



## SYMPOSIUM ON THE LIBERALIZATION OF AIR TRANSPORT IN ASIA/PACIFIC A GOVERNMENT AND INDUSTRY DIALOGUE

(Shanghai, China, 25-27 May 2005)

### REGULATORY AND INDUSTRY OVERVIEW

(Presented by ICAO)

#### 1. INTRODUCTION

1.1 For the past decade, there have been significant developments in the air transport regulatory scene and in the airline industry. Much progress has been made in the liberalization of international air transport regulation with an increasing number of States being parties to arrangements towards full market access. At the same time, the airline industry has witnessed major structural transformation, inter alia, through alliances, mergers and acquisitions in order to cope with an increasingly competitive environment. This paper provides a brief global overview of regulatory and industry trends and developments that have taken place in recent years, primarily in the context of market access. The **Appendix** summarizes the air passenger traffic links in the region as well as bilateral air services agreements registered with ICAO.

#### 2. REGULATORY DEVELOPMENTS

2.1 **International Air Services Transit Agreement.** Although most international air services operate under bilateral or regional regimes, the International Air Services Transit Agreement (IASTA), which provides for the multilateral exchange of rights of overflight and non-traffic stop for scheduled air services among its Contracting States, has made an important contribution to the development of international air transport. The Agreement is a cornerstone of multilateralism in air transport. The number of Contracting States which are parties to the IASTA increased from 99 in 1994 to 122 as of May 2005, but more than one-third of ICAO Contracting States, including several with large land masses, remain outside the Agreement. Assembly Resolution A35-18 Appendix A “Urges Contracting States that have not yet become parties to the International Air Services Transit Agreement (IASTA) to give urgent consideration to so doing”. The fifth Worldwide Air Transport Conference (ATConf/5) recognized IASTA's contribution to the sound and economic development of air transport to the States which are parties to it and reaffirmed its importance for liberalization and for multilaterally developing the air transport system.

2.2 **Bilateral liberalization.** Bilateral air services agreements are still the prevailing approach used by States in expanding international air transport services. During the period from 1995 to 2004, about 800 bilateral air service agreements (including amendments or memoranda of understanding) were reportedly

concluded. Over 70 per cent of these agreements and amendments contained some form of liberalized arrangements such as unrestricted traffic rights (covering Third, Fourth and in some cases Fifth Freedom rights), multiple designation with or without route limitations, free determination of capacity, a double disapproval or country-of-origin tariff regime, and broadened criteria of air carrier ownership and control. As the airline business evolves, some of the more recent bilateral air service agreements have included provisions dealing with new types of commercial activities, some of which have market access implications, such as computer reservation systems (CRSs), airline codesharing, leasing of aircraft and intermodal transport.

2.3 One notable development is the considerable increase in the number of “open skies” agreements, which provide for full market access without restrictions on designations, route rights, capacity, frequencies, codesharing and tariffs. The first such agreement was concluded in 1992 between the Netherlands and the United States. Since then, 102 “open skies” agreements were concluded, involving 79 States, with the United States being one of the partners in 65 cases. These agreements involve not only developed countries but also an increasing number of developing countries (about 65 per cent). In addition to the basic market access elements, 63 agreements also grant “Seventh Freedom” rights for all-cargo services (five agreements also granting this right for passenger services). Twenty-five of the “open skies” agreements concluded by the United States have a transition annex that places limits on or provides for the phase-in of, inter alia, frequencies, Fifth Freedom rights, Seventh Freedom rights for all-cargo, third-country codesharing, charter services, and ground handling, some of which are applied only to United States carriers.

2.4 **Regional and plurilateral liberalization.** Some agreements negotiated in recent years have sought to liberalize air transport services on a regional or sub-regional basis or amongst a group of like-minded States. The regional and/or plurilateral liberalization arrangements have the basic objective of providing greater market access and improving services amongst the member States concerned. Small groups of States of comparable size and development would find it easier to agree on market access than larger, diverse groups of States. The small groups would also provide a more manageable environment to test liberalized air transport policies.

