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**AN APPRAISAL OF THE BILATERAL AIR SERVICE AGREEMENTS: TOWARDS A LIBERAL
LEGAL FRAMEWORK FOR INTERNATIONAL AIR TRANSPORT**

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DEDICATION

Dedicated to my late Brother Master Samuel Mbatia Kamau, may God rest your soul in Eternal Peace.

ACKNOWLEDGEMENT

To my supervisor Dr. Kithure Kindiki, thank you for accepting to supervise this project. To my research assistant Henry Waweru Njuru, thank you for your hard work. To my Secretary Anne Wanjiku Muchemi thank you for your support. To the following persons who offered access to their research materials: Mr. Kuria Waithaka of Kenya Civil Aviation Authority; Mr. Samuel Githaiga of International Civil Aviation Organization; Mr. William Yagomba of Ministry of Transport and Communications; Mr. Ano and Ms Mercy Awori both of Kenya Civil Aviation Authority.

DECLARATION

I Mercy Wambui Kamau do declare that this is my original work and has not been submitted and is not currently being submitted for a degree in any other University,


CUaaA/J '
Mercy Wambui Kamau

This thesis is submitted for examination with approval as university supervisor.



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Dr. Kithure Kindiki (Ph.D)

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CHAPTER ONE: INTRODUCTION

1.0 INTRODUCTION TO THE STUDY

This study concerns itself with bilateral air service agreements (BASA), which form the legal basis for the current organization and operation of international civil aviation. BASAs have been defined as international trade in services agreements whereby two sovereign nations regulate the performance of commercial air services between their respective territories.¹ BASAs deal only with the performance of scheduled international air services, which is defined in the Chicago Convention² as an air service, which passes through the airspace over the territory of more than one State.³

BASA are usually negotiated at the level of senior civil service although they may be negotiated at the higher level of ministerial level. In most countries negotiations falls under the jurisdiction of the foreign affairs ministry and may include other government departments as well as ministries.⁴ Once BASA has been reached, it may be called an "air transport agreement," an "air services agreement," or a "memorandum of understanding." Whatever the form and the title may be, all the forms of BASAs are in writing and between sovereign nations. They are treaties in accordance with the Vienna Convention on the Law of Treaties.⁵

¹ Haanapel, P.P.C. (2001) "Bilateral Air Transport Agreements" in Richard J. & Joseph W. *Government Regulations of Air Transport*, Institute of Air & Space Law, McGill University.

² Convention on International Civil Aviation, 7th December 1944, 15 UNTS 295. Also see Chapter Two of this study for detailed analysis of the Chicago Convention.

³ see Article 96 of the Chicago Convention.

⁴ see *supra* note 1.

⁵ See Articles 1, 2(1) (a) and 3 of the Vienna Convention on the Law of Treaties.

States contracting BASAs are under obligation under Article 83 of the Chicago Convention to register them with International Civil Aviation Organization (ICAO)⁶ which should make them public "as soon as possible." There are no specific way in which BASAs come into force, but they may come into force after official signing and once constitutional requirements for their approval have been met in both contracting States. There are several reasons why two countries may decide to execute a BASA among them economic, political, defence and socio-cultural reasons.

In general, the state of economic development of a country will to a significant extent determine its BASAs negotiating policy. The more developed nations generate more traffic than less developed ones, and equally, the developed nations will have a larger traffic receiving capacity than developing nations. Besides setting the policy, economic development of a country will also determine its negotiating power. Increasingly, BASA negotiations are characterized by the need to protect a nation's flag carriers invariably bringing in the element of protectionism especially where the flag carrier is weaker vis-a-vis the negotiating partner's carrier.

To appreciate the consequences of protectionism in the international air transport industry, it is imperative to underscore the nature of international air transport as a trade.

1.1.0 Nature of Production and Trade in International Air Services

Each city origin and destination pair for air services can be considered a separate 'product' with limited substitution possibilities with other city pairs. These products are geographically differentiated and not homogeneous. Further, the

⁶ International Civil Aviation Organization is established under Article 43 of the Chicago Convention.

characteristics of production in the airline industry mean that few routes are likely to be served by a large number of airlines, even in the absence of formal restrictions contained in the bilateral system. Small group oligopolies, duopolies or even monopolies are likely to predominate and the costs of entry can be significant.

One country alone cannot produce international air services. An international flight requires inputs from both the origin and destination countries in the form of infrastructure and rights to exercise various freedoms of the air such as rights to embark and disembark passengers and freight, and to take-off and land. This means that at least two countries must agree to produce an international air service. Governments exercising control over their own airspace in accordance with the Chicago Convention and other provisions of international law are able to specify conditions under which production may occur. This is in contrast with goods and most other services whereby a country is generally free to produce whatever it likes on a unilateral basis. For most countries, the production of particular goods and services is small relative to worldwide output. Producers assume they will be able to export freely if they can produce at or below the world price. However, whether it is possible to export what they produce will depend on the trade policies of other countries.

Freedom to produce and trade does not apply in international aviation. Given the bilateral nature of production of any particular international flight, each origin and destination country has power to veto production. Without agreement, one country's airline cannot produce international services even for the country's own citizens, regardless of its relative efficiency. International air services do not necessarily involve an export or import. If the airline and its passengers are all residents of the same country, in economic terms, the flight can be considered to be an internal domestic activity rather than an international trade. That is, the flight is more like a temporary extension of the

nation's boundary. An export of the service only occurs if an airline carries passengers or freight from another country, while an import only occurs if a resident of one country uses another country's airline. The international trade context is not apparent from the flight itself.

Thus, Kenya exports air services when foreign passengers fly Kenya Airways. But Kenyans flying Kenya Airways internationally are not involved in international trade at all. Any particular Kenya Airways flight to or from Kenya is likely to produce both non-traded and export services, while the carriage of Kenyan passengers on a South Africa Airline flight on the same route is an import of air services by Kenyans.

The main differences between regulation of international trade in air services and trade in most other goods and services include:

- (i) Bilateral aviation-specific rather than multilateral multi-product agreements govern most aviation relations;
- (ii) Trade is prohibited unless various 'freedoms of the air' are invoked under specified conditions in BASAs; and
- (iii) Most aspects of trade in air services do not come under the rules of the WTO.

As a result, there are significant differences between production and trade in international air services compared with production and trade in most other goods and¹ services. It is necessary to recognize these differences when examining trade in the international air transport.

1.2 STATEMENT OF THE PROBLEM

The bilateral relationships which have evolved for international air services, mean that each bilateral partner has considerable bargaining power. Each country can determine the size of the total supply to the bilateral market, not just its own level of output. Such market power is equivalent to the 'terms of trade' effect in international goods trade.

However, the international air services bilateral framework also supports many regulatory constraints on the efficient production of, and trade in, international air services that are essentially protective and anticompetitive. These constraints arise from the bargaining power of the bilateral partners, rather than the nature of production of international air services itself.

There are other services which also cannot be produced without cooperation between at least two countries, such as international telecommunications and postal services. Multilateral free trade agreements have been concluded for both of these services, with significant benefits. Similarly, the global shipping industry has effectively operated on the basis of free market in that there need not be a bilateral agreement between two countries for a ship from one country to deliver goods or passengers to another country. Thus, the nature of the product does not imply that international agreements need be bilateral, or that they should be of a highly constraining nature, yet despite international air transport being considered as a trade, States continue to retain restrictions.

With the rapidly changing economic environment brought on by trade liberalization, globalization and e-commerce, it has become increasingly clear that BASAs, while they have led to steady improvements in the international air

transport, can no longer of themselves meet the rapidly changing needs of airlines, users or the global economy.⁷ This is the problem, which this study looks at and argues that it is brought about by the practice of bilateralism whereby two countries must conclude an agreement for an international air transport to take place between them. Various organizations and individuals have voiced criticisms against this restrictive practice of undertaking an international trade. For example Shane has stated that:

"Our final challenge in the aviation industry is adjusting to globalization as many have observed, it is a paradox of the first magnitude that the industry that has done so much to foster globalization in other sectors of economic activity continues, in certain key markets at least, to be hamstrung by bilateral air services agreements that limit designation routes, scheduling and pricing flexibility"⁸

In 1993 the then US President appointed a National Commission to Ensure a Strong Competitive Airline which concluded that the current bilateral system is not sufficiently growth oriented in the global trade environment. In 2001, the President of the Council of ICAO, stated that ICAO actively supports the process of progressive liberalization of BASAs and noted that "no less than 159 of the ICAO's 187 member States are now formally committed" to liberalization of international air transport.⁹ John Anderson MP, Australia's Deputy Prime Minister and Minister for Transport in his speech during International Air Transport

⁷ See Policy statement titled "the need for greater liberalization of international air transport" by ICC Commission on Air Transport 7 December 2000 at <http://www.icc.org>. (last accessed on 30th September 2005)

⁸ Shane, J. N. U.S. Under-Secretary of Policy Department of Transportation speech to the American Bar Association Forum on Air and Space Law. Speech titled, "Aviation Policy: Looking Back and Looking Forward."

