

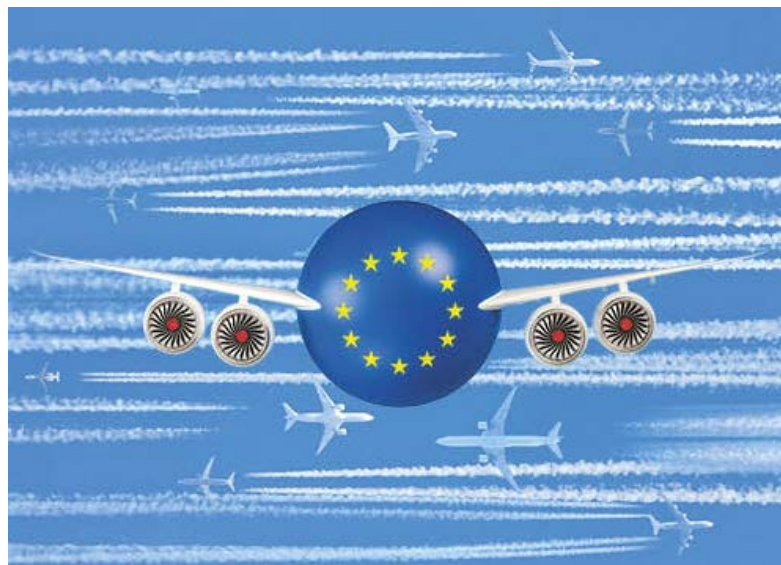
STUDY

Requested by the ECON committee



Competition in Air Transport

Workshop proceedings





DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Competition in Air Transport

PROCEEDINGS OF THE WORKSHOP
BRUSSELS, 24 JANUARY 2018

Abstract

Competition in the aviation sector pertains to different sets of rules, competition law on the one hand and, given the cross-border interdependencies of transport markets, international rules on the other hand. The workshop aimed to examine the current situation of competition in air transport using the proposed regulation on Safeguarding competition in air transport, repealing Regulation (EC) No 868/2004 as a practical example and starting point for the discussion. The Committee on Economic and Monetary Affairs (ECON) has prepared a legislative opinion to this dossier.

This Workshop was prepared by Policy Department A at the request of the Committee on Economic and Monetary Affairs (ECON).

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

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1. PROGRAMME

DIRECTORATE GENERAL FOR INTERNAL POLICIES



Европейски парламент Parlamento Europeo Evropský parlament Europa-Parlamentet Europäisches Parlament
Euroopa Parlament Ευρωπαϊκό Κοινοβούλιο European Parliament Parlement européen Parlaimint na hEorpa
Europski parlament Parlamento europeo Eirópas Parlaments Europos Parlamentas Európai Parlament
Parlament Ewropew Europees Parlement Parlament Europejski Parlamento Europeu Parlamentul European
Európsky parlament Evropski parlament Euroopan parlamentti Europaparlamentet

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

WORKSHOP Competition in air transport

24 January 2017, 17.00 to 18.00 h, European Parliament, Brussels

Room PHS 3C50; interpretation provided; public event with webstreaming

<http://www.europarl.europa.eu/ep-live/de/committees/video?event=20180124-1430-COMMITTEE-ECON>

17.00 - 17.05 h	Welcome and Introduction by Markus FERBER, ECON Vice-Chair and Chair of the ECON Working Group on Competition Policy
17.05 - 17.55 h	Introductory statements by the expert speakers followed by a discussion with ECON Members
Kay MITUSCH	Professor of Network Economics, Institute for Economics (ECON), Karlsruhe Institute of Technology (KIT), Germany
Pablo MENDES DE LEON	Professor of Air and Space Law and Director of the International Institute of Air and Space Law of Leiden University, The Netherlands

Possible points/issues to be discussed:

- In which way will the proposed regulation be more efficient than the current regime of Regulation No 868/2004?
- Issues of compatibility between EU rules (including the proposed regulation) and bilateral or multilateral agreements: Are there specific points of conflict? Will this lead to disagreements on international level, such as WTO and at the International Civil Aviation Organization (ICAO)? Can the proposed regulation be implemented without frictions?
- How to strike a balance between fair competition and the connectivity of remote EU-regions and security and rights of passengers and citizens?
- Is there a risk that third country service providers might suffer competitive disadvantages by the application of the proposed regulation?
- How to deal with the issue of competition in regions where the government controls the air carriers or companies? How severe are the obstacles/challenges EU carriers have to face on markets outside the EU, in relation to tax regimes, potential subsidies or State aid?
- How could a worldwide cooperation in the aviation sector be strengthened? Is there a chance to standardise the trade practices in the aviation sector?

17.55 – 18.00 h	Closing remarks by Markus FERBER, ECON Vice-Chair and Chair of the ECON Working Group on Competition Policy
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2. CURRICULA OF THE SPEAKERS

Kay MITUSCH

Kay Mitusch is Professor of Network Economics and since 2009 chair in Network Economics at Karlsruhe Institute of Technology (KIT). In addition, scientific advisor of IGES Institut GmbH, Berlin, section mobility. Member of the Advisory Board to the German Federal Minister of Transport, Building and Urban Development. Consulting activities for the Ministry, for the German Regulatory Agency (Bundesnetzagentur) on railway regulation, for the European Commission and other. Several expert testimonies in front of the Committee on Transport, Building and Urban Affairs of the German Parliament (Bundestag). Main fields of research: transport economics and policy, regulation economics, industrial and competition economics, impacts of natural events on transport networks and their economic consequences. Member of Transportnet and CEDIM.

Pablo MENDES DE LEON

Pablo Mendes de Leon is Professor of Air and Space Law and Director of the International Institute of Air and Space Law of Leiden University, which is one of the leading international scientific research and teaching institutes in the world, specialised in legal and policy issues regarding aviation and space activities. The Faculty of Law of Leiden University founded the institute in 1986. In addition to his duties as Director of the International Institute of Air and Space Law of Leiden University, Pablo Mendes de Leon maintains a vast range of memberships in organisations that work to combine law and practice of aviation law and policy. For instance, he is President of the European Air Law Association, Member, Panel of Experts, Shanghai International Economic and Trade Arbitration Commission, Member, Court of Commercial Arbitration, Bucharest, Romania, Member of the Dutch Aviation Accident Board, a Board Member of KLM-Air France foundation (charity), a Board Member of the magazines Air and Space Law, Journal of Air Law and Commerce and the Italian ANIA Insurance Newsletter and the Director of the Series of Publications in International Aviation law and Policy with Kluwer Law International. He is the author of a large number of publications on topical issues regarding aviation law and policy.

3. PRESENTATIONS DURING THE WORKSHOP

3.1. Presentation by Kay MITUSCH




KIT
Karlsruhe Institute of Technology

Economic Perspective of Trade Policy in the Aviation Sector

EU Parliament, Committee on Economic and Monetary Affairs
Workshop Competition in air transport, 24 January 2018
Prof. Dr. Kay Mitusch

CHAIR OF NETWORK ECONOMICS, mitusch@kit.edu

KIT – The Research University in the Helmholtz Association www.kit.edu



Ante portas! – Who exactly is it?

