

WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND OPPORTUNITIES OF LIBERALIZATION

Montreal, 24 to 29 March 2003

Agenda Item 2: Examination of key regulatory issues in liberalization 2.2: Market access

LIBERALIZING AIR CARGO SERVICES

(Presented by the Secretariat)

SUMMARY

This paper addresses the distinctive features of international air cargo and its regulatory treatment by States, discusses the need for regulatory reform and proposes measures for greater liberalization of this sector.

Action by the Conference is in paragraph 6.1.

REFERENCES

Doc 9626, *Manual on the Regulation of International Air Transport*

1. INTRODUCTION

1.1 Air cargo is an important component of international air transport¹. The past decade has seen substantial growth worldwide in air cargo traffic, which has recorded a higher annual average growth rate than that of passenger traffic (except for 2001 when both had a downturn). Air cargo plays an increasingly important role in the global economy, as well as in the national development and international trade of many States, and is often critical for landlocked and island developing countries and States whose main export commodities are high-value goods or perishables.

1.2 While the current regulatory regime, primarily composed of some 4000 bilateral air services agreements covering both passenger and cargo services, has provided the basis for the steady growth and development of air cargo service, it has also been called into question and considered by some States as well as the air cargo industry as a major hindrance to the optimal efficiency and economic operation of air cargo networks and services. There are growing calls for regulatory reform in recognition of the distinct features of air cargo transport, and for special regulatory treatment separate from that for passenger service. This paper reviews the regulatory treatment of air cargo, identifies some of its specificities and discusses possible

¹ In the context of this paper, cargo (which may be used interchangeably with freight) includes express but not mail (which refers solely to objects tendered by and intended for delivery to postal administrators).

regulatory approaches including a recommended regulatory arrangement for accelerated liberalization, in particular, of all cargo operations.

2. BACKGROUND

2.1 International air cargo transport has the following distinct features:

- a) cargo, by nature, is generally less sensitive than passengers to time elapsed between origin and destination (except express), routes and stops. While passengers must be transported to their destinations without delay, cargo can often wait if space is not immediately available, can move on different routes and can make numerous stops;
- b) while passengers tend to make round trips, air cargo generally moves only one way. There are few routes where the volume of cargo traffic is the same or similar in both directions, but many where the volume is several times greater in one direction than the other; and
- c) air cargo tends to use more intermodal transport, combining other forms of transport, e.g. truck, rail or ship with aircraft. This permits all cargo services to use remote and less congested airports which are not attractive for passenger services.

2.2 Different types of carriers are engaged in international cargo transport, including:

- a) scheduled international airlines which operate passenger aircraft, combi aircraft and/or dedicated all cargo aircraft, and offer scheduled and non-scheduled cargo services; some of these airlines have established a cargo division for dedicated all cargo operations (such as Lufthansa Cargo, Northwest Cargo, Singapore Airlines Cargo);
- b) international all cargo carriers which operate freighter aircraft only and offer scheduled and non-scheduled services (such as Cargolux);
- c) international express/small package carriers (also known as integrators) which operate freighter aircraft and provide multi-modal services (such as FedEx, UPS); and
- d) international all cargo non-scheduled airlines, some of which provide specialized services such as the carriage of live animals, flowers, and heavy equipment.

2.3 Most scheduled international airlines regard air cargo carried in the aircraft's lower deck compartment as an additional source of revenue, treating it traditionally as a by-product of their passenger services. However, in a more competitive environment the revenue from air cargo can assume greater importance, particularly on a route with a sufficient volume of cargo traffic to justify using a combi aircraft (which carries both passengers and cargo on the main deck). Presently, over 50 per cent of the revenue from scheduled and non-scheduled international air freight is generated by combination carriers (those which carry cargo in the belly hold or in combi aircraft on scheduled passenger services) with the rest by all cargo airlines.

2.4 States have taken action unilaterally, bilaterally and multilaterally to liberalize cargo services. One example of unilateral action at State level has been India which has opened certain airports to all cargo service by all air carriers without requiring bilateral reciprocity. There are reportedly twenty-eight bilateral "open skies" type agreements which provide all cargo services with additional traffic rights in the form of the so-called Seventh Freedom (the right to carry traffic between the bilateral partner and a third State without

the requirement to connect to or be an extension of any service to/from the carrier's home State) for scheduled and non-scheduled services. Furthermore, many States have included in their air services agreements special provisions for air cargo operations, or have allowed for greater route flexibility. The Andean Pact "Open Skies" agreement includes full freedom for all cargo non-scheduled flights for member-country airlines within the region and between member countries and third countries.