⁹ President of the Council of ICAO, Dr. Assad Kotaite Address to the World Air Transport Summit 57th IATA Annual General Meeting, Madrid Spain on 28th May, 2001, titled "Progressive Liberalization through ICAO"

Association Annual General Meeting and World Air Transport Summit observed¹⁰ that while the bilateral system has served us well for the last fifty years, its flaws have become increasingly clear.

Despite such vociferous criticism and unanimity that BASAs should be reformed, countries of the world are yet to take to a united approach to making BASAs more liberal or to substituted them with a multilateral liberal framework. This study therefore presents proposals on how BASAs can be reformed to make them more liberal and competitive. This is achieved through analysis of the Chicago Convention which forms the bedrock of modern aviation law, and by looking at recent steps taken by States to free international air transport from restrictive BASAs.

1.3 THEORETICAL FRAMEWORK

There have always been theories in international law, which have tried to explain the relationship between idealism and realism, between the way things ought to be and the way things are.

The way things ought to be is a view propounded by the Natural Law school of thought. At its basic form, this school of thought argues that there exist a higher law which all other laws should be subordinate to and unjust laws had to be opposed by virtue of a higher, Natural Law. Many ideas and principles of international law today are rooted in the notion of Natural Law and the relevance of ethical standards to the legal order, such as the principles of non-aggression and human rights.¹¹

¹⁰ HON. John Anderson MP Address: towards A free World Aviation: <http://www.ministers.dotar.gov.au/ja/speeches> 5 June 2000-AS7/2000 (Last accessed on 30th September 2005).

¹¹ See Shaw, M. N. (1997) International Law, Cambridge University Press: London

The positivist school declares that law as it exists should be analyzed empirically shorn of all ethical elements. It believes that man-made laws should be analyzed as such and the metaphysical speculations of the Natural Law rejected because what count is the practical realities, not general principles which are imprecise and vague. One of the eminent proponents of this school is Kelsen who defined law solely in terms of itself and eschewed any element of justice. Law is regarded as a normative science consisting of rules which lay down patterns of behaviour, which depend for their legal validity on a prior norm and this process continues until one reaches what is termed as the basic norm of the whole system.¹² According to this theory, the principles of international law are valid if they can be traced back to the basic norm of the system. The basic norm is the rule that identifies custom as the source of law, or as Kelsen stipulates "the States ought to behave as they customarily behaved."¹³ One of the rules of this category is *pacta sunt servanda* declaring that agreements must be carried out in good faith and upon that rule is founded the second stage within the international legal order. This second stage consists of the network of norms created by international treaties and conventions and on to the third stage which includes those rules established by organs which have been set up by international treaties.

The theoretical framework of this study is inspired by positivist school of thought. In particular, it dwells on the Chicago Convention and the resulting BASA framework regulating international air transport. The study also looks into States practices regarding aviation and also considers the role of international organizations such as the ICAO.

¹² see Hart, H. L. (1961) The Concept of Law, London

1.4 OBJECTIVES OF THE STUDY

This study aims at achieving the following objectives:

- (1) Examine the BASA framework which emerged after the 1944 Chicago Convention;
- (2) Identify elements of BASAs which makes the framework uncompetitive in a world driven by free market ideology;
- (3) Examine the current trends in liberalizing BASAs and determine success or lack of it from these trends;
- (4) To determine whether the aviation industry can be freed from limits imposed by BASA without compromising fundamental principles such as sovereignty of States.
- (5) To make recommendations on how BASAs should be reformed for continued growth of international air transport.

1.5 HYPOTHESES

The study aims at testing the following hypotheses:

1. That BASAs as currently constituted are outdated and hinder the growth of civil aviation in this era of globalization;

¹³ see Dworkin, R. (1977), Taking Rights Seriously, London

2. That the BASA legal framework can be separated from the concept of sovereignty for liberal reforms to be effective;
3. That the need to protect States' economic interests is the greatest hindrance to liberal reforms in the international air transport.

1.6 RESEARCH QUESTIONS TO BE ANSWERED

The research questions to be answered in this study are:

1. How have BASAs evolved since the 1944 Chicago Convention?
2. Have BASAs hindered the growth of civil aviation, and if so, to what extent?
3. What reforms should be undertaken to liberalize BASAs?

1.7 RESEARCH METHODOLOGY

The study uses both theoretical and historical materials, thus relies mostly on secondary and library research. It utilizes Internet as a research tool to access online libraries such as the University of McGill online library; electronic journals and internet- based websites.

1.8 LITERATURE REVIEW

This study reviews literature on aviation both academic and judicial and literature specific on bilateral air service agreements. In order to examine conflicts surrounding bilateralism in the international air transport, this study

analyzes the existing legal framework of bilateralism vis-a-vis their applicability in this era of globalization especially the Paris Convention, Chicago Convention, ICAO statute, and IATA literature.

1. Rynerson, S, D¹⁴ whose work brought out the revolutionary idea in the international aviation of seeking to move beyond the framework that has dominated the industry for over half a century. However his work was limited in scope as it only examined the problem from European perspective and not worldwide. It therefore failed to provide how a worldwide harmony can be achieved.
2. Bederman, D. J.¹⁵ on the other hand tried to examine the Framework of Air Ocean Transport and its effects on globalization. He suggested that a global activity like the international air transport should benefit from global regulation so as to maximize widespread effects on the development of trade and technology. He further suggested that the regulatory framework on international civil aviation extend beyond harmonization and standardization of operating practices. He was rather pessimistic that a much liberal framework would be realized soon because the control of national airspace has often been linked to national sovereignty.
3. Haanappel, P¹⁶ and Mendes, P. M. J examined trends in international air transport, including international air transport to and from Canada.

"Rynerson, S. D. "Everybody Wants To Go To Heaven, But Nobody Wants to Die: The Story of the Transatlantic Common Aviation Area", *Denv. Journal of international law & Policy*, Vol. 30:4.

¹⁵ Bederman, D J "Globalization and International Law" available at <http://www.georgetown.edu/> (Last accessed on 30th September 2005).

¹⁶ Haanappel, P. & Mendes de Leon, P.M. J, "International aviation Framework and Implications for Canadian Policy", *International Institute of Air and Space Law*, Universiteit Leiden, Netherlands March 2001.

The trends examined included the open-skies agreements and their provisions on airline alliances; the efforts towards air transport liberalization in international organizations such as the International Civil Aviation Organization (ICAO), the World Trade Organization (WTO), the United Nations Conference on Trade and Development (UNCTAD), and the Organization for Economic Cooperation and Development (OECD) and the creation of regional common aviation areas. They specifically addressed the legal and regulatory implication for Canada if it were to allow foreign airlines and investors to participate in Canadian domestic airtransport.

4. Clancy, M.¹⁷ dwelt on the methodology of opening up the skies. He however did not give an analysis of how his proposals would be implemented in view of the rigid bilateral air service agreements.

1.9 SUMMARY OF CHAPTERS

Chapter One

Chapter One gives a definition of the International air service agreements. It goes on to give a brief description on the nature of production and trade in the international air services in order to appreciate the differences with trade in other goods. It also includes the introduction to the study; background to the study; the statement of the problem; the objectives of the study; the research questions; the methodology used; and the literature review.

¹⁷ Clancy, M. "Globalizing the Skies: Domestic and International Sources of the Liberalization of Commercial Air Transport" at <http://www.hartford.edu> (Last accessed on 30th September 2005).

Chapter Two

Chapter Two takes a look at the general background in the development of the aviation industry. It analyses the Paris Convention and the Chicago Conventions and the resulting BASAs framework from each Convention. It dwells on how the Chicago Model Agreement laid the foundation for further agreements including Bermuda I Agreement. It also discusses the multilateral system that emerged from the Chicago Convention and shows how States control their airlines through the "substantial ownership and effective control" clause in the BASAs.

