



ASSEMBLY — 36TH SESSION

ECONOMIC COMMISSION

Agenda Item 40: Regulation of international air transport services

DEVELOPMENT AND 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 facilitating and assisting States in economic liberalization, including important studies and activities in promoting and updating relevant ICAO policy and guidance material. It also provides a brief overview of the regulatory and industry trends and developments. In assessing the future, the paper identifies seven key issues that will require attention, namely: trade in services, air service negotiations involving a group of States, safety and security aspects of liberalization, airline ownership and control, participation and fair competition, consumer interests and taxation. It then presents the Organization's plan of action for the next triennium, including closely monitoring developments, promoting and keeping existing policy guidance current and responsive, developing new guidance as required, and fostering cooperation with other international organizations and aviation stakeholders.

Action: The Assembly is invited to:

- a) endorse the future work plan of the Organization in the field of economic regulation of international air transport; and
- b) request Contracting States to cooperate with and support ICAO's work in this field, including implementing relevant Assembly resolutions and providing information on their policies and experiences of liberalization.

<i>Strategic Objectives:</i>	This working paper relates to Strategic Objectives A, B and D. The action proposed in this paper will further Strategic Objective D through ICAO's leadership role in the liberalization process of economic regulation, and will supplement and complement Strategic Objectives A and B through guidance on coherent implementation of technical and economic policies.
<i>Financial implications:</i>	The future work outlined in paragraph 5 will be undertaken according to priority with the resources available in the Budget 2008-2010.
<i>References:</i>	Doc 9587, <i>Policy and Guidance Material on the Economic Regulation of International Air Transport</i> Doc 9626, <i>Manual on the Regulation of International Air Transport</i> Doc 9847, <i>Report of the Economic Commission of the 35th Session of the Assembly</i> Doc 9848, <i>Assembly Resolutions in Force (A35-18)</i> A36-WP/xxxx, Consolidated statement of continuing ICAO policies in the air transport field

1. INTRODUCTION

1.1 ICAO's activities in the field of economic regulation stem mainly from Article 44 (aims and objectives of the Organization) and Articles 54 and 55 (mandatory and permissive functions of the Council) of the *Convention on International Civil Aviation* (Doc 7300) and are guided by Assembly Resolution A35-18 (continuing ICAO policies in the air transport field) and relevant Council resolutions and decisions.

1.2 Since the Fifth Worldwide Air Transport Conference (ATConf/5, 2003), the Organization has focussed its work on the promotion and implementation of ICAO's regulatory framework and policy guidance, and on facilitating and assisting States in the liberalization process. This paper reports on the progress made since the last Assembly, major developments and key issues, and the Council's intentions with respect to future work.

2. MAJOR WORK DONE BY ICAO

2.1 During the past three years, pursuant to relevant Assembly resolutions and decisions and the Strategic Objectives of the Organization, the Secretariat has followed up on the recommendations of ATConf/5 and accomplished the major tasks under the economic policy programme listed below. (Further details of the work done can be found in the Annual Reports of the Council.)

2.2 To ensure that States capture the benefits of liberalization without compromising safety and security, the Secretariat conducted a comprehensive study on the safety and security aspects of economic liberalization. The study identified various situations arising from the liberalization process and the evolution of business and operating practices in the air transport industry which could have implications for safety and security regulation. It also provided clarification on how relevant ICAO provisions should be implemented to address some of these situations. The study highlighted the need for States to fulfil their primary regulatory oversight responsibilities for aviation safety and security, irrespective of any change in economic regulatory arrangements.

2.3 By decision of the Council, the study was disseminated to Contracting States for information and appropriate action (State letter EC 2/93, AN 11/41-05/83 of 12 August 2005). Based on the findings of the study, ICAO has subsequently taken many concrete steps to improve the global safety and security regulatory system, including amendments to the relevant Annexes to the Convention and guidance material, strengthening its safety and security audit programmes and assistance to States.

2.4 The Secretariat completed another study, also arising from ATConf/5, on an Essential Service and Tourism Development Route (ESTDR) scheme. The study examined how essential air services schemes existing in some States have helped support certain specific domestic and regional routes, and how such schemes might be applied in an international context at States' discretion. In cooperation with the World Tourism Organization (UNWTO), a support mechanism was developed which could also be used for the development of tourism routes, particularly by the Least Developed Countries. In November 2005, ICAO and UNWTO launched a programme of training courses to assist States that wish to apply such a scheme (more information can be found at the ICAO website).

2.5 During the triennium, the Secretariat organized and conducted several workshops and symposiums on air transport liberalization, including regional ones for States in the Asia Pacific region (May 2005 in Shanghai, China) and for States in the Eastern Caribbean sub-region (May 2006 in

Antigua). A global symposium was held in September 2006 in Dubai, United Arab Emirates, which was attended by over 250 participants from 65 States and 11 international organizations. These meetings were an effective means to disseminate and promote ICAO policy guidance, and provided a useful forum for States to share their liberalization experiences, exchange views on trends and issues, and discuss policy options. The feedback on the relevance and value of such meetings was very positive.