2.5 The Organisation for Economic Co-operation and Development (OECD), an Organisation of 30 developed States, produced and published in 2002 an extensive examination of the current situation and long-term outlook of the air cargo industry, as well as a comprehensive model Protocol to existing bilateral air service agreements and a separate all-embracing multilateral agreement². The OECD study has been taken into account in the development of this paper and its proposals for the further liberalization of air cargo. Air cargo is also considered by some members of the World Trade Organization (WTO-OMC) as a potential aviation activity for inclusion in the Annex on Air Transport Services to the General Agreement on Trade in Services (GATS).

3. DISCUSSION

3.1 In an increasingly globalized and liberalized environment, air cargo operations need to be as efficient, economical, and expeditious as possible to meet user demands, particularly for transport of high value and time-sensitive freight. Many of the provisions under current bilateral air services agreements, because they are principally designed for passenger transport, can limit the ability of air carriers to respond to market developments and to exploit the regional and global market potential that would otherwise be available.

3.2 A major problem for all cargo operators, for example, is the lack of flexibility in market access rights in air services agreements. The limitations usually imposed on passenger service in respect of routes, traffic rights, frequency, etc. may also apply to all cargo services. Since there are limited synergies between passenger and cargo operations (e.g. because of different customers, different departure/arrival time requirements, directional imbalance of traffic movement), such regulatory restrictions often make it difficult for air carriers to sustain an economically viable all cargo service.

3.3 All cargo operators are also constrained by a range of other rules affecting operational and "doing business" opportunities, for example, national ownership and control requirements, restrictions on the use of leased aircraft, ground handling, and commercial cooperative arrangements such as blocked space and codesharing. Other regulatory problems all cargo operators may encounter include: airport curfews, which often limit the flexibility in flight scheduling, particularly for courier and express services; and in some cases, limitation on airport slots that can be used by cargo flights, especially at congested airports where all cargo operations are often given lower priority than passenger services.

3.4 In considering greater liberalization of the air cargo sector, it should be recognized that there remain some concerns about whether there should be special or separate treatment for international air cargo operations. Some carriers and their governments may be reluctant to apply separate, liberal treatment of air cargo, as they regard their competitive position as an indivisible combination of passenger and cargo operations. Such thinking could reflect a concern that treating cargo separately could risk losing leverage in passenger negotiations, especially where the carrier does not operate all cargo services. Nevertheless, in pursuing the reform required, governments need to weigh such views against the general economic benefits

² "Liberalization of air cargo transport", OECD, May 2002.

(trade and development) that can be expected from market-access liberalization and the benefits to air cargo users, such as exporters, in particular.

3.5 Another concern related to air cargo liberalization is the competitive balance between different types of air carriers which carry air cargo, those which carry it in combination with passengers and those which carry only cargo (all cargo operators). All cargo carriers have potential advantages in terms of capacity and flexibility in using less congested airports but may have some disadvantages *vis-à-vis* combination carriers in terms of access at congested airports and marginal cost pricing of their service.

3.6 Combination operations are part of the passenger regulatory regime and therefore directly affected as to the pace of liberalization by developments under that regime. Consequently the exploration of further liberalization in international air cargo transport could most usefully focus on possible measures for all cargo services which may be treated separately from passenger services. The main target should be measures for scheduled international all cargo services (still carrying nearly 60 per cent of the total international air cargo traffic), as they are the most affected by existing arrangements principally designed for passenger service.

3.7 Bearing in mind the problems faced by all cargo operations, as enumerated in paragraphs 3.2 and 3.3 above, all cargo service operators essentially need regulatory arrangements that would provide for more route and operational flexibility, more traffic rights, particularly “beyond rights”, and relaxation on the national ownership requirement, use of leased aircraft, as well as other “doing business” freedoms (e.g. ground handling). The measures outlined below may be considered by States in their air transport negotiations and treatment of all cargo operations.

- a) In terms of traffic rights, consideration may be given to grant rights beyond Third and Fourth Freedoms because awarding such rights (e.g. Fifth to Seventh Freedoms) would add flexibility to the planning of air cargo service, particularly in light of the fact that the cargo traffic flows are often one-way movements. Such rights would also allow air cargo operators to organize the most direct and efficient services possible, rather than being constrained to routes established principally for passenger services. Triangular operations and better return traffic possibilities would address the directional imbalance traffic issue, enhance the economic and commercial efficiency of air cargo transportation, and allow improved services to users.
- b) In the areas of route and operational flexibility, consideration may be given to more liberal provisions allowing, *inter alia*: 1) operation of flights in either or both directions; combination of different flight numbers within one aircraft operation; omission of stops at any point or points; 2) unrestricted frequency, type of aircraft and capacity to be used in conducting the services; 3) conclusion of commercial agreements with other carriers such as blocked space, codesharing and interline arrangements; and 4) combination on the same aircraft of traffic originating in the territories of the parties concerned as well as from that of the third parties.
- c) With regard to the ownership and control requirement, the liberalized regulatory arrangement discussed in ATConf/5-WP/7 would apply to all cargo carriers.
- d) As for aircraft leasing, the ability to use leased aircraft is very important for air cargo operations because it can enhance the flexibility of the air cargo transport industry by facilitating the development of cargo operation with limited capital. Leasing can also bridge shortages of capacity and reduce cost and debt levels. It can contribute to the strengthening of competition because it allows smaller cargo carriers to enter a market

