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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
2.1: Air carrier ownership and control

LIBERALIZATION OF AIRLINE OWNERSHIP AND CONTROL FOR DEVELOPING NATIONS

(Presented by Barbados)

SUMMARY

This paper examines issues and policy options related to the liberalization of airline ownership and control for developing nations in an economic grouping of States as an advancement of the liberalization already taken under the Community of Interest Principle.

Action by the Conference is in paragraph 5.

REFERENCES

Doc 9587, *Policy and Guidance Material on the Economic Regulation of International Air Transport*

Report of the Air Transport Regulation Panel Working Group on Air Carrier Ownership and Control

ATConf/5-WP/7, Liberalizing Air Carrier Ownership and Control

(5 pages)
ATConf.5.WP.48.en.wpd

1. INTRODUCTION

1.1 The importance of commercial aviation to economies of all sizes is unquestionable. However, that importance is magnified when that economy is heavily dependent on tourism or trade in goods or services by air as is the case with many developing nations. Such nations therefore become heavily dependent on the presence of efficient and profitable commercial air carriers in order to ensure growth.

1.2 However, these States which are so dependent on the presence of air carriers are also the least likely to have the financial resources to finance the operations of the much needed airlines either through government subsidy or from domestic money markets and investors. This restricted access to capital is not a reflection of the unsuitability of carriers based in the developing world to attract additional investment, but is rather as a result of the restrictions imposed by existing airline ownership and control rules.

1.3 These facts have already been recognized by ICAO and form the rationale for the Community of Interest Principle as set out in ICAO General Assembly Resolution A32-17, which was originally recommended as Resolution A24-12. However, the difficulty associated with the Community of Interest Principle is that, while it widens the pool of possible investors which can legitimately invest in a "community air carrier", it bands together groups of nations which both singly and collectively have very limited resources to devote to aviation.

1.4 With globalization opening up new markets for trade in goods and services in worldwide, the time is now right for the Community of Interest Principle to be revisited so as to ensure that developing nations are able to fully benefit from these new markets. Accordingly, this paper discusses ways in which the rules governing airline ownership and control can be further liberalized to the benefit of these developing nations.

2. DISCUSSION

2.1 In many developing nations, tourism continues to make a disproportionate contribution to the Gross Domestic Product of these nations when compared to tourism contribution to the GDP of developed nations. Yet despite this contribution and the obvious role which airlines play in determining the important role of tourism, there are very few profitable airlines based in these developing nations.

2.2 As an examination of their competitors from the developed world would show, the limited number of profitable air carriers from the developing world is not as a result of the absence of access to profitable routes, but rather is a result of the under capitalization of these airlines from their inception. This initial under capitalisation is carried forward throughout the life of the carrier as a result of the limiting of the pool of potential investors consequent on restrictive substantial ownership and effective control rules.

2.3 In many cases the traditional Government owned flag carrier has been forced from the marketplace, not only as a result of administrative and operational inefficiencies, but also as a result of the inability of developing nations to finance these carriers over other developmental priorities such as education, health care and other social and infrastructural needs. The inability of national airlines to meet their financing requirements from their Government is perpetuated when these airlines seek to obtain financing from domestic investors with limited funds who have to chose between investment in a national air carrier or investment in other ventures both nationally and internationally. As an investment opportunity, aviation must compete for investor funds against international investment opportunities in many other economic sectors, which do not suffer from restrictive substantial ownership and effective control measures.

2.4 The result is that airlines based in the developing world must resort to seeking investment capital from a limited pool of investors with inadequate resources to invest. Alternatively, these carriers must seek loans on the international market at an unacceptable cost which, rather than improving the carrier's financial position is likely to worsen that position in the long term. Opportunities for the sourcing of venture capital are also limited as the restrictions on ownership and control can limit repayment options and increase the cost of the capital.

2.5 Difficulties associated with the sourcing of investment capital are only partially rectified by the application of the Community of Interest Principle. For, while the Community of Interest Principle introduces the concept of a community carrier and widens the market access of such a carrier, it only expands the pool from which capital can be drawn amongst developing nations in similar economic circumstances. Indeed, analysis of those carriers from developing nations, which have benefited from the Community of Interest Principle, will demonstrate that these carriers have not benefited from improved access to investment capital. Furthermore, while their market access has been expanded, the ability of carriers from developing nations to exploit these new opportunities has been severely limited by their continuing under capitalisation as a result of limited access to investment capital.

