

WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND OPPORTUNITIES OF LIBERALIZATION

Montreal, 24 to 29 March 2003

Agenda Item 1: Preview

BACKGROUND AND OVERVIEW OF CONFERENCE TASK

(Presented by the Secretariat)

SUMMARY

The paper provides an overview of the Conference task against the background of industry and regulatory developments and explains the main tasks under its agenda as well as its expected outcome.

Action by the Conference is in paragraph 4.1.

REFERENCES

Doc 9644, *Report on the World-wide Air Transport Conference on International Air Transport Regulation: Present and Future*

1. INTRODUCTION

1.1 This Conference is the fifth in a series of worldwide conferences convened by the Council of ICAO since 1977 to address economic regulatory issues in international air transport. The first three conferences in 1977, 1980 and 1985 focussed on the coordination and harmonization of policy and the development of ICAO positions and policy guidance on specific regulatory issues such as the regulation of airline capacity, tariffs and non-scheduled services. In response to the changing global economic and trading environment which evolved from the 1980s, the fourth conference in December 1994 took a different approach by examining all major aspects of economic regulation to adjust the regulatory framework to the new global environment. The theme of the 1994 conference was "International Air Transport Regulation: Present and Future" and its principle outcome was a single Recommendation encompassing a series of principles and recommended actions for States, service providers and ICAO, the latter including requested follow-up action. The essence of the outcome at the fourth Conference was the need for regulatory change, including progressive liberalization, in order to adapt this sector to the changing environment. However, it was stated clearly that such change would be at the path and pace of each State's choosing.

1.2 The imperatives that prompted the convening of the 1994 conference, and affected its outcome, continue to impact on the present international aviation scene, and have in fact compounded many

of the adjustment problems existing at that time. Since 1994 the forces of globalization, liberalization and privatization, and regional integration, to name just a few, continue to shape the world's economy and international economic relations as well as industry structures and business practices and models. Added to these has been the emergence of a new multilateral trading mechanism with the establishment on 1 January 1995 of the World Trade Organization (WTO-OMC), which has a broad mandate for the liberalization of all service sectors. The aviation industry, including infrastructure, service and equipment providers, has found itself in a constant process of realignment and change to the pressures of the marketplace and to competitive forces. Moreover, the nexus between the aviation marketplace and its regulation by governments has not always been easy to maintain in such a rapidly moving and often uncertain economic and commercial scene.

1.3 For international aviation the events of 11 September 2001 in the United States were profound in their immediate negative impact. Most notable were its effects on traffic, routes and services, employment and equipment planning, on the cost and availability of war risk insurance, and on consumer confidence, all of which also had severe knock-on consequences for associated service and equipment providers as well as dependent businesses, including tourism. International air transport has always been vulnerable to global events, notably those affecting fuel prices, which have both tempered demand and driven up costs. While in the past, it has generally proved to be resilient, the current situation is likely to have a more pervasive and long term impact, affecting, for example, industry structures and practices, business models and strategies. Of particular significance is the fact that as a result of the 11 September events, aviation security has taken on the highest importance with consequences for facilitation of passengers, costs of providing increased security measures and, in differing degrees around the world, consumer confidence, something which was previously a cyclical and economic issue in aviation.

1.4 The present Conference has been convened to address once again future regulatory needs for the aviation sector, focussing on liberalization and taking into account changes that have taken place in the past decade. Given that the past few worldwide conferences have been convened by ICAO at 8-10 year intervals the perspective of this particular conference must out of necessity extend beyond present difficulties, while unavoidably keeping them in context. Acknowledgement of the new realities, together with the continuing and fundamental needs for regulatory adaptation and reform in this sector, should enable the Conference to focus on its longer term task. The ongoing viability and contribution of the aviation industry to economic growth and development will continue to be determined to a large extent by the way in which the aviation sector responds to its future regulatory needs. This Conference, with ICAO as the facilitating agency, has a pivotal role to play in that response.

