



AGENDA FOR FREEDOM SUMMIT

ISTANBUL, 25-26 OCTOBER 2008

CHAIRMAN'S SUMMARY

At the invitation of Mr Giovanni Bisignani, Director General and CEO of the International Air Transport Association, representatives of fourteen nations and the European Commission met in Istanbul to discuss further liberalisation of the airline industry.

The meeting was held in the midst of an unprecedented crisis driven initially by record high oil prices and a subsequent drastic drop in demand resulting from the global financial crisis. IATA noted that the industry generally has not been financially sustainable over the long term, due in part to Government-imposed regulatory constraints on commercial practices some of which are no longer justified.

The Minister of Transport of the Republic of Turkey welcomed participants to Istanbul and stressed the timeliness of the meeting and the potential benefits of carefully managed liberalisation.

The Chief Economist of IATA made a presentation describing the economic challenges confronting international aviation today and advocating wider and deeper liberalisation of air transport as one important means of facilitating a more robust and sustainable air transport system.

As an initial premise, the proposition was tabled that Governments should focus their scarce resources on matters that deliver value, and only impose restrictions where overriding public policy objectives justify intervention.

The meeting considered the attached paper and within that context focused on two areas of primary concern: market access and foreign ownership and control of airlines.

Participants broadly agreed that further liberalisation would be desirable. In doing so, the group was mindful of the following issues:

- The need to maintain leverage to address 'doing-business' issues.
- The need to avoid overwhelming available infrastructure with increased traffic;
- The special needs of developing nations, and those in transition to fully open markets;
- The need for a level playing field;
- The dependency of remote island States on air transport;
- The impact on labour interests; and
- Issues of national pride and sovereignty.



The group agreed that these issues would need to be addressed and did not necessarily constitute insurmountable obstacles to success.

Mindful of the industry's desire for accelerated action by governments, the group also considered possible ways to expedite further liberalisation. The IATA proposal suggested that States could unilaterally waive certain clauses in existing bilateral air services agreements, possibly subject to reciprocity. Another proposal was to waive nationality clauses via a multilateral convention. There was a discussion on the advantages and disadvantages of each approach.

A third proposal emerged from the group to establish a multilateral, non-binding policy "Statement of Principles" reflecting the commitment of interested governments to interpret existing agreements liberally. In addition, more publicity could be given to the most progressive existing agreements that could serve as model language for others.

Participants were urged to reflect on these ideas, consider how their respective Governments could pursue them further in light of their particular circumstances, and report on progress at a follow-up meeting to be held in early 2009.

The group commended IATA for proactively bringing the participants together to address this important challenge and strongly encouraged it to continue to foster this very useful and productive initiative.

Finally, participants thanked the Government of Turkey for its hospitality.