2.6 Pursuant to Assembly Resolution A35-18 (Appendix A, Section V), the Secretariat has continued to update and revise ICAO policy and guidance material in the field of economic regulation, including improving the ICAO website to provide better accessibility by States and the public to the relevant guidance material and information.

3. REGULATORY AND INDUSTRY DEVELOPMENTS

3.1 This section highlights some major regulatory and industry developments, which present both opportunities and challenges for States and ICAO. A more detailed report, titled Regulatory and Industry Overview, will be available on the Assembly website, under “Documentation”, (www.icao.int/icao/en/assembly/a36/docs).

3.2 The last few years have seen a continuing trend of liberalization in air transport regulation. More and more States have embraced liberalization. At the national level, several States have unveiled new liberal aviation policies or measures (e.g. regarding air service negotiations, market access and tariff regulation). At the international level, the number of bilateral “open skies” agreements has reached [127] by [May 2007], involving [90] States. There has been increasing regionalism in air transport liberalization, with 11 regional liberalization arrangements across the world now in operation.

3.3 Along with intra-regional liberalization, interaction between regions has also been on the rise. In this respect, the European Union (EU) has been the most active, where the European Commission is now engaged in such negotiations under specific mandates on behalf of all EU member States. This approach has led to the conclusion or negotiation of several liberalized arrangements (e.g. between the EU and the United States, the EU and Morocco, and between the Association of Southeast Asian Nations (ASEAN) and China), and is continuing to spread.

3.4 In many States, regulatory objectives and structures of international air transport have been changing towards more emphasis on the broader benefits of economic development, protection of consumer interests, and enhancement of competition. There is a shift in regulatory approach, from detailed regulation of airline operations to relying more on market forces. The industry and other stakeholders have become more active in the government policy-making process.

3.5 There has also been continued interest and involvement of other international bodies in air transport matters. In December 2005, the World Trade Organization (WTO) launched its second round of review of the Air Transport Annex under the General Agreement on Trade in Services (GATS). The review will assess the developments of liberalization in the air transport sector and the operation of the Annex with a view to possible expansion and clarification of its coverage. ICAO has maintained a good working relationship with the WTO and provided assistance and support to the WTO Secretariat in its preparation for the review.

3.6 The airline industry has continued its structural transformation. The traditional business model of full-service network airlines has been facing mounting challenges. Low-cost carriers have been

expanding rapidly at the national level as well as regionally and beyond. In the increasingly competitive environment, airline strategy and planning has generally been directed towards alliances, consolidation and cross-border equity investments in order to exploit network-based economies of scale and scope. In addition, e-commerce has become a common facility, which has been used extensively by the industry in marketing and selling its products. These developments have presented some new challenges to regulatory authorities.

3.7 The unstable global oil market and rising fuel prices in recent years have had a direct and severe impact on the operating cost of the airline industry and its overall financial situation. This, in turn, has adversely affected consumers, who often have to bear the increased cost for travel. The uncertainty of the future oil situation and its long-term implications for the airline industry will continue to be a matter of concern for both the industry and governments.

4. KEY REGULATORY ISSUES

4.1 This section identifies some key regulatory issues that have global implications, which will require attention by States and drive the work of the Organization in this field for the next triennium.

4.2 **Trade in services.** Over the years, attention in this area has revolved around the role of ICAO, issues relating to the application of trade rules to air transport and the coverage of the GATS Air Transport Annex. This will likely continue in the coming years, with more focus on seeking the most suitable and effective means to achieve liberalization. The Air Transport Annex presently covers only three air transport services, namely, aircraft repair and maintenance, selling and marketing of air transport, and computer reservation systems. The first round of review by the WTO ended in 2003 with no change to the Annex.

4.2.1 As reported in paragraph 3.5, the second round of review is now under way. The Council of Trade in Services (CTS) has held two meetings (September 2006 and March 2007), which reviewed the developments in the air transport sector for the period 2000 to 2005 to assess the degree of liberalization. In addressing the operation of the Annex, some members called for clarification of the scope of the Annex so that its coverage could be extended to some other auxiliary air transport services such as ground handling and airport operation services. Others expressed caution and concern over the proposal to extend the GATS coverage, questioning its desirability and feasibility and preferring that present efforts be focussed on liberalizing the three existing services covered by the Annex. The CTS took note of the different views expressed, and would address these issues in future meetings, the next one being scheduled for October 2007.

4.2.2 ICAO's policy on trade in services is set out in Assembly Resolution A35-18, Appendix A, Section IV, which *inter alia* reaffirms the primary role of ICAO in developing guidance for international air transport regulation. As the issues being addressed by the WTO can have significant implications for the regulation of air transport, it is important that States take appropriate actions to implement the Assembly Resolution, follow the developments closely and participate actively in the CTS meetings. Meanwhile, ICAO should continue to exert its leadership in facilitating and supporting States in the liberalization process, taking into account safety, security and environmental considerations.