Chapter Three

Chapter Three examines current trends undertaken by countries like the United States of America and by regional blocs such as the European Union in liberalizing international air transport within BASAs framework. It also highlights the shortcomings of these trends.

Chapter 4.

Chapter Four gives a conclusion to this study by putting forth recommendations on what should be done to address the shortcomings in the BASA framework by further liberalization of the international air transport.

CHAPTER TWO: EVOLUTION OF INTERNATIONAL AIR LAW AND THE BILATERAL AIR SERVICE AGREEMENTS

2. GENERAL BACKGROUND

Humanity's desire to fly probably dates back to when the prehistoric man observed birds flying. In the Greek legendary story of Daedalus and his son Icarus, they built wings out of feathers and wax to escape from the island of Minos. Icarus flew too close to the sun and the wax melted thereby destroying the wings and causing him to fall to the sea. The legend was a cautionary tale about attempting to reach heaven, but it exemplifies Man's desire to fly.¹⁸

There is no general agreement on when the modern history of aviation began. Some sources trace it back to the 15th Century when Leonardo da Vinci designed an aircraft (glider), but did not build one. The designs were preserved and utilized in the 20th century to "build a prototype, which actually flew."¹⁹ Be that as it may, the first recorded human flight took place in a hot air balloon powered by wood fire when two Frenchmen, Francois d'Arlandes and Francois Pilatre de Rozier flew 8 kilometers. Although the flight was uncontrolled, it paved way for ballooning in Europe in the 18th century and this provided detailed understanding of the relationship between altitude and the atmosphere²⁰.

Nevertheless, in 1852 in France, the first powered, controlled, sustained lighter-than-air flight with a steam engine mounted on a dirigible took the sky and "throughout the latter half of the 19th Century and the first half of 20th century,

¹⁸ Wikipedia, online encyclopedia at <http://www.wikipedia.org/wiki> (Last accessed on 30th September 2005).

¹⁹ *Ibid*; also see <http://www.geocities.com/capecanveral/> (Last accessed on 30th September 2005).

²⁰ *Supra* note 9.

this 'airship' was considered to be a serious option for air transport."²¹ It should be noted that the early history of flight and credit for various accomplishments are often highly contested especially between the Europeans and the Americans. For example, some people view the first controlled powered heavier-than-air flight by Wright Brothers in December 17, 1903 as a milestone in aviation history, while some view Alberto Santos- Dumont flight in September 13, 1906 as the true controlled powered flight since the plane did not need headwinds or catapults to take off. Similarly, some sources credit Leon Delagrange, who rode with French pilot from a meadow outside Paris in 1908 as the first person to fly as passenger²² while other sources credit Charlie Furnas flight with Wright Brothers in May 14, 1908.²³

2.1 First World War

Whatever is the case, aviation seems to have advanced rapidly and in 1910 there was an attempt at international regulation when 19 European countries held an International Air Conference in Paris. A draft Convention was produced but unanimous agreement on the definitive text could not be reached and the meeting was abandoned.²⁴ Shortly thereafter, World War I broke out and there was extensive use of aircraft in offensive, defensive and reconnaissance capabilities.²⁵ This ensured rapid advancements in aviation technology as governments funded rapid manufactures of aircraft to fight the war.²⁶

²¹ *Ibid.*

²² See <http://www.geocities.com/capecanaveral> and also <http://www.answers.com/wiki> (Last visited on 30th September 2005).

²³ *Supra* note 9.

²⁴ Roger, M. "The Creation of the Civil Aviation Branch and its Early Years" at <http://www.airwavsmuseum.com/aeneral>. (Last accessed on 30th September 2005).

²⁵ *Supra* note 3.

Before the outbreak of the First World War, there was no overriding theory on how the airspace should be managed or utilized. Some theories viewed the airspace as equivalent to the idea of territorial sea in that there was a limit to which a country could utilize airspace above its territory, while other theories viewed the airspace as free for all. That is, the airspace was free to anyone who had capability to manage and utilize it. Another theory stated that the airspace above a State was entirely within its sovereignty while another posited a right of innocent passage through the airspace for foreign aircraft.²⁷ However, there was general agreement that airspace above the high seas and *terra nullius* was free and open to all.

The outbreak of First World War brought with it the recognition of security implications of the use of aircraft and this realization settled the 'debate on theories' in favour of the *aer clausum* (closed skies) theory. From then on, regulatory framework of international air transport came to be informed by governments' need to protect their national security by placing the control of the airspace firmly into each State's jurisdiction. Simply, there was no 'freedom of air' and all rights of air transport had to be negotiated with the host State. This was confirmed at the end of Second World War in the 1944 Chicago Convention. The circumstances at the Chicago Conference were similar to those of 1919 Paris in that the negotiating States at the Chicago Conference had witnessed how each State's national security could be compromised through the air. This may be the most significant reason why the concept of closed skies took precedence in international air transport unlike the maritime industry where the 'freedom of seas' as advocated by the Dutch jurist Hugo de Grotius in 1633 in his book "Freedom of Seas: The Right which Belongs to the Dutch to take Part in the East India Trade", prevailed over the concept of *mare*

²⁶ <http://www.answer.com> (Last accessed on 30th September 2005).

²⁷ See Shaw, M. 1997, *International Law*, Cambridge University Press: London.

clausum (closed oceans) in the 1500s- 1600s. Freedom of seas triumphed because it was consistent with the "mercantilist and commercial policies of the great maritime powers: Britain, Holland, France, Spain, and Portugal."²⁸

2.2 The Paris Convention

When European countries met at the Peace Conference in Paris at the end of the First World War, there was realization of the importance of aviation in both military use and in general transport. These countries signed an agreement titled the Convention Relating to the Regulation of Aerial Navigation (hereinafter Paris Convention)²⁹, which codified the basic principle of international aviation that every State has complete and exclusive sovereignty over the airspace above its territory³⁰. This was encapsulated in Article 1, which stated "the High Contracting parties recognize that every power has complete and exclusive sovereignty over the air space above its territory." In addition, each state was entitled for military reasons or in the interest of public safety to prohibit the aircraft of other States and to publish and notify beforehand the locality and the extent of prohibited areas.³¹ These provisions indicated the concerns of the contracting States after witnessing how their national security could be compromised through the airspace.

On nationality of the aircraft, Article 5 of the Paris Convention was strict that no contracting State should allow an aircraft over its airspace that does not possess the nationality of any contracting State unless by a special and temporary

²⁸ Bederman, J. D. "Globalization and International Law" at <http://www.law.georgetown.edu/legaltheory> (Last accessed on 30th September 2005).

²⁹ League of Nation Treaty Series (1922) No. 297 at 173; no longer in force. Signed at Paris October, 13 1919.

³⁰ Middeldorp G. Substantial Ownership and Effective Control of International Airlines; Article presented for Netherlands Comparative Law Association. Available at http://www.eicl.org/64/art64-1_6.html (Last accessed on 30th September 2005).

Article 3.

authorization. This Article seemed to create impediments to the conclusion of BASAs especially between the former enemies. That was why it was later amended by a Protocol in 1922 which allowed special BASAs with any other state provided such agreements did not infringe upon the rights of State Parties to the Paris Convention, and provided that such agreements were consistent with the rules of this Convention.³²

All aircraft engaged in international navigation were required to bear their nationality and registration marks as well as the name and residence of the owner.³³ It also stipulated that contracting States could only register an aircraft that "wholly belongs" to it and that "no incorporated company can be registered as the owner of an aircraft unless it possess the nationality of the State in which the aircraft is registered" unless the President or Chairman of the company and "at least 2/3 of the directors possess such nationality".³⁴ Presumably these provisions were meant to curb use of non-contracting States aircraft to undermine each other's security concerns. The consequences of these provisions were to give rise to the concept of ownership and control in the aviation industry and the establishment of national carriers.

On admission of an aircraft above foreign territory, the Paris Convention stipulated that an aircraft has a right of flight over a foreign territory without landing but should land if ordered to and it should follow the route fixed by the State over which the flight takes place.³⁵ States' right to establish reservation and restrictions in favor of their national aircraft in connection with the carriage of persons and goods for hire between two points of each State's territory was

³² See Matte, *Treatise on Air-Aeronautical Law*, ICASL- Montreal, The Carswell Co. Ltd. Toronto (1981) at 110-

³³ Article 10.

³⁴ Article 7.

³⁵ Article 15.

established and concretized.³⁶ Evidently, this allowed each State's national carrier to enjoy economic monopoly over all domestic flights by restricting foreign carriers from operating in the domestic market.

