedure with respect to such obligations. In this regard, Article 2 of the proposal defines the applicable international obligations as meaning: «any obligations that are contained in an international air transport or air services agreement to which the Union is a party or any provision on air transport services included in a trade agreement to which the Union is a party, and which relates to practices that may affect competition or other conduct relevant to competition between air carriers».

In addition, if the proposed amendment to the Regulation 868/2004 would be approved, it would be allowed to single airlines, groups of airlines and Member States to legitimately file a complaint in their own right. While on the contrary, today, an investigation under the current Regulation can be initiated upon the lodging of a written complaint on behalf of the Community industry and neither Member States nor individual air carriers are able to lodge complaints in their own right ([48]).

The proposal includes a new set of rules that the Commission is going to use to examine in advance whether to further proceed in an investigation. The European Commission, in order to legitimately open an investigation under the Article 3(*b*) of the proposal, called «Initiation of proceedings», would have to verify the existence of one of the following circumstances: «(i) a practice affecting competition, adopted by a third country or a third country entity; (ii) injury or threat of injury to one or more Union air carriers; (iii) a causal link between the alleged practice and alleged injury or threat of injury». Moreover, the proposal seeks to ensure that the investigation can extend to the widest possible range of elements, allowing the Commission to investigate in third countries, but it is evident that this provision will be of limited significance since it is limited to the third state's approval, which is unlikely to be obtained.

If an investigation finds that a third country or one of its airliners has violated Article 3 (*b*) of the amendment proposal to the Regulation and has caused not only injury but also a threat of injury to a

([48]) Article 3, lett. (*b*) defines «Community industry» as «the Community air carriers supplying like air services as a whole or those of them whose collective share constitutes a major proportion of the total Community supply of those services».

EU air carrier, the Commission will be entitled to impose redressive measures. Those measures can be found under Article 13.2 (*a*) and (*b*) in «financial duties or any measures of equivalent or lesser value» ([49]).

The aim of the redressive measures is to counteract the injury occurred or the potential threat of injury resulting from the unfair practices suffered by EU air carriers. This may include the suspension of concessions of services owed or of other rights of the third country air carrier ([50]).

Therefore, it is important to point out that, in order to comply with the principle of proportionality, the redressive measures have to be restricted to what is necessary to offset the injury or threat of injury identified during the investigation. According to the same principle, as stated by the Commission: «redressive measures have to remain in force only as long and as to the extent that, it necessary in view of such practice and the ensuing injury or threat of injury». In accordance with Article 291 TFEU, redressive measures would be imposed by the Commission.

The Commission is aware that such redressive measures could lead to retaliation measures towards European operators. In this regard, the Commission in Article 10.2, let. (*b*), of the proposed Regulation set out that it may decide not to take action if it would go against European air carriers' interest designing, if necessary, redressive measures with the aim of minimising the risk of side effects, including retaliation.

In conclusion, the proposal makes it easier to file a complaint since it is removing the Community industry requirement and widening the circumstances of unfair practices. Nevertheless, the proposal, providing a number of «get out» clauses such as Article 10.2, let. (*b*), allows the Commission to dismiss a complaint regardless of the adoption of redressive measures which could harm wider EU interests and the aviation market. The proposed Regulation seems to

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([49]) Article 13.2, «The redressive measures referred to in paragraph 1 shall be imposed on the third country air carrier(s) benefiting from the practice affecting competition and may take the form of either of the following: (*a*) financial duties; (*b*) any measure of equivalent or lesser value».

([50]) It is not clear enough from the Proposal and a future intervention on the point by the Commission is already required if under the amended Regulation would be possible to suspend air traffic rights. This a clear symptom of the difficulties faced by the EU Commission while drawing up the Proposal.

have a dual nature aiming to discipline markets and, at the same time, to find mutually agreeable solutions. Whether this instrument will be an effective tool depends on its capacity to counteract unfair competition behaviours.

14. *Conclusions* — It is therefore clear that no significant steps were made in the last decades to foster a regulatory harmonisation in the air transport industry other than unilateral and regional approaches. Bilateralism did not offer efficient and effective instruments to enforce a fair global aviation market and to secure the air transport sector against possible unfair practices. The American and European aviation industry is still suspicious that subsidies in favour of airlines in emerging countries can hinder and hamper the establishment of a level playing field.

In the context of GATS/WTO, promoting the developments of disciplines for subsidies seems difficult, although such disciplines already exist for goods as provided by the WTO Agreement on Subsidies and Countervailing Measures. Article XV of the GATS recognises that, under certain circumstances, subsidies may have distortive effects in trade in services. Therefore, it is provided that WTO Members should enter into negotiations in order to develop the necessary multilateral disciplines to avoid such trade distortive effects. Although initiatives have already started in the WTO, negotiations on this issue are not underway.

Also the solution to develop a smart regulation for a global aviation in another international forum such as ICAO resulted in nothing, considering the outcome of the ICAO Assembly Resolution 2013.

It is also difficult in these days to foresee, without major efforts in this direction, effective forms of cooperation between the two Organizations. It is noteworthy to recall that ICAO in 2002 has already requested the WTO to develop a Memorandum of Understanding (MoU) to define their respective roles for strengthen cooperation on Air Transport Services and other air transport issues, including liberalisation, to make the market more competitive. In the lack of consensus on the development of the MoU, the subject was retained as a standing item on the agenda for a subsequent meeting ([51]).

([51]) A. GOLDSTEIN-C. FINDLAY, *Liberalisation and Foreign Direct Investment in Asian Transport Systems: The Case of Aviation*, Asian Development Bank & OECD De-

In the absence of internationally harmonised solutions, it is the organisations or states that have to find solutions to these problems which are undoubtedly very challenging, with the total uncertainty that, however, at regional level these problems could be solved. Among these problems, the unfair competition has to be included. We have seen that the European Commission, in introducing future measures to protect competition in the European market, has raised the problem of the retaliation measures that non-EU states could adopt in response to a tightening of European competition policy. This uncertainty is a clear sign of the weakness of every solution adopted at the regional and not at international level, as would be desirable.

velopment Centre, Experts' Meeting on Foreign Direct Investment in Developing Asia, Paris 26-27 November 2003.

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