



WORKING PAPER

ASSEMBLY — 38TH SESSION

ECONOMIC COMMISSION

Agenda Item 41: Economic regulation of international air transport

ECONOMIC REGULATION OF INTERNATIONAL AIR TRANSPORT

(Presented by the Council of ICAO)

EXECUTIVE SUMMARY

This paper reports on major work accomplished by ICAO since the last Assembly in the field of air transport policy and regulation. It also provides a brief overview of significant industry and regulatory developments and presents future work to be undertaken by the Organization in this field.

Action: The Assembly is invited to:

- a) review the developments and related ICAO work presented in this report;
- b) endorse the Organization's plan for future work in the field of air transport policy and regulation as presented in paragraph 4; and
- c) consider the information contained in this working paper for the update of Assembly Resolution A37-20.

<i>Strategic Objectives:</i>	This working paper relates to Strategic Objective C — <i>Environmental Protection and Sustainable Development of Air Transport</i> .
<i>Financial implications:</i>	The activities referred to in this paper will be undertaken subject to the resources available in the 2014–2016 Regular Programme Budget and/or from extra budgetary contributions.
<i>References:</i>	A38-WP/56, Outcome of the Sixth Worldwide Air Transport Conference (ATConf/6) A38-WP/55, Consolidated statement of continuing ICAO policies in the air transport field Doc 9587, Policy and Guidance Material on the Economic Regulation of International Air Transport Doc 9958, Assembly Resolutions in Force (as of 8 October 2010) Doc 10008, <i>Report of the Economic Commission of the 37th Session of the Assembly</i> Doc 10009, <i>Report of the Sixth Worldwide Air Transport Conference (ATConf/6)</i>

1. BACKGROUND

1.1 Since the 37th Session of the Assembly, the focus of ICAO's work in the field of air transport policy and regulation has concentrated on the promotion of ICAO policy guidance on the economic aspect of sustainable air transport development, and in the preparation of the Sixth Worldwide Air Transport Conference (ATConf/6, March 2013).

1.2 Recognizing that air transport is an integral part of the civil aviation system and a major contributor to economic development and global trade, the Council established for the 2014-2016 triennium a new Strategic Objective, *Economic Development of Air Transport*, to guide the work of the Organization in fostering the development of a sound and economically viable civil aviation system. When considering the convening of the Sixth Worldwide Air Transport Conference, the Council agreed on the theme "Sustainability of Air Transport". According to a definition adopted by the United Nations (UN), "sustainability" is an economic, social, and environmental concept that involves meeting the needs of the present without compromising the ability of future generations to meet their own needs. In the air transport context, it means that the air transport system should be affordable and environmentally friendly while operated safely, securely, fairly and efficiently. It should offer choices of air services while supporting a competitive economy and balanced regional development.

2. WORK ACCOMPLISHED BY ICAO

2.1 **ICAO Air Services Negotiation Conference (ICAN).** The Organization continued to provide this innovative facility to Member States. Since its inception in 2008, events have been held annually, in different regions, with increasing participation. ICAN/2011 took place in Mumbai, India, hosted by the Ministry of Civil Aviation of India; and ICAN/2012 was held in Jeddah, Saudi Arabia, hosted by the General Authority of Civil Aviation of Saudi Arabia. By 2012, a total of 107 States (representing 56 per cent of ICAO membership) utilized this facility at least once, resulting in the signing of over 300 air services agreements and arrangements, including many "open skies" agreements. Echoing Resolution A37-20, States have widely recognized the value of ICAN as an efficient and cost effective means for conducting air service negotiations.

2.2 **Global symposia and regional seminars.** During the triennium, the Secretariat conducted a number of global symposia and regional seminars in preparation for ATConf/6. In April 2012, the Organization held an ICAO Air Transport Symposium (IATS), in partnership with the Air Transport Research Society, the theme of which was *Strategies and Tools for Sustainable Air Transport*. The Symposium identified major impediments to sustainable air transport development, and explored strategies to overcome them, including tools to support implementation; additional information is provided in the Appendix.

