



# Committee on Economic Development of Air Transport – Topic 2

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<sup>1</sup> This paper reflects the author's personal views and cannot be considered as the views of ICAO.

# THE QUESTION OF GLOBAL ECONOMIC REGULATION OF AIR TRANSPORT

## 1. Introduction

The economic regulation of international air transport has been a long-standing question mark in particular since globalisation has started reshaping the international air transport industry.

This briefing paper provides a short background on the history of the economic regulation of air transport, the role of the International Civil Aviation Organization (ICAO) and the challenges that a fragmented regulatory framework based on sovereignty has raised for a global industry.

## 2. Economic regulation and ICAO

The question of the economic regulation of air transport goes back to the beginning of commercial aviation and was a core issue during the preparations and negotiations of the Chicago Convention of 1944 (“the Convention”), which still serves as the backbone of the regulation on international civil aviation. Indeed, even today the Convention covers almost the whole spectrum of aviation from safety and security, licensing, communication, operational aspects, etc. However, what is clearly missing is any meaningful regulation of the economic aspects of international air transport, namely traffic rights and related issues, with the Convention being restricted to a few isolated references to economic matters.<sup>2</sup>

Historically, this limitation of the scope of the Convention can be explained by the lack of agreement among the States negotiating the Convention back in 1944, the UK and the US in particular. The US, on one hand, which had a huge capacity of aircraft that could be reused for civil purposes after the Second World War, desired to obtain access for its airlines to all markets around the world, while the UK, which suffered enormous losses in the war and had much more limited airlift capacity, was keen on maintaining privileged air connections with the (former) British Empire. Such diverging views finally resulted in leaving out economic matters, especially traffic rights, from the scope of the Convention. A separate convention on traffic rights<sup>3</sup> attracted a very limited number of signatories and thus failed to gain importance.

Examining further the roots of this historical omission, one can observe that State *sovereignty* over the airspace, the most fundamental principle underlying the Convention, must have a role to play. Indeed, by opting for almost unlimited sovereignty as the basis for international aviation relations,

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<sup>2</sup> See in the Preamble: “equality of opportunity”; in Article 44: “fair opportunity” and “avoid discrimination”; and in Article 54 (i): “subsidies paid to airlines”.

<sup>3</sup> International Air Transport Agreement, signed at Chicago, on 7 December, 1944 (“Transport Agreement”)

States also decided to directly manage access to their airspace including by commercial aircraft.<sup>4</sup> Bilateral air service agreements (ASAs) following the Bermuda model<sup>5</sup> became the norm to regulate access by the designated airlines of the two parties to the air transport market between the two signatory States. ASAs, even today, regulate all areas of providing air services, from the number of airlines that may be designated, through air routes to fly, frequencies (number of flights operated in a given time period), aircraft capacity, to air ticket prices etc. Traditionally, the civil aviation authorities of States kept a close eye on how the “market” developed and intervened to protect their airlines from any undesirable consequences, for example, when the other airline introduced “excessive” capacity on a route.

### 3. Challenges by liberalisation and globalisation

This regulatory model was working well in a structure where airlines (“flag carriers”)<sup>6</sup>, airports, air navigation service providers - the whole aviation value chain - were all owned and managed directly by the State. However, this started to change when, at the end of the 1970s, the US deregulated its domestic air transport market and then adopted a highly liberal “Open Skies” policy towards other States, offering to remove all limitations on frequencies, capacity, routes, pricing etc. The European Union (“the EU”, called European Community at the time) followed suit and gradually introduced liberalisation of its internal air transport market through successive legislative “packages” (1987-1992).

Based on their experience, the US and the EU concluded between them a quite liberal comprehensive air transport agreement in 2007 (amended in 2010) and both have negotiated several other agreements with partner States thus driving further liberalisation.

Under this new approach, States tend to leave market forces to work out and intervene mainly by applying their competition laws as in other industries to address market distortions (rules on anti-competitive practices, abuse of market dominance and merger control). State subsidies may also raise serious concerns as demonstrated by the recent debate about alleged subsidies to Gulf carriers. Most States nowadays follow aviation policies that fall somewhere between the two extreme ends of the spectrum i.e. traditional restrictive ASAs and liberal ones; nevertheless, liberalisation has generally been considered as the way forward for the international air transport industry as expressed by the ICAO *Long-Term Vision for International Air Transport Liberalisation* adopted in 2013.