2. THE LIBERALIZATION EXPERIENCE

2.1 The Conference will preview under Agenda item 1 its discussions on the key regulatory issues (Agenda item 2) by considering the present regulatory scene and the development of liberalization since 1994. Information on commercial and regulatory developments over the past decade is provided in WPs 20 and 21 and includes material on trends and developments, while drawing attention to some of the regulatory issues raised by these developments. Suffice for the purposes of this background paper to highlight here some of the most significant developments.

2.2 The current commercial scene is marked by a difficult phase of recovery. The particular problems of recovery for the airline industry differ widely among regions and air carriers, with some continuing to experience serious negative growth in traffic and major financial losses while others are already in growth and expansion patterns and profitability. In addition to the traffic and financial consequences, the present difficulties of the aviation sector have had some implications that are largely unprecedented in this sector. The following is a non-exhaustive but indicative list:

- ! several major airlines have ceased operations while some others have been forced into bankruptcy and, at times associated with this, has been debate over the role and impact of State aids/subsidies for the airline industry;
- ! the traditional business model of the full service airline has come under scrutiny, particularly for airlines with global reach, and has spawned experimentation with alternative models in order to survive;
- ! the low cost carrier phenomenon has expanded rapidly to challenge established operators not only at national level but increasingly regionally and even beyond;
- ! airline strategy and planning has generally shifted to one based on alliances and network markets, in contrast to traditional route by route market development;
- ! the constant downward pressures on airline cost structures in response to falling yields have continued, even though air transport remains an industry with high fixed costs;
- ! e-commerce is being used to minimize intermediary marketing and selling costs and the airline distribution business and channels continue to be restructured;
- ! airlines have had to adjust to structural shifts in passenger demand with implications not only for the type but also the level of services offered; and
- ! industry instability and constant adjustment have had social and labour impacts.

2.3 Many of the developments in the previous paragraph can be traced to the inevitable evolution of the industry whereby liberalization has been changing the nature and lessening the degree of direct control by regulators in many markets, while globalization, competition and commercial flexibility have been transforming the operating environment for international airlines. But their emergence and impact have also been accelerated by recent events. Some other significant industry developments of the past decade worth noting in this scene setting exercise have been:

- ! the continuing strength of the air cargo sector;
- ! the progressive increase in the importance of leasing in airline fleet management and operational responses in the marketplace, *inter alia* facilitating the establishment of many new airlines;
- ! the steady expansion of alliances for strategic purposes and to achieve market access and synergies;
- ! the shifting development and marketing power of global alliances, together with their competitive consequences, including their dominance at some hubs;
- ! an increase in the use of cross-equity among airlines and foreign investment in the airline industry, both of which, however, are largely governed by the regulation of ownership and control at national, bilateral and regional level;
- ! the progressive privatization of the airline industry, though with a small counter trend of renewal of government ownership as a national interest response to the potential demise of a national airline;
- ! the increasing influence in many markets of consumers, whose responses to airline service and pricing has begun to affect airline strategic planning and marketing of the airline product; and
- ! the shifting concept of participation from one based on a nationally owned and operated “flag carrier” to one based on the adequate provision of air transport services.

2.4 The regulatory side has also been marked by considerable change in recent years. International air transport continues to be defined by its traditional approach to market access and regulation through the treaty-based system of bilateral air services agreements, though now with a substantial overlay of regional and plurilateral arrangements. Bilateral agreements remain the primary vehicles for liberalization of international services for most States. Such agreements now range from the liberal “open skies” models, through the increasingly widespread adoption by bilateral partners of different liberalizing provisions, to the

traditional agreements with controls over market access and capacity. However, given the nature of bilateralism, with its underpinning of reciprocity, it has been both a convenient means to liberalize on a case-by-case basis but at the same time has sometimes been seen as a constraint on the liberalization and adjustment process.

2.5 The adoption of group (regional and plurilateral) approaches to market access ,and especially to liberalization has, however, proved to be an alternative and palatable approach to regulatory change for many States in recent years, as attested by the adoption of a substantial number of regional and sub-regional arrangements. All are at different stages of development and implementation, but most have the objective of liberalizing the market on a group level. Some agreements are also beginning to build legal and institutional regulatory frameworks to govern the group market as a whole. Another feature of the evolving regulatory environment is that it has also been affected by a slow but steadily increasing involvement by competition law in aviation regulation in a number of jurisdictions. Furthermore, there are an increasing number of interests involved with the policy development and implementation process, and, as a corollary, an expanding concept of the “national interest” to embrace such entities. Despite such developments, regulators are often seen by the industry and some wider interests in society as lagging behind in responding to the needs of the globalized marketplace.