2.3 The Organization conducted a series of short and focused regional seminars in cooperation with regional organizations and ICAO Regional Offices in different regions, including: Rabat, Morocco (July 2012), for the Arab States; Buenos Aires, Argentina (July 2012), for States in Latin America; Martinique, France (October 2012), for States in the Caribbean; Dakar, Senegal (October 2012), for African States; Paris, France (November 2012), for European States; and Hong Kong, China (January 2013), for States in the Asia and Pacific Regions. In addition, the Secretariat held preparatory meetings with a few States. Lastly, a one-day pre-ATConf/6 Symposium was held on 17 March 2013 for the Conference participants, who heard thought-provoking views and insightful discussions from key players and panellists regarding the major challenges and policy options facing the aviation community. These preparatory meetings increased States' awareness of the ATConf/6 agenda and associated key issues which and resulted in increased participation in the Conference.

2.4 The Fourth ICAO Pre-Assembly Symposium is scheduled to take place from 21 to 22 September 2013 at ICAO Headquarters. This event will be conducted jointly with the McGill University Institute of Air & Space Law and will address key issues in air transport economics, management and regulation and provide a preparatory forum for the 38th Session of the ICAO Assembly.

2.5 **Air Transport Regulation Panel (ATRP).** In the past three years, the Panel has continued to provide advice and assistance to the ICAO Secretariat with respect to a number of tasks, such as the development of model bilateral clauses on slot allocation. Under new terms of reference approved by the Air Transport Committee (ATC), the Panel held its eleventh meeting (ATRP/11) in June 2012, which provided advice and recommendations for the preparation of the Conference. During the lead-up to ATConf/6, the Secretariat continued to consult the Panel when its advice and assistance were required.

2.6 **ICAO policy and guidance material.** Pursuant to Assembly Resolution A37-20 (Appendix A, Section V), the Secretariat updated the Database of the World's Air Services Agreements (WASA), increasing the coverage to 2 480 agreements involving 166 States, and the ICAO Template Air Services Agreement (TASA). As an on-going task, the Secretariat continued to monitor major regulatory and industry developments in international air transport. For example, the Secretariat compiled information on consumer protection rules and practices by States and the industry, and published a summary, with subsequent updates, on the ICAO website (http://www.icao.int/sustainability/pages/eap_ep_consumerinterests.aspx). In addition, the ICAO Secretariat has participated in the work of the World Tourism Organization (UNWTO) for the development of a convention on the protection of tourists and tourism service providers, to ensure coordination between the two organizations and in order to avoid duplication of work.

2.7 **Cooperation with aviation stakeholders.** ICAO increased its engagement with the industry and other stakeholders in promoting the sustainable development of air transport, and in policy making. To pursue such cooperation, on 18 April 2012 during IATS, representatives of the Airports Council International (ACI), the Civil Air Navigation Services Organization (CANSO) and the International Air Transport Association (IATA) presented ICAO with a declaration signed by the industry during the Aviation and Environment Summit in March 2012; the declaration pledged support and a common effort in promoting the sustainable development of air transport worldwide. On 18 March 2013, during ATConf/6, ICAO signed a Joint Statement with UNWTO on Aviation and Tourism to strengthen cooperation on issues of common priority, such as the protection of passengers and tourists, visa facilitation and taxation.

3. MAJOR DEVELOPMENTS

3.1 Reported below are some major industry and regulatory developments since the last Assembly. A more detailed report, titled Regulatory and Industry Overview, will be available on the Assembly website, under "Documentation".

3.2 **Industry developments.** In the past three years, the growth in passenger traffic was a reflection of positive economic growth worldwide. Air cargo also became increasingly important to global trade, achieving an 18.5 per cent growth in the past three years in terms of total tonne-kilometres performed. Overall, impressive international traffic growth and robust domestic market development in developing countries, coupled with economic growth higher than in developed economies (where some States have been troubled by a serious sovereign debt crisis), created a two-speed pattern leading to regional disparities in the development of the air transport industry. Nevertheless, the airline industry continued its structural transformation to adapt to the dynamic marketplace confirming the trend toward more airline consolidation through alliances, cross-border equity investment, and mergers. While low-cost

airlines continued to expand, notably in Asia and Europe, and to increase their market share, network airlines also took measures to adjust to the challenges, including establishing separate business entities or subsidiaries to operate low cost short haul services. Although the airline industry has proven its resilience in challenging times, it continues to be vulnerable to the impact resulting from external factors, such as the local and global economic climate, fluctuation of oil prices, and social instability.