KIT
Karlsruhe Institute of Technology

- The small **Gulf States** (UAE, Qatar) try to take a similar development route like the famous “Four Asian Tigers” some decades ago
- In contrast to them, they focus on service industries, particularly those connected to travelling
- Like them at the time, they run into conflicts with sectoral interests in the developed countries
- State-owned airlines from the Persian Gulf witnessed strong growth and became major players on some international routes
- In addition, there is a number of countries with **emerging large markets** (China, India, Brazil, Turkey): they also enter international airline markets, and at the same time are reluctant to open up their home markets

2 24 January 2018 Prof. Kay Mitusch - Economic Perspective of Trade Policy in the Aviation Sector Chair of Network Economics

What is the Union interest of the EU with respect to these countries



- EU is interested in a sound economic growth of these countries and in their integration into the world economy
- In the long run these countries have to acknowledge fair trade practices and curb government interventions
- But for some time to come, some degree of selective intervention by their governments should and will be accepted

3

24 January 2018

Prof. Kay Mitusch - Economic Perspective of Trade Policy in the Aviation Sector

Chair of Network Economics

The allegations



- These countries' airlines receive government support of diverse kinds
- State aids are claimed to consist of direct subsidies, cheap loans from government sources and subsidies to local hub airports leading to low airport fees
- The exact numbers are disputed
- Vertical integration and involvement of the state (state-owned airlines and airports and financial institutions) create intransparency and distrust
- Some countries do not grant fair access to their home markets or airports for international flights

4

24 January 2018

Prof. Kay Mitusch - Economic Perspective of Trade Policy in the Aviation Sector

Chair of Network Economics



General principles of international fair trade

- WTO and GATS do not apply for air traffic rights
- General principles of WTO Agreement on Subsidies and Countervailing Measures may still be invoked:
- State aid, like export subsidies, is not allowed and may give reason for countervailing duties by importing countries
- Complaining country must present **sufficient evidence** of the existence of
 - a) a subsidy and, if possible, its amount
 - b) injury to its domestic industry, and
 - c) a causal link between the subsidized imports and the alleged injury
- Simple assertion, unsubstantiated by relevant evidence, is not sufficient
- These criteria of the WTO Agreement are echoed by the proposed EU Regulation



General principles of international fair trade

- From a general economic perspective **countervailing measures** can be justified on two grounds:
 - they are protective for the economy of the **importing country**, safeguarding it against distortions and undue economic adjustments
 - they are corrective for the **country that grants export subsidies**, by convincing it that subsidies cannot be the basis of a sustainable, long-term economic structure

The Watchword should be: **Caution**

- **In transport**, government involvement and subsidies are not unusual
- Principle of **reciprocity**: If countervailing measures are considered, distortionary practice of EU countries themselves that might possibly exist should be taken into account:
 - Which subsidies have been granted in the EU?
 - How easy is it for a foreign airline to acquire attractive airport slots in the EU?
- **Competition** in air transport proved to be very beneficial to consumers
- The big European airline groups are currently in healthy conditions
- Recent consolidations in the EU (Air Berlin, Alitalia) currently lead to higher prices for customers and higher profits for the remaining airline groups (Germany)
- So the focus of **safeguarding competition** in air transport might be laid on the intensity of competition, rather than on shielding oneself against outside competitors

Summary and Recommendations

- If foreign state aid is massive and long-lasting, something must be done about it
- International consultations and the threat of countervailing measures may even be helpful for developing countries
- Evaluations of other countries' practices and of countervailing measures should take account of general practices in the transport sector and of recent practices in the EU air transport sector (principle of reciprocity)
- Policies should be carefully and cautiously gauged, based on a broad understanding of Union interests: fair competition, strong competition, growth of developing countries, ...
- Much will depend on the actual conduct of the EU executive in applying the Regulation
- The practice of applying the Regulation should be evaluated scientifically

3.2. Presentation by Pablo MENDES DE LEON



'Fair competition' in international air transport:
How to align perceptions of market management?

Presentation for
Economic and Monetary Affairs
of the European Parliament

Brussels, 24 January 2018

By Dr Pablo Mendes de Leon,
The Netherlands

'Fair competition' in air transport: what does it mean?

- The scope of 'fair competition' ought to be defined.
- Jurisdictions around the world may give different interpretations to it – for instance, does the provision of State subsidies affect the fairness of competition?
- The EU is one of the very few jurisdictions in the world regulating State aid – which is often perceived as a governmental tool immune from jurisdictional control
- Remarkably: air transport is the only sector which fell, *ab initio*, outside of the WTO/GATS framework – thus also outside the (anti-) subsidies rules and procedures of this organisation

Brussels, EP, 24.1.18

2

Competition in air transport: the external regulatory dimension

- The reasons for which Regulation 868/2004 could not be applied do not only have internal - as identified by the EU Commission but also external - that is, related to the regulatory and policy environment - causes.
- Those external causes are basically related to the existence of - mostly - bilateral Air Services Agreements (ASAs)
- Competition principles and concepts cannot be easily aligned with the traditional aviation law regime as laid down in Air Services Agreements (ASAs).

Brussels, EP, 24.1.18

3

Competition in air transport: the impact of ASAs

- ASAs are designed to open airspaces for the operation of international air services which are closed by the provisions of the Chicago Convention on international civil aviation (1944)
- Those ASAs do not regulate competition and may even encompass anti-competitive clauses as they pre-determine the market behaviour of airlines
- Airlines are supposed to and sometimes even mandated to cooperate in terms of pricing, scheduling and capacity sharing
- Even if airlines would like to behave differently, their governments may restrict their freedom of action in the 'marketplace'

Brussels, EP, 24.1.18

4

Competition in air transport: the market access factor

- While the proposed Regulation on safeguarding competition in international air transport attempts to reconcile the market oriented approach of the EU with more traditional, public service oriented regimes governing the operation of international air services (ASAs), a number of questions remain as to the practicality and perhaps also legality of certain provisions of the proposed Regulation.
- Airlines should be qualified as 'undertakings' before being admitted to operate their services under provisions of ASAs which premise the EU Commission could table in its negotiations.

Brussels, EP, 24.1.18

5

Competition air transport: multilateral solutions?

- Other solutions may be found on an unilateral - such the employment of the 'effects' doctrine' or
- Multilateral - such as the involvement of international organisations, in particular the International Civil Aviation Organization (ICAO) which however also depends on more 'traditional' jurisdictions - measures

Brussels, EP, 24.1.18

6

4. BRIEFING NOTES

4.1. Economic Perspective of Trade Policy in the Aviation Sector (Kay MITUSCH)

KEY FINDINGS

- This paper provides **context information** on the **proposed EU Regulation on safeguarding competition in air transport** from economic perspectives.
- Trade policies should be based on a broad understanding of **Union interests**.
- Concerning **the countries** who are alleged to give State aids to their airlines, the EU is interested in a sound economic growth of these countries and in their integration into the world economy. The example of the East Asian countries demonstrated that such growth might entail aggressive or protective behaviour in selective branches for some time periods.
- European citizens want to benefit from **intense competition** between several large and sustainable airline groups, which in the long run might require a market size larger than the EU market. Competitors from outside the EU are therefore in principle welcome.
- International airline markets should not be distorted by massive and long-lasting government **subsidies** from any country. Eliminating such distortions is in the end beneficial to, both, the importing and the exporting countries.
- However, **in transport**, government subsidies are generally much more accepted than in other branches. Subsidies may be justified by desirable investments in airport infrastructure, by considerations of regional mobility and regional development, and by considerations of general economic development.
- Taken together, the **watchword for trade policy in air transport should be: caution**. Any claims against other countries and any countervailing measures should well-justified and balanced, also with a view to EU's own practices in, for example, granting subsidies and grandfather rights for airport slots. Trade policies should be documented and scientifically evaluated in order to learn for future steps and for other markets.

4.1.1. Ante portas! – Who exactly is it? And what are the allegations against them?

In the last decades, three **state-owned airlines from the Persian Gulf** – Qatar, Etihad, and Emirates Airlines – have witnessed a strong growth and became major players for flights between Europe and East Asia as well as on other international routes. Their home airports of the cities of Doha, Abu Dhabi and Dubai became international hub airports. Although the total quantity of international flights has grown substantially during the same period, these new players took market shares away from European as well as American incumbent airlines on these routes. Moreover, the bold strategic moves of the Gulf airlines pose a threat to incumbent airlines or losing more market shares in the future.

The growth of the Gulf airlines is an outcome of several factors. **Geographically**, the Gulf States are well situated between Europe and the fast growing countries in East Asia, South East Asia and South Asia. They are trying to exploit and develop this business potential by making strategic investments in airports and airlines. And these growth strategies are nurtured and organised by the oil-rich **governments**: Airlines are state-owned and

received government support of diverse kinds worth about 40 bn. dollars, according to interested U.S. sources. These State aids are claimed to consist of direct subsidies to the airlines, cheap loans from government sources, subsidies to local hub airports leading to low airport fees, and other. Since also the airports and financing institutions are state-owned in these countries, the whole endeavour looks like a vertically integrated and coordinated attack on the European and American incumbent airlines.