which would have not been financially feasible without a leased aircraft. Therefore, leasing should generally be allowed, subject to compliance with relevant safety requirements. It is recognized that there exist concerns on certain safety and economic aspects of the practice. States' regulatory treatment varies as well. Accordingly, there is a need for more common or standard treatment on the international level, particularly for wet leases. A possible regulatory arrangement to address this concern is discussed in ATConf/5-WP/9 on aircraft leasing.

- e) Consideration may be given to more liberal arrangements for other aspects specific to all cargo operations, including pricing freedoms, intermodal transport, ground handling and warehousing (both of which should be subject, however, to safety and security considerations), as well as customs clearance and other facilitation.

4. CONCLUSIONS

4.1 The Conference is invited to conclude that:

- a) air cargo, and in particular all cargo operations, should be considered for accelerated liberalization and regulatory reform in view of its distinct features, the nature of the air cargo industry and the potential trade and economic development benefits possible from such reform.
- b) States should:
 - i) consider the possibility of unilateral liberalization of market access for all cargo services without the requirement for bilateral reciprocity or negotiation; and
 - ii) consider measures to liberalize all cargo in their existing and future air services negotiations and regulatory treatment. Paragraph 3.7 includes a partial list of such measures.

5. RECOMMENDED REGULATORY ARRANGEMENT

5.1 Air cargo liberalization, including all cargo, might also be addressed through existing and future air services agreements by provision of an annex on air cargo services. Such an annex could be used by States at different stages of liberalization of international air transport services. The annex would have two basic elements. First, provisions ensuring non-discriminatory access for every cargo operator (whether combination or all cargo) to common facilities such as cargo clearance, handling, storage, and intermodal service as well as elements whose liberalization has competitive implications such as codesharing, leasing, blocked space arrangements and pricing. Such liberalization may only have been extended previously to passenger operations. Also, by using an annex, when elements in the main agreement are subsequently liberalized for passenger services, the same treatment will be extended to air cargo services in a harmonized manner. In the later stages of liberalization the annex would probably no longer be necessary. (In fact, the proposed annex would be redundant with respect to many "open skies" agreements because all of the elements in the annex would have been liberalized in the main agreement.) The second basic element is that the annex would liberalize all cargo service to the greatest extent possible. It would provide the Third through the Seventh freedoms of the air for all cargo service operated on a scheduled or non-scheduled basis. Operational flexibility is described in general terms and includes those elements usually regarded as important for all cargo operations.

5.2 The proposed annex would not create a separate, stand-alone regime for air cargo operations which would remain subject to the provisions in the main agreement such as safety and security as well as other conditions to which international air services are subject, such as slot allocation rules and procedures at congested airports. The language in the annex proposed by the Secretariat is a model, and States may find it necessary to modify it to meet their particular circumstances. For example, if a bilateral or multilateral agreement has already liberalized non-scheduled services, there will be no need to include non-scheduled all cargo services in the air cargo annex.

5.3 The following regulatory arrangement, in the form of the draft model annex, is proposed for consideration by the Conference for Contracting States to use at their discretion in bilateral, regional or plurilateral air services agreements. This provision has been inserted in the Template Air Services Agreements (see ATConf/5-WP/17).

ANNEX ON AIR CARGO SERVICES

The Parties agree that:

1. *Every designated airline when engaged in the international transport of air cargo*
 - a) *shall be accorded non-discriminatory treatment with respect to access to facilities for cargo clearance, handling, storage, and facilitation;*
 - b) *may use and/or operate directly other modes of transport;*
 - c) *may use leased aircraft, provided that such operation complies with the safety and security standards applied to other aircraft of designated airlines;*
 - d) *may enter into cooperative arrangements with other air carriers including, but not limited to, codesharing, blocked spaced, and interlining;*
 - e) *may determine its own cargo tariffs which shall not be required to be filed with the aeronautical authorities of either (any) Party.*
2. *In addition to the rights in paragraph 1 above, every designated airline when engaged in all cargo transportation as scheduled or non-scheduled services may provide such services to and from the territory of each (any) Party, without restriction as to frequency, capacity, routing, type of aircraft, and origin or destination of cargo.*

6. ACTION BY THE CONFERENCE

6.1 The Conference is invited to:

- a) review and adopt the conclusions in paragraph 4; and
- b) recommend the adoption of the model annex on air cargo services in paragraph 5.

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