

## EXECUTIVE SUMMARY

1. This study, carried out in collaboration with the World Tourism Organization (WTO-OMT), arises from the work of the fifth Worldwide Air Transport Conference (ATConf/5). It seeks to develop a regulatory scheme that could be used at States' discretion for granting financial support and/or regulatory assistance to airlines on international routes that may be considered essential air services (EAS) or for essential tourism development routes (ETDR) especially to Least Developed Countries (LDCs).
2. The EAS concept, which already exists in certain liberalized domestic or regional environments, denotes a passenger service of a public or social service nature which a State may consider needs to be provided and where the market may not have sufficient incentive to do so. The ETDR concept, as proposed by the WTO-OMT, refers to international routes between tourism-generating markets and tourism-receiving markets, particularly in LDCs, where an adequate level of service is not (fully) supplied or would be at risk, under existing market and regulatory arrangements.
3. Financial support to airlines and other partners for international air service using the EAS and ETDR concepts would have two interrelated objectives: a) to assure lifeline provision of air services for remote or peripheral destinations of the world irrespective of the profitability of individual operations, especially in a situation of transition to liberalization or in an already-liberalized market, and b) to facilitate and even drive economic development, particularly through stimulating inward tourism and investments.
4. The study develops an Essential Service and Tourism Development Route (ESTDR) scheme by applying the modalities of existing EAS schemes internationally. In the case of an EAS concept, the application of an ESTDR scheme would need to be in a liberalized or liberalizing environment. In the case of an ETDR concept, its application need not be so limited. In principle, the entire mechanism and process of an ESTDR scheme should be transparent, accountable, non-discriminatory, sufficiently flexible and, as far as possible, market-oriented to minimize the market distortion and enhance airlines' efficiency incentives.
5. The study uses a step-by-step analytical approach to design an ESTDR scheme for both concepts around the following headings: route selection, service level specification, carrier selection, contract duration, subsidy payments, sources of financing, and supplementary options. The flow chart (see Appendix C) may be used as an aid in the step-by-step construction of the scheme.
6. **Route selection:** The eligible routes should be solidly based on socio-economic objectives and economic justification. The study proposes a two-stage test. The first would be to examine whether there is a demonstrated need for an adequate level of an international air service (for example, routes serving "remote or peripheral areas" and/or "development areas" for tourism). The second stage of the test would be an economic assessment based on demand for air services and airlines' operating cost conditions.
7. **Service level specification:** States would also need to determine an adequate level and minimum standard of air service (usually in terms of frequency, capacity etc.) on each selected route. A flexible and market-oriented approach is advocated so that the airlines' ability to be entrepreneurial would not be constrained.

8. **Carrier selection:** The airline serving the route would be selected through a competitive tendering/bidding system having clearly-defined criteria and equally applicable to all the eligible airlines. The eligibility of an airline would depend on the air services agreements governing the route concerned. The selection of the airline would be either the tender requiring the lowest financial compensation or the overall best tender. Some States may also wish to award an exclusive concession or licence to one airline, to guarantee a monopoly, in conjunction with or in lieu of a subsidy.

9. **Contract duration:** Since contract duration has implications for airlines' efficiency and incentives, it should be determined carefully on a case-by-case basis. For long-term contracts, a mid-term review and/or enforcement, monitoring, audit and re-negotiation may be necessary to deal with unforeseeable changes.

10. **Subsidy payments:** In the interests of good governance and transparency, the requested subsidy amount and the reimbursement would need to be assessed thoroughly. The risks of overcompensation and inefficiency could be partially mitigated by attracting sufficient number of potential bidders.

11. **Sources of financing:** The State having called for the tender should have a prime responsibility to secure the necessary funds. If the responsible State faces budgetary constraints or other national spending priorities, then it would need to seek financial support from or make a collaborative arrangement with outside bodies, for example, bilateral aid from the other party of the air services agreement, third-party aid from international agencies, or the participation of the private sector by the establishment of a public-private partnership (PPP).

12. **Supplementary options:** Consideration may need to be given to a number of optional measures, which are supplementary or alternatives to an ESTDR scheme. Supplementary measures, such as indirect subsidies or other support to airline or tourism partners, could contribute to reducing the absolute subsidy amounts and the number of subsidized routes in the mid- or long-term with relatively smaller implementation costs, if properly designed. However, any supplementary measure should be governed by the same conditions and principles as those applied to an ESTDR scheme itself because of the potential for distortion of the market.

13. The unilateral implementation of an ESTDR scheme in a "reduced form" (such as one without the guarantee a monopoly operation) may be the most feasible in practical terms. Since a unilateral approach enables an individual State to implement the scheme fairly quickly at a single stroke, it may be particularly attractive for States wishing to provide emergency subsidies to deal with extraordinary situations.

14. A more complex approach is to conclude a special clause for an ESTDR scheme under a bilateral, regional or plurilateral arrangement with the States concerned, so that a State could implement the scheme in a "full-scale form" (such as one involving the guarantee of a monopoly operation, if necessary). The study, therefore, develops a model of an "Annex on essential service and tourism development routes", which could be used in air services agreements by each State at their discretion. This Annex gives legal certainty to the parties involved and also allows individual States to exercise pragmatism and flexibility.

15. In both cases, States would need to develop further the details of the scheme through regulations or other means.

16. The study and the model of an Annex for air services agreements could serve as a practical checklist and a possible regulatory framework for States to effectively implement an international ESTDR scheme. For LDCs, the use of this scheme for essential tourism routes could have even broader benefits than the public service objective.

-----