It should be noted, though, that the '*governments*' of these countries could themselves be characterised as '*enterprises*', since taxes play only a minor role in these states' financing compared to their oil and gas incomes. The appraisal of State aid as being unfair usually rests on the presumption that it rests on government's power to tax. In contrast, if an oil company would invest its proceeds into airlines, this could be just as threatening to the incumbents, but would not be blamed as an unfair practice. One might say that this is a problem of these countries and that a government economy is not suitable for international trade on a large scale and in the long run.

But from the Gulf States' point of view it's their (only) way out of a '*desert with a few resources*' to becoming a modern economy. They are in fact taking a **similar route like the famous 'Four Asian Tigers' some decades ago** (Singapore, South Korea, Taiwan, Hong Kong), with the difference that they are, at the moment, not focusing on steel, ships, and electronics, but on services, particularly on services that are connected to travelling. At the time, the Four Asian Tigers also came into conflict with international trade policies, with some retaliatory measures being taken against them. But they made their way, and also paved the way for Chinese growth and international economic integration, and nowadays we are quite happy about the East Asian growth engines. Maybe the Gulf States are just the forerunners of a Middle East growth engine in some decades to come.

Besides the Gulf States there is a number of large countries with **emerging large markets, like China, India, Brazil, and Turkey** whose airlines also have or will become active on international routes. Unlike the Gulf States, these emerging markets bring along a large and developing home market of customers. Also in these cases there are allegations about State aids and, more importantly, about shielding their own home markets against international competition while at the same time they use the Open Skies policies of developed countries for their own benefit.

These countries mainly want to develop their domestic air transport markets plus some profitable extensions to the market of international flights. From a broader EU's point of view the development of these markets and their integration into the world economy is surely more important than some possible temporary distortions they cause in the airline markets. But, of course, these countries need to respect international fair trade standards in the long run, and the more so the more developed they are.

4.1.2. General principles of international fair trade

Concerning trade policy, the world market for international flights never made it into one homogenous trade regime under the umbrella of the World Trade Organization (**WTO**). The **Chicago Convention** of 1944 paved the way for bilateral agreements about direct international flights, and since the 1990s a series of Open Skies agreements were enacted that liberalised air transport markets between, mainly, the G7 countries.

The International Civil Aviation Organization (**ICAO**), also founded by the Chicago Convention, claims that it should play a leading role in '*identifying and developing tools to promote dialogue and the exchange of information among interested authorities with the goal of fostering more compatible regulatory approaches*'. However, until now no trade rules of global validity have been set up or promoted by ICAO.

Only some aspects of air transport are since 2006 covered by WTO's General Agreement on Trade and Services (**GATS**). They concern aircraft repair and maintenance services, selling and marketing of air transport services, and computer reservation system services. Explicitly excluded are measures affecting traffic rights and all services that are related to exercising those rights. Issues of State aid are not addressed.

Notwithstanding, WTO's general principles of international fair trade can still be leaned on for evaluating air transport markets. Of particular relevance is the **WTO Agreement on Subsidies and Countervailing Measures**. It basically states that export subsidies are prohibited, where subsidies may take any of the following forms:

- a direct transfer of funds from the government to the exporter
- a tax rebate or the like for the exporter
- a government provision of goods or services other than general infrastructure, or purchase of goods
- a government subsidised financing to the exporter.

A country that has reason to believe that a prohibited subsidy is being granted by another country can enter into a dispute settlement procedure under the Article 4 of the WTO Agreement. This procedure is, however, not available for air transport since the latter is not part of the WTO. In any case, if no agreement is reached, a country may, according to the WTO Agreement, levy a countervailing duty that matches the amount of the subsidy found to exist. In order to take such a countervailing measure the complaining country must present sufficient evidence of the existence of (a) a subsidy and, if possible, its amount, (b) injury to its domestic industry, and (c) a causal link between the subsidised imports and the alleged injury. Simple assertion, unsubstantiated by relevant evidence, is not sufficient, and the Agreement states a list of criteria for the sufficiency or insufficiency of arguments.

The proposed EU Regulation on safeguarding competition in air transport basically echoes the criteria and procedures of the WTO for the EU air transport sector, which is good.

From a general economic point of view, a country must not necessarily react to export subsidies of another country. After all, its consumers benefit from cheap imports. However, a country may also care about its domestic companies and jobs. Moreover, there is reason to prevent a disturbance of an industry that is viable in principle, but threatened by distorting behaviour of other states. Why let us being pushed by another state into a non-sustainable or sub-optimal path of development, and even incur the costs of adjustment to such distortions? From a broader, worldwide perspective such distortions are even less desirable, taking into account the welfare loss of the country that grants the export subsidies.

Countervailing measures can therefore be justified on two grounds: (a) they are protective for the economy of the importing country, safeguarding it against undue economic adjustments, and (b) they are corrective for the country that grants the subsidy, by convincing it that subsidies cannot be the basis of a sustainable, long-term economic structure.

There are instances in economic history where several exporting countries of a good were stuck in a race of subsidies, which was only put to an end by countervailing duties of an importing country. In the current case of the airline industry, a carefully gauged joint action by Europeans and North Americans could be useful in making clear to other countries that Open Skies policies are not meant as a playground for export subsidies infinitely (in, both, size and time).

A careful gauge, however, should take into account **the development needs** of these countries as well as the EU's general interest in these countries' long-run growth and their trade relations to the EU. The WTO Agreement on Subsidies and Countervailing Measures recognizes that government subsidies may play an important role in economic development programs of developing countries (Article 27). And the proposed EU Regulation on safeguarding competition in air transport invokes the notion of **Union interest**: redressive measures against other countries shall not be taken if the Commission concludes that adopting redressive measures would be against Union interest (Article 10). This is an important provision that should be taken seriously when applying the Regulation.

4.1.3. Countervailing measures: the watchword should be caution

- **In transport, government subsidies are sometimes accepted, at least for infrastructure investments**

Unlike most other sectors of the economy, **the transport sector is used to government involvement and subsidies of various kinds**. In urban and local transport (buses, trams, etc.) tax money often covers the cost of investment in, both, infrastructure and rolling stock, and sometimes even a part of the operating costs. In railways huge government subsidies to the infrastructure are not only allowed, but even encouraged and asked for by the EU, and access prices to the railway infrastructure are supposed to cover only a small part (say, 10 to 20%) of the infrastructure cost. In addition, regional railway transport undertakings can get subsidies to cover part of their remaining operating costs.

For the EU internal air transport sector the Commission has issued the Communication 2014/C 99/03 '*Guidelines on State aid to airports and airlines*' that followed several decisions by the EU Court of Justice. Concerning airports, it is forbidden to subsidise operating costs (after 2024) as long as these costs are incurred by the airport's economic activities. However, air traffic control, police, customs, firefighting and safety measures are not considered economic activities and can fully be subsidised by the government. Subsidizing the investment costs of airports is allowed under certain conditions and to a limited degree. This is meant to help small, regional airports that are deemed important for regional mobility or regional development. In addition, State aid for airport investments may also be justified for a major hub airport if it helps to combat congestion. Concerning airlines, start-up aid is allowed under certain, quite restrictive conditions to cover no more than 50% of the airport charges (i.e., in this case a specific subsidy for the airline's operating costs), but no longer than 3 years. It is meant to help establishing a new route that is considered to be of regional importance by connecting a small airport.

These are EU internal standards, not directly applicable for international affairs. But in view of them the EU should not blame any other country for subsidising air traffic control or its airports' police, customs, firefighting and safety measures. Moreover, it should be acknowledged that transport infrastructure in general, including airports, is subsidised by many countries inside and outside the EU and that the same holds for some airline flights of national interest. Even in the EU, prior to 2001, airports were not generally considered as economic activities, so that they could be fully subsidised by governments. Consequently, subsidies granted prior to 2001 are still not considered as State aid today, according EU Communication 2014/C 99/03.

- **Let's be honest: It is not so easy for foreign airlines to acquire attractive slots on the main European airports**

Europe is a region with relatively high-paying customers. European airlines are in a privileged position to crop this demand potential. One particular advantage stems from their exclusive '**grandfather rights**' for slots on major European airports. Once an airline owns a slot (i.e. the right to land, stay, or take off at an airport at a particular time

during the week) – and if it uses this right more than 80% in a year – it will retain the right for this slot for the next year to come.