2.5 Before the fourth Worldwide Air Transport Conference (ATConf/4) in 1994, there were just two such regional arrangements, namely the European Union (EU) — single market completed by 1997 with 15 member States and three States belonging to the European Economic Area (EEA), joined by Switzerland through bilateral agreements in 2002, and expanded to include another ten member States in Central, Eastern and Southern Europe in 2004 — and the Andean Pact involving five States in South America. Since 1995, eight more regional arrangements have emerged with a worldwide dispersion. They include:

- a) the Caribbean Community (CARICOM) Air Service Agreement amongst 15 States in the Caribbean (1996, entry into force in 1998 for nine States);
- b) the Fortaleza Agreement amongst six States in South America (1997);
- c) the Banjul Accord amongst six States in Western Africa (1997, a separate more liberal multilateral agreement was signed among seven States in 2004);
- d) the CLMV Agreement by Cambodia, Lao People’s Democratic Republic, Myanmar and Viet Nam (1998, a formal multilateral agreement was signed in 2003);
- e) the Intra-Arab Freedoms of the Air Programme amongst 16 States of the Arab Civil Aviation Commission (ACAC) in the Middle East and Northern Africa (1999);
- f) an agreement amongst the six States of the Economic and Monetary Community of Central Africa (CEMAC) (1999);

- g) an agreement amongst the 20 States of the Common Market for Eastern and Southern Africa (COMESA) (1999); and
- h) the Yamoussoukro II Ministerial Decision amongst 53 African Union States (1999, entry into force in 2000).

Of these ten agreements, seven provide for instant or phased-in liberalization leading to full market access. In addition, there are two area-specific agreements covering IMT-Growth Triangle region by Indonesia, Malaysia and Thailand (1999), and BIMP-East ASEAN Growth Area region by Brunei, Indonesia, Malaysia and Philippines (1999).

2.6 At the plurilateral level, the Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT) known as the “Kona” open skies agreement was signed in 2001 by five like-minded members of the Asia-Pacific Economic Cooperation (APEC) (i.e. Brunei, Chile, New Zealand, Singapore and the United States). It is open for adherence by other members of APEC as well as non-member States. Peru, Samoa and Tonga subsequently joined the agreement (Peru withdrew in 2005). In 2004, Brunei, Singapore and Thailand signed two Multilateral Agreement — one on the Full Liberalization of All-Cargo Services and the other on the Liberalization of Passenger Air Services — both of which are open to other member States of the Association of South East Asian Nations (ASEAN).

2.7 Several potential arrangements are also in the pipeline, for example, a common air transport programme amongst eight States of the Economic and Monetary Union of West Africa (WAEMU); a Pacific Islands Air Services Agreement (PIASA) amongst 16 States of the Pacific Islands Forum; an ASEAN Economic Community amongst ten member States of the ASEAN; an Open Aviation Area (OAA) between the EU and the United States as well as a Common Aviation Area between the EU and its neighbouring countries<sup>1</sup>; and an air transport agreement for a Common Aviation Area, which is open to 24 member States and three associate members of the Association of Caribbean States (ACS).

2.8 **Trade in services.** At the multilateral level, the World Trade Organization (WTO-OMC) came into being on 1 January 1995, and along with it, the entering into force of the General Agreement on Trade in Services (GATS). The GATS Annex on Air Transport Services applies trade rules and principles such as most-favoured nation (MFN) treatment and national treatment to three specific so-called “soft” rights, namely, aircraft repair and maintenance, selling and marketing of air transport, and CRS services. It excludes from the application of the GATS “services directly related to the exercise of traffic rights”. Pursuant to an earlier ministerial decision, the WTO-OMC launched in 2000 the first review of the operation of this Annex with a view to considering a possible extension of its coverage in this sector. During the review, there was some

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<sup>1</sup> There was a development affecting a common EU policy with third countries. In November 2002, the European Court of Justice (ECJ) ruled on a case brought, in 1998, by the European Commission against eight member States which have concluded or amended bilateral air services agreements (seven of them “open skies” agreements) with the United States. The judgement affirmed the ability of the member States to enter into bilateral agreements with third countries to the extent that these do not affect Community rules on air transport, but found that some of the provisions in these bilateral agreements infringed the Community’s exclusive external competence, as regards air fares and CRSs. The Court also found that the clause regarding ownership and control of airlines infringed Community law on freedom of establishment. Following the Court’s judgement, in June 2003, the Council of the EU conferred on the Commission a mandate to negotiate air services agreements on behalf of all member States with the United States for creation of an OAA between the two territories, as well as a so-called “horizontal” mandate to negotiate with third countries on the replacement of certain specific provisions in the existing agreements. In April 2004, the Council of the EU and the European Parliament also adopted a regulation on the negotiations and implementation of air services agreements between member States and third countries. While the OAA negotiations with the United States have been ongoing, the Commission has so far initialled “horizontal” agreements with Chile, Georgia, Lebanon, Azerbaijan, Croatia, and Bulgaria. In addition, the Commission has been proposing the creation of a Common Aviation Area with neighbouring countries, as well as a framework for negotiations with other regions in a targeted fashion.