3.3 **Regulatory trends.** The trend toward air transport liberalization has continued, and at the bilateral level, between 2011 and March 2013, States signed an approximate 115 additional open skies agreements, increasing the total number of such agreements signed since 1992 to over 410. The number of States that have signed one or more open skies agreements has reached 145, representing 76 per cent of ICAO membership. At the regional level, the European Union (EU) continued to pursue liberal agreements with major partners, while other regional groupings have also continued their liberalization programme, through the development and adoption of intra-regional and inter-regional liberalization arrangements. For example, in November 2010, Members of the Association of Southeast Asian Nations (ASEAN) adopted a plan to achieve a single open sky aviation market by 2015. Member States of the Latin American Civil Aviation Commission (LACAC) also reached agreement on the development of an open skies regime for the region. At the multilateral level, there has been no movement at the World Trade Organization on the review of the Air Transport Annex.

3.4 Emerging issues, such as fair competition and consumer protection, have attracted increasing regulatory attention.

3.5 Regarding the fair competition issue at the multilateral level, many States have recently turned to regional solutions. Several regional bodies, such as the African Union (AU), in coordination with AFCAC, the Association of Southeast Asian Nations (ASEAN), the Arab Civil Aviation Commission (ACAC) and the Latin American Civil Aviation Commission (LACAC), have been developing provisions on fair competition, using in some cases ICAO guidance. There is a recognized need for cooperation among competition authorities, notably in the context of approval of alliances and mergers.

3.6 In the area of consumer protection, some States and regional bodies such as the EU, have updated or formulated rules to address concerns and enhance measures to protect air passengers. The World Tourism Organization (UNWTO) initiated the development of a convention on the protection of tourists and tourism service providers.

4. FUTURE WORK

4.1 The establishment of the ICAO Strategic Objective, *Economic Development of Air Transport*, will provide a focus on concrete action to be undertaken during the next triennium, involving considerable work for ICAO.

4.2 With a view to advancing this Strategic Objective, the Organization plans to work in the area of economic regulation of air transport in the manner presented below, taking into account the implementation of the related ATConf/6 recommendations approved by the Council.

4.3 The Organization will follow-up on the outcome of ATConf/6 through continuous consultation with the ATRP.

4.4 The Organization will engage and cooperate with Member States, industry, international organizations and other stakeholders in advancing the objective of economic development of air transport.

It will foster collaboration with other international organizations to address emerging issues of common interest in the air transport field.

4.5 In support of a long term vision for international air transport liberalization, the Organization will provide the ICAN facility to States, by improving its utilization, notably for meetings of a regional or multilateral nature and by offering seminars on fair competition with a view to fostering cooperation between competition authorities.

4.6 The Organization will develop a set of core principles on consumer protection.

4.7 The Organization will ensure that policies, guidance and other material related to economic regulation remain relevant, current and responsive to changing situations and requirements of States.

4.8 The Organization will monitor and keep States informed of significant developments in international air transport and will also provide support and assistance to Member States in the area of economic regulation through seminars conducted on a cost-recovery basis and through training courses.

4.9 Where necessary, the Organization will conduct quantitative and qualitative studies of air transport developments addressing issues of major concern and will share its analyses with States, international organizations and the industry.

4.10 The Organization will establish an air transport fund to seek voluntary contributions from Member States with a view to enhancing the work of the Organization in the field of economic regulation of air transport. This fund should be administered transparently in accordance with relevant ICAO rules of governance and policies.