Under such conditions it is not easy for potential market entrants, domestic or international, to obtain attractive slots at the attractive airports where slots are scarce. From the point of view of competition policy this practice constitutes an unwarranted privilege of the incumbent airlines. This fact might be taken into account when considering countervailing measures against other countries.

- **Competition in air transport proved to be very beneficial to consumers**

In the EU the removal of all commercial restrictions for airlines has led to an increase of supply, such that more connections with differentiated qualities are offered, and to a reduction of prices. Efficiency of airlines has increased. Therefore, additional competitive pressure coming in from other countries should generally be welcomed whereas **any measures that impair competition should be seen critically**. But, of course, for a sustainable market structure the principles of **fair competition** must be adhered to.

Some experts contend that in the long run the EU market may not be large enough to support five big airline groups as they currently exist (Air France-KLM, International Airlines Group, Lufthansa, Ryanair, EasyJet). In other words, even after the recent consolidations (Air Berlin, Alitalia) more consolidations could come up in the future, reducing the strength of competition in the EU further. If it turns out the other way and market growth is large enough to support more airline groups, additional competitors from outside are welcome from the consumer and welfare points of view. Thus, in any case, **a joint EU and Middle East market** could be an attractive vision for European citizens in the long run. This would require fair competition and the absence of distorting State aids in this large market. At the same time this perspective calls for a carefully gauged and co-operative approach in the consultations with these neighbouring countries.

- **The big European airline groups are currently in healthy conditions**

Although some smaller European airlines have encountered difficulties recently (Air Berlin, Alitalia), the five big groups are doing well at the time, and the whole market, both domestic and international, is expected to grow during the next decades. Shareholder values of the big five are increasing and their EBITs¹ are substantial. According to Boeing estimates, passenger kilometres within the EU will almost double from 890 bn. in 2016 to 1.600 bn. in 2035.

This does not preclude that some injury has been inflicted on the European airlines by subsidies of other countries. Possibly they could have fared even better. But at least their existence and basic profitability has not been endangered by it. So it appears that there is **no need for hasty action**. Trade policy can and should proceed in well-considered steps.

4.1.4. Summary and recommendations

- **If subsidies of foreign states are massive and systematic, something must be done about it**

EU should then take steps to safeguard fair competition, possibly by taking countervailing measures.

- **International consultations and the threat of countervailing measures may even be helpful for developing countries**

¹ EBIT, Earnings before Interest and Tax.

State aid discipline, transparency, and the establishment of clear boundaries between government and companies are important institutional elements of economic development. For a developing country, it might be politically difficult to take such steps if they disturb well-running and profitable businesses.

Insisting on fair trade practices by importing countries like the EU might then be helpful for these countries to get ahead institutionally. This requires, however, that all complaints and demands by the importing country are well-justified and based on, both, generally accepted fair trade principles and reciprocity of actual practices.

- **Evaluations of other countries' practices should be based on general practices in the transport sector, assessment of countervailing measures should take recent practices in the EU air transport sector into account**

Subsidies are not unusual in the transport sector. They may be justified by desirable investments in airport infrastructure, by considerations of regional mobility and regional development, and by considerations of general economic development.

Moreover, evaluations of other countries' practices and of countervailing measures against them should be made in view of and comparison to EU practices. This includes assessing the effects of EU subsidies and grandfather rights for slots on the competition for international flights.

- **Policies should be based on a broad understanding of Union interests**

When deciding about policy measures, several interests of the European Union are to be taken into account. Firstly, the European Union is interested in a sound growth of the countries in question, and in their integration into the world economy. Secondly, European citizens want to benefit from intense competition between several large and sustainable airline groups, which might require a market size larger than the EU market. Thirdly, international airline markets should be working freely, without major distortions by government subsidies. Finally, European airlines should be able to take part in the growth of the overall airline markets.

At the moment, partial consolidations of the European airline market lead to higher prices for customers and higher profits for the remaining airline groups (Germany). So the focus of safeguarding competition in air transport might be laid on the intensity of competition, rather than on shielding oneself against outside competitors.

Taken together, Union interests may be seen as calling for a cautious approach towards countervailing measures.

- **Much will depend on the actual conduct of the EU executive in applying the Regulation**

How will the proposed Regulation be put into practice? It leaves ample room for different ways of applying it. The Regulation will be successful if it creates a balanced view of the facts and triggers fruitful consultations between the countries. It will be unsuccessful if it leads to strong countervailing measures that are perceived as unjust and non-reciprocal. Any actions should be based on a broad understanding of Union interests and the watchword should be: caution.

- **The practice of applying the Regulation should be evaluated scientifically**

This act of trade policy, its conduct and consequences, should be well documented and scientifically evaluated in order to learn for future steps and for other markets. Transparency and thorough evaluation of the countervailing measures, their specific justifications and their effects on competitiveness and competition and on consumer prices should be part of the package.

4.2. Legal Perspective of Trade Policy in the Aviation Sector (Pablo MENDES DE LEON)

KEY FINDINGS

- The scope of '*fair competition*' ought to be defined.
- Competition principles and concepts cannot be easily aligned with the traditional aviation law regime as laid down in Air Services Agreements (ASAs).
- '*The reasons for which Regulation 868/2004 could not be applied do not only have internal causes – as identified by the EU Commission – but also external causes, that is, related to the regulatory and policy environment.*'
- While the proposed Regulation on safeguarding competition in international air transport attempts to reconcile the market-oriented approach of the EU with more traditional, public service-oriented regimes governing the operation of international air services, a number of questions remain as to the practicality, and perhaps also legality, of certain provisions of the proposed Regulation.
- Airlines should be qualified as '*undertakings*' before being admitted to operate their services under provisions of ASAs. The EU Commission could table this premise qualifying airlines pursuant to its envisaged market approach in its negotiations with third countries.
- Other solutions may be found on unilateral measures, such as the employment of the '*effects*' doctrine', or multilateral measures, such as the involvement of international organisations, in particular the International Civil Aviation Organization (ICAO) which, however, also depends on more '*traditional*' jurisdictions.

4.2.1. The Proposal for a Regulation of the European Parliament and of the Council on safeguarding competition in air transport, repealing EU Regulation 868/2004²

On 8 June 2017, the EU Commission submitted the above proposal to the EU Parliament and Council, henceforth also referred to as the Proposal. In it, the EU Commission articulates the strong growth of European and global air transport which is taking place under the forces of 'global competition' while an '*international framework ... governing competition among air carriers*' is missing, resulting in a different treatment of practices of air carriers providing their services internationally. The Proposal also signals that the lack of a global regime may result into '*unfair competitive advantages to air carriers from ... third countries*' caused by '*discriminatory practices and subsidies*' in such third countries.

While the Commission acknowledges that '*EU airlines are ultimately responsible for their competitiveness and must continue to adapt their products and business models to the prevailing market conditions (...)*' it is '*equally important that competition, both within the EU and externally, is based on openness, reciprocity and fairness and that it is not distorted by unfair practices*'³. This state of affairs could or should be remedied not only by the air carriers themselves, as to which see above, but also by the establishment of regulatory measures from the side of the EU in the absence of:

² COM(2017) 289 final.

³ EU Commission Communication, The EU's External Aviation Policy - Addressing Future Challenge COM(2015)598 final, 7.12.2015.

- A global competition regime addressing competitive behaviour of, and subsidies benefitting certain carriers;
- The applicability of the General Agreement of Trade in Services (GATS) of the WTO, including subsidy rules and procedures for addressing subsidies, to – core – air services;
- Competition and State aid rules laid down in Air Services Agreements (ASAs) governing the operation of the agreed international air services.

Thus, the EU must take action because principal interests including connectivity and competition are at stake. This EU action has consisted of the introduction of EU Regulation 868/2004, henceforth also referred to as the Regulation, but it has never been applied. The EU Commission continues to explain the shortcomings of this Regulation which, it says, are due to factors pertaining to:

- The limited scope of the Regulation;
- Procedural shortcomings;
- The provision of evidence.

That is why the Commission has made a Proposal for a new Regulation which is the subject of the discussions in the present Workshop. The proposed articles are attached to the above 'Explanatory Memorandum' and will be examined in the next section.

