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International Civil Aviation – All Together or All Against All?

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1. Introduction

International civil aviation has without doubts worked as one of the strongest drivers of globalization for the past 30 years. It is paradoxical that although it helped liberalize multiple industries, the aviation sector itself remains highly protectionist, governed by 60-year-old framework of the Chicago conference.

In 1944, United States of America organized an inter-governmental conference in Chicago. The aim was obvious: to create a liberal international aviation regime, where all the airlines from all the countries of the world would have the same rights and would be able to operate scheduled flights between any major airports without restrictions. Unfortunately, this attitude wasn't shared by the majority of participants. A group of mainly European countries led by the United Kingdom preferred a more protectionist structure. The aviation infrastructure of European countries had been severely damaged in the Second World War – therefore, they felt a liberal regime would serve the interests of the United States and would increase their dominance in civil aviation. Thus, since the Chicago conference, economic structure of international civil aviation has been based on bilateral air service agreements (ASAs).

Scheduled air transportation services can only be operated between countries that have signed an ASA. ASAs contain a set of rules valid for air transport between the two signatory countries: they specify permitted routes, designate airlines, set capacity, frequency and pricing restrictions. As every country-pair in the world needs to have an ASA to establish aviation relations and every ASA is a separate treaty containing different combination of provisions, the system based on ASAs is very robust and complicated. If we take into account that there are approximately 200 countries today we come to a total of 20,000 agreements needed for trouble-free aviation relations between all the countries!

The nature of air transport agreements ranges from very restrictive to completely liberal. The most important factor in determining how liberal an ASA is, is market access. Market access is granted in terms of “freedoms of the air”. There are nine freedoms of the air. The first two of them – also called “technical freedoms” – are included in all the ASAs and they constitute a right of an airline from the first country to overfly or to make a technical stop in another country. Freedoms three-

five are “commercial freedoms”. They include a right to carry passengers from the home country to another country and back, and the right to carry passengers from the home country to another country with a stop in a third country. Freedoms six-eight are combinations of the first five freedoms. The ultimate freedom is called cabotage: it is a right of an air carrier to operate independent domestic flights in a foreign state.

The freedoms of the air are shown in the following table.

Table 1: The freedoms of the air

<i>Technical freedoms</i>		
1 st freedom	To overfly one country en-route to another country.	B
2 nd freedom	To make a technical stop in another country.	B
<i>Basic commercial freedoms</i>		
3 rd freedom	To carry PCM from the home country to another country.	A-B
4 th freedom	To carry PCM to the home country from another country.	B-A
5 th freedom	To carry PCM from the home country to another country, then continuing to a third country.	A-B-C
<i>Derived freedoms and cabotage</i>		
6 th freedom	To carry PCM between two foreign countries with a stop in the home country.	B-A-C
7 th freedom	To carry PCM between two foreign countries without a stop in the home country.	B-C
8 th freedom	To carry PCM from the home country to another country, then continuing to another airport in the same country.	A-B-B
9 th freedom	Cabotage.	B-B

A – home country, B a C – foreign countries

PCM – passengers, cargo and mail

ASAs differ in number of freedoms granted. The more freedoms they include, the more liberal they are. Technically, an ASA containing all nine freedoms would imply a common aviation market between the signatory countries.

2. Partial liberalization and its effects

Until 1978, almost all ASAs were restrictive in terms of market access, that is, points to be served, and capacity and price controls.¹ They used to include only first to fourth freedoms, designate single airline and set strict limits on capacity and tariffs. The driver of change was – as in many other cases – the United States. First, the Carter administration liberalized domestic US market, by allowing every US-

¹ DOGANIS, R.: The Airline Business, 2006. P. 29.

owned airline to operate air transportation services between any city pair within the USA. Economists from the Brookings Institution and George Mason University have estimated that consumers save some \$19.4 billion per year thanks to the lower fares resulting from a competitive airline marketplace.² In the same year the administration started signing liberal ASAs with like-minded countries including the Netherlands, Belgium and Germany. R. Doganis calls these “open market” agreements.³ They set new rules on market access and eliminate capacity and frequency restrictions. In the field of price-setting, open market agreements introduce the concept of double disapproval – proposed tariffs become operative unless they are rejected by both governments (as opposed to the double approval method used in pre-1978 ASAs).

In Europe, aviation markets were protected and fragmented, dominated by state-owned carriers and airports. This began to change in mid-1980s thanks to an effort of the European Commission and a 1986 decision of the European Court of Justice. The change has been brought about by means of so-called “three liberalization packages,” approved between 1987 and 1992. The path of regulatory reform culminated with the creation of a single aviation market in 1997. The reform introduced a concept of “community carriers” – all the airlines licensed and owned by a EU-citizen have equal rights to provide aviation services anywhere in the EU, including cabotage. Later, the single market was extended to include Norway, Switzerland and Iceland.