2.6 The relaxation of airline ownership rules and increased market access together with easy access to investment capital can lead to substantial improvements in efficiency, profitability and consumer benefits as has already been demonstrated within the European Union (EU). Within the EU, "community carriers" have not only the opportunity to exploit liberalized aviation market existing in Europe but also, more importantly, access to a large and diverse investment community able to finance route expansion and equipment acquisition.

2.7 In addition to the strengthening of the financial and competitive position of carriers based in developing nations as a result of the influx of investment capital which can result from relaxed rules with respect to airline ownership, increased flows of investment capital can also help to improve the safety oversight of these carriers. Greater access to and cheaper investment capital will lead to an acceleration of fleet renewal in the developing world with a resulting diminution of safety issues related to aging aircraft as well as environmental concerns associated with emissions and noise.

3. AN APPROACH TO LIBERALIZATION OF AIRLINE OWNERSHIP AND CONTROL

3.1 Restrictive airline ownership clauses and aircraft registration clauses have limited the ability of airlines from developing nations to attract investment which has in turn affected their capacity to effectively compete on existing routes or to fully exploit new market opportunities which have arisen as a result of either the Community of Interest Principle or liberal bilateral agreements. In order to ensure that carriers from developing nations can more fully exploit the benefits to tourism and trade to be derived from commercial aviation, there needs to be:

a) relaxed rules pertaining to airline ownership; and

b) relaxed rules pertaining to the basis for establishing effective control.

3.2 With respect to a), the revising of airline ownership control rules to permit the only basis for acceptance of designation under a particular air services agreement should be revised to specify that for a developing nation no more than 25% of the share ownership of the airline needs to be held by the nationals of the country giving the designation.

3.3 In terms of b), the relaxing of the rules pertaining to effective control to provide that the only basis for establishing effective control should be that the principal place of business exists within the territory of the designating State. Guidelines for establishing the principal place of business of a carrier have been set out in the draft model clause of the Template Air Services Agreement (TASA) in ATConf/5-WP17 as Article X: Designation and authorization.

3.4 These new rules would provide carriers from developing nations with an increased access to international sources of capital and thereby give them the ability to effectively compete and exploit new market opportunities.

4. CONCLUSIONS

4.1 The Conference is invited to conclude that:

a) Due to its role as a facilitator of international trade in goods and services, particularly tourism, civil aviation holds important significance for developing nations and has the potential to significantly improve, both directly and indirectly, the economic prospects of a developing nation. The benefits to a developing nation of commercial aviation are disproportionate when compared to developed nations.

b) Developing nations are the least likely to be in a position to make the extensive and sustained capital investments, whether through domestic public or private sources, which are required in order to ensure the operation of efficient and dynamic air carriers. At the same time these carriers are restricted from pursuing foreign capital by existing rules regarding substantial ownership and effective control of a designated airline.

c) The Community of Interest Principle has given carriers from developing nations which are part of an economic grouping important flexibility in terms of airline designation as well as improved market access. In addition, the provisions of some of the more liberal bilateral agreements entered into by developing nations in recent years have increased market access. However, banding together of equally financially restricted nations has negated much of the benefits to be accrued from the provisions of the principle or some of the more liberal bilateral agreements as lack of finances has prevented full exploitation of new market opportunities.

d) Further Liberalization of rules regarding substantial ownership and effective control of airlines of developing countries will permit such airlines to compete more effectively by improving their ability to exploit market access opportunities thus significantly improving commercial viability.

e) The rules regarding substantial airline ownership should be relaxed to provide for the acceptance of the designation of carriers from developing nations where at least 25% of share ownership vested in the nationals of the designating country.

f) The rules in relation to effective airline control should be relaxed to provide that the principal place of business located in the designating country should be the only requirement for determining the effective control.

g) The new substantial ownership and effective control rules proposed will not only improve the financial condition of the airlines from the developing world, but would also act to indirectly improve aircraft safety and reduce the environmental costs associated with aging aircraft fleets in the developing world due to an increased rate of fleet renewal consequent on enhanced access to capital.

5. ACTION BY THE CONFERENCE

5.1 The Conference is invited to:

a) review the conclusions in paragraph 4.1 a) to g); and

b) adopt the conclusions in paragraph 4.1 a) to g).

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