

## **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**

### **AIR CARGO AND THE WORLD TRADE ORGANIZATION (WTO)**

(Presented by the International Chamber of Commerce)

#### **INFORMATION PAPER**

#### **1. BACKGROUND**

1.1 The combination of the development of global trade and the growth of the Internet have dramatically changed the manner in which business is transacted around the world. Developments in these two areas alone have rendered distances, time and national borders almost irrelevant. New ways of doing business driven by the Internet revolution, such as electronic commerce, are rapidly developing and creating new revenue streams. "E-commerce" presents enormous opportunities for both individual consumers and businesses, making it possible to trade at low cost across borders with the prospect of creating a truly global marketplace. However, the commercial success of e-commerce relies heavily on the existence of efficient, liberalized delivery networks of which air cargo services constitute the key link.

1.2 It is time that the implications of air cargo liberalization for industry at large are fully assessed. Air cargo plays a crucial role in ensuring the competitiveness and commercial success of most industries around the globe. So far, governments and airlines have, to a large extent, focussed their interest on passenger and aeropolitical issues, and have failed to consider the broader implications of air cargo liberalization on industry and consumers in general. Yet no sector today can do without just-in-time delivery, logistics and door-to-door time-definite services, all of which depend on reliable transportation services.

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***Acknowledgement:** The International Chamber of Commerce gratefully acknowledges the work of Professor Richard Janda, of McGill University, as an important source of research for this paper.*

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## 2. **INDUSTRY OVERVIEW**

2.1 While in terms of weight, only 2 per cent of all cargo moves by air worldwide, the OECD estimates that air freight transport now accounts for well over a third of the value of the world trade in merchandise. Air cargo is an indicator of wider economic trends, often showing the way into and out of recession. Although time-definite services were the exclusive domain of the integrated carriers in the past, all carriers of freight are now forced by the market to offer this service. According to the Avmark Aviation Economist, the proportion of just-in-time freight in total freight has risen from 18 per cent in 1990 to 28 per cent in 1995, and is forecast to grow to 39 per cent by 2000.

2.2 Despite the fact that 58 per cent of global airfreight is currently carried on the lower-deck of passenger aircraft (“belly hold freight”) this proportion is now changing due to the activities of integrators, forwarders and other specialized freighter services. Airbus sources indicate that 1184 all-cargo aircraft were in service in 1994, more than triple the 1980 fleet and forecasts suggest that the overall fleet of cargo jets will grow to 1701 by 2005. Boeing anticipates that long-term air cargo growth will average 6.6 per cent per year while the world economy pushes ahead at 3 per cent.

## 3. **INADEQUACY OF THE CURRENT BILATERAL FRAMEWORK**

3.1 Traditional air transport services agreements are outdated and ill-suited to the new activities developed by the air transport industry. This is particularly true in the case of cargo services, where significant changes have taken place in the last 20 years. In most parts of the world, aviation has become a very competitive industry, with carriers seeking to enlarge the scale of their operations beyond their national boundaries. Although recent “liberal” bilateral agreements (e.g. US “Open Skies” agreements) have dramatically improved the situation, many important issues are still left out: ownership and control, cabotage, right of establishment, etc. These anachronistic restrictions must be addressed in order to allow a transition into a truly efficient, global air cargo transport system.

3.2 While other sectors of the economy have benefited from the liberal multilateral trade regime initiated by GATT and continued within the WTO framework (see the recent agreements in the telecommunications and the financial services sectors) aviation has, so far, not followed that pattern. Bilateral air services agreements are incompatible with GATT's principles of Most Favoured Nation (MFN) and National Treatment since access to agreed routes is limited to the national carriers of the bilateral parties. Consequently, only three areas of air transport are currently included in the transport annex of the General Agreement on Trade in Services (GATS): aircraft repair and maintenance services, Computer Reservation System services, and the selling and marketing of air transport services.

3.3 The exclusion of aviation from the mainstream developments applicable to trade in services and trade in goods will increasingly put aviation at a disadvantage:

- a) current bilateral restrictions prevent air carriers from planning their route networks purely on the basis of commercial considerations;
- b) air carriers cannot establish themselves within a State outside of their “national” State;

- c) they cannot take a majority share in, or fully merge with, a foreign airline; and
- d) they do not have free access to the world's capital markets. They are thus largely restricted to investors from their own country; this is particularly significant for carriers registered in small or less prosperous States.

3.4 The International Chamber of Commerce (ICC) supports the idea that air cargo transportation should be treated as a trade matter. This will result in a more liberal environment for the air cargo industry.

