ASSEMBLY — 32ND SESSION

ECONOMIC COMMISSION

Agenda Item 31: **Regulation of international air transport services**

REPORT BY THE COUNCIL ON TRADE IN SERVICES

ADDENDUM NO. 1

1. INTRODUCTION

1.1 This Addendum provides an update on developments involving air transport and trade in services, including plans for the review of the Annex on Air Transport Services of the General Agreement on Trade in Services (the GATS Annex). The Appendix to this paper contains a brief, preliminary analysis by the Secretariat of three key elements of that review: 1) developments in the air transport sector related to its progressive liberalization; 2) the liberalizing effects from the operation of the GATS Annex to date, and 3) the possible further application of the GATS to air transport, for example, to all-cargo and/or non-scheduled air services.

2. UPDATE ON DEVELOPMENTS

2.1 The formal review of the GATS Annex is now expected to begin in December 1999. In the meantime, in preparation for the next round of negotiations on services in the year 2000, the World Trade Organization (WTO) has begun a programme of exchange of information with respect to each of the sectors involved. A meeting of the WTO's Council for Trade in Services to address air transport in the framework of the information exchange is planned for November 1998.

2.2 With respect to ICAO's request to be accorded observer status to the WTO, the Council for Trade in Services decided in July 1998 that, rather than accord formal permanent observer status to specialized agencies of the United Nations such as ICAO, observer status would be conferred on an *ad hoc*, case by case, meeting by meeting basis. For purposes of the information meeting in November 1998 (to which ICAO will be invited) ICAO will be requested to provide a written contribution explaining its activity in the fields covered by the WTO.

2.3 As regards the involvement of other international organizations in trade in services, the United Nations Conference on Trade and Development (UNCTAD) will consider in September 1998 two recommendations arising from an Experts Meeting on Tourism in June 1998 which are relevant to air transport and the GATS. The first is that UNCTAD conduct, with the assistance of the appropriate international organizations, a study on the feasibility of alternative modalities for including air transport services in plurilateral or multilateral negotiations on services; the second is that UNCTAD convene an expert meeting on air transport services.

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APPENDIX

THREE KEY ELEMENTS OF THE REVIEW OF THE GATS ANNEX ON AIR TRANSPORT

1. DEVELOPMENTS IN THE AIR TRANSPORT SECTOR

1.1 In recent years the air transport regulatory and operating environment has changed considerably as it adjusts to globalization, increasing competition and liberalization. Through the World-wide Air Transport Conference in 1994 and the follow-up work of the Air Transport Regulation Panel, ICAO has developed guidance for States wishing to adapt to the new situation. Given the goal of the GATS to progressively liberalize trade in all service sectors, the nature and degree of liberalization within the existing regulatory framework of international air transport will be relevant in any consideration of the further application of the GATS to this sector. The following is a brief summary of some of the significant regulatory trends and developments on market access and ownership in air transport since the Conference and the coming into force of the GATS on 1 January 1995.

1.2 **Liberalized market access.** During the period since 1995, States concluded more than 300 bilateral air service agreements, amendments thereto and memoranda of understanding. Two regional air service agreements were concluded in the Western Hemisphere – one by 17 States in the Caribbean Community (CARICOM) and one by 6 States in South America, the Fortaleza agreement – and one by 6 States in Africa, the Banjul Accord. This brings the total of such formal regional agreements and arrangements to 5, including the existing European Union and the Andean Pact air transport regimes.

1.3 With respect to content, regulatory measures that progressively liberalize while ensuring effective and sustained participation in a competitive international air transport environment were reported in at least one-third of the 300 new or modified bilateral instruments. The most popular measures were the gradual, negotiated expansion of market access in terms of the number of authorized airlines, traffic points and capacity increases; and more liberal provisions on matters such as ground handling. The concept of full market access – that is, where there are traffic rights to/from/beyond the territory of the bilateral partners as well as full tariff and capacity flexibility for the airlines of both bilateral partners – was found in 42 of the bilateral air service agreements and amendments as well as within the Andean Pact and the European Union.

1.4 **Privatization and airline ownership.** Privatization has been a trend in air transport since the mid-80s. The current status of airline ownership shows an uneven pattern in terms of regions. All North American airlines are privately owned as are most in Latin America and the Caribbean. Half of the major air carriers in Western Europe are privately owned and the other half have been targeted for partial or full privatization. Most of the national carriers of the Eastern European States are still majority government-owned, but there are plans to privatize 12 carriers. In Asia and the Pacific, of the 18 airlines targeted for partial or full privatization before 1998, 5 airlines have achieved their privatization goals. Almost all national airlines in the Middle East are government-owned, but there are plans to privatize 9 airlines. In Africa, although privatization efforts have been made for 14 airlines, most national airlines remain government-owned.