Istanbul, 26th October 2008

Jeffrey N. Shane
Chairman



AGENDA FOR FREEDOM SUMMIT

Çırağan Palace Kempinski Hotel, Istanbul, Turkey, 25-26 October 2008

A SHORT PATH TO GREATER COMMERCIAL FREEDOM FOR AIRLINES

I - EXTRAORDINARY TIMES CALL FOR EXTRAORDINARY MEASURES

1. Since the tragic events of September 11, 2001, airlines have collectively lost 37 billion US dollars. The years from 2002 to 2006 in fact saw losses of as much as 42 billion US dollars; only in 2007 did airlines come back to modest profitability. To achieve this result, they went through an unprecedented search for efficiency and cost cuts. The figures speak for themselves. Between 2001 and 2007, airlines:
 - Cut non-fuel unit costs by 18%
 - Cut distribution costs by 25%
 - Improved fuel efficiency by 19% (i.e. over 3% per annum), and
 - Improved labour productivity by 68%
2. Despite all these efforts, the airline industry faces a bleak and uncertain future once again. The extraordinary surge in oil prices could prove more damaging than the post-September 11 crisis, especially if high oil prices are sustained over a long period, or are here to stay. The massive efficiency improvements achieved over the last few years have been wiped out by the 99 billion US dollars in additional fuel costs the industry has incurred over the last twelve months. Indeed, the crisis could drive substantial structural changes to the industry.
3. Current national and international rules governing the international aviation business seriously limit airlines' ability to tap international equity capital and achieve optimal structures, whether by cross border mergers, acquisitions or establishing themselves abroad.
4. Given the magnitude of the current crisis in air transport, it is time to acknowledge the direct link that exists between anachronistic economic regulation of the industry and the airlines' long history of suboptimal financial performance. International airlines drive robust economic activity in every other sector, but are uniquely prohibited from participating meaningfully in the global economy they have helped to engender. Unless they are unshackled at last from regulatory requirements that no longer have any coherent public policy justification, their future will remain bleak, with serious consequences for global economic health.
5. In other words, achieving greater commercial freedom for air transport should no longer be treated as a mere philosophical aspiration; it is an essential prerequisite to a robust and sustainable future for global air transport, and indeed a driver of future economic growth. It is time to make aviation just another normal, global business.
6. This document puts forward a possible way of lowering the barriers that stand in the way of greater commercial freedom for air transport. It is a pragmatic approach based on the need for rapid and positive change. It aims at minimising the need for complex



multilateral negotiations and, where possible, avoids altogether any amendments to existing aviation treaties, especially the Chicago Convention, which continues to serve the interests of all nations well. In short, it does not seek to alter fundamentally the rules of the game. It seeks to identify the minimum changes to the existing rules that would achieve quick wins for all.

7. In a way, this could be described as the completion of a task that many States have begun but have left unfinished. Over the last three decades, and especially since the first open-skies agreement was signed in 1992, States have abandoned – some de jure, many de facto – their requirement to approve airline tariffs, entry, routes, frequency and capacity in many bilateral markets, and have instead instilled healthy competition in the business. There has been no compromise of safety as a result. Now is the time to finish this task and move beyond mere operational freedom to full commercial freedom, including the ability to seek optimal corporate structures across borders, establish ventures in foreign territory, and tap international equity markets. Airlines need to enjoy the same levels of opportunity that all other globally networked industries - e.g. information technology, telecommunications and financial services - have long enjoyed.

What are the barriers?

8. The main barriers to greater commercial freedom in today's regulatory system can be identified as follows (in no particular order):
 - **Limits to free competition:** calibrated traffic rights, limited designations, tariff and capacity regulation.
 - **Barriers to foreign ownership:** 'Substantial ownership and effective control' clauses in bilateral agreements, national laws requiring ownership and control by citizens, and ultimately prohibitions on the right of establishment of foreign-owned carriers.

Chicago is not the Issue

9. None of these barriers is embedded in the Chicago Convention. They have been developed later in separate instruments, most importantly country-to-country bilateral air services agreements. Bilateral ASAs were a compromise solution developed as a consequence of the failure of the Chicago signatories to reach consensus on the multilateral regulation of the aviation business. They have outlived their usefulness. This should make it easier to lower these barriers without engaging in complex amendments to the existing regulatory framework¹. The Chicago Convention need not be revised in order to give airlines greater commercial freedom.
10. Equally important, States must retain their ability to set and enforce internationally accepted standards for ensuring the safe and secure operation of airlines in their territory.

II - A FAST WAY FORWARD: CHANGE WITHOUT AMENDING

11. It would be a formidable task to remove, through bilateral or multilateral negotiations, all these barriers from the web of (up to) 3,500 bilateral air services agreements. It would potentially yield a very uneven result too, with ensuing complexity. Creating a new set of

¹ In some cases, limits to foreign ownership are found in domestic law, too. In these cases, amendments will be required to such laws in order to achieve full rights of establishment.



rules from scratch to replace the current one would be equally formidable and long. The result would also be unpredictable.