support to extend the Annex to include some additional “soft” rights (for example, ground handling) as well as some aspects of “hard rights” (for example, air cargo, non-scheduled and multi-modal transport), but there was no global consensus on whether or how this would be pursued. In 2003, the WTO-OMC decided to end a first review process of the Annex as well as any further discussions on its expansion. The result of this review was that the Annex remains unchanged and continues to cover the existing three “soft” rights. The second review of the Annex will formally be launched in December 2005.

### 3. INDUSTRY DEVELOPMENTS

3.1 **Airline alliances and codesharing.** A relatively recent and rapidly evolving global phenomenon is the formation by airlines of alliances, i.e. voluntary unions of airlines held together by various commercial cooperative arrangements. There are now over 600 such alliance agreements in the world which contain a variety of elements, such as codesharing, blocked space, cooperation in marketing, pricing, inventory control and frequent flyer programmes, coordination in scheduling, sharing of offices and airport facilities, joint ventures and franchising. Intermodal alliances with railways have also grown in Europe and North America. The steady expansion of transnational alliances for strategic purposes and to achieve market access and synergies are a consequence of air carriers’ response to, *inter alia*, perceived regulatory constraints (for example, bilateral restrictions on market access, ownership and control), a need to reduce their costs through economies of scope and scale; and a more globalized and increasingly competitive environment.

3.2 While numerous agreements concern cooperation on a limited scale (for example, codesharing on certain routes), the number of wide-ranging strategic alliances has been on the rise. Most notable was the emergence of several competing “global alliance” groupings. Each group is composed of some major airline members having different geographical coverage with fairly extensive networks. Through the alliances, these carriers have combined their route networks which extend to most parts of the world, and carried together over 50 per cent of the worldwide scheduled passenger traffic. Three existing global alliance groupings are:

- a) “Star Alliance” founded in 1997 (Air Canada, Air New Zealand, All Nippon Airways, Asiana Airlines, Austrian Airlines, bmi British Midland, LOT Polish Airlines, Lufthansa, SAS, Singapore Airlines, Spanair, TAP Air Portugal, Thai Airways International, United Airlines, US Airways and Varig; to be joined by South African Airways);
- b) “oneworld” founded in 1998 (Aer Lingus, American Airlines, British Airways, Cathay Pacific, Finnair, Iberia, Lan Airlines, and Qantas);
- c) “SkyTeam” founded in 2000 (AeroMexico, Air France, Alitalia, Continental Airlines, CSA Czech Airlines, Delta Air Lines, KLM Royal Dutch Airlines, Korean Air, and Northwest Airlines; to be joined by Aeroflot and China Southern Airlines).

The fourth global alliance group dubbed “Wings” was absorbed into the SkyTeam group in 2004 when Continental Airlines, KLM, and Northwest Airlines joined in the latter group. The Swissair-led European alliance group “Qualiflyer” was dismantled in 2001 following the demise of Swissair and Sabena.

3.3 The partnership of each global alliance group, however, remains unstable. For instance, a trans-Tasman alliance was proposed in 2002, which involved Qantas (oneworld member)’s equity investment in Air New Zealand (Star Alliance). In 2004, Mexicana withdrew from Star Alliance and switched its codeshare partner from United Airlines (Star Alliance) to American Airlines (oneworld). In 2004, Cathay Pacific (oneworld) acquired a 10 per cent stake in Air China, which has a close relationship with Star Alliance members.