The Paris Convention also contained provisions that expressly related to military issues. Article 26 prohibited carriage of explosives and of arms and munitions of war in international navigation, and stated that no foreign aircraft shall be permitted to carry any such articles between two points in the same contracting State. Further, each State could prohibit or regulate the carriage of photographic apparatus or restrict any other objects.³⁷

Article 34 established the International Commission for Air Navigation (ICAN) under the League of Nations, the predecessor to the United Nations (UN). Among the duties of ICAN was to receive proposals from or make proposals for the modification of the Paris Convention, and to collect and communicate information of every kind concerning international air navigation especially relating to wireless telegraphy, meteorology and medical service which may be of interest to air navigation.

2.2.1 Bilateral Air Service Agreements Under the Paris Convention

The BASAs concluded after the Paris Convention were between State Parties to this Convention and they explicitly or implicitly granted rights for the carriage by air of persons and goods from one country to the other.³⁸ Compared with the BASAs signed after Second World War, the Paris Convention based BASAs lacked precise route schedule and traffic rights, if exchanged, were mostly

³⁶ Article 16.

³⁷ Articles 27 and 28.

³⁸ See *supra* note 1.

exchanged without reference to precise routes to be flown. For example Haanapel³⁹ gives an example of a 1922 Provisional Convention between the Netherlands and Germany Relating to Air Navigation which only opened the possibility for regular air services, but nothing more. Article 12(1) of the said Provisional agreement provided that:

"Each of the contracting States shall have the right to make the carriage for hire of persons or goods to and from or within its territory subject to special regulations."

However, the 1928 Convention between France and Spain Relating to Air Navigation went further. Its Article 1 provided that the establishment of regular air routes between the two countries would be subject to special conventions between the two governments involved. It also stated that once air routes had been established, the two nations would grant each other in respect of those routes "the treatment of the most favoured nations."⁴⁰

Another example is the 1929 BASA between the United States of America (US) and Canada in which clause 6 potentially contained a very broad exchange of traffic rights. Canada aircrafts licensed to carry passengers and/or cargo in Canada were also allowed to do so between Canada and the US, but not between points within the US. Conversely, American aircrafts licensed in the US could carry traffic between the US and Canada, but not between Canadian points.⁴¹

³⁹*Ibid.*

⁴⁰ Reprinted in Vlastic and Bradley, "The Public International Law of Air Transport; Materials and Documents," McGill University Montreal (1974) Vol. 1.

⁴¹ Arrangement effected by Exchange of Notes between the US and the Dominion of Canada, August 29, 1929, and October 22, 1929. Publications of the Department of State No. 19. Executive Agreement Series, No. 2: Canada Treaty Series 1929, No. 13. Canada was a party to the Paris Convention.

States became more restrictive in granting traffic rights under the Paris Convention's BASAs and by the latter part of the 1930s, traffic rights were often *exchanged only upon* the basis of reciprocity.⁴² For example the US- Canada BASA of 1929 was replaced by several other agreements one of which of 1939 explicitly provided that operating rights for American and Canadian carriers were to be exchanged on the basis of reciprocity.⁴³

Haanapel states that prior to the Second World War, there were many informal intergovernmental agreements in force, a large number of temporary arrangements and agreements. Pan American World Airways largely built its pre war South American route network on the basis of concessions obtained from South American Governments.⁴⁴

Given the extent and advancement in international air transport at the time of the Paris Convention, it is generally accepted that restrictions on air transport imposed by the BASA regime did not hinder the development of aviation and States subsidies actually aided the development especially in technological advancement. The protection was expanded in the Warsaw Convention⁴⁵ with "the birth of international civil aviation in the 1920s"⁴⁶. This Convention gave international airlines the benefit of limited liability in the event of an accident or crash causing bodily injury or death. The Warsaw Convention determined that the owner or operator of the carrier is liable for any injury, death, or property damage, but capped the damages that an airline would pay in the event of an air disaster to less than \$10,000 per passenger (although this limit has been

⁴² See *supra* note 1.

⁴³ Agreement Relating to Air Transport Services, Canada Treaty Series 1939, No. 10.

⁴⁴ See *supra* note 1 at 671.

⁴⁵ The Warsaw Convention on International Carriage by Air 1929.

⁴⁶ *Supra* note 10

amended through the years).⁴⁷ It also established broad international framework for settling liability claims involving international civil aviation.⁴⁸

2. THE CHICAGO CONVENTION AND THE BILATERAL AIR SERVICE AGREEMENTS

2.3.1 Background to the Chicago Convention

Immense growth was recorded during the Second World War in the development of aircrafts and it was apparent by 1943 to the major allied powers that air transportation was capable of significantly changing the world in social and economic development. The range and load carrying capacity of transport aircraft had increased significantly and "viable transoceanic crossings with significant commercial payload were now practicable."⁴⁹ The commercial benefits could not be realized because different rules, procedures, and aviation practices existed between States thereby necessitating some form of standardization to achieve safe and efficient global air services.⁵⁰

Moreover, the USA had large-scale production of aircraft suitable for civil transport while aviation industries of the UK, the Soviet Union, Germany, France and Japan, although highly developed, had concentrated their designs and production to military aircraft during the war. The USA manufacturing companies were therefore more prepared than the rest to play a major role in providing suitable aircraft after the war.⁵¹ It is therefore not surprising that it was

⁴⁷ See Montreal Protocol of 1999.

⁴⁸ See Warsaw Convention on International Carriage by Air 1929 and *supra* note 10.

⁴⁹ Varley, M. R. G. "Some Observations on the Conduct of International Air Transportation Including Air Service Agreements and Traffic Rights"

⁵⁰ *Supra* note 37.

⁵¹ <http://www.tech.purdue.edu/at300> (Last accessed on 30th September 2005).

the USA which sponsored the Chicago International Civil Aviation Conference (Chicago Conference).⁵²

The Chicago Conference was attended by 54 States, which did not include the USSR and the Axis Powers⁵³ though the USSR indicated its agreement with the aims of the Conference but could not attend due to 'military reasons.'⁵⁴

In terms of policy to be adopted with regard to the economic aspect of international air transport, the Chicago Conference was divided into two conflicting groups. One was led by the USA which argued for the freedom of airlines to provide international commercial air services in a relatively uncontrolled manner similar to maritime practise,⁵⁵ that is, "laissez-faire, free market philosophy."⁵⁶ However, some sources dispute this assertion and argue that the USA had no such intention. For example, Rynerson (2002) states that;

"it could be argued that the path to restrictive bilaterals was set down from the very beginning when in his opening statement the U.S. representative to the International Civil Aviation Conference, where the Chicago Convention was drafted, analogized international aviation to railroading, which was already being crippled domestically by heavy regulation at the time of the Conference."⁵⁷

He goes on to state that;

"Regardless of whether the possibilities of a liberal multilateral regime were defeated before drafting even began, the structure of the Chicago Convention shows it clearly was not designed to easily facilitate such a system, as several articles in the final document gave national

⁵² *Ibid.*

⁵³ *Supra* note 37

⁵⁴ *Ibid.*

⁵⁵ *Supra* note 38; also see *supra* note 32

⁵⁶ Warner, S. M. "Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Non-Citizens in Second Class," 43 *AM. University Law Review* 111, 285 (1993).

⁵⁷ *Supra* note 27 at p. 423.

governments broad powers to regulate international air traffic that crossed their borders."⁵⁸

The other group was led by the UK and other European nations, which called for an international regulatory body that would determine the particular services offered.⁵⁹ Whatever is the case, it is generally agreed that the US advocated for a multilateral approach in international air transport while the group led by the UK wanted national governments to have control on how air transport would develop. Neither group prevailed and BASA 'amounted to a compromise to any multilateral agreement'⁶⁰ and Article 78 of the Chicago Convention was drafted to permit the Council of ICAO to suggest to States the formation of joint air service operating agencies, and "two optional agreements were proposed in addition to the Convention; an 'International Air Services Transit Agreement' and an 'International Air Transport Agreement', both of which would be open for States to sign separately from the Convention."⁶¹

Therefore, the resulting Convention on International Civil Aviation (Chicago Convention) was basically a compromise between two conflicting positions on international air transport. The Chicago Convention laid the basis for the modern legal framework on international air transport and, as a result, this work would be incomplete without a detailed analysis of the same especially in regard to BASA.