4.3 **Air service negotiations involving a group of States.** As reported in paragraph 3.3, the European Commission has been actively pursuing negotiations with other States and regions. In response, some regional groupings, such as the African Union, the Arab Civil Aviation Commission and the Latin

American Civil Aviation Commission, have also started to develop common policies for negotiation of air services agreements both between their member States and with third parties.

4.3.1 The evolution of such a regional group or market may have implications for external parties (e.g. some regulations of the EU apply not only to EU airlines but also to third party airlines operating in the EU). Also, when negotiation of air service arrangements involves a group of States, it not only introduces new dynamics in the negotiation process itself (e.g. in terms of exchange of commercial rights), but also a new dimension in aviation relations between States (e.g. how to deal with a supra-national regulatory body on issues which used to be addressed between sovereign States). Furthermore, if such arrangements achieved a critical mass in number or covered a large proportion of the world's aviation market, it could have a significant impact on the liberalization process.

4.4 **Safety and security aspects of liberalization.** In the constantly changing environment, maintaining high levels of safety and security will continue to be of paramount importance for States and ICAO. As stressed by the Secretariat study, referred to in paragraph 2.2, all parties, including governments, service providers and air operators, must have a clear understanding of their respective responsibilities for safety and security compliance and oversight. The Directors General of Civil Aviation Conference on a Global Strategy for Aviation Safety, held in March 2006, recommended several follow-up actions by ICAO, including further study on issues such as “flags of convenience”, the definition of “State of the Operator” and “principal place of business”, which have implications for both economic and technical regulations. The Conference also recommended that ICAO develop guidance material for use by States to implement coherent economic and technical policies by their civil aviation authorities.

4.5 **Airline ownership and control.** This continues to be an important issue in air transport liberalization, having implications for both economic and safety regulations. While the issue has been extensively addressed and ICAO has developed guidance for optional use by States, including alternative criteria for designation and authorization of airlines, there has been limited progress in both the extent and scope of liberalization in this area. Therefore, how to address States' existing concerns and achieve greater liberalization in practice remains a challenge for the international aviation community.

4.6 **Participation and fair competition.** While liberalization has generally been accepted and has shown positive results (e.g. growth in traffic and services) in many markets, due to the disparity between States and regions in their stage of development and competitive strength of their carriers, some concerns still remain on the issues of participation, sustainable development, and how to ensure fair competition at the international level. In addition, as liberalization spreads and deepens, States have increasingly applied competition rules to regulate international air transport. How to avoid possible conflicts over the application of differing national or regional rules will need to be properly addressed.

4.7 **Consumer interests.** This matter has gained increasing importance in the economic regulation of air transport. Consumer interests cover many issues, including air “passenger rights” and the contractual relationship between airlines and their users. The subject has also many implications: for governments, it involves the need for, and nature of, regulatory action; at the industry level, it touches on numerous competitive, cost and operational consequences, as well as the issue of self-regulation; and globally, it may raise the question of how to avoid potential risks of conflict between differing regimes and extra-territorial application.

4.8 **Taxation.** The existing *ICAO Policies on Taxation in the Field of International Air Transport* (Doc 8632) endorse the approach of reciprocal exemption from taxes on aviation fuel, aircraft and technical supplies, income of air transport enterprises, and elimination of taxes on the sale and use of

international air transport. However, in recent years air transport has become increasingly targeted as a source of funding for various purposes, with more taxes or charges being imposed by States. As the increase in taxation could have an impact on the growth and development of air transport and, in turn, on States' economic development in general, it is important for States to follow ICAO's policies and to ensure that international civil aviation does not suffer from unfavourable discrimination in relation to other modes of transport.

5. FUTURE WORK

5.1 The present trends in the air transport industry and the evolution of the regulatory framework will increase the demand on ICAO's leadership role in the liberalization process. Based on the Strategic Objectives and the Business Plan of the Organization for the next triennium, the Council intends to carry out its work in the economic policy area in the following manner.

5.2 The Council will continue to monitor regulatory and industry developments (e.g. on trade in services, air service negotiations involving groups of States, airline alliances and cross-border mergers); analyze emerging trends and issues, and provide information to States.

5.3 The Council will keep ICAO's existing policy guidance on economic regulation current and responsive; and where required and appropriate, develop new policy and guidance material to facilitate and assist States in liberalization, paying particular attention to addressing the key issues identified in paragraph 4.

5.4 The Council will continue to take a proactive approach to involve States, the industry and other interested parties in the promotion and implementation of ICAO's policy framework and practical guidance related to economic regulation and liberalization (such as those on safety and security responsibilities, and liberalization of airline ownership and control).

5.5 The Council will foster cooperation with other international organizations to address issues of common interest in the air transport field. It will continue to organize workshops, seminars or symposia to provide a forum for States on economic policy issues; and explore new avenues to facilitate liberalization.

5.6 The Council will continue to promote ICAO policies on taxation and address emerging issues on taxation or charges as required, including those relating to the environment.

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