3.5 ICC is convinced that the worldwide liberalization of air cargo services constitutes the only appropriate remedy to the current fragmented situation. The WTO has accumulated experience and expertise in the international administration of trade liberalization and, therefore, has positioned itself as an appropriate forum for achieving this objective. However, recognizing the specific features of the industry, emphasizes the need for transport officials to be involved in all steps of the liberalization process. Many arguments support the inclusion of air cargo services within GATS. Transport, together with financial services and telecommunications, form the key elements of the international business infrastructure. National regulations limiting access to domestic markets for foreign carriers also inevitably result in diminishing the movement of persons, goods, and capital.

3.6 Whereas national regulations restricting access to foreign carriers may, in the short term, be in the interest of domestic carriers, it is contrary to the need for increased business links and trade growth in developing countries. National restrictions against foreign access also postpone the emergence of financially sound, and efficiently organized international service markets. This is particularly problematic in the case of international air transport, for which global networks cannot achieve their full potential in the current patchwork of bilateral air services agreements.

#### **4. AGREEMENT COVERING CARGO TRAFFIC**

4.1 While the overall liberalization of the air transport sector may be a long-term objective, ICC firmly advocates an agreement covering air cargo services in the short term. A successful agreement covering air cargo services could possibly pave the way to the liberalization of the entire sector. There is a strong case for a deal covering air cargo services as illustrated below:

- a) Air cargo serves the interest of the wider economy and has expanded to cover many areas that were not even considered when the pattern of bilateral agreements was conceived (door-to-door time definite services, just in time deliveries, logistics services, etc.). The introduction of these new services explains the growing importance of air cargo in the world economy.
- b) As import barriers for the entry of goods are progressively lifted in many countries, the transport means used for this purpose needs to be liberalized simultaneously. The new opportunities granted should not be affected by the restrictions inherent in the bilateral agreements.

- c) The notion of national traffic – where air carriers are supposed to cater primarily for traffic originating from or destined for their “own” countries – which forms the basis of traditional bilateral agreements, has become particularly irrelevant for air cargo traffic due to the globalization of the manufacturing process. Many manufactured goods are shipped to various locations before final assembly, meaning that there is no such thing as national traffic but rather international traffic.
- d) Air cargo services have specific features and requirements that are significantly different from passenger traffic: cargo is usually one direction, it is less sensitive to airport slots and the time of travel – day or night – is often irrelevant.
- e) Air cargo traffic is by nature less subject to national sensitivities and more open to competition than passenger traffic. New entrants in the air cargo market can usually offer competitive services with limited frequencies from other, less congested airports.
- f) Air cargo services used to be by-products, with cargo filling up the unused passenger capacity of aircraft, but this is no longer the case as an ever increasing proportion of high value commodities are transported by air, justifying new all cargo services.
- g) Air transport is increasingly becoming only one of the many elements in the overall intermodal cargo transport chain. The point of focus has moved from the transport mode to the goods themselves. For the users of integrators, for example, the mode of transport is irrelevant, it is the on-time delivery factor which is important. Air transport is only one of the means of achieving this result. With this in mind, it seems only logical to conclude that all the elements of the transport chain should be liberalized in the same way, in order to guarantee a seamless and successful operation.

## 5. **TRADITIONAL PROBLEMS ASSOCIATED WITH GATS IN AIR TRANSPORT**

5.1 The GATS framework has frequently been dismissed as unsuited to the special features of the air transport industry because the two basic GATS disciplines, MFN and national treatment, are extended to all parties regardless of reciprocity. Traffic rights, on the other hand, have traditionally been exchanged bilaterally and negotiated on the basis of reciprocity. It is worth noting that, in this case, the argument against MFN is based on carrier – not consumer – interests. In essence, the argument is that route rights are economically valuable and should be granted only if something is received in return. Other countries felt that, under the GATS, the most liberal countries would actually lose the leverage they enjoyed in the bilateral system to encourage other countries to liberalize.

5.2 While the argument for reciprocity should be discussed further, it should be noted that no service sector is excluded from GATS. The Annex on Air Transport Services is formulated so as to apply, in principle, to all aspects of the industry whether scheduled or non-scheduled, as well as ancillary services. Secondly, it is not quite true to say that GATS does not allow for reciprocity since there is scope within its framework for reciprocity. While recognizing that the application of the reciprocity principle/conditional MFN are not common within the WTO framework, ICC would like to point out that applications of conditional MFN can be found in the appendices to the WTO Agreement on Government Procurement signed in Marrakech

on 15 April 1994. Other exceptions to the strict application of MFN include, for example, the way in which countries within a region can set up a free trade agreement that does not apply to goods and services from outside the group.

## **6. HOW THE GATS ANNEX ON AIR TRANSPORT CAN BE EXPANDED TO COVER “HARD” RIGHTS**

6.1 Unlike other services which can be offered from the territory of a foreign country to consumers in a domestic market, international air transport services are offered in a market of consumers and goods moving between and coming from at least two countries. The service is thus offered in a transborder market. The implications are that the MFN principle, inappropriately applied, can lead to absurd results in air transport. This would be the case if, as a result of the MFN principle, two carriers operating in the same market were subjected to different rules<sup>1</sup> – the very opposite of the non-discriminatory outcome sought through the MFN principle. Therefore, other more appropriate applications of the principle should be considered. In that respect, one should bear in mind that the purpose of MFN is to make best existing treatment afforded by a country to foreign service suppliers the baseline for all WTO members.