⁵⁸*ibid.* See also Convention on International Civil Aviation, Dec, 7, 1944, arts, 1, 6, 7, 17, 18, at <http://www.iasl.mcgill.ca/airlaw/public/cl/iicaqo1944a.pdf> (Last accessed on 30th September 2005).

⁵⁹See Doganis, R. "The Bilateral Regime for Air Transport: Current Position and Future Prospects," in OECD, ed, *International Air Transport: The Challenges Ahead*, Paris, OECD, pp 45- 73.

⁶⁰Supra note 35.

⁶¹ Supra note 36. see also Edwards, A. "The International Legal Framework for Aviation Regulation" at <http://www.tech.purdue.edu/at/courses/at300/materials> (Last accessed on 30th September 2005).

232 Chicago Convention and its Provisions

The Preamble to the Chicago Convention reveals the most overriding issues that informed its content. The first was to ensure that the development of international civil aviation would "preserve friendship and understanding among the nations and peoples of the world" so as forestall its abuse which "can become a threat to the general security." The second was the desire to have international civil aviation "developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically." Evidently, the former was an acknowledgement of the role of aviation in the Second World War. It is thus not surprising that some provisions of the Paris Convention were confirmed.

Article 1 of the Chicago Convention confirmed that "contracting States recognize that every State has complete and exclusive sovereignty over the airspace above its territory." It went on to specify that "the territory of a State includes the land areas and adjacent territorial waters under the sovereignty, suzerainty, protection or mandate of Such State."⁶² Though the Convention specifically stated that it applied only to the civil aircraft, it nevertheless provided for aircraft used in military, customs and police services (defined as State aircraft), "no contracting State shall fly [them] over the territory of another State or land thereon without authorization by special agreement or otherwise, and in accordance with the terms thereof."⁶³ Similarly, for military reasons and public safety each State may prohibit or restrict the aircraft of other States from flying over certain areas of its territory and description of such prohibited areas shall be communicated to the International Civil Aviation Organization (ICAO).⁶⁴

⁶² Article 2.

⁶³ Article 3.

⁶⁴ Article 9.

Article 10 stipulated that every foreign aircraft shall land at an airport designated by that State for the purpose of customs and other examination and shall depart from a similarly designated customs airport. Each State is required to publish particulars of such designated customs airports and transmit them to the ICAO. These provisions are in line with the need to maintain security and public order by keeping track of what enters or leaves within each contracting State's territory.

The Convention recognizes the right of one contracting State to operate non-scheduled air services between or over the territory of another contracting State without prior permission, although conditions and limitations could be imposed.⁶⁵ However, it should be noted that most States have exercised such severe constraints as to almost destroy the apparent intent of this provision.⁶⁶

Article 6 gave each State the right to control scheduled air services by stating that "no scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization. A State can therefore deny entry to a scheduled international air transport into its airspace for whatever reason, and this has put aviation negotiations in the hands of national governments.⁶⁷ Article 7 ensured that each State would have a monopoly in its territory in regard to passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory. Article 7 went to state that "each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an

« Article 5.

⁶⁶ See *supra* note 36.

⁶⁷ MacKenzie, D. "The Bermuda Conference and Anglo-American Aviation Relations at the End of the Second World War", *Journal of Transport History*.

exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State."

On nationality, aircraft has the nationality of the State in which it is registered⁶⁸ and cannot have dual registration,⁶⁹ and every aircraft engaged in international air navigation shall bear its appropriate nationality and registration marks.⁷⁰ Equally, every aircraft engaged in international air navigation is required to carry certain documents such as;

- (a) Its certificate of registration;
- (b) Its certificate of airworthiness;
- (c) The appropriate licenses for each member of the crew;
- (d) Its journey logbook;
- (e) If it is equipped with radio apparatus, the aircraft radio station license;
- (f) If it carries passengers, a list of their names and places of embarkation and destination;
- (g) If it carries cargo, a manifest and detailed declarations of the cargo.⁷¹

Chapter XVI dealt with joint operating organizations and pooled services. Article 77 states that nothing in the Convention "shall prevent two or more contracting States from constituting joint air transport operating organizations or international operating agencies and from pooling their air services on any routes or in any regions," but such organizations or agencies and such pooled services are subject to all the provisions of the Convention. A State may participate in joint operating organizations or in pooling arrangements, either through its government or through an airline company or companies designated by its

⁶⁸ Article 17.

⁶⁹ Article 18.

n Article 20.

⁷¹ Article 29.

government. The companies may, at the sole discretion of the State concerned, be state-owned or partly state-owned or privately owned.⁷² Under Article 78 ICAO may suggest to the contracting State concerned that they form joint organizations to operate air services on any route or region, but ICAO has never invoked this provision, and "consequently it can be considered to have been a complete failure."⁷³

Article 82 abrogated all obligations and understandings between contracting States which are inconsistent with the terms of the Chicago Convention. Bilateral air service agreements were left to be as they are not inconsistent, and yet the Chicago Convention did not compel the formation or abrogation of bilateral agreements.⁷⁴

2.3.3 Multilateralism in the Chicago Convention

2.3.3.1 International Civil Aviation Organization

From its provisions, the Chicago Convention maintained the basic principle of international aviation that every State has complete and exclusive sovereignty over the airspace above its territory, a rule that was first codified in the Paris Convention as discussed above. This is the principle which still provides the general framework for international air transport. The differences between the USA and the UK on how the air transport should be managed is what eventually led to Article 6 which granted State power to essentially veto whether to allow scheduled international air service into its territory.

⁷² Article 79.

⁷³ *Supra* note 36.

⁷⁴ See Thornton. C. & Lyle C., "Freedom's Paths", *Airline Bus March* 2000 at 74.

The State parties to the Chicago Convention could have granted each other traffic rights while leaving the sovereignty principle unaffected, but due to differences already stated they failed. Therefore, any chance of a multilateral approach in the Chicago Convention did not materialize.

Nevertheless, ICAO represents a trace of multilateralism from the Chicago Convention as it was not only tasked with developing the "principles and techniques" of international air transportation, but it was also obligated to do such things as "prevent economic waste caused by unreasonable competition" and to make sure that "every contracting State has a fair opportunity to operate airlines."⁷⁵ Obviously this is a regulatory role that discourages competition since the term "unreasonable competition" is not defined. Any contracting State is at liberty to argue "unreasonable competition" and to demand a "fair opportunity to operate airlines" even when its airlines turn out to be unnecessarily expensive and inefficient. Indeed, the ambiguity of the Chicago Convention led each country to interpret the agreements differently and "for decades, the ICAO would meet again and again to debate standards for airports and to create and enforce rules to keep passengers and aircraft safe."⁷⁶

2.3.3.2 International Air Services Transit Agreement and the International Air Transport Agreement

Although the Chicago Convention failed to categorically give direction on multilateralism in air transportation, it led to the signing of "two side-

⁷⁵Supra note 11.

⁷⁶"International Civil Aviation" at [http://www.centennialofflight.aoy/essav/government role/intl_civil](http://www.centennialofflight.aoy/essav/government%20role/intl_civil) (Last accessed on 30th September 2005).

agreements⁷⁷ which did more than the Chicago Convention to promote an infant multilateral framework and began the process of establishing the spectrum of aviation freedoms as known today. These agreements were International Air Services Transit Agreement and the International Air Transport Agreement.⁷⁸ However, only the latter attained the required number of signatories to enter into force, thus obligating nations to separately negotiate agreements to gain additional international traffic rights.⁷⁹

In the International Air Service Transit Agreement, States parties grant each other the privileges, also known as freedoms of the air, to fly across their territory without landing and to land for non-traffic purposes, the so called transit or non-commercial rights. Thus, this agreement granted "two freedoms" to the contracting States.

The International Air Transport Agreement envisaged exchange of three commercial traffic rights in addition to the above-mentioned transit rights:

- (i) The privilege to put down passengers, mail and cargo destined in the territory of the State whose nationality the aircraft possesses;
- (ii) The privilege to take on passengers, mail and cargo destined for the territory of the State whose nationality the aircraft possesses;
- (iii) The privilege to take on passengers, mail and cargo destined for the territory of any other contracting State and the privilege to put down passengers, mail and cargo coming from any such territory.

However, this agreement was never ratified⁸⁰ and privileges therein are negotiated and granted on a bilateral basis thereby forming the bedrock of current BASAs. These privileges are commonly referred to as 'freedom of the

⁷⁷ *Supra* note 27.

⁷⁸ December 7, 1944, 59 Stat. 1693, 84 United Nations Treaty Series 389 and 1701, 171 UNTS 387 respectively.

