

**WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND
OPPORTUNITIES OF LIBERALIZATION**

Montreal, 24 to 29 March 2003

Agenda Item 1: Preview

1.1: Background to and experience of liberalization

**THE PACIFIC ISLANDS AIR SERVICES AGREEMENT (PIASA):
PHASED DEVELOPMENT OF A SINGLE AVIATION MARKET IN THE PACIFIC**

(Presented by the Pacific Islands Forum Secretariat)

INFORMATION PAPER

SUMMARY

The Pacific Islands Air Services Agreement (PIASA) was developed at the request of Ministers through the 1998, 1999, and 2001 Forum Aviation Policy meetings. The final text was agreed by Forum island country representatives at Vava'u, Tonga on 30 October 2002 and is expected to be signed by Forum Leaders at their annual meeting in August 2003.

This paper explains the rationale for the initiative, outlines the expected benefits of an eventual agreement, responds to some of the issues that have been raised in other fora, and describes next steps for continued development of the single aviation market for the Pacific.

1. BACKGROUND

1.1 When Forum Aviation Ministers held their first Aviation Policy Meeting in 1998, they identified two main issues as important for the region. First were the problems created by the numerous bilateral air service agreements that are needed between member countries. Second was the need to adapt to the changing world situation with respect to globalization and trade agreements.

1.2 Since that time, liberalization has progressed in many sectors. In particular, trade integration has been developed as a regional strategy for responding to globalization and provides an opportunity for the region to prepare their economies to be more efficient through increased economies of scale, before they are subjected to the rigours of full global competition.

1.3 The need for regional trade liberalization is now fully recognised by Leaders. Forum Trade Ministers endorsed a trade initiative comprising PACER (Pacific Area Closer Economic Relations) and PICTA (Pacific Island Countries Trade Agreement) in June 2001 that was opened for signature by Forum Leaders when they met in Nauru in August 2001. PACER is an umbrella agreement covering all 16 Forum members. Beneath this, PICTA is a free trade agreement that covers the 14 FICs.

1.4 The aviation sector is also liberalizing worldwide. Global regimes of regularly negotiated bilateral air service agreements are being superseded by an environment featuring liberalized operating environments.

1.5 In some respects the aviation sector in the region is already benefiting from these developments, but in other areas it lags behind. The 14 island members of the Forum are parties to 67 bilateral air services agreements, 25 of which are between FICs only. This proliferation of agreements has made gaining multiple international route approvals in the Pacific region a difficult and time-consuming task and is believed to have acted as a brake on multi-destination tourism, inward investment, and industry development.

1.6 There are many areas in which benefits are expected as the current system of 25 inter-FIC bilateral agreements is replaced by a unified multilateral agreement, including:

- a) expanded inter-island tourism and reinforced thinner regional air routes;
- b) maintenance and improvements in safety standards;
- c) increased FIC airline access to air routes between FICs;
- d) expansion and efficiency improvements for FIC airlines;
- e) greater use of code sharing and alliances;
- f) greater cargo options for exporters and importers; and
- g) cost savings to airlines which can be shared with users.

1.7 The Pacific Islands Air Services Agreement (PIASA) is designed to gradually replace the existing system of bilateral air services agreements between FICs with one agreement to cooperatively liberalize air services.

1.8 The PIASA sets out an ambitious, but achievable, programme that will deliver long term benefits to the island economies. It will do so by creating a regulatory framework that will equip the FIC airlines to operate in an increasingly competitive global and regional commercial environment.

2. ISSUES

2.1 The issues surrounding PIASA have been covered widely in various fora, although only a partial picture has been presented. A full summary of the main features of the draft PIASA and its expected benefits are outlined below.

2.2 In the emerging global system, smaller governments do not have the resources or the power to deliver the protection to air services that they could previously. Adaptation to market forces has become essential. Codesharing and market consolidation are creating a totally new operating environment, where some smaller airlines risk being marginalised and eventually excluded from the market. PIASA is designed to support the airlines of the Pacific region in adapting to coming changes and to proactively take hold of the opportunities offered, rather than to rapidly react to changes forced upon them.

2.3 The PIASA is intended to provide, through the creation of a Forum Island Country Single Aviation Market, a gradual, staged process which will assist in the strengthening and growth of FIC airlines. The PIASA aims to place the control of change in the hands of FICs rather than having changes forced upon FIC airlines at a pace determined by external factors. The intention is to give Pacific airlines a basis from which to grow and expand, in an environment where large international airlines are prohibited from competition. The PIASA will provide incentives for Pacific airlines to expand their sphere of activity and to take advantage of the benefits of alliances and cooperation.

2.4 The PIASA allows FIC airlines to develop within the region first, and to establish stronger relationships with the major airlines and alliances. The intention is to strengthen Pacific airlines so they can eventually survive in a market with larger international carriers at the end of the adjustment phase. The three phases of PIASA apply only to services between the Forum Island Countries. It does not apply to air services between FIC and non-FIC countries (which will continue to be governed by bilateral agreements), nor does it give any additional rights to airlines designated by non-FIC countries. For these reasons, the initial impact within FICs is expected to be small, allowing gradual adjustment.

2.5 The PIASA places great importance on implementation, through three stages of increasing liberalization. The unique step-by-step scheme describes a gradual process designed to allow governments and airlines to adapt as the system is introduced incrementally. These phases are designed to show how FICs can help support the smaller airlines to survive in a very competitive marketplace.