Indeed, ICAO has regularly organised global “Air Transport Conferences”, seminars, symposia, expert meetings etc. to discuss issues in the economic regulation of international air transport focusing on liberalisation and its impact on the sector. ICAO has also prepared guidance material<sup>7</sup> to help States and industry in their efforts to develop and manage a regulatory framework fit for their policy objectives, address emerging regulatory challenges and “harmonizing the global

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<sup>4</sup> See especially Articles 1 and 6 of the Convention.

<sup>5</sup> Bilateral air services agreement between the UK and the US (1946).

<sup>6</sup> The notable exception being the US where airlines have always been privately owned.

<sup>7</sup> ICAO Doc 9587 and Doc 9626, see Selected Bibliography

regulatory framework". ICAO has also set up databases to disseminate and exchange of information on States' air transport policies and practices, ASAs, taxes, and industry trends and developments.

Following the Worldwide Air Transport Conference in 2013, ICAO received a mandate to draft multilateral agreements to liberalise market access (traffic rights) in passenger and cargo transport as well as airline ownership and control. Despite all efforts though, no tangible results have been achieved so far with this initiative. This is mainly due to the diverging views of States in relation to fundamental questions on process and substance: possible multilateral instruments to use, implementation timeframes, the envisaged scope of the agreements, regulatory conditions etc. that should be part of any multilateral agreement to be ambitious and attractive enough for States to adhere to.

Clearly, ICAO does not possess responsibilities and powers in economic regulation as in other areas of aviation, which has important consequences, including but not limited to the following challenges:

- *Any initiative by ICAO* in the economic domain, including work on the above-mentioned multilateral agreements planned to take forward liberalisation, *can only be restricted* and up to States (mainly the ICAO Council) to support or not. This makes it highly questionable if any multilateral economic framework can be established by ICAO in the future;
- Therefore, the *regulatory landscape* of international air transport continues to be *fragmented and complex*. Overlapping and sometimes conflicting national and regional rule<sup>8</sup> lead to uncertainties and higher regulatory costs, which could be avoided or mitigated by having harmonised basic rules agreed at multilateral level;
- There is *no international authority* in the air transport sector (like WTO<sup>9</sup> in trade relations), which would have the mandate to oversee market developments and could intervene when the rules of the game are not followed, for example, through dispute resolution mechanisms;
- As the Covid-19 pandemic has demonstrated, even the exercise of *traffic rights* confirmed in ASAs can be *suspended any time* (for justifiable or non-justifiable reasons), on the basis of public policy or public security considerations, that is invoking *sovereignty*;
- The *lack of consensus about key principles* of the operation of the global air transport market, such as the mechanisms for granting State subsidies, result in further uncertainties as it could be observed during the recent EU-US-Gulf debate about alleged subsidies to the Gulf carriers; and

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<sup>8</sup> A good example of overlapping or conflicting regulations is the area of air passenger protection where, despite non-binding Core Principles laid down by ICAO, States have developed national policies and legislation with little harmonisation.

<sup>9</sup> Interestingly, there was interest in exploring if WTO could cover air transport. However, key WTO concepts, the most-favoured principle and national treatment, go against the logic of bilateral ASAs.

- *Outdated restrictions*, for example on airline ownership and control but also on traffic rights, remain applicable, which *prevents the “normalisation”* of the air transport sector so that it can become more open and transparent as many other sectors in our globalised economy, living up to its real potential as a key economic and social enabler.

In sum, one can argue that in the globalised air transport market of the 21<sup>st</sup> century, following decades of liberalisation, the lack of multilateral harmonisation of the economic regulation of international air transport should be addressed through appropriate fora and instruments. Others may disagree saying that States continue to have diverging rules whether a multilateral approach should or should not be preferable or feasible and even if it should be they may ask by whom and in which manner; and further arguing that any attempt to achieve minimum global consensus would end up as a repetition of previous exercises started with the drafting of the Chicago Convention in 1944.

#### 4. Non-exhaustive list of potential questions to be addressed by the delegates

1. What is your State's experience with the economic regulation of international air transport?
2. What are the challenges you have faced when managing the negotiation and implementation of bilateral/regional agreements on traffic rights and related matters?
3. Does your State believe that the current (fragmented) regulatory framework is adequate to govern in the 21<sup>st</sup> century such a global industry as air transport?
4. Would your State agree that ICAO should play a more prominent role in the economic regulation of international air transport?
  - If not, how do you see the further development of a global air transport network without a multilaterally agreed regulatory framework existing at the global level?
  - If yes, what instruments could be considered to be used to empower ICAO to do more in this important area? Should, for example, the Chicago Convention be amended or a new multilateral treaty on economic regulation (or specific areas thereof) be drawn up?

## 5. Selected Bibliography

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