2.6 Of more recent and significant consequence, is the possible global impact of the European Court of Justice decision of 5 November 2002 on “open skies” agreements between the United States and certain European Union States. The long term regulatory and air service relationship implications of this decision are yet to be determined.

2.7 Even though there is now widespread acknowledgement of the need for regulatory change and adjustment, the adoption of a liberalization programme and liberalization measures by States to open up the sector has varied enormously. To some States the pace of progressive liberalization globally has been too slow and the systemic obstacles to change in air transport too entrenched. Yet many other States continue to have concerns about the consequences and benefits of a liberalization agenda, the cost of participation through a national airline and the long term viability of that airline in a competitive, liberalized and globalized environment. Just as major disparities persist in competitive aviation resources and capabilities among States, so there are widespread differences in regulatory perspectives and responses. This Conference presents an opportunity to provide further regulatory tools for the liberalization process while building the climate of confidence necessary for those States wanting, in principle, to liberalize but uncertain about the outcome or how to go about harnessing the opportunities.

2.8 Notwithstanding the liberalization debate and its differing concerns over the direction, speed and results of regulatory reform – a debate that is often shaped by objectives and perspectives which are not always global – this Conference also is a forum to debate the challenges and opportunities of liberalization at the global and aviation community levels. The aviation community is an inclusive sector under the umbrella of the Chicago Convention and the objectives of regulatory change and reform, including progressive liberalization, are fully consistent with the Convention principles of sovereignty, non-discrimination, cooperation and interdependence, and the objectives of “equality of opportunity” and of “safe, regular, efficient and economical air transport”.

3. THE CONFERENCE TASK

3.1 The objectives of the Conference, as established by the Council, are “to develop a framework for the progressive liberalization of international air transport, with safeguards to ensure fair competition, safety and security, and including measures to ensure the effective and sustained participation of developing countries”. The Conference is not being asked to negotiate a multilateral agreement or text. Nevertheless, it is expected to respond with a global perspective and the development of a global policy framework on the liberalization issues set out in the agenda.

3.2 The Conference agenda, as agreed by the Council and reproduced in WP/1, was designed firstly to allow a comprehensive examination of those key liberalization issues that have broad significance and importance. Although there are many regulatory issues that are considered important to individual States or regions, with the limited time available for the Conference to address a number of complex subjects, the focus of the agenda has, of necessity, been given to those issues that are broadly relevant to most States. Secondly, the agenda has been designed to produce an outcome that is of practical value to States, hence the emphasis by the Council that the Conference address “how to” rather than “whether to” liberalize. Some States already have at their disposal all the required resources as well as the policy orientation and objectives and have embraced a liberalization process. However, many States have yet to reach that point and look to ICAO for the guidance and the means that would enable them to be a part of that process, in order that they can be assured of its long term benefits.

3.3 The “framework for the progressive liberalization of international air transport” which is the Conference objective will be comprised of firstly, the conclusions and any recommendations on Agenda items 1 and 2, which are policy guidance and formulae for liberalization on specific topics, secondly, the Template Air Services Agreements (TASAs) under Agenda item 3, which are comprehensive texts for facilitating liberalization through air services agreements; and finally, the Declaration of global principles which will give an outward and forward-looking focus to future liberalization policy development. Consequently the “framework” is not to be seen in terms of a single text, as was the case in 1994, but as a package that will be the Conference outcome. Nor is the “framework” to be viewed as a fixed policy package. Greater and added value to States may be obtained if it is seen as a flexible policy framework open to future development and elaboration by ICAO.