2.6 This phasing process addresses two main issues:

- a) progressive liberalization of market access, moving in the second step to unlimited internal Fifth Freedom operations between the island states and, in the final phase extending to allowing beyond Fifth Freedom rights where the third country involved permit it; and
- b) relaxation of restrictions on national ownership of airlines – and in particular in terms of limited access to capital funding, where the FICs' national economies are so small. The requirement for national “substantial ownership and effective control” of designated airlines had become an immense handicap to effective operation in a now-cutthroat

marketplace. The difficulties of raising private funding in one country effectively meant that only government-ownership could provide the necessary support.

3. PHASING

3.1 Under Stage 1, the “Initial phase”, which commences six months after the Agreement comes into force, “The designated airlines of one Party may operate scheduled services to and from the territory of another Party (3rd and 4th Freedoms), and between the territories of Parties via the territory of their own Party (6th Freedom)”.

3.2 This is extended under Stage 2, 12 months after coming into force, to an “Internal Single Aviation Market”, when access is extended to include 5th Freedom operations among the FICs, that is “designated airlines of any party to the Agreement are entitled to operate scheduled 3rd, 4th, 5th, 6th Freedom services between territories of all parties to this Agreement”.

3.3 Stage 3, the “Full Single Aviation Market” commences 30 months after the Agreement comes into force. This extends the market to include 5th Freedom services with Australia and New Zealand, if those countries choose to accede to the agreement. There is provision for other countries, subject to the relevant bilateral agreements, to also accede.

4. OWNERSHIP AND CONTROL

4.1 There are two phases for the transition to what is effectively a community ownership and control regime, the first after 6 months' effectiveness and the second after 30 months.

4.2 Stage 1 permits designation where the designated “airline is substantially owned and effectively controlled by one or more of the Parties to this Agreement and/or their nationals”. This stage also gives a signal of the subsequent broader regime by permitting a state with no existing flag carrier to designate another country's airline, so long as “its place of residence and principal place of business (is) in the territory of the designating Party”.

4.3 There is no change under Stage 2, but by Stage 3, an option is provided, extending the earlier use of place of residence and business to all FICs. Thus, the Agreement permits designation subject the airline being:

- a) substantially owned and effectively controlled by one or more of the Parties to this Agreement and/or their nationals; or
- b) (having) its place of residence and principal place of business in the territory of the designating Party.

4.4 Making cross-ownership permissible by removing the requirement for substantial ownership and effective control in any single Forum Island country also opens up the potential for rationalisation of airline ownership, hand and hand with the more flexible route networking. Thus, with the relaxed ownership and route access rules, a double opportunity exists to entrench sustainable airlines and air services.

5. OTHER FEATURES

5.1 Many of the clauses contained in the PIASA appear in various bilateral and multilateral agreements that have been developed in recent years, so are not expected to be controversial. Important protective measures include:

- a) staged implementation with protection for FIC during adjustment phases;
- b) maintenance of current safety and security requirements;
- c) allowance for codesharing and alliances;
- d) mechanisms for consultation, amendments and review;
- e) rules for fair competition and pricing;
- f) allowances for transparent subsidies to ensure maintenance of social services; and
- g) dispute settlement mechanisms.

5.2 A vital feature of a multilateral open system or Single Aviation Market is the removal of government intervention in commercial decisions, implying generally increased levels of competition between airlines.

5.3 For a fragile airline system it is important however to avoid such practices as predation and capacity dumping. Annex 2 of the Agreement provides some assistance in this respect by setting out “Indicators of possible Unfair Competitive Conduct”. Annex 3 then offers guidelines for dispute resolution, in support of the clauses in the main Agreement.

5.4 Growth of the aviation market in the region is expected in several ways. The PIASA will allow airlines access to foreign capital sources through changes to the ownership and control provisions, give greater access for smaller carriers to the Single Aviation Market between the FICs, and stimulate market growth by allowing innovative pricing. For each country in the region, the potential loss of revenue to the national airline caused by the grant of new rights is just as likely to be offset by the expected increase in traffic between all FICs.

5.5 PIASA has not been designed as the complete answer to air transport problems in the Pacific. It is however, one component, along with issues such as infrastructure constraints (especially hotels), which are holding back growth.

6. IMPLEMENTATION

6.1 The pre-negotiation draft PIASA was developed by the Secretariat drawing on external expertise. It incorporates the instructions of Forum Aviation Policy Ministers in 1998, 1999 and 2001; visits and discussions with governments and airlines; the issues covered in bilateral agreements that member countries have entered; and relevant international developments.

6.2 Negotiations on the content of the PIASA concluded in October 2002, during which time the pros and cons of the specific clauses were investigated. The Forum Secretariat provided technical assistance and a facilitator for the PIASA negotiations.

6.3 Aviation Ministers of Forum member countries are expected to meet in mid-2003 to formally recommend the PIASA to their governments, and to forward the final agreement for signature at the annual Forum Leaders' meeting in August 2003.

6.4 Development of PIASA should not be seen in isolation, but should be incorporated in broader strategies (such as tourism infrastructure development and trade liberalization) to ensure that the potential benefits of greater air access are genuinely achievable.

6.5 Consultation between stakeholders is an important aspect of implementation. Governments, airlines, tourism industry, and airfreight users are among those who have interests in the outcomes.

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