4.2.2. Comments and analysis of the Proposal

The Commission's concerns are understandable. It is tasked with protecting the '*core values*' of the EU encompassing an 'open market economy with free competition'⁴. The basic question is how to apply these goals to the air transport sector and reconcile them with the regulatory regime governing it, which does not proceed from '*open markets*' and '*free competition*' – in many cases, this regulatory regime proceeds from a contrary position, as to which see section 4.2.3. below.

The Commission opts, and I believe rightly so, for the concept of '*fair competition*' rather than '*free competition*'. As I see it, '*fair competition*' proceeds from balanced rules designed to maintain a '*level playing field*' – in this case among air carriers – whereas '*free competition*' sounds more akin unbridled competition. The term '*unbridled*' may not be the right interpretation either, as the EU proceeds from the 'rule of law', but the term '*open market ... with free competition*' gives a very liberal view of the marketplace which is dominated by the '*invisible hand*' of the forces working there. The opposite is true for the operation of air services, as to which see section 4.2.3. below.

However, '*fair competition*' is nowhere defined. Admittedly, it is not easy to define this term but it would seem that the grant of subsidies is an '*unfair practice affecting competition*'⁵. In other words, the performance of this practice, that is, 'the grant of subsidies', equals '*unfair competition*', next to, presumably, the engagement into concerted actions and abuse of a dominant position⁶. That seems, at least, to be the European position regarding '*fair competition*', but there is no global understanding of its meaning. Remarkably, the EU is one of the very few jurisdictions in the world regulating State aid and subsidies. Most other jurisdictions prefer to keep subsidies as a trade instrument which is, and should remain at the disposal of governments without control from the judiciary, at least insofar as

⁴ See, among others, Articles 119, 120 and 127 TFEU.

⁵ See, Art. 2(f) of the Proposal: "*practices affecting competition*" means *discrimination and subsidies*'.

⁶ See, Articles 101 and 102 TFEU.

air transport is concerned. In other words, subsidising is not necessarily unfair outside the EU.

This remark leads to another point regarding the question why Regulation 868/2004 has never been applied. While the EU Commission, in its *'Explanatory Memorandum'*, focuses on the internal shortcomings, as to which see the end of section 1 above, it does not analyse the international regulatory context in which this regulation is placed, and which has led, in my view, to the frictions between that Regulation (868) and *'the outside world'* that is, the global air transport market and the regimes governing it. The signalled friction between the EU position and that of the *'outside world'* comes back in the following situations:

- There is no definition of which acts or behaviour, and conducted by which parties, might constitute *'fair'* - or *'unfair'* - competition.
- In recital 3 of the proposed Preamble the Commission states that *'fair competition is an important principle of the ... Chicago Convention ...'* and refers to a number of provisions of that Convention which, in my view, do not refer to, or regulate *'fair competition'* - a subject which falls outside the scope of this Convention which is basically a safety convention rather than a convention on economic regulation of air services which is in turn left to States pursuant to their ASAs with other States.
- I understand that the Commission should be mandated to conduct investigations *'and to take measures where necessary.'* But how should this happen in relation to States where the EU is not a party to the ASA in question? Prominent examples are ASAs with China, Russia, and India, though many more exist. Even when the EU is a party to the ASA in question, that ASA should provide for the intervention from the Commission - which in most cases is not underpinned by legal procedures and provisions. True, the EU Commission acknowledges that the EU should follow such procedures in cases where *'The Union is party to an air services agreement with a third country ...'* (recital 10), but I miss an analysis of provisions of relevant agreements explaining how this should work in practice.
- In the same vein, the reference to a *'trade agreement to which the Union is a party'* in Article 2(c) is puzzling as airlines do not fly under trade agreements but, rather, under ASAs, as to which see section 4.2.3. below.
- Realistically, on the one hand, the EU Commission acknowledges that such investigations are carried out *'subject to the consent of the third country and the third country entity concerned'* (recital 12); however is it realistic, on the other hand, to expect that such third parties will grant consent considering that they can only lose from such an investigation, and may be hesitant to convey confidential public policy and private enterprise information to the Commission?
- I would put forward the same question in the context of enforcement (recital 19). Is it realistic that the public authorities in the third countries will help the EU Commission get hold of assets - unless such assets are located in an EU State? Yet even in the latter case, I believe that the parties, including the EU, should have an agreement on the remedies and enforcement as this is how States work together - in consultations and negotiations - when agreeing on the operation of air services, as to which see the last part of the next section.
- Although I understand the underlying rationale, legally speaking I am nonetheless slightly puzzled why *'fair competition'* principles in the EU apply to *'undertakings'* (see Articles 101, 102 and 107 TFEU), whereas the Proposal is designed to apply to a *'third country entity'* - whether this entity is an undertaking or a public body. To apply competition principles to public bodies appears to be a brave exercise, not

only from a legal but also from a public policy perspective. I guess that trade, perhaps in the form of retaliation, and diplomatic actions cannot be excluded – but again, this point deserves a deeper examination.

The above are my principal considerations. They may be contextualised in the next two sections.

4.2.3. The global air transport market and regime

The global air transport market is governed by the Chicago Convention on international civil aviation of 1944. The Chicago Convention has a global reach: 192 States, including all EU States, are party to it⁷. Only States can become a party to this convention; Regional Economic International Organisations (REIOs), including the European Union (EU), cannot accede to it.

Sovereignty is the cornerstone of the Chicago Convention which must be considered as the constitution of world-wide civil aviation. As a corollary of the '*complete and exclusive*' sovereignty governing national airspace, it was *de iure* closed for foreign aircraft and their operators, that is, international airlines. In the economic field, this starting point is laid down in Article 6 of the Chicago Convention, which states that 'special permission' must be granted for the operation of scheduled international air services. Such '*special permission*' is given in so-called Air Services Agreements between States, opening each other's national airspace and market for the operation of international air services, and containing conditions pertaining to market access and market behaviour of the designated airlines. There are at present some 4000 to 5000 Air Services Agreements regulating international air services and market access world-wide. In other words, the '*skies*' are closed until they are opened up by an Air Services Agreement concluded between States, and, in exceptional cases, the EU⁸.

Under the now out-dated Bermuda II Agreement between the US and the UK, restrictive provisions contained therein did not intend to create open market access, and promote '*fair competition*.' The idea was to give carriers of each State an '*equitable share*' of the transport market created by the agreement between the two States. To determine the '*equitable share*' was left to the clauses of the agreement. Predetermined access to the market by the establishment of equal capacity limited competition in those markets. Predetermined economic regulation drastically levelled up the playing field, prohibiting market entry and exit. One could also speak of an '*incontestable market*.'

While the international air transport market – as, traditionally, regulated by bilateral air services agreements – came to be divided on the basis of the '*home*' traffic of the designated carriers, the EU and other competition law regimes stand squarely opposed to concepts such as '*predetermination*' and division of market shares. Rather, the EU competition law regime proceeds from a policy of open markets in which services and goods can be freely offered and sold. Thus, that market is regulated by competition rules which apply to the market behaviour once it has taken place (*ex post facto*).

In traditional bilateral agreements, airline cooperation is not only favoured but it may also be mandated, thus restricting or eliminating competition between the designated air carriers from the two sides. This tension between the two regimes is explained by the Secretariat of the International Civil Aviation Organization (ICAO) in the following statement:

⁷ Per January 2018.

⁸ See the EU-US Agreement on air transport of 2007/2010, and the EU-Canada Agreement on air transport of 2009.

'Furthermore, the traditional approach in many bilateral agreements favouring airline cooperation on issues like capacity and pricing is *squarely at odds* with competition laws that strictly prohibit price fixing, market division and other collusive practices by market competitors.'⁹.

As a consequence, competition rules may be made to apply in markets which are governed by an absence or minimum of predetermined economic regulation as exemplified by 'Open Skies' agreements. The most prominent examples of 'open markets' governed by 'fair competition' principles are the EU internal air transport market,¹⁰ markets linking the EU internal market with markets in the Mediterranean area, for instance, Israel and Morocco, and those governed by a very limited number of ASAs between EU Member States and third countries such as the US and Canada.

Thus, I would put forward that the lack of application of EU Regulation 868/2004 is not only due to the '*internal*' factors identified by the EU Commission, but also due to '*external factors*' which are referred to above. It - the Regulation regulating subsidies - has to fit in a rather uneasy relationship: it has to reconcile the - EU - competition regime severely limiting the use of subsidies, with '*global rules*' - including of the Chicago Convention and ASAs - which do not address subsidies, or which even implicitly allow them through the combined effect of practices and lack of regulations limiting or forbidding them. That challenge must also be taken care of, as to which see section 4.2.4.