⁷⁹ Abeyratne, R. i "Would Competition in Commercial Aviation Ever Fit into the World Trade organization?" *Journal of Air Law & Commerce*, 793 (1966).

⁸⁰ ICAO Journal 2004 "Status of Certain International Air Law Instruments" available at <http://www.icao.org/> (Last accessed on 30th September 2005).

air', a phrase which Havel⁸¹ has correctly termed as a euphemism for barriers to free air transport services. There are generally nine freedoms of air recognized today and they are:

The right to from a home country over another country enroute to another without landing. That is, the right to over-fly a territory. Also called transit freedom.

2. The right to land in another country for non- commercial purposes such as refueling, maintenance or emergencies.
3. The right to load passenger, cargo and mail in the carrier's country of origin and unload them in another country. For example, Kenya Airways loads passengers in Nairobi and unloads them in London.
4. The right to load passengers, cargo and mail in another country and bring them back to the country of origin. For example, Kenya Airways loads passengers in Istanbul and unloads them in Nairobi.
5. The right to load passengers, cargo and mail in another country and then fly to another country. For example, Kenya Airways flying from Nairobi to London stops in Cairo and loads passengers bound for London.
6. The right to load passengers, cargo and mail in another and unload them in a third, after stop over from the country of origin. For example, on a flight from London to Nairobi to Pretoria, Kenya Airways loads passengers in London bound for Pretoria.

⁸¹ Havel, B. *In Search of Open Skies*, The Hague: Kluwer Law International, 1997.

The right to carry passengers, cargo or mail between two countries on a stand-alone service, where the flight does not go via the carrier's country of origin. For example, Kenya Airways operates a route from Dubai to Lagos without passing through Nairobi.

The right to carry passengers, cargo or mail on a route from a home country to a destination that uses more than one stop along which passengers may be loaded and unloaded. For example, Kenya Airways operates a route from Nairobi to Johannesburg, where it loads passengers and unloads them in Pretoria.⁸²

9. The ninth freedom is also referred to as "full cabotage" or "open-skies" privileges. It involves the right of a home country to move passengers within another country.⁸³

Though these Freedoms somehow met the United States concept for liberalized international scheduled air transport, they apply only between States, which have concluded BASAs between them. It is therefore correct to support Havel and postulate that these so called freedoms granted between States are actually what give BASA their effectiveness because if these freedoms were granted on a multilateral basis there would be no need to have BASAs as they are today.

⁸² Adopted from European Union Commission, "Air Transport, The Eight Freedoms of Air Traffic" at <http://www.europa.eu.int/comm/transport/themes/air> (Last accessed on 30th September 2005) It states, "There are now eight generally recognized Freedoms."

⁸³ Sourced from Rodrigue, J. P. "Air Freedom Rights", from <http://people.hofstra.edu/aerotrans/eng/ch3en/cone3en/airfreedom.html>. (Last accessed on 30th September 2005).

2.3.4 Institutional Mechanisms

2.3.4.1 International Civil Aviation Organization

The Chicago Convention established the International Civil Aviation Organization (ICAO) "made up of an Assembly, a Council, and such other bodies as may be necessary"⁸⁴ with the aims and objective to develop the principles and techniques of international air navigation and to foster the planning and development of international air transport so as to:

- (a) Insure the safe and orderly growth of international civil aviation throughout the world;
- (b) Encourage the arts of aircraft design and operation for peaceful purposes;
- (c) Encourage the development of airways, airports, and air navigation facilities for international civil aviation;
- (d) Meet the needs of the peoples of the world for safe, regular, efficient and economical air transport;
- (e) Prevent economic waste caused by unreasonable competition;
- (f) Insure that the rights of contracting States are fully respected and that every contracting State has a fair opportunity to operate international airlines;
- (g) Avoid discrimination between contracting States;
- (h) Promote safety of flight in international air navigation;
- (i) Promote generally the development of all aspects of international civil aeronautics.⁸⁵

ICAO still micro- manages regulation of safety, communications, and other technological aspects of the international aviation industry, but has maintained

⁶⁴ Article 43.

⁸⁵ Article 44. ICAO operated as a provisional organization until 1947 when permanent ICAO was established and affiliated with the United Nations.

only consultative and advisory functions in the economic sphere.⁸⁶ While this organization has definitely improved the safety of flight in international air navigation, it has not been instrumental in influencing economic policies within member states in relation to international air transport. Therefore, member States have continued to pursue own economic interests, which are reflected in negotiating BASAs. It is arguable whether ICAO would have by now influenced a broad based economic policy between member States had it pursued its mandate of preventing economic waste caused by unreasonable competition.

2.3.4.2 International Air Transport Association

The Chicago Convention was all but accompanied by the emergence of the International Air Transport Association (IATA), "which as a peak association of international air carriers, quickly came to set prices on most international routes."⁸⁷ IATA was created in Havana, Cuba in 1945 as a voluntary organization to prevent airlines from practising unethical methods of setting rates and schedules. It is till the prime vehicle for inter- airline cooperation in promoting safe, reliable, secure and economical air services for the benefit of the world consumers. It also provides a forum for setting various technical, operational and commercial standards. This allows carriers to coordinate scheduling of flights and to interline, that is, connecting passengers between two airlines on the same ticket. IATA further operates a clearing house for inter- airline debts arising from interline traffic. Non- IATA member airlines are able to pay to use the clearing house service.

Traditionally, airfares and cargo rates were negotiated and agreed at IATA Tariff Conferences and subsequently approved by governments under bilateral air

«Ibid.

⁸⁷Sochor, Eugene, *The Politics of International Aviation*, Iowa City: University of Iowa Press, 1991.

service agreements. IATA however indicated that the function of the Tariff Conferences was to focus on 'reference fares', mainly to facilitate interlining and to determine the airlines operating the service. As a result, the fares negotiated and agreed at IATA tariff Conferences usually do not reflect the final fares paid by consumers.

Participation in fare coordination was a condition of IATA membership until late 1970s when the U. S. Civil Aeronautics Board argued that IATA was illegally fixing airfares and blocked American participation in IATA agreements. Subsequently, IATA agreed to allow optional participation in tariff coordination. IATA still holds conferences to review airfares, to ease passengers and cargo, and to help make airline documents standard. One of the major players in the aviation industry, the U.S., has often indicated that it will withdraw the memberships of its airlines if the IATA acts to set prices, which it calls a cartel.⁸⁸ The US stand is justified in that an association of airlines that set prices is detrimental to international air transport, as airlines would collude to maintain high prices even without corresponding improvement in services.

2.3.5 Bilateral Air Service Agreements under the Chicago Convention

It should be stated that the 1944 Chicago Conference developed a document called the Standard Form of Agreement for Provisional Air Routes (hereinafter Chicago Model). It is a model BASA recommended to States wishing to conclude bilateral air transport agreements. As Haanapel states, this document must be understood in the light of the failure of the Chicago Conference to

⁸⁸ See http://www.centennialofflight.gov/essay/Government_Role/Intl_Civil/Pol19.htm (Last accessed on 30th September 2005); And <http://www.zsrlaw.com/publications/newsletters/> (Last accessed on 30th September 2005); Also www.iata.org/history. (Last accessed on 30th September 2005).

agree upon a multilateral regime of exchanging traffic rights for commercial international air services.⁸⁹

The Chicago Model does not state the air routes to be operated in the main agreement, but left the issue to be stated in an Annex to the agreement between two States involved. The Annexes or Schedules to BASAs have become the preferred mechanism to actually exchange route rights on more or less precisely defined routes.⁹⁰

The Chicago Model does not contain provisions on the determination of prices to be charged by airlines and the capacity and frequency of services to be provided by airlines, thereby leaving these issues to be determined by the airlines designated to perform international air services under such an agreement. It is argued that leaving such important issues to be decided by the airlines was a concession to the USA which advocated minimal regulation of the international air transport,⁹¹ while the UK and others wanted national governments to have more control in the international air transport.

The USA concluded a number of pure Chicago Model agreements with Canada, Denmark, Iceland, Ireland, Norway, Portugal, Spain, Sweden and Switzerland. The agreement with Canada only exchanged Third and Fourth Freedom rights between the two countries, whereas the other agreements also contained Fifth Freedom rights.⁹² These agreements were short-lived as they were replaced by agreements based on the Bermuda Agreement⁹³ between

⁸⁹ See *supra* note 1.