APPENDIX

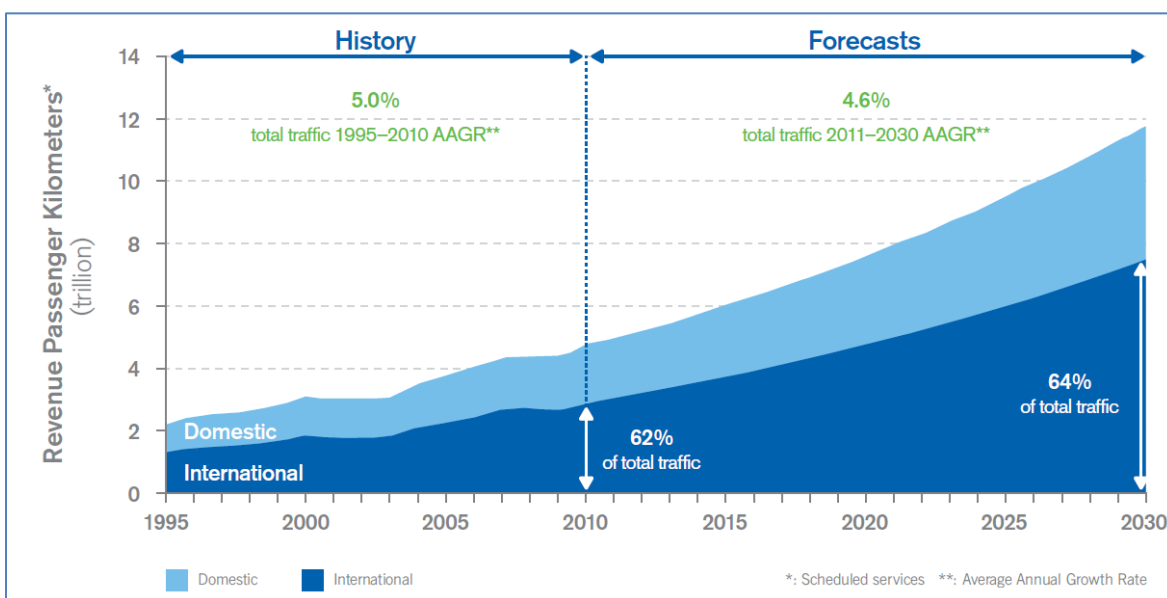
BACKGROUND INFORMATION

1. ECONOMIC BACKGROUND OF AIR TRANSPORT DEVELOPMENT

1.1 Since 1995, the world gross domestic product (GDP) grew at 2.8 per cent annually. During this period, the world passenger air traffic (expressed in revenue passenger kilometres) increased at an average annual growth rate of 5.0 per cent. According to industry, around 50 million employees are working in aviation and related tourism activities, and about 10 million are working directly in the air transport industry. Despite past and anticipated challenges to air transport development, and as detailed in Circular 333, *Global Air Transport Outlook to 2030*, ICAO forecasts a similar sustained traffic growth for the next 20 years (**Graph A** below). By the year 2030, scheduled passenger traffic around the world is expected to more than double, from 2.9 billion in 2012 to over 6 billion passengers annually. The expected growth of air transport is, however, constrained by several impediments, both cyclical and structural, as explained below.