States parties to ASAs normally agree to enter into consultations and negotiations when they disagree on a point which is covered by the provisions of that ASA. Obviously, such a point of discussion could concern the question of how competition between the designated air carriers from the two sides should be managed. The representatives of those States, mostly civil servants of the Civil Aviation Authority (CAA) and the Ministry of Foreign Affairs, start talking, which may result into an amendment of the agreement. Exceptionally they take recourse to arbitration or terminate the ASA. Thus, disagreements are solved by diplomatic action.

4.2.4. Conclusions and recommendations

The question of '*fair competition*' in international air transport is not an easy one to handle. Its scope has to be defined, and policy makers ought to realise that it will not be easy to formulate an internationally agreed definition. It follows from section 4.2.3. that the regulatory regimes under which air services are operated in the various parts of the world, and the prevailing differences between them, also does not help to introduce this concept into those regimes.

States may consider air transport as a '*public utility*' serving its interests, rather than a commercial enterprise. Admittedly, this view is changing but is still present.

The EU has always been in the forefront when it comes to venturing more up to date perspectives regarding the operation of air services. It considers air transport as a '*normal economic activity*' which should not be protected by State policy or protection. From that line of reasoning, the introduction of the proposal is a logical step. Moreover, it attempts to remedy the shortcomings of Regulation 868/2004, and succeeds in doing so in certain cases by articulating, among others, the relevance of '*international obligations*', even though it still shows arguments and provisions which cannot be easily aligned with the existing regime governing international air services, and the way disagreements are solved.

⁹ Air Transport Conference (ATC) 6, Working Paper 4 at 4.4 (2013), italics added by the author.

¹⁰ See EU Regulation 1008/2008.

'Fair competition' concerns market behaviour of the undertakings, in this case airlines, or air carriers. I would suggest that competition must be linked with market access principles; in other words, access to the 'air transport market' governed by the ASA ought to be allowed to airlines which qualify as 'undertakings' as defined by the European Court of Justice¹¹. Air carriers are defined in the Proposal,¹² whereas airlines are an 'air transport enterprise offering or operating an international air service' under the Chicago Convention. These notions should be more strictly addressed because the application of 'fair competition' principles to public entities may yield problems.

Other steps may include the proposals for 'fair competition' clauses in ASAs. The European Commission has already made suggestions thereto. The Aviation Strategy (2015)¹³ also underlines the importance of pursuing the negotiation of fair competition clauses in EU and Member States' bilateral aviation agreements, and making progress at the multilateral level in parallel to improving the effectiveness of this instrument.

Many jurisdictions in the world allow for the use of the 'effects' doctrine in which case the European Commission, as the EU competition authority, may intervene in market behaviour in case a non-EU airline's behaviour, including perhaps the use of public funds for its operations, produces anti-competitive effects on the EU market. Reliance on the 'effects' doctrine can also contribute to address subsidies granted to non-EU air carriers.

Enforcement could be organised by:

- Consultations and negotiations to begin with;
- Involvement of the Joint Committee established under EU 'sponsored' agreement which may be mandated to refuse or suspend the operating authority of the subsidised carriers (see the EU-Canada (2009) and the EU-Israel (2013) agreements);
- Making use of the model of the dispute settlement mechanism of the WTO, including the effect of the imposition of 'countervailing measures in case of 'adverse effects' of the subsidisation on the trade relations between the concerned parties.

On the longer term, the formulation of an international fair competition regime can be suggested through ICAO - rather than WTO/GATS - by supporting ideas for the formulation of economic regulation in an ICAO Annex.

The foregoing initiatives are not mutually exclusive and may be achieved in combination.

However, the application of competition law regimes to the operation of international air services also remains subject to the bilaterally - or plurilaterally¹⁴ - agreed standards laid down in Air Services Agreements. As remarked in section 4.2.3., the relationship between bilateral air transport agreements on the one hand, and competition law regimes on the other is a delicate one which must be approached with caution, and this on a case-by-case basis.

¹¹ See, for instance, ECJ Case C-41/90 *Höfner and Elser v. Macrotron GmbH* (23/04/1991) ECR I-1979, para. 21.

¹² See, Art. 2(a).

¹³ See, section 2.1.

¹⁴ WTO term, meaning that only some members are involved; whereas 'multilateral' would mean that all members are involved.

4.3. Written contribution by the International Civil Aviation Organization (ICAO), European and North Atlantic Office

Since a representative of ICAO could not participate in the Workshop, ICAO kindly agreed to reply in a written form to some of the questions discussed.

4.3.1. Is there a risk that third country service providers might suffer competitive disadvantages by the application of the proposed regulation?

The area of concern for a third country service provider may include:

- The proposed amended regulations seem as a safeguard or protection for the EU carriers against carriers from third country rather than regulations on fair competition.
- The nature of the regulation itself does not create a 'level playing field' which is the primary objective of 'fair competition'.
- The process of the investigation stated in Article 3 does not give the air carrier from the third country the opportunity to react to any allegation against it by the Union's air carrier for the commission to determine whether there is basis for the investigation. The third country air carrier or its representative is only officially notified after the publication of the notice to initiate investigation has been made in the official Journal of the European Union based only on evidence provided by the Union's air carrier.
- Nothing is stated in the regulation on proposed action to be taken against an air carrier of a third country whose government denies access to the Commission to carryout investigation in its country.
- The regulations may necessitate the renegotiations of some existing bilateral air services agreements.

One of the conclusions of the 5th Worldwide Air Transport Conference (ATConf/5) states that *'in cases where national competition laws are applied to international air transport, care should be taken to avoid unilateral action. In dealing with competition issues involving foreign air carriers, States should give due consideration to the concerns of other States involved. In this context, cooperation between or among States, especially between or among competition authorities, and between such authorities and aviation authorities, has proven useful in facilitating liberalization and avoiding conflicts'*;

It is also important to refer to ICAO's Assembly Resolution A39-15, Appendix A, Section III (4) which *'encourages Member States to incorporate the basic principles of fair and equal opportunity to compete, non-discrimination, transparency, harmonization, compatibility and cooperation set out in the Convention and embodied in ICAO's policies and guidance in national legislation, rules and regulation, and in air services agreement'*.

4.3.2. How to deal with the issue of competition in regions where the government controls the air carriers or companies? How severe are the obstacles/challenges EU carriers have to face on markets outside the EU, in relation to tax regimes, potential subsidies or State aid?

There is nothing wrong in public ownership of commercial enterprises in a competitive environment as long as such entities can operate under the same conditions as the privately-owned entities and are separated from the regulatory authorities. ICAO's Assembly Resolution A39-15, Appendix A, Section III (1) urged *'Member States to take into consideration that fair competition is an important general principle in the operation of*

international air transport services. Air carriers must be given equal opportunity to operate irrespective of whether they are government owned or privately owned.

The issue of taxation on international air transport is normally addressed in the bilateral air services. Most air services agreements contain clauses which address the issue of taxation especially avoidance of double taxation. ICAO has developed policy guidance for States, which encourages the exemption from taxation, mostly on a reciprocal basis, of certain aspects of international Air Transport operations. This policy guidance is contained in *ICAO Doc. 8632 – ICAO's Policies on Taxation in the Field of International Air Transport*.

Government support to air carriers, through the provision of subsidies and aids that are not available to competitors in the same international markets may distort trade in international air services and can constitute or support unfair competitive practices. However, there are certain circumstances which may justify such aids/subsidies, particularly when such aids/subsidies are to ensure sustainability of the air transport industry and to address their legitimate concerns relating to assurances of services as well as ensuring essential air services of public service nature. Granting such aids/subsidies should however be done in a transparent manner.

4.3.3. How could a worldwide cooperation in the aviation sector be strengthened? Is there a chance to standardise the trade practices in the aviation sector?

Worldwide cooperation in the aviation sector can be strengthened through dialogue and exchange of information among States and regional competition authorities. ICAO, on its part, has continued to develop tools to enhance the transparency of States' competition rules, and to foster cooperation, dialogue and regulatory compatibility.