⁹⁰ See Middleldorp, G. "Substantial Ownership and Effective Control of International Airlines: The Netherlands " at <http://www.eicl.org/64/art64/>. (Last accessed on 30th September 2005).

⁹¹ See Cheng, *The International Air Transport*, Stevens: London 1962.

⁹² See Lowenfeld, *Aviation Law*, 2nd ed. Mathew Bender: New York 1981 at p2- 140.

Air Services Agreement, Feb. 11, 1946, US- UK, 60 Stat. 1499.

the USA and the UK (hereinafter Bermuda I). Nevertheless, specific provisions of the Chicago Model keep on reappearing in one form or the other especially provisions based on the Chicago Convention. Some of these provisions relate to:

- (i) Non-discriminatory application of national air regulation based on Article 11 of the Chicago Convention;
- (ii) Use of airports and other navigation facilities and charges therefrom based on Article 15 of the Chicago Convention;
- (iii) Customs exemptions for fuel, lubricating oils, spare parts, regular equipment and aircraft stores in line with Article 24 of the Chicago Convention; and the
- (iv) Recognition of certificates of airworthiness and personnel licences which is in accordance with Article 33 of the Chicago Convention.

Most of the BASAs contain the above standards clauses. These standard clauses do not, as a rule, give rise to dispute as they deal with questions of general facilitation, particularly administrative questions, concerning international air transport and not the field of commercial competition. Their wording and in some cases their spirit may vary according to particular national legislation, which does not hinder their generalized acceptance and application.

Other provisions of BASA do not confirm or elaborate on the Chicago Provisions of which the most important is the provision on designation of air carriers which may perform services pursuant to a BASA, and the rule that carriers so designated should be substantially owned and effectively controlled by citizens of the designating nations. The rule on substantial ownership and effective control of national airlines, although absent in the Chicago Convention itself, is found in both the International Air Services Transit Agreement and the International Air Transport Agreement, which have an identical provision:

"Each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a contracting State."⁹⁴

The phrase "substantial ownership and effective control" is not defined and an IATA study has revealed that most countries have given specific percentages of either maximum foreign ownership or of minimal national ownership, the latter ranging from more than 50% to more than 76%. Thus, the word 'substantial' has been interpreted as "at least more than 50%."⁹⁵ Justification for this requirement is hard to find, but some have argued that justification lies in the economic protectionist policies of States and also in the realm of national security and for reasons of maintaining national pride. National security concerns comes from the fear that rights granted to friendly States would pass into the hands of enemy States, without any possibility of intervention by the grantor State.⁹⁶

Whereas it is easy to ascertain substantial ownership by looking at the national legislation, effective control is a *de facto* condition that must be judged according to the precise facts of every case. Some have described effective control as the power, direct or indirect, actual or legal, to set policy and direct or manage execution thereof.⁹⁷

⁹⁴ See Article 1, section 5 of the International Air Services Transit Agreement and Article 1 section 6 of the International Air Transport Agreement.

⁹⁵ See Fenema van, "Ownership Restrictions: Consequences and Steps to be Taken," *Air & Space Law*, Vol. XXIII, No. 2, 1998 and also see www.iata.org/ (Last accessed on 30th September 2005).

⁹⁶ See Gertler, J. "Nationality of Airlines: Is it a Janus with Two (or more) Faces?", *Annals of Air and Space Law*, Vol. XIX-1, 1994. also see Dierikx, M. "Bermuda Bias: Substantial Ownership and Effective Control 45 Years On," *Air Law*, vol. XVI, No. #, 1991.

⁹⁷ *Supra* note 91. Also see Haanappel, P. "Airline Ownership and Control, and some Related Matters," *Air & Space Law*, Vol. XXVI, No.2, 2001.

This requirement of "substantial ownership and effective control" plays an important role in designating an airline which will enjoy traffic rights granted under a BASA. This is because although it is States that exchange traffic rights, they are usually not the entities which actually operate air transport services. Indeed, States negotiate rights on behalf of and for the benefit of their airlines. As a result, each State designates one or more of its national airlines, depending on the provisions of the agreement allowing either single, multiple or even free designation, which may use those traffic rights. This is what links the States negotiations with airlines. Ordinarily, for a State to designate an airline, the nationals of that State must have "substantial ownership" of that airline. This means that its nationals must have majority shareholding or shareholding specified in that State laws. This is of uncompetitive because States favour their airlines even when the said airlines are inefficient.

24 BERMUDA AGREEMENTS

2.4.1 Bermuda I

Soon after the Chicago Convention, delegates from the United States of America met at Hamilton, Bermuda in 1946 to resolve the remaining issues. They produced what came to be known as the Bermuda I Agreement.⁹⁸ The Bermuda Agreement represented a compromise between the US and British interests." The US accepted governmental control over international air tariffs, which it was unwilling to do at the Chicago Conference and UK relinquished the desire for strict intergovernmental capacity control leaving the determination of capacity and frequencies of services primarily to airlines through the IATA. The

⁹⁸ Air Services Agreement, Feb 11, 1946, U.S-U.K 60 Stat. 1499 (Hereinafter Bermuda I so as to distinguish it from the Bermuda II Agreement of 1977 (Agreement Concerning Air Services, July 23, 1977 U.S. - U.K.28 UST 5367, 1977.

⁹⁹ *Supra* note 30.

Bermuda I agreement became a template for other nations and today thousands of similar BASAs determine the nature of passengers and cargo air services between countries.¹⁰⁰

The US and the UK were at the time the major civil aviation powers. In addition, the UK had many overseas possessions and thus great geographical power. Due to its importance in setting the tone for BASAs, it is important to reproduce the agreed text as follows:

- (J) That the two Governments desire to foster and encourage the widest possible distribution of the benefit of air travel for the general good of mankind at the cheapest rates consistent with sound economic principles; and to stimulate international air travel as a means of promoting friendly understanding and good will among peoples and ensuring as well the many indirect benefits of this new form of transportation to the common welfare of both countries.*
- (2) That the two governments reaffirm their adherence to the principles and purposes set out in the preamble to the Convention on International Civil Aviation signed at Chicago on the 7th December, 1944.*
- (3) That the air transport facilities available to the traveling public should bear a close relationship to the requirements of the public for such transport.*
- (4) That there shall be a fair and equal opportunity for the carriers of the two nations to operate on any route between their respective territories (as defined in the Agreement) covered by the Agreement and its Annex.*
- (5) That in the operation by air carriers of either Government of the trunk services described in the Annex to the Agreement, the interest of the air carriers of the other Government shall be taken into consideration so as not to affect unduly the services which the latter provides on all or part of the same routes.*
- (6) That it is the understanding of both Governments that services provided by a designated air carrier under the Agreement and its Annex shall*

¹⁰⁰ Supra note 46.

retain as their primary objective the provision of capacity adequate to the traffic demands between the countries of ultimate destination of the traffic. The right to embark or disembark on such services international traffic destined for and coming from third countries at a point or points on the routes specified in the Annex to the Agreement shall be applied in accordance with the general principles of orderly development to which both Governments subscribe and shall be subject to the general principle that capacity should relate:

(a) to traffic requirements between the country of origin and the countries of destination;

(b) to the requirements of through airline operation; and

(c) to the traffic requirements of the area through which the airline passes after taking account of local and regional services.

(7) That in so far as the air carrier or carriers of one Government may be temporarily prevented through difficulties arising from the War from taking immediate advantage of the opportunity referred to in paragraph (4) above, the situation shall be reviewed between the Governments with the object of facilitating the necessary development, as soon as the air carrier or carriers of the first Government is or are in a position increasingly to make their proper contribution to the service.

(8) That duly authorized United States civil air carriers will enjoy non-discriminatory "Two Freedom" privileges and the exercise (in accordance with the Agreement or any continuing or subsequent agreement) of commercial traffic rights at airports located in territory of the United Kingdom which have been construed in whole or in part with United States funds and are designated for use by international civil carriers.

(9) That it is the intention of both Governments that there should be regular and frequent consultation between their respective aeronautical authorities (as defined in the Agreement) and that there should thereby be close collaboration in the observance of the principles and the implementation of the provisions outlined herein and in the Agreement and its Annex.

s clear from the above provisions that the Bermuda I Agreement is essentially Chicago Model with some elaboration. Article 1 (Bermuda I Agreement)

(exchanges traffic rights between the contracting Parties. However, there were five Annexes to the Bermuda I Agreement which revealed important economic details as the exchange of traffic rights. Annex I defined the rights exchanged as rights of transit, stops for non-traffic purposes, commercial entry and departure for international traffic of passengers, cargo and mail. These rights are exchanged on the air routes as specified in Annex III or as amended in accordance with Annex IV. Annex II contained the Agreement's pricing provisions. Annex V dealt with 'change of gauge', the practice whereby a carrier designated under a BASA changes the size or type of aircraft enroute in the territory of the other Contracting Party. The Final Act included a resolution on capacity and frequency of services.