3.4 The shifting development and marketing power of global alliances, together with their competitive consequences, including their dominance at some hubs, have caused concerns to small and medium-sized airlines regarding their survival and have prompted efforts by these airlines to either develop a particular segment of a market or to compete as low-cost, point-to-point airlines. Some small airlines also moved to become affiliate or regional members of global alliances (for example, Adria Airways, Blue 1 and Croatia Airlines joined in Star Alliance as regional members in 2004), and to enter into franchise agreements with major airlines (for example, Comair of South Africa has been operating as British Airways' franchise carrier since 1996). Overall, airline alliances are widespread but still evolving, with partnership relations becoming more intertwined and complex.

3.5 Airline alliances and codesharing have regulatory implications because of their potential effect on market access, competition and consumer interest. In 1997, ICAO released a major study of the *Implications of Airline Codesharing* (Circ 269) and has since produced recommendatory guidance on the consumer protection aspects of codesharing (see Doc 9587). In practice, there has been no systematic regulatory treatment of these arrangements but rather on an *ad hoc* basis, often dictated by general aero-political considerations of the States concerned. Nevertheless, it has now become a general practice that international codesharing is treated within the context of bilateral air services agreements and that underlying traffic rights are required for codesharing services. Some major alliances have also been examined closely by relevant national and regional regulatory bodies (notably, the United States Department of Transportation, the European Commission and the Australian Competition and Consumer Commission); and, in some cases, certain regulatory measures were introduced to ameliorate the anti-competitive aspects of the arrangements.

3.6 **Mergers and acquisitions.** Airlines in many parts of the world continued the pursuit of the perceived advantages of enhanced market strength through mergers, acquisitions or operational integration under a single holding company. The common thread of this trend is the continuing development of growth strategies designed to hold and expand the existing market shares, gain access to new markets, achieve unit cost reduction, shield themselves against fierce competition, and increase the scale of operations in order to attain a critical market position. Most mergers or acquisitions have been achieved within the same country, as were the cases of Air Canada's acquisition of Canadian Airlines in 2000; American Airlines's bankruptcy buyout of Trans World Airlines in 2001; Alianza Summa jointly established by Avianca, Aces (liquidated in 2003) and SAM Columbia in 2002; Japan Airlines System (now Japan Airlines Corporation) jointly established by Japan Airlines and Japan Air System in 2002; and the creation of three Chinese airline groups headed by Air China, China Eastern Airlines and China Southern Airlines through mergers with other smaller State-owned airlines in 2003-04. Against the industry consolidation, however, quite a few States expressed their concerns, and scrutinized proposed mergers with great caution. For example, the United Airlines – US Airways merger plan was blocked by the United States Department of Justice in 2001.

3.7 The opportunity for cross-border mergers and acquisitions has increased as many States adopted a new policy or amended existing rules on foreign investment or control in national carriers (for example, Australia, Brazil, China, India, and Malaysia), and relaxed the air carrier ownership and control conditions in the air services agreements. For example, in 2004, Air France and KLM Royal Dutch Airlines created a cross-border European airline group under a single holding company through a share exchange offer by Air France for KLM's shares. In 2005, Lufthansa commenced a takeover and integration of Swiss International Air Lines, which will be completed with a phase-in period. Most attempts to initiate cross-border mergers or acquisitions, however, have been abandoned owing to the aero-political, economical and regulatory complexity (for example, Alitalia - KLM and British Airways - KLM merger plans in 2000). Even in the successful cases, the control and management of foreign carriers was not financially risk-free (for example, Iberia and its parent company SEPI's majority control of Aerolineas Argentinas, and Air New Zealand's acquisition of Ansett, both of which fell through in 2001). Because of the difficulties in implementing cross-border mergers and acquisitions with success, most foreign investments in the airline industry have been made in a limited scale, instead of taking a majority stake or pursuing a full-scale merger, and often as part of

a strategy to forge or strengthen alliances. Nevertheless, foreign investments have sometimes been short-lived (for example, Singapore Airlines' minority shareholdings in Air New Zealand from 2000 to 2004). As of February 2005, about 65 carriers had shareholdings in foreign airlines while about 230 airlines had equity owned by foreign investors in various degrees.