ICAO has therefore developed a compendium of competition policies and practices in force, nationally or regionally, which can be found at:

<http://www.icao.int/sustainability/compendium/Pages/default.aspx>.

In addition, the organisation has provided several exchange fora on competition issues for the aviation community through various meetings, including the ICAO Air Services Negotiation (ICAN) 2014 event in Bali, Indonesia and the third ICAO Air Transport Symposium (IATS, March 2016, Montréal). The report of the IATS2016 is available at: <http://www.icao.int/Meetings/iats2016/Pages/default.aspx>.

One of the conclusions of the IATS2016, is that while global regulatory convergence on competition rules and policies is desirable, regional harmonisation of competition policies and rules are more feasible in view of the varying levels

4.3.4. Is there a lack of transparency about the funding (i.e. State aid) received by third country air service providers?

ICAO is yet to carry out an investigation concerning the granting of aids/subsidies. Moreover, some airlines do not disclose their financial results meant to be submitted in *ICAO Form EF – Financial Data – Commercial Air Carriers* as statutorily required.

One of the conclusions of the 5th Worldwide Air Transport Conference (ATConf/5) on the issue of subsidies and aids to national airlines was that: *'because of the lack of an acceptable quantification method and the existence of various non-monetary measures, it is very difficult to estimate accurately the full scale of State assistance and the impact of specific State assistance on competition. Given this difficulty, States should recognize that any actions against foreign airlines which receive State aids/subsidies might lead to retaliatory action by the affected State and hamper the ongoing liberalization of international air transport'*.

ICAO has continued to encourage its Member States to comply with ICAO policies on competition issues on international air transport including those on the granting of aids/subsidies.

- 4.3.5. Some international agreements provide for the obligation to exhaust all available legal instruments before a sanction can be established. This results in a conservation of the status quo and a long duration of the procedure before a conflict can be solved. How would this obligation impact the application of the proposed Regulation?

Article 1 of the Chicago Convention recognises that every Contracting State has complete and exclusive sovereignty over the airspace above its territory. Therefore, international air transport services are governed by air services agreements between States. Such agreements have stipulated provisions for dispute resolution mechanisms, which States are to comply with. EU Member States or/and the third Countries may request for amendment of the dispute resolution clause which allows for speedy resolution of disputes and implementation of the new Resolution.

ICAO has developed '*Guidance Material on the avoidance or resolution of conflicts over the application of competition laws to international air transport*' contained in Appendix 2 of the *ICAO Doc 9587 - Policy and Guidance Material on the Economic Regulation of International Air Transport*.

- 4.3.6. Since there seem to be no rules that ensure fair competition on the international level, what chances are there that ICAO can successfully advocate to establish such principles?

As earlier stated, ICAO has developed several policies and guidance materials on the basic principles of fair competition including the Assembly resolutions on competition issues and the recommendation of ATConf/5 on what constitutes unfair competitive practices. Some of these policies and guidance materials are contained in *ICAO Doc 9587 - Policy and Guidance Material on the Economic Regulation of International Air Transport*. In addition, ICAO has also published the *Manual on the Regulation of International Air Transport (Doc 9626)* which describes the regulatory practices of States and discusses some related key issues in air transport.

Most ICAO Member States are using these policies and guidance materials in their regulatory practices.

- 4.3.7. In which way will the proposed regulation be more efficient than the current regime of Regulation No 868/2004?

The new regulation that the EU commission proposed will be more efficient if it is perceived to foster and promote a level playing field than as safeguard for the EU carriers by the third country. Moreover, it would have been easier to implement if there were clear definitions of terminologies or criterion which can be measured in a quantitative way.

The international air transport today requires a balanced regulation which supports competitive aviation business environment that allows all air carriers irrespective of nationality to compete and consistently improve their service quality for the benefit of the travelling public.

The Commission needs to promote continuous exchange of information on the regulation as it supports fair competition and dialogue with authorities of third countries, as an important key in building trust and resolving disputes.

- 4.3.8. Issues of compatibility between EU rules (including the proposed regulation) and bilateral or multilateral agreements: Are there specific points of conflict? Will this lead to disagreements on international level, such as WTO and at the International Civil Aviation Organization (ICAO)? Can the proposed regulation be implemented without frictions?

The comments provided above already answer this question. In addition, ICAO encourages the EU to engage in dialogue with the third Countries whose carriers may be affected by the implementation of the regulation.

- 4.3.9. How to strike a balance between fair competition and the connectivity of remote EU-regions and security and rights of passengers and citizens?

Air connectivity has acquired a new strategic relevance in the context of global economic shift and the growth of emerging economies. Those emerging economies concerned have successfully integrated aviation into their economic development policies which enhance their competitive advantage.

ICAO believes that liberalisation on air transport should be intensified for the benefit of air connectivity and the larger economy. States should put air connectivity and the interest of the traveling public at the core of their aviation policies based on a long term and coherent strategic vision. Cooperation amongst aviation industry, tourism industry and the broader economy are critical to the advancement of this industry.

In addition the following should be noted:

- The aim of aviation regulations should be to ensure equality of opportunity (in line with the spirit of Chicago Convention) rather than equality of outcome.
- There is need for an agreed international framework to define acceptable public subsidies across the aviation value chain.
- Air connectivity is required for assurance of essential services and development of trade and tourism as well as the larger economy.
- States should continue to pursue the liberalisation of air transport as it engenders the maximisation of the socio economic benefits of aviation to the people and the States.
- States should ensure that enforcement mechanism of regulations does not impede liberalisation and growth of sustainable international air transport.

5. SUMMARY OF THE DISCUSSION

After having followed the presentations by Professor Kay MITUSCH and Professor Pablo MENDES DE LEON the discussion started with a question by Ramon TREMOSA i BALCELLS (MEP, ALDE), rapporteur of the ECON legislative opinion on the Proposal for a Regulation on Safeguarding competition in air transport, repealing Regulation (EC) No 868/2004. Ramon TREMOSA i BALCELLS asked Professor MITUSCH about the economic condition of European airlines and whether he regarded them as healthy enough to compete successfully with competitors coming from outside the European Union, especially from the Gulf area. Mr TREMOSA i BALCELLS was worried about the financial power of those airlines. To illustrate the financial power of airlines Mr TREMOSA i BALCELLS mentioned that for example Emirates had significantly more aircrafts at their disposal than Air France, British Airways and Lufthansa together. He was interested to know whether third country airlines could be required to provide financial transparency. He also asked about the most significant changes to EU airlines resulting from the proposed new regulation. Professor MITUSCH replied that probably transparency would be the most positive effect of the proposed regulation and would also have long term benefits. He added that for the time being he did not see European airlines in an emergency situation and pointed at rising share values. Should the proposed regulation enter into force, the European Commission could proceed in well thought steps and ask airlines to disclose how their financial situation has evolved. However he feared that big airlines would urge for quick reactions which might lead to premature measures.

Wolf KLINZ (MEP, ALDE) raised the question whether it would not be good to find a way to also apply WTO rules to the air transport services. He recalled the example of the aircraft manufacturers Airbus/Boeing when WTO rules helped to settle a long-lasting conflict. In reply to Professor MITUSCH, Mr KLINZ was more sceptical about an increase of transparency. With view to Chinese or Indian airlines of those of the Arab region he was in doubt whether those airlines would be willing to open their books. The access to financial data was of course no issue if these companies were stock listed but since especially Arab airlines were mostly government owned, financial transparency does not seem easy to achieve. On the economic state of EU airlines Mr KLINZ pointed at the recent cases of Air Berlin and Alitalia that have or were about to disappear. Turning towards low cost carriers that are currently catching up he emphasized that for instance Easy Jet was now bigger than Lufthansa and carried more passengers in the previous year. This resulted in the question whether economic problems indeed came from '*unfair*' competition or was it more the fact that certain airlines had accepted wages and working conditions that were no longer competitive. Professor MENDES DE LEON explained that with the exemption of three ancillary services¹⁵, services generally fall outside the scope of WTO/GATS rules because of frictions between the European Union that would like its principles, such as competition principles and anti-subsidy principles, to be applied in the internal market and third countries who are reluctant to apply them. Both sides would like to keep their influence on the airlines and air transport services of their regions as a tool of trade policy and did thus not come to a consent. As a difficult example Qatar Airways was mentioned, whereas Emirates might be more flexible and easier accessible. On the conditions of the European market Professor MITUSCH added that the state of competition was more important than the number of competitors. He regarded it as a good sign that in the current situation of economic growth in the European Union five different airline groups were operating, profitable and in competition with each other. He referred to other experts who argued that the European Union market was not even big enough for five groups and that those groups would have to search for a bigger geographic market. Here one could think to a combined

¹⁵ Aircraft maintenance, repair distribution and selling of computerised, i.e. GDS, systems.

area of the European Union and the Middle East which would then be shared by six or seven groups.