In 1992, the US government decided to bring liberalization of its international aviation relations to a higher level by starting to conclude “open skies” agreements. This inaugurated a new phase of international deregulation. The key elements of “open skies” agreements were as follows:⁴

- open route access – airlines from either signatory country can fly to any point in the other with full traffic rights;
- multiple designation of airlines;
- unlimited fifth freedom rights;
- no frequency or capacity control;
- no tariff controls (unless tariffs are too high or too low);
- airlines free to code share or make other commercial agreements.

Since 1992, the United States government has signed almost 100 open skies agreements with countries all over the world.⁵ It has become a template to follow and many other countries have changed their ASAs to comply with the open skies

² POOLE R. – BUTLER, V.: *Airline Deregulation...*, 1998. P. 6.

³ DOGANIS, R.: *The Airline Business*, 2006. P. 32-37.

⁴ DOGANIS, R.: *Flying Off Course*, 2007. P. 62.

⁵ For an up-to-date list see: http://ostpxweb.dot.gov/aviation/X-40%20Role_Files/bilatosagreement.htm .

rules. However, the majority of bilateral ASAs are still restrictive: for each liberal ASA there are at least 5-10 restrictive ones.

The most recent example of liberalization tendencies is the US-EU Open Skies Air Transport Agreement in force from March 2008. The two regions, being the two largest air transport markets in the world and accounting for more than half of all global scheduled passenger traffic⁶ opened the North Atlantic market to greater competition. The agreement allows all EU and US air carriers to fly from any point in the EU to any point in the USA, removes restrictions on air fares, allows airlines more freedom to cooperate in marketing arrangements such as leasing, code-sharing etc. Thus, it is an important step on the way towards full liberalization of the North Atlantic air transport market. Various studies predict it will generate 26 million additional passengers, 72,000 new jobs, bring a consumer surplus worth up to €12 billion,⁷ etc. To sum up, the three main efficiency effects will be cost savings, price reductions and output expansion.⁸

However, except for intra-European common aviation market, even the most liberal ASAs stop short of full liberalization. US-EU Open Skies Agreement is no exception.

3. Obstacles on the way towards full liberalization

We identify three crucial obstacles on the way towards full liberalization:

- Nationality clauses – almost all the ASAs contain a nationality clause stating that “only airlines that are substantially owned and effectively controlled by nationals of the signatory state can operate direct service between signatory states.”⁹ For example, Air France (as a French-owned airline) is not allowed to operate a direct service from Germany to Canada. Nor is Lufthansa (as a German-owned airline) allowed to operate direct service from France to Canada.
- Investment restrictions – foreign ownership of airlines is restricted. Usually laws don’t allow airlines to sell the majority of their shares to foreign companies. In the European Union, the limit is set to 49%, that is, the majority share has to be controlled by European citizens. In many countries of the world the limit is even lower – the United States keeps it down at 25%.

⁶ ALFORD, E. – CHAMPLEY, R.: The Impact of the 2007 U.S.-EU..., 2007. P. 1.

⁷ Brattle Group: The Economic Impact of an EU-US Open Aviation Area, 2002. P. i.

⁸ ROBYN, D. – REITZES, J. – MOSELLE, B.: Beyond Open Skies..., 2005. P. 58.

⁹ Ibid. P. 55.

- Restricted cabotage – cabotage is a right of an airline to operate domestic flights in a foreign country. For example, Mexicana (as a Mexican-owned airline) would be allowed to operate flights between two US cities. Thus, cabotage is the highest level of air transport liberalization. It is restricted in 99 percent of ASAs. The only noteworthy exceptions are internal market of the European Union and a bilateral agreement between Australia and New Zealand.

What are the reasons behind these obstacles? After a thorough analysis we divide them into four groups.

1. National security issues

National security is a primary goal of governments everywhere in the world. Aircrafts, airports and the whole aviation infrastructure are a vital part of war-time strategies of every country. Therefore, governments tend to restrict access to these only to domestic investors.

One of the best examples can be found in the United States – a program called Civil Reserve Air Fleet (CRAF). As a part of this program “selected aircraft from U.S. airlines [...] support Department of Defense airlift requirements in emergencies when the need for airlift exceeds the capability of military aircraft.”¹⁰ The program is voluntary. However, the airlines that decide to participate get a lucrative access to government-funded traffic. Currently more than 1,300 aircraft from all the major US carriers are enrolled in the program.¹¹ The Department of Defense (DOD) officials are concerned that loosening foreign investment restrictions might have negative impacts on the willingness of US airlines to participate in the CRAF, especially in case they will be owned by foreign companies. Therefore the DOD is likely to block all the attempts to liberalize investment rules.