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## Appendix

STATE-PAIRS (including dependencies/overseas territories)	Bangladesh	Bhutan	Brunei Darussalam	Cambodia	China (excluding Hong Kong & Macao SAR)	Hong Kong SAR, China	Macao SAR, China	Democratic People's Republic of Korea	India	Indonesia	Japan	Lao People's Democratic Republic	Malaysia	Maldives	Mongolia	Myanmar	Nepal	Pakistan	Philippines	Republic of Korea	Singapore	Sri Lanka	Taiwan, Province of China	Thailand	Timor-Leste	Viet Nam	
<b>MIDDLE EAST (including rest of Asia)</b>																											
Afghanistan					D				B										C								
Bahrain	C					B			A				C						B	C		B	C		B		
Iran, Islamic Republic of	D				D				C		C		D						C		D		F		C		
Iraq																											
Israel					D	C			C																C		
Jordan									B				E						C				C		C		
Kuwait	B				D				A	C									A (D)	C		C	B		B		
Lebanon													C														
Oman	B								A				C						A (C)	D			C		C (F)		
Qatar	B				C				A	C			B	B			B	A	B	C	C (F)	A		B			
Saudi Arabia	A		C			C			A	A			C	F			(C, F*)	A (D)	A			C	B		(F)		
Syrian Arab Republic									C										D								
United Arab Emirates	A (C)		B		B	A			A (A)	A (C)	C		A (C)	B (D)			B (E)	A (B)	A (F)	C	A (D)	A (C)			A (C)	F	
Yemen	E								C	C			C														
<b>AFRICA</b>																											
Algeria										F																	
Egypt									C		C		C						F	E	C	C			C		
Libyan Arab Jamahiriya																			D								
Morocco																											
Sudan																											
Tunisia																											
Congo																											
Dem. Rep. of the Congo																											
Djibouti					(F)																				(F)		
Eritrea									(F)																		
Ethiopia					C	C			C										E						C		
Ghana																											
Kenya						C			B																C		
Lesotho																											
Liberia																											
Madagascar																										D	
Mauritius						C			B				C												D (D*)		
Niger																											
Seychelles									D					C										E			
South Africa						B			C				C											B			
Togo																										F	
Uganda																											
United Republic of Tanzania									C																		
Zambia																											
Zimbabwe					F																					F	
<b>EUROPE</b>																											
Albania																											
Austria					C				C		B		B	C					F	E				D	D	C	B (C)
Belgium	C				(F)																						
Bulgaria																											
Croatia																											
Cyprus																								E			
Czech Republic																										F	
Denmark					B						B								C				B			B	
Estonia																											
Finland					B	C					C															B	
France	E				A	A			A (B)	C	A (C)		C (C)	(F)					C	C	B	A (C)	C	C	A	B	
Germany	E		C		A	A			A (E)	B	A		B	C	C				C	B	A	A (B)	B	C	A (C)	C	
Greece																			D		F	C (F)				C	

Appendix

STATE-PAIRS (including dependencies/overseas territories)	Bangladesh	Bhutan	Brunei Darussalam	Cambodia	China (excluding Hong Kong & Macao SAR)	Hong Kong SAR, China	Macao SAR, China	Democratic People's Republic of Korea	India	Indonesia	Japan	Lao People's Democratic Republic	Malaysia	Maldives	Mongolia	Myanmar	Nepal	Pakistan	Philippines	Republic of Korea	Singapore	Sri Lanka	Taiwan, Province of China	Thailand	Timor-Leste	Viet Nam	
Hungary					D																						
Iceland																											
Ireland																											
Italy	C				B	C		B		A (D)		C	D (F*)		F		C		C	C	C	E (F*)	C	B (D, F*)			
Latvia																											
Lithuania																											
Luxembourg																											
Malta																											
Netherlands					A	B		B (B)	B	A		B (F)				E	C	C	B	B (C)	E	A	B (B)				
Norway																		C									
Poland																											
Portugal																											
Romania																											
Serbia & Montenegro																											
Slovenia																											
Spain																				F	C			C			
Sweden					C								E												C		
Switzerland						C		B		B		C	(D)					C	E	C	B	C		A			
Turkey					B	C		C		C		C						C		C	B			B (F)			
United Kingdom	B		B		A	A (E)		A		A (C)		A (D)	(D)					A		B	A (A)	B	C	A (B)			
Armenia																											
Azerbaijan					D																						
Belarus																											
Kazakhstan					C			D				F		E				D		C				F			
Kyrgyzstan					C			D											E (D)								
Republic of Moldova																											
Russian Federation					A	C		C	B		A			E	B			E		A	F	F	E	C		C	
Turkmenistan					F			B																C			
Ukraine					D			C																D			
Uzbekistan	C				C			B		C		C						E		C			C		C		
<b>LATIN AMERICA AND CARIBBEAN</b>																											
Argentina													C														
Brazil										B																	
Chile																											
Cuba																											
Mexico										C																	
Panama																											
Peru																											
<b>NORTH AMERICA</b>																											
Canada					A	A		C		A								C	C	A (C)	C		B				
United States (excl. Hawaii)	C				A	A (B)		A		A (A)		B						B	A	A (B)	A		A (B, F*)	A		E	
Hawaii (US)					C					A (C)										C	C			B			
Grand Total (International only)	21,624	1,712	12,672	29,862	172,707	157,843	21,274	887	141,328	95,440	307,331	7,511	120,662	8,717	2,981	8,918	10,506	48,410	65,141	156,471	201,751	33,329	199,146	202,070	1,743	56,208	