12. The critical situation airlines are facing as a result of historically high oil prices and a drop in demand require a more urgent solution.
13. One way to go about this change could be to waive existing barriers on a conditional, reciprocal basis. In other words, States that are ready and willing to do so could waive certain requirements embedded in bilateral agreements with other States that share the vision. Such leniency is already being observed in some areas of the world, but in many instances it is tacit, and it lacks transparency. This is about moving from tacit leniency to legal certainty.
14. Under international law, States could use conditional, binding unilateral declarations² issued by their Ministers responsible for Civil Aviation³. They could be addressed only to similarly minded States on a reciprocal basis.⁴
15. Such declarations could be worded so that States retain control over developments in the free-trade area they would create. For instance, if a State believes that there are instances of free-riding, or unfair play, it could take responsive measures.
16. As these declarations intend to waive rights acquired under bilateral agreements, they ought to mirror them. Potentially they could cover the areas listed below, typically covered by bilaterals. Whether they should be packaged together, or States should be allowed to pick and choose, remains to be determined.
17. In order to give this solution the required transparency, States could ask the International Civil Aviation Organisation (which is the depositary of bilateral air services agreements) to keep a central, public registry of such declarations.

Capacity/Frequency

18. States could unilaterally suspend any restriction that they are entitled to impose on the number of seats that can be sold or frequencies that can be flown under bilateral air services agreements with other countries making the same declaration. Arguably, capacity and frequency restrictions should be easy to waive for States with a liberal vision of air transport. This is an easier way of achieving what typical 'open-skies' agreements do.

² Unilateral declarations 'if given publicly, and with an intent to be bound, even though not made within the context of international negotiations, [are] binding'. See International Court of Justice, Nuclear Tests Case (New Zealand v. France, ICJ Recueil 1974, p. 457).

³ The 2006 Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations adopted by the UN's International Law Commission state that "Other persons representing the State [i.e. apart from the Head of State or Government, or the Minister of Foreign Affairs] in specified areas may be authorized to bind it, through their declarations, in areas falling within their competence;"

⁴ Ibid. Unilateral declarations may be addressed to the international community as a whole, to one or several States or to other entities;



Designation

19. States could unilaterally suspend any restriction that they are entitled to impose on the number of carriers that can be designated under bilateral air services agreements with other countries making the same declaration (even if they chose to maintain ownership and control restrictions). Again, the result would be similar to what has been achieved under open-skies agreements.

Traffic rights

20. As a first step, States could unilaterally declare that airlines designated by other States making the same declaration are permitted to operate services between any point in the State and any point in any other State making the same declaration. It sounds convoluted, but it is tantamount to opening all international routes to all the countries in the club, and their airlines. De jure and de facto, it leads to a multilateral trade area in air services. Beyond and behind rights with other countries (not in the club) would be governed by whatever (traditional) air services agreements are in place with them.
21. As a second step, countries could unilaterally open their domestic markets to airlines of other 'ready and willing' countries, thus eliminating all restrictions for other 'club members' to offer air transport services in one's own market. This is not unprecedented. Chile has foreign-owned airlines operating domestic services, and Australia and New Zealand have entered into a single aviation market. And of course there is the European Union's internal market. But the point here is that this can be achieved without having to create a complex set of trade rules alongside the authorisation to operate.

Ownership and control

22. A real breakthrough, however, would come from a change to ownership and control restrictions. This alone could facilitate the search for optimal cross-border structures for airlines, give them greater access to international equity markets, and allow foreign venture capital to invest in airlines.
23. Such restrictions are typically found in bilateral agreements, linked to designation clauses, but also in national laws. Because of this peculiarity, a two-stage process may be required to achieve full commercial freedom in this area.

Restrictions arising from bilateral agreements

24. The first step, which could achieve a substantial amount of benefits quickly, would be to suspend restrictions on ownership arising from bilateral air services agreements. A State thus allows other States to open 'their' airlines to foreign ownership but does not change its own policy. This could be achieved, once again, by means of reciprocal and unilateral declarations. A State would declare that it forgoes its right under air services agreements with other States that make similar declarations, to refuse the acceptance of the designation of carriers licensed by those States on the basis that the 'ownership and control' test is not met.
25. An option to be discussed is whether to include a requirement that such carriers have a principal place of business in any of those States, although it would arguably limit the ability for cross-border restructuring. By contrast, a statement that limits ownership and control to the "ready and willing" States or their citizens would not be desirable, as this



option would be more limiting. In order to avoid potential free-riding issues, however, some States may wish to require that controlling owners of such airlines be domiciled in one such country.