Currently there are more than 19,000 airliners in service. Boeing predicts this number will almost double in the next 20 years.¹² Supposing average capacity of an aircraft is 100 passengers and applying simple mathematics we come to a total capacity of more than 3 million people in 2027. This means if a single country was to own all the aircrafts it would be able to transport more than 3 million soldiers on a daily basis. Such a power constitutes a serious global threat. Although the situation is clearly hypothetical, it is taken into account by national governments when deciding about liberalizing ownership rules.

Another potential security issue of air transport is terrorism. As demonstrated on 9/11/2001, civil aircraft may be used as a weapon of mass destruction. To minimize

¹⁰ US Air Force: <http://www.af.mil/factsheets/factsheet.asp?id=173>

¹¹ Ibid.

¹² Boeing: Current Market Outlook 2008-2027, 2008. P. 3.

the risk of terrorism countries seek to execute the highest level of control possible over the airlines. This implies not allowing foreign ownership of airlines and including nationality clauses in ASAs.

2. Economic security

All countries view aviation as vital to their national economic well-being. It enables personal contact between distant regions and movement of persons, cargo and mail between any points in the world within 24 hours. Disruption of air transportation in a country could have serious effects on the national economy, especially if we take into account that in some markets air transport provides for more than 35% of the value of trade. Moreover, some goods (like hi-tech products or perishable goods) can only be transported by air.

Some of the most intensive opposition to liberalization of ownership rules comes from labor unions. Their members have a legitimate fear of possible discrimination by foreign airlines. Exactly as in other industries, investors routinely seek to employ the cheapest laborers. For example, airlines could consider hiring Thai flight attendants instead of Japanese or American workers, because Thai workers can be paid up to 90% less.¹³ In this manner opening the labor market in aviation will lead to huge job losses in developed countries.

A general rule states that liberalism prevails in times of welfare and economic growth, whereas hard times always wake up protectionist tendencies. These days are no exception. Economic security concerns will almost surely intensify as a result of the current global crisis. It is hard to imagine a government that would open access to its air transport market in times of economic insecurity.

3. Safety

Another important obstacle are safety concerns of Western countries. Nationality clauses and other protective measures in ASAs prevent the emergence of “flags of convenience.” In the current regulatory system airlines have a clear national identity determined by the identity of their majority shareholder. Thus, every aircraft has to be registered and licensed in the country of its owner. If ownership rules were to be loosened, airliners could be registered in any country in the world. This would lead to an emergence of so-called open registries as we know them from maritime transport – countries like Liberia or Panama would set attractive technical rules and low taxes in order to have foreign owners register aircrafts in their national registries. As a result of this many experts warn that “changing the ownership rules may lose protection from flags of convenience, with companies able to escape safety regulations and labor laws.”¹⁴ On the other side of the debate, advocates of liberalization analyze the situation in maritime transport and come to a conclusion that open registries have no adverse impacts on safety.

¹³ WARDEN, J.A.: *Open Skies at a Crossroads...*, 2003. P. 251.

¹⁴ CHANG, Y. – WILLIAMS, G.: *Changing the Rules...*, 2001. P. 208.

4. National pride

National carriers, also called flag carriers, are an important element of national pride of many countries in the world. For the biggest part of the 20th century civil aviation was funded and organized by governments and every country had its own national carrier. Although the situation today is different and the largest airlines are no longer directly controlled by governments, the merits remain the same: Lufthansa is still considered a part of German national pride; Air France is one of the most influential French companies; Qantas is as Australian as ever. In many parts of the world it is unimaginable that a “flag carrier” might be sold to foreign investors.

As a result of the four factors mentioned, countries are unwilling to open international aviation markets to competition and tend to protect their national carriers, even if they show low productivity level and their survival is economically doubtful.

Conclusion

Most aviation experts agree that nationality rules and investment restrictions have become obsolete in a globalized economy. However, the opinions of these experts differ from opinion of general public and from policies followed by the majority of world governments. We identified various reasons accounting for this fact. Probably the most important of them are national security issues, economic protectionism, safety concerns and national pride. The world is not governed by a single power that would try to maximize global welfare. Rather the world consists of 200 countries, each of them following the goals of its own.

Taking into account all the factors mentioned we do not foresee an era of intergovernmental cooperation in the field of civil aviation. There are various evidences that support our claim:

- There has been a single attempt to liberalize air transportation on global level – the Chicago conference of 1944. After its failure to achieve a worldwide open aviation area no further attempts have been made, not even within the framework of International Civil Aviation Organisation (ICAO).
- General Agreement on Trade in Services (GATS) specifically excludes air transport from its agenda.
- The United States – as the largest aviation market in the world and former driver of change – doesn’t seem to be interested in air transport liberalization any more. The Obama government has made clear signals it is not willing to revoke restrictions in foreign ownership of US airlines.

- Currently the only world region willing to advance with liberalization of air transport is the European Union. In the atmosphere of global crisis it will not achieve its objectives and protectionism will prevail.

Therefore civil aviation of the next decade will still be marked by an “all against all” structure. Where unity us unachievable ambivalence wins.

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