														STATE-PAIRS (including dependencies/overseas territories)														
Australia	Cook Islands	Fiji	Kiribati	Marshall Islands	Micronesia, Federated States of	Nauru	New Zealand	Palau	Papua New Guinea	Samoa	Solomon Islands	Tonga	Tuvalu	Vanuatu	American Samoa (US)	Christmas Islands (AU)	Cocos/Keeling Islands (AU)	French Polynesia (FR)	Futuna Island (FR)	Guam (US)	Northern Mariana Islands (US)	New Caledonia (FR)	Niue (NZ)	Norfolk Island (AU)				
																										Hungary		
																											Iceland	
																											Ireland	
																											Italy	
																											Latvia	
																											Lithuania	
																											Luxembourg	
																											Malta	
																											Netherlands	
																											Norway	
																											Poland	
																											Portugal	
																											Romania	
																											Serbia & Montenegro	
																											Slovenia	
																											Spain	
																											Sweden	
																											Switzerland	
																											Turkey	
A							B																				United Kingdom	
																											Armenia	
																											Azerbaijan	
																											Belarus	
																											Kazakhstan	
																											Kyrgyzstan	
																											Republic of Moldova	
																		F									Russian Federation	
																											Turkmenistan	
																											Ukraine	
																											Uzbekistan	
														<b>LATIN AMERICA AND CARIBBEAN</b>														
C							C																				Argentina	
																												Brazil
C							C											C									Chile	
																												Cuba
																												Mexico
																												Panama
																												Peru
														<b>NORTH AMERICA</b>														
B	(D)	C								(F)					D												Canada	
A	(C)	C (C)					A (B)			(D)		(D)						A (C)		A							United States (excl. Hawaii)	
B (B)	D	C		B	B		C			D (E)		F			C			D		B							Hawaii (US)	
136,897	2,205	8,465	548	3,912	5,270	933	59,358	2,641	2,805	9,116	649	2,455	283	2,151	6,908	0	0	4,013	158	17,253	5,328	2,937	144	278		Grand Total (International only)		

**Note:** Above table shows scales of annual flight frequencies (total outbound and inbound) on respective State-pair routes in 2004.

- A, B, C, D, E and F denote 1 400 or more, 700 - 1 399, 200 - 699, 100 - 199, 50 - 99, 1 - 49 frequencies of Third/Fourth Freedom carriers (as well as domestic carriers) respectively;
- Frequencies of non-Third/Fourth Freedom carriers operating with or without traffic rights are shown by the same codes in parenthesis;
- \* indicates frequencies operated by non-Third/Fourth Freedom carriers but published by Third/Four Freedom carriers' codes;
- + indicates frequencies operated by Third/Fourth Freedom carriers but published by non-Third/Fourth Freedom carriers' codes;
- Frequencies in italics show domestic services including between homeland States and their dependencies, and between dependencies in the same States;
- Cells with dark-gray shade denote that bilateral air services agreements between the States are registered with ICAO;
- Cells with light-gray shade denote that bilateral air services agreements between the States are not registered with ICAO but included in the database as non-registered agreements.

Source: BACK Aviation Solutions OAG Database, and Database of the World's Air Services Agreements (ICAO Doc 9511)