6.2 If the purpose of MFN is to be fulfilled with respect to “hard rights”, the principle must be applied in a way that takes account of how countries grant their best existing treatment, that is through bilateral agreements establishing joint economic regulation of a transborder market.

6.3 The MFN principle ought therefore to apply to the most favourable equal exchange of inbound and outbound access to transborder markets which a country is prepared to make. In other words, the MFN principle would be applied in such a way that every WTO member should be required to offer to all members the elements of its most favourable bilateral agreement, on the basis of mirror reciprocity. For example, a member prepared to enter into liberal arrangements might offer to all other members all points, multiple designation, double disapproval pricing and unrestricted capacity in exchange for the same. A more restrictive member might for example offer only one point, single designation, double approval pricing, and specified capacity in return for the same. Each member would have to identify in its market access schedule the most liberal terms upon which it is currently prepared to enter into equal exchange of rights.

6.4 To achieve this, the Annex on Air Transport Services could be amended to include a definition of “hard rights” incorporating the notion of reciprocal exchange of equal access. This approach would therefore combine existing bilateralism with the MFN principle, thereby meeting the main objection against inclusion of hard rights within the GATS. It would represent an improvement upon existing bilateralism because the opportunity to enter into liberal bilateral arrangements would be available equally to all members on the basis of mirror reciprocity. A country could no longer choose to be liberal with some partners and illiberal with others or partly liberal in exchange for completely liberal access. This point can be best illustrated by the following example: the US and Singapore have a very liberal air transport agreement, while the US and Peru have a very restrictive agreement. Under the model proposed in this

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<sup>1</sup> For example: Country A and country B have a very liberal bilateral agreement, whereas country A and country C have a very restrictive agreement. Nevertheless, by virtue of the MFN principle country C claims the benefits of the liberalized environment between A and B to provide its carriers with opened access to country A, while at the same time maintaining limited access to its market for carriers of country A through the restrictive A-C bilateral agreement.

paper, Peru would be automatically entitled to the same liberal access to the US that Singapore gets when Peru becomes as open as Singapore. For the US, this would also mean that if Peru were to sign a liberal agreement, with Spain for example, the elements of that agreement would be immediately available to the US and all other countries on the basis of reciprocity. This would set in motion a mechanism for progressive multilateral liberalization.

6.5 Under the GATS, the MFN principle would be coupled with market access commitments establishing a threshold of liberalization beneath which a member could not go in the future. Over time, this would evolve into a true multilateral arrangement. Similarly to the Bermuda agreement which became a model for international bilateral arrangements, a pattern of liberal market access schedules would emerge, which in subsequent GATS rounds could form the basis of a unified regime. For example, if practices of all point to all point, unrestricted capacity and frequency were to appear, those principles could be codified in the Annex on Air Transport Services.

6.6 Furthermore, under the impulse of liberal, like-minded countries, the MFN principle would also apply directly to domestic foreign investment rules, the right of establishment and cabotage, since these areas are severable from the joint regulation of country-to-country route rights. This would represent a significant breakthrough from the pattern of traditional bilateral agreements.

## **7. PROSPECTS FOR A SEPARATE AGREEMENT ON AIR CARGO SERVICES**

7.1 The possibility for a separate liberalization of air cargo services has been considered by the United States government on various occasions. The 1995 US International Air Transportation Policy Statement reads “We will continue to follow our long-standing policy of seeking an open, liberal operating environment to facilitate the establishment and expansion of efficient, innovative and competitive air cargo services” (Statement p. 6). Furthermore, this document states that, should an approach covering all air transport prove unsuccessful, “...we can consider agreements that eliminate restrictions only on services in specific aviation sectors such as air cargo...” (Statement p. 10). There is every reason to believe that the European Union (EU) would also support this approach. Advocating a horizontal approach to the liberalization of trade in services, Sir Leon Brittan, in a recent speech expressed the view that “It is right to proceed sector by sector for unfinished business...” and that “Where sectoral liberalization can bring balanced benefits now, no player is keener to pursue sectoral liberalization quickly than the European Commission”. Sir Leon also pointed out that “...it would be easier if all sectors – air as well as sea transport for example – were covered by clear non-discriminatory rules in the WTO”.

7.2 While these statements are encouraging, no change will take place unless the industry pushes for the necessary adjustments to be made. ICC, therefore, calls on all interested parties to actively pursue the liberalization of air cargo services at national, regional and international levels.