1.5 Article XVI of the GATS prohibits WTO Members that make specific commitments for market access from imposing limitations on foreign ownership of service suppliers; the status of foreign ownership of air carriers is therefore relevant to any extension of GATS coverage of air transport. Since 1995 the trend of partial foreign ownership of airlines has continued and several governments have adopted new policies or amended existing rules to relax restrictions on foreign investment in national airlines (e.g Australia, Brazil, China, Mexico, New Zealand, Peru and the Republic of Korea). By the end of 1997, some 50 carriers had investments in foreign airlines (often as part of a strategy to forge or strengthen alliances and expand market access) while about 65 airlines had equity owned by foreign, non-airline investors.

1.6 Taking this trend into account in its follow-up work arising from the 1994 World-wide Air Transport Conference, ICAO developed guidance for States concerning foreign ownership of airlines in relation to the ownership and control criteria for the use of market access. Since 1995 some form of broadened airline ownership and control criteria has been included in 33 bilateral agreements, the most prevalent one being "incorporation and principal place of business in the designating State". Broadened ownership and control criteria are also contained in one regional agreement concluded since 1995, the CARICOM agreement, which uses a combination of legal establishment and registration in a CARICOM State and majority ownership and effective control by one or more of such States or their nationals.

2. OPERATION OF THE GATS ANNEX

2.1 The review of the GATS will need to take into consideration the effectiveness of the GATS as a means for progressive liberalization of the three aspects of international air transport presently covered by the Annex, namely, computer reservation systems, selling and marketing, and aircraft repair and maintenance. The extent of progressive liberalization of each of the three services in the GATS Annex is a function of the number of exemptions from most-favoured-nation (MFN) treatment and the number of specific commitments to market access and national treatment. Of 131 individual WTO Members (the European Union, which participates alongside its 15 Member States, makes the current WTO membership 132), 28 made MFN exemptions for computer reservations systems (CRS), 27 for selling and marketing but only 3 for aircraft repair and maintenance. With respect to specific commitments 22 WTO Members made unrestricted commitments to market access and national treatment for CRSs in one or more of the four ways a service could be provided (modes of supply) in the GATS, 22 made such commitments for selling and marketing, and 21 for repair and maintenance.

2.2 However, given the complexity with respect to the extent of market access resulting from allowing States to condition their specific commitments, choose the number of modes in which these would apply and make market access but not national treatment commitments (and vice versa) for specific modes, this brief analysis will focus on the progressive liberalization of the three air transport services resulting from the operation of the GATS MFN obligation. The MFN obligation becomes effective when: a WTO Member with no foreign suppliers allows one to enter its market; a Member with a foreign supplier in its market on 1 January 1995 accords the same treatment to similar suppliers from other WTO Members; or when an exemption to MFN treatment is removed. This analysis is limited in certain instances by a lack of pertinent data and any conclusions should be considered tentative, given the effects on market access of factors other than MFN commitments.

2.3 **Computer Reservation Systems**. Based on the number of countries in which major multinational CRS vendors operated in 1995 and 1998, of the 21 WTO Members with an MFN obligation for CRS which did not have a CRS vendor in 1995, 10 had one in 1998. In terms of MFN potential in this category, in 1998 17 WTO Members, about 13 per cent, had no CRS vendor (11 which had no vendor in 1995 and 6 which lost a vendor or vendors in the period due to consolidation in the industry). Of the 76 WTO members with MFN obligations for CRS which had one or more CRS vendors in 1995 and 1998, 26 experienced decreases, 33 had the same number and 17 showed an increase.

2.4 In terms of competition at present between and among CRS vendors, WTO Members with MFN obligations for CRS have a higher proportion of States (over 50 per cent) with two or more vendors than States which are not WTO Members (about 30 per cent). Although the 28 WTO Members with MFN exemptions for CRS represent a significant part of the market, removing these exemptions is unlikely to have much impact on market access because 21 of the 28 each had 4 CRS vendors operating in their territory in 1998, suggesting that market access for CRS vendors is not a problem in these States.