GRAPH A

World scheduled passenger traffic: history and forecasts



Source: ICAO, Cir 333 *Global Air Transport Outlook to 2030*

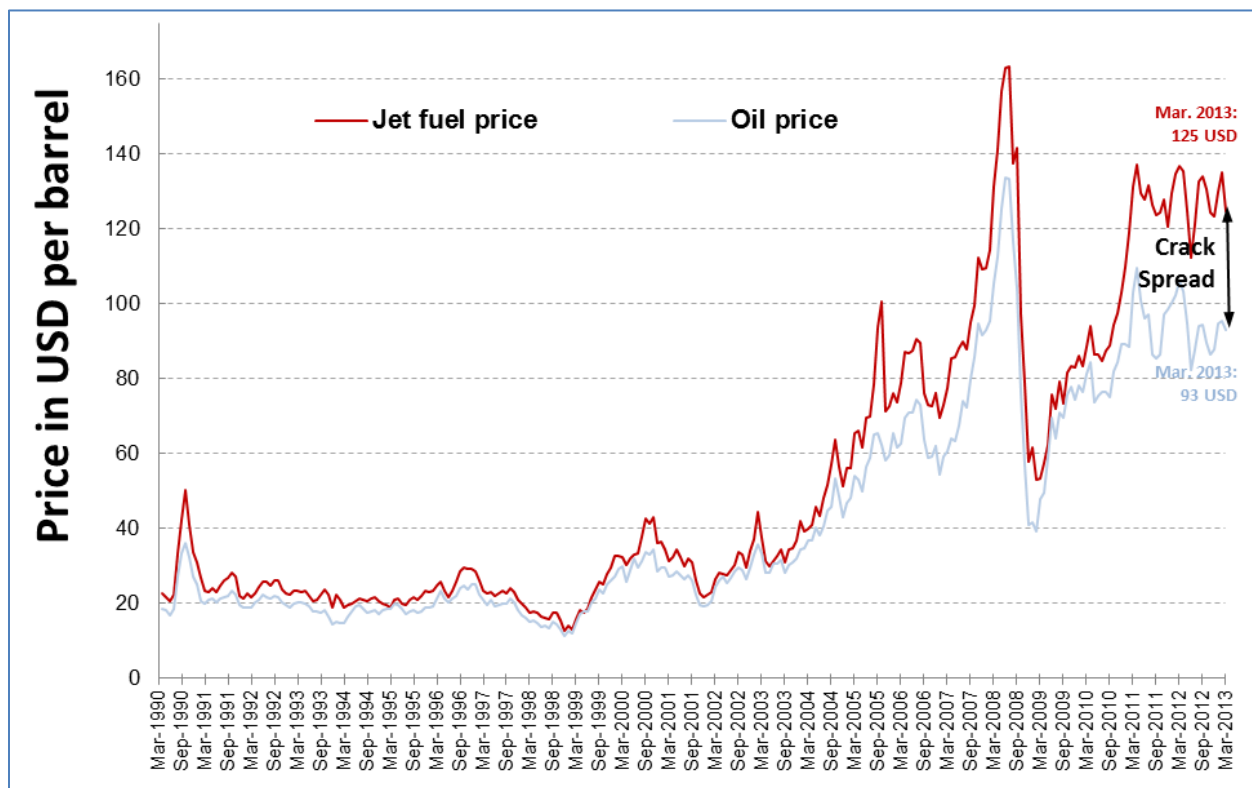
2. IMPEDIMENTS TO SUSTAINABILITY OF AIR TRANSPORT

2.1 Cyclical impediments

2.1.1 *Fuel cost volatility* – As shown in **Graph B** below, while the variation of oil and fuel prices generally fluctuated between 20 and 40 USD a barrel between 1990 and 2003, prices varied between 40 and 150 USD a barrel from 2003 to 2012 (a ratio of almost 1 to 4). The cost of fuel is an item over which airline management has little control, as the price of fuel is directly linked to the global supply of, and demand for, crude oil. Although some financial tools, such as fuel hedging, are available for air carriers to assist in maintaining more stable costs, fewer and fewer aircraft operators generate the cash flow required to benefit from such strategies. As a consequence, brutal variations in fuel costs are likely to have severe impacts on operators' costs and consequent profit margins, and can threaten financial sustainability.

GRAPH B

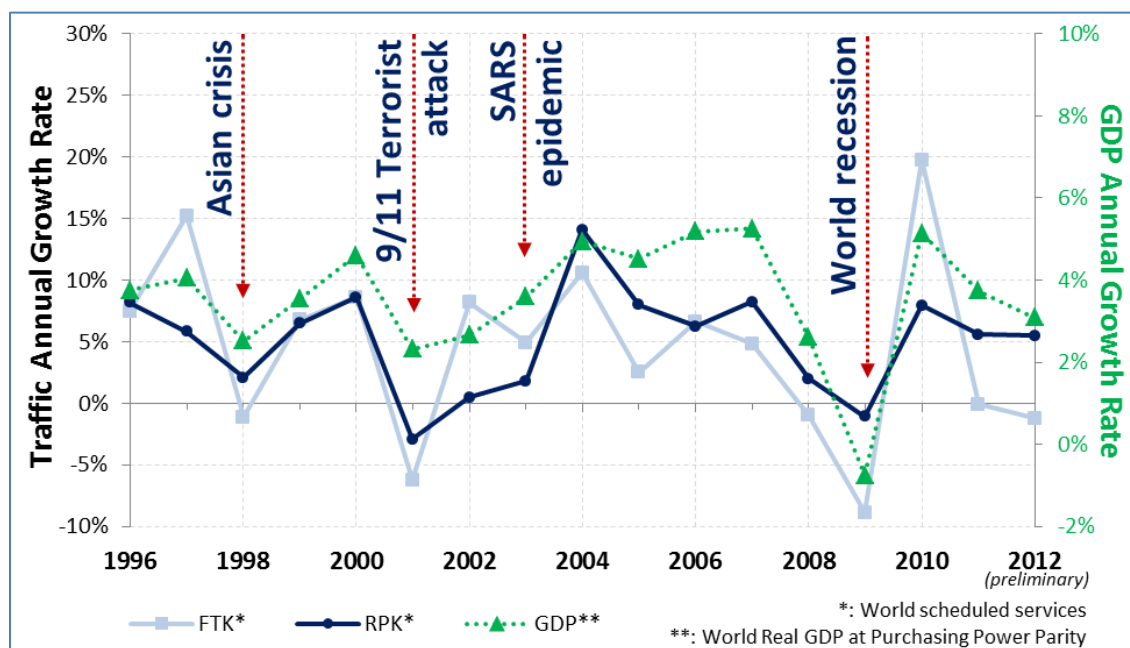
Oil and fuel price instability (1990-2012)