Upon the question by Mr KLINZ whether there existed currently fair competition in the European Union and whether airport slots and how they are allocated had to be seen as a serious competition problem inside the European Union, Professor MITUSCH agreed to this assessment and replied that since competition only started as of the 1990s he was satisfied to see five healthy and, for the time being, also sustainable groups in the market. He emphasized that the international markets grew intensively and very fast during this time and the existing five groups fared very well in this context. Professor MENDES DE LEON put the question of fair competition and the remark on slots into the context of having a level playing field within the European Union where some competitors have to deal with congested airports such as London, Charles de Gaulle or Frankfurt etc. He also agreed that the state of competition within the European Union was very beautifully harmonised, which could also be seen as a result of Regulation No 1008/2008¹⁶. However, he saw a more serious problem in the fact that tax and labour rules were exploited and fiscal advantages were taken by airlines such as Ryanair or Norwegian Air who try to make use of different national rules that are not harmonised.

Markus FERBER (MEP, EPP) described the European policy in aviation more as market driven compared to the approach of the United States which was much more politically driven and asked whether the European Union should design its own strategy on aviation including taxation, labour rules etc. and to develop the market. A mainly market driven approach could entail the risk of having third country air carriers playing a major role within the European Union. Professor MENDES DE LEON explained that this political question highly depended of the willingness of the Member States. The same was true for the development of the project of a Single European Sky or air traffic management. Such questions of harmonisation did not advance very quickly. A more holistic approach was a good idea but proved to be rather difficult.

Caroline NAGTEGAAL (MEP, ALDE) also referred to the Single European Sky and asked which approach would be ideal to achieve a level playing field and fair competition in the future. Professor MENDES DE LEON replied that inside the European Union it should not be underestimated that a lot had already been achieved for the air transport sector through Regulation No. 1008/2008 which is currently reviewed by the European Commission. Further harmonisation would require the harmonisation of other facets, including for instance environmental issues, which increasingly affect the operation of air services inside the European Union.

With view to the proposed regulation Professor MITUSCH added that the general market conditions, i.e. rules on labour, taxation or environment, were a question 'internal' law of the European Union. Professor MENDES DE LEON agreed to this. For instance, labour conditions were not the same in the European Union and elsewhere. Consequently it would be misplaced to introduce them into the proposed regulation that primarily deals with trade rules.

¹⁶ Regulation (EC) No 1008/2008 on common rules for the operation of air services in the Community, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32008R1008&from=EN>.

6. BACKGROUND

The topic of the workshop was selected by the ECON Working Group on Competition Policy to have a look at the current state of competition in the aviation sector. Next to this, the workshop should provide expertise with regard to committee discussions about the legislative opinion ECON prepares on the proposal for a regulation of the European Parliament and of the Council on Safeguarding competition in air transport, repealing Regulation No 868/2004¹⁷.

The aviation sector is characterised by a network of service interlinkages to provide connectivity between different destinations, countries and jurisdictions. Air carriers play a key role in providing these services.

On the international level, the Chicago Convention¹⁸ of 1944 is the legal basis for bilateral agreements. On this basis, the International Civil Aviation Organization (ICAO) establishes standards and practices to ensure safe and efficient civil air transport¹⁹. However, the existing standards lack coherent rules on competition.

Within the European Union the European rules ensure that air carriers are granted the same rights and opportunities of accessing related services. For this purpose three packages of measures covering intra-EU traffic, air carrier licensing, market access, full freedom with fares were adopted by the European Institutions, chronologically in 1987, 1990, and 1993²⁰.

However, liberalisation and deregulation of international air transport have fostered unprecedented competition within the European Union market and globally. Around 918 million passengers travelled by air in the European Union, and more than 1.45 billion passengers arrived and departed via EU airports in 2015²¹. Air carriers based in the EU are confronted with third country competitors that do not have to adhere to the same strict rules, such as EU competition law including the regime on State aid. This results in different business conditions which are deemed to be unfair.

The European Commission has recognised that while EU airlines are ultimately responsible themselves for their competitiveness and must continue to adapt their products and business models to the prevailing market conditions, it is important that competition, both within the EU and externally, is based on openness, reciprocity and fairness and that it is not distorted by unfair practices.

The current proposal for a regulation of the European Parliament and the Council on safeguarding competition in air transport, repealing regulation (EC) No. 868/2004, aims to establish a defence mechanism that could be triggered in case EU air carriers suffer from unfair disadvantages caused by, for instance, discriminatory practices by third country providers. The previous regulation is considered to have been unable to adequately address the specific characteristics of the aviation services sector and has thus never been used.

By replacing the existing regulation with the proposed instrument combined with increased efforts on the international scene, including the negotiation on air transport or services agreements, it is aimed to promote a more effective competition in the aviation sector.

¹⁷ <https://ec.europa.eu/transport/sites/transport/files/com20170289-proposal-regulation-safeguarding-competition-air-transport.pdf>.

¹⁸ https://www.icao.int/publications/Documents/7300_orig.pdf.

¹⁹ For more details on the role of the ICAO see <https://www.icao.int/about-icao/Pages/default.aspx>.

²⁰ http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/582021/EPRS_BRI%282016%29582021_EN.pdf.

²¹ http://europa.eu/rapid/press-release_MEMO-17-1473_en.htm.

ANNEX: FOR FURTHER READING

European Commission, Proposal for a Regulation of the European Parliament and the Council on safeguarding competition in air transport, repealing Regulation (EC) No 868/2004.

<https://ec.europa.eu/transport/sites/transport/files/com20170289-proposal-regulation-safeguarding-competition-air-transport.pdf>

European Commission, Commission staff working document executive summary of the impact assessment, accompanying the document proposal for a Regulation of the European Parliament and of the Council on safeguarding competition in air transport, repealing Regulation (EC) N° 868/2004.

<https://ec.europa.eu/transport/sites/transport/files/swd20170183-executive-summary-ia.pdf>

Regulation (EC) No 868/2004 of the European Parliament and of the Council of 21 April 2004 concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community.

<http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex:32004R0868>

Debyser, Ariane, Safeguarding Competition in Air Transport. Briefing covering the background history, and the European Commission Proposal on repealing the Regulation (EC) No 868/2004, EPRS, September 2017.

http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/608689/EPRS_BRI%282017%29608689_EN.pdf

Debyser, Ariane, EU external aviation policy. Briefing covering the International Civil Aviation Organization (ICAO), the development of the EU's external aviation policy, its current challenges and recent developments. It also analyses the views of the European Parliament on the EU's external aviation policy, EPRS, May 2016.

[http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/582021/EPRS_BRI\(2016\)582021_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/582021/EPRS_BRI(2016)582021_EN.pdf)

WORKSHOP



POLICY DEPARTMENT A
ECONOMIC AND SCIENTIFIC POLICY

COMPETITION IN AIR TRANSPORT



DATE
24 January 2018

TIME
17:00-18:00

ROOM
**PAUL-HENRI SPAAK
BUILDING
03 C 050**

**Committee on Economic
and Monetary Affairs**

The workshop will take place during the committee meeting.
The meeting will be webstreamed.

NOTES

Competition in the aviation sector pertains to different sets of rules, competition law on the one hand and, given the cross-border interdependencies of transport markets, international rules on the other hand. The workshop aimed to examine the current situation of competition in air transport using the proposed regulation on Safeguarding competition in air transport, repealing Regulation (EC) No 868/2004 as a practical example and starting point for the discussion. The Committee on Economic and Monetary Affairs (ECON) has prepared a legislative opinion to this dossier.

This Workshop was prepared by Policy Department A at the request of the Committee on Economic and Monetary Affairs (ECON).

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