2.5 **Sales and Marketing**. Unlike the case with the supply of CRS services which has a small number of multinational vendors, the selling and marketing of air transport is done primarily by a large number of travel agents in many countries, as well as by airlines directly, via their own offices and increasingly via the Internet. Although the data, for example, on travel agents accredited by the International Air Transport Association (IATA) does not distinguish between national and non-national travel agents, all agents sell transportation on foreign airlines and the presence of non-national agents would trigger this type of MFN market access. Of the 104 WTO Members with obligations for selling and marketing 98 had IATA accredited travel agents in 1995 and there were two more in 1998, leaving only 4 such WTO Members without this type of travel agent. Where the volume of foreign airline sales in a country, both directly and through agents, reaches a level where co-operative settlement of accounts is more efficient than doing so individually, such airlines often establish a Billing and Settlement Plan (BSP) under the auspices of IATA. Looking at the possible MFN effects of changes between 1995 and 1997 in the number of such plans and airline participation therein (by both IATA and non-IATA airlines) indicates that new BSPs were established in about 19 per cent of WTO Members with MFN obligations for selling and marketing while the rate for States not members of the WTO was approximately 9 per cent. The rate of increase in airline participation in existing BSPs was about the same (13 per cent) in both groups of States.

2.6 Bilateral air service agreements with selling and marketing provisions (permitting the foreign airline to sell directly or via its agents) can also trigger the MFN obligation. About 46 per cent of WTO Members with MFN obligations for these activities had one or more such agreements in 1995, an additional 10 per cent concluded such an agreement between 1995 and 1998. The comparable rate for States not Members of the WTO was, respectively, approximately 55 and 8 per cent. As in the case with CRS services, there is a large segment of the market for the sale and marketing of air transport which is subject to exemptions from MFN treatment, but removal is unlikely to increase market access because all WTO Members with such exemptions have large numbers of IATA accredited travel agents, BSP or comparable programmes with the highest level of participation by foreign airlines, and the largest number of bilateral air service agreements with selling and marketing provisions.

2.7 **Repair and Maintenance**. In contrast to CRS and the selling and marketing of air transport, there are only three MFN exemptions for aircraft repair and maintenance services, resulting in MFN obligations applying to a substantial part of this market (e.g. 68 per cent of jet transport aircraft are registered in WTO Members with such obligations). A survey of trade listings of companies engaged in repair and maintenance of jet transport aircraft in 1995 and 1998 suggests a greater MFN effect with respect to such Members (11) which had such firms in 1995 and experienced increases than those which did not have this type of facility in 1995 (3).

2.8 Another means of providing aircraft repair and maintenance services is to have firms in a WTO Member's territory authorized to perform repair and maintenance on aircraft registered in another WTO Member. Using the United States, which has a high proportion of the world's aircraft on its register as an example to measure the changes in foreign repair stations certificated by the U.S. Federal Aviation Administration (FAA) between 1995 and 1997 indicates, firstly, there were 2 WTO Members which had such a facility in 1997 but not in 1995 and secondly, for the 50 WTO Members with MFN obligations for aircraft repair and maintenance which had one or more FAA certificated foreign repair stations in 1995, 18 had an increase by 1997; 20 had the same number, and 12 experienced a decrease. Removal of the existing MFN exemptions for repair and maintenance would have little effect on market access because they affect only a small portion of the market in WTO Members.

3. BROADENED APPLICATION OF THE GATS TO AIR TRANSPORT

3.1 There has recently been discussion and some suggestions to expand the application of the GATS with respect to air transport. Two specific suggestions for potential inclusion are all-cargo and non-scheduled air services. The present regulatory arrangements for market access for these two services, which are summarized below, would determine the extent of market access insofar as the application of the MFN principle is concerned, if they were included in the GATS.

3.2 When operated as scheduled services, international all-cargo services fall under the market access provisions of bilateral, regional and sub-regional air services agreements which grant the right to transport passengers, cargo and mail. However, a small number of bilateral agreements, 24 according to ICAO's records, have specific provisions dealing with all-cargo services. These provisions include, for example: approval of air-cargo operations as non-scheduled services; specific measures relating to some aspect of all-cargo operations, such as cargo handling facilities; capacity and pricing regimes; authorization for intermodal services; and specific all-cargo routes.

3.3 Unlike all-cargo services, non-scheduled (charter) flights are primarily regulated at the national level, the result of Article 5 of the Chicago Convention which permits non-scheduled flights to overfly and land without prior permission but allows each Contracting State to determine the conditions under which such flights may pick up or discharge passengers, cargo and mail. However, there are bilateral and regional agreements dealing with non-scheduled services.

3.4 Approximately 10 per cent of bilateral air service agreements as well as 5 regional agreements and arrangements deal with market access for non-scheduled air services. The relevant provisions take one (and in a few cases more than one) of the following approaches: authorizing specific types of non-scheduled flights, such as humanitarian/emergency, air taxi, all-cargo, inclusive tour passenger; prescribing numerical limitations; allowing non-scheduled services which a concerned State believes do not harm scheduled services; prescribing which State's charter rules will apply, such as country of origin; specifying wide latitude for non-scheduled flights (one-way, round-trip, passenger/cargo, stop-overs); and making no distinction between the authorization granted for scheduled and non-scheduled services.

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