Right of Establishment

26. For airlines to achieve full commercial freedom across borders, further reforms will be required. A full right of establishment will not be achieved unless ‘substantial ownership and effective control’ requirements are removed from domestic law, where they exist. In other words, States would also have to accept that ‘their’ own airlines might be foreign-owned as well. This entails amending or repealing such laws, which will require longer processes than are envisaged here, and could be undertaken in a second stage of reform⁵.

III - SAFEGUARDS

27. Naturally some States might be concerned about the potential risks that this model could pose to safety (and to their own responsibility as safety oversight authorities), on the one hand, and fair competition, on the other hand. These issues can be addressed satisfactorily.

Licensing and Air Operator Certificates

28. The airline industry has an outstanding safety record that should be maintained in an environment of full commercial freedom. Under the Chicago Convention, every State is responsible for the safety of airlines it designates. Some States have concerns about liberalisation leading to a regime of flags of convenience. At the same time, it is important that licensing requirements do not become abusive barriers to trade.
29. Again, there are precedents in which a balance has been found between these interests. The European Union, for instance, has adopted a Regulation whereby any holder of a national AOC and license from an EU member State is considered an ‘EC carrier’ and enjoys full commercial freedom in that trade area. Likewise, States making the unilateral declarations discussed above would only make them with respect to States whose safety standards they trust to be of the highest quality. The requirement for reciprocity means that each State retains control over its choice of partners.
30. The industry has also developed a common operational safety audit standard – IOSA – which could readily form the basis of a pan-national safety requirement in such a free operating environment. Indeed, several States have already taken the step to mandate IOSA, in order to enhance their oversight capability of both domestic and foreign operators. Inherent in IOSA is a complete assessment of the management and control processes of an airline as they relate to safety of operations. It can reasonably be argued, therefore, that maintenance of IOSA Registration (the audits are conducted biennially and monitoring programmes are in place for the inter-audit period) provides the necessary safety assurances for States.

⁵ Additional legislative reforms may be required to establish a truly free movement of capital, and equal tax treatment for national and foreign-controlled corporations.



Ensuring a level playing field

31. Free trade in aviation services may give rise to new issues, not unlike those seen in other sectors. States joining this area will wish to retain a degree of control over developments, to make sure their interests are not damaged, e.g. by free-riding or other abusive behaviour.
32. There are a number of options to make sure this legitimate interest is secured. This paper puts forward three possibilities as examples, but others could also be considered.
 - States could include a clause in their unilateral waiver declaration allowing them to revert to the status quo ante, and cancel (e.g. with some months notice) any waivers they had granted in respect of one or several countries. This could then lead to traditional consultations, or international arbitration.
 - The policing of commercial behaviour in this free-trade area could be left to national competition watchdogs. This is the case today, and increasingly so with the adoption of competition law by a growing number of countries.
 - The more ambitious solution, and arguably one that can be left for later development, would be the setting up of an ad-hoc dispute resolution body to oversee the functioning of this trade area. Clearly, it would have to be set up through a special international agreement. States making unilateral declarations could also include a statement recognising this body's jurisdiction over trade disputes involving air services with other countries that also recognise its jurisdiction.

IV - CONCLUSION

33. The double exposure to record oil prices and falling demand is leading airlines into uncharted territory. Structural changes are likely to occur soon despite the arcane regulations that govern the industry's international business (in which case it will be disorderly and unpredictable). It is urgent to give international airlines the tools they need to survive this crisis by letting them adapt their international structures to meet the demands of a new business environment. Other strategic industries have long taken such commercial freedom for granted.
34. This paper proposes a pragmatic way forward to generate most of what is required in a simple and fast way, while making sure that States retain full control over the process.

Geneva, October 2008