3.4 Under Agenda item 1: Preview, the Conference is invited to consider firstly the background and experience of liberalization and secondly, the safety and security aspects of liberalization. Under the first of these sub-items, the Conference will be able to place the background and experience of liberalization within the context of its broader environment of service providers (airport and air navigation in particular) and its interaction with trade, labour and other policies that impact on the sector. In this connection the Conference will be able to examine the record of liberalization. Especially useful will be the actual liberalization experiences of States and regions, particularly since 1994 when liberalization began to spread and deepen in its application. Not only will this assist the subsequent discussions but also place on record for the benefit of the wider aviation community the practical lessons of liberalization initiatives thus far.

3.5 Agenda item 2: Key regulatory issues are expected to occupy most of the Conference time and attention, since it will involve the in-depth analysis of the liberalization issues listed in sub-items 2.1 to 2.7 and the consideration of specific proposals. The Secretariat has put forward proposals in the form of regulatory arrangements for use by States in their aviation relationships for the Conference to consider under item 2.1, air carrier ownership and control (WP/7); item 2.2, market access for air cargo (WP/10) and leasing (WP/9); item 2.3, fair competition and safeguards (WP/11) and participation measures (WP/12); item 2.6, dispute resolution (WP/15); and, item 2.7, transparency (WP/16). Other papers from States and organizations have put forward additional proposals on various sub-items of item 2.

3.6 It is on Agenda item 2 that progress can be made through agreement on regulatory arrangements to facilitate the liberalization process. Agreement on such proposals will not entail unanimous approval nor subsequent implementation but rather a broad consensus in the Conference that such arrangements will assist a large number of States at a practical (“how to”) level, but without derogating, however, from the rights of States to adopt more liberal approaches. A feature of ICAO guidance emanating from a worldwide meeting such as this is in its broad acceptability; the problem lies in the fact that its impact through implementation may only be felt over time. It is with this in mind that some proposals are included in WP/7 on the critical issue of air carrier ownership and control, where it is considered desirable to bring about more immediate liberalization through the use of practical arrangements such as coordinated action between States.

3.7 Under Agenda item 3: the review of the TASA, the Conference will be presented with two TASAs attached to WP/17, one for the bilateral situation and the other for regional or plurilateral situations. The Conference is being asked to review and comment on the concept of the TASAs but is not requested to review or endorse the text in the TASAs. This is an ongoing ICAO project, the emphasis of which is on the bilateral TASA, which is aimed at providing a comprehensive framework air services agreement for States to use at their discretion in their air services relationships when liberalizing. It offers text for traditional, transitional and full liberalization approaches. The Conference views on its usefulness and application will greatly assist its further development as a practical tool in the liberalization process.

3.8 Under Agenda item 4: consideration of global framework for ongoing liberalization, the Conference is expected to address firstly the mechanisms to facilitate further liberalization and secondly a Declaration of global principles for international air transport. The first sub-item will involve looking at ICAO’s role and its future work programme, particularly as regards liberalization, as well as its relations with other international organizations and, in particular, the World Trade Organization (WTO-OMC). In this connection, some of the Secretariat papers under Agenda item 2 propose to the Conference monitoring and information dissemination tasks for ICAO while a more active role is envisaged under item 3 on the further development of guidance for implementation of the TASAs. In addition, WP/18 addresses the role of ICAO in the further development and facilitation of liberalization.

3.9 The “Declaration of global principles”, presented in WP/19, will be the first attempt by ICAO to place the future regulatory development and liberalization of international air transport in a package of guiding principles and objectives. The intention of the declaration is to project a forward and outward looking statement from the aviation community to non-aviation sectors and the public at large. The Declaration is meant to be comprehensive and inclusive and to encompass the various interests and interrelated issues in this sector. A preliminary draft has been developed by the Secretariat after broad consultation including the Air Transport Regulation Panel and the Conference will be expected to develop this further taking into account decisions under the previous agenda items.

3.10 As is customary with ICAO worldwide meetings, the Conference, as its final task, will be expected to adopt its report, including the summary of discussions, conclusions and any recommendations. In addition it will be expected to approve the final text for the Declaration of global principles. The final half day of the meeting has been set aside for these report adoption tasks.

4. **ACTION BY THE CONFERENCE**

4.1 The Conference is invited to note the overview of the Conference task contained in this paper.

— END —