Source: U.S. Energy Information Administration website.

2.1.2 *Other cyclical impediments* – During the past 15 years particularly, the development of civil aviation has been severely impacted by several crises directly or indirectly related to aviation (**Graph C** below). The Asian economic crisis in 1997, the events of 11 September 2001 in the United States, the severe acute respiratory syndrome (SARS) outbreak in 2003, and the 2008 to 2009 world financial crisis have all been detrimental to the overall profitability of the civil aviation system.

GRAPH C

World air traffic vs. economic growth

Source: ICAO and IHS/Global Insight

2.2 Structural impediments

2.2.1 *Restrictions to market access and on air carrier ownership and control* – These two restrictions present strong constraints on both market expansion and wider access to capital markets. They clearly preclude allowing for a more efficient airline industry and a greater variety of services in the market, which in turn could feed into consumer benefits.

2.2.2 *Regulatory fragmentation* – The two areas where regulatory convergence is missing are related to competition policies and consumer protection. Regarding the latter, regulations typically cover issues such as price transparency; assistance to passengers in the event of delays, cancellations and/or denied boarding; as well as assistance to passengers with disabilities. At issue here is the fragmentation of these regulations, which may provide different and overlapping protection mechanisms, and ultimately generate operational and legal uncertainty for users and operators. In that context, the Sixth Worldwide Air Transport Conference (ATConf/6) noted the importance of the ratification of the Convention for the Unification of Certain Rules for International Carriage by Air, adopted in Montréal on 28 May 1999 (MC99). There was strong support for encouraging States who have not done so to become parties to MC99 and for ICAO to provide assistance toward the ratification of MC99.

2.2.3 *Infrastructure constraints* – Economic development of air transport is constrained by the availability of infrastructure. In order to meet an increased demand of air traffic, a critical component of the civil aviation system is the availability of sufficient airports and air navigation services capacity.

2.3 **Other impediments**

2.3.1 A major impediment to the sustainable growth of air transport is the recent proliferation of various levies, including taxes or fees. For example, in some European States, taxes levied on air passengers, but not levied on other modes of international transport, have been introduced as “air passenger duty”, “air transportation tax”, and “air travel tax”. They range in value from 4 to 260 USD depending on the destination and class of travel. Other taxes, for purposes outside aviation, such as “solidarity” taxes established to combat different types of diseases, have been introduced in approximately 12 States. The past decade has also seen the development of tourism taxes in some regions, in particular, Latin America, the Caribbean and to a lesser extent in Africa, ranging from 1.50 to 55 USD. In many cases, revenues from the tourism taxes such as a “tourism enhancement fee” and “travel promotional levies” are not being reinvested in tourism development. Other States impose value added tax (VAT) and various sales taxes on: a) fuel and other items purchased within their borders although used in international air transportation; b) air navigation and over flight charges, passenger user charges and/or services fees; c) capital purchases such as importation of aircraft; and d) international air transactions on cargo or excess baggage.

— END —