The essential features of Annex II were preserved in "the great majority of post-World War II bilateral air transport agreements."¹⁰¹ These features are:

- Fares and rates shall be subject to the aeronautical authorities of both Contracting Parties, a rule that is normally referred to as the dual or double tariff approval rule.
- (ii) Delegation of ratemaking power to the Traffic Conference machinery of the IATA. Any fares and rates agreed upon through the IATA machinery would be subject to government approval.
- (iii) There is the requirement that fares and rates shall be "reasonable" taking into account all relevant factors, such as cost of operation, reasonable profit and the rates charged by other air carriers.
- (iv) A rule that all fares and rates shall be filed with the appropriate aeronautical authorities of both Contracting Parties so as to facilitate the governmental approval process; and

¹⁰¹ *Supra* note 1.

- (v) A rule on ratemaking in the event of absence of IATA agreed fares and rates, or in the event of intergovernmental disagreement over fares and rates.

The Final Act of Bermuda I Agreement provides:

That air transport facilities available to the traveling public must bear a close relationship to the requirements of the public for air transport;

- f (ii) That there must be fair and equal opportunity for the carriers to operate on the agreed air routes;
- (iii) That carriers of one country shall take into consideration the interests of the carriers of the other country so as not to affect unduly each other's services; and
- (iv) That the primary objective of the provision of capacity is to meet traffic demands between the country of nationality of the air carrier and the country of ultimate destination of the traffic with subsidiary Fifth Freedom traffic capacity related to the traffic requirements between the country of origin and the country of destination of air traffic, requirements of through airline operation and traffic requirements of the area through which the airlines pass after taking into account of local and regional services.

These provisions of the Final Act have been termed as vague as the US and UK intended to redress unfair competition between the carriers of the two nations, but did not intend to divide traffic between the US and UK carriers on a 50-50 percent basis.¹⁰² The criticism is well founded given the fact that the sizes of the two markets are comparatively different, with the US having the biggest share. One of the essential elements of Bermuda I Agreement was the provision of a system of regular and frequent consultations between the aeronautical

¹⁰¹ *Supra* note 1.

authorities in the event of governmental dissatisfaction with capacity as offered by air carriers.

2.4.2 Bermuda II

As the Bermuda I Agreement took effect, its liberal nature began to be a source of friction between the US and the UK with regard to international air transport. The UK expressed its discontent that the US had authorized an unacceptable high number of its carriers on the London route thereby diminishing UK's airlines revenue. In addition, the US airlines began to develop the practice of combining non-stop trans-Atlantic services from 'gateway' airports in the US with feeder services from cities within that country; a system called 'hub and spoke'. In the 1970s the British Air Transport described the combination of the Pan American Chicago to London service with a feeder service from Dallas and Houston to Chicago while TWA operated via Washington to London service which actually originated in San Francisco, and called at Denver and St. Louis.¹⁰³ Thus the UK's strategy of privileged access to a major part of the US market was not being realized as Bermuda I had led to the growth dominance of the US airline industry, which was reflected by the fall in the share of the market between the US and UK operated by British carriers from 37.08 per cent in 1961-62 to 30.9 per cent in 1966-67.¹⁰⁴ As a result, the British Government announced in 1976 that it intended to renounce the Bermuda I Agreement. That decision led to one year of intense negotiation whose result was the Bermuda II Agreement, which came into force in 1978.¹⁰⁵

¹⁰³ *Ibid.* See also *supra* note 74; British Air Transport Services in the Seventies Para 351.

¹⁰⁴ Eighteenth Report: House of Commons- Environment, Transport and Regional Affairs available at <http://www.parliament.the-stationery-office.co.uk/pa/cm/199900>. (Last accessed on 30th September 2005).

¹⁰⁵ *Supra* note 75.

The Bermuda II Agreement was significantly more restrictive than Bermuda I. It limited the number of carriers that could serve routes between the two countries and gave the parties' respective governments considerable control over capacity. It further diminished the US Fifth Freedom rights beyond the UK market.¹⁰⁶

In simple terms, Bermuda II proposed limits on the number of 'gateways' in the United States, which could be served from Heathrow, in terms of the airlines permitted to operate trans-Atlantic services from the airport (initially British Airways, Pan American and TWA), and the gateways in the United States, which could be served from Heathrow. It also instituted controls on fares, which had to be approved by regulatory authorities from both countries, although the activities of non-scheduled airlines were substantially freed from restrictions.¹⁰⁷ Bermuda II has been termed as "a unique agreement which enshrined an elaborate system of controlling capacity on routes between the two countries" in an attempt to "provide a framework within which the airlines of the two countries can compete on broadly equal terms."¹⁰⁸

Bermuda II Agreement has frequently been reviewed to adapt to the changing circumstances. However, although both governments have for a long time sought a "new air services regime that would enable airlines themselves to determine the price and supply of air services in a fair competitive framework,"¹⁰⁹ progress has been limited to a number of specific amendments to the terms of the Agreement. For example, 'Manchester Agreement' of 1990

¹⁰⁶ Edwards, A. "Foreign Investment in the US Airline Industry: Friend or Foe?" *Emory International Law Review* 595, 601-02 (1995). Also Articles 3,11, Annex I Bermuda II.

¹⁰⁷ *Supra* note 82

¹⁰⁸ House of Commons, "The Analysis of British Airways in 1993" (1993- 1994) 47- II p.55.

¹⁰⁹ *Ibid.*

allowed US airlines to operate direct air services on certain routes to and from Manchester airport.¹¹⁰ Significant amendment to Bermuda II agreement came in 1991 after the demise of Pan Am and TWA when the two countries reached an agreement which permitted American Airlines and United Airlines to operate instead from Heathrow. In return a second British carrier, Virgin Atlantic, was permitted to operate trans- Atlantic routes from Heathrow alongside British Airways. New Fifth Freedom rights were obtained for flights between the US and Asia, Australia and Central and South America, and Seventh Freedom rights were obtained in respect of services between points in Europe and the United States. In addition, UK's airlines were given rights to 'code- share' with the US carrier, \Wd\ \no CQ\\le\ opel\ale sepatcAe YlgYis Wn^cVi conned wWn one another, and which share the same flight number.¹¹¹

It should be noted that disputes regarding already concluded BASAs are generally precipitated by economic interests just as in the case of the UK which renounced Bermuda I Agreement upon realization that its airline carriers were losing out to the US airlines' dominance of trans- Atlantic route. Equally, renegotiations are carried out to accommodate changing circumstances, which \n reaVity means to accommodate economic interests of the day.

2.5 CONCLUSION

This Chapter has discussed how the international legal framework on international air transport developed since it was first concretized in the 1919

¹¹⁰*ibid.*

¹¹¹ Information sourced from http://www.centennialofflight.gov/essay/government_role/Intl_Civil; www.tech.purdue.edu/at/courses/at300 (Last accessed 30th September 2005); www.zsrslaw.com/publications/newsletter (Last accessed on 30th September 2005); and www.parliament.the-stationery-office.co.uk/pa/cm119990. (Last accessed on 30th September 2005).

Paris Convention. It has delved into how the current BASA framework came into being after the Chicago Convention, and the resulting Chicago Model that set the template for BASAs between contracting States. The chapter has also shown how the Bermuda I Agreement came into being and its importance in the evolution of BASAs. It has shown the restrictive and illiberal nature of BASAs. In other words, they do not offer an effective way of liberalizing international air transport.

The emergence of "Freedoms of Air" through the International Air Services Agreement and the International Air Transport Agreement was a positive step toward liberalizing. However, lack of ratification of the "Five Freedoms" agreement meant that international air transport would lack a multilateral approach, and thereby BASAs became entrenched as another State's airline could only enjoy such 'Freedoms' by concluding BASAs with other States.

This chapter has also *shown how States control their airlines through the* "substantial ownership and effective control" clause. This means that States negotiate air freedoms for their airlines. In other words, airlines do not necessarily negotiate routes based on economics, but also on such issues as politics.

The chapter has also discussed institutional mechanisms resulting from the Chicago Convention which have not ensured total liberalization of international air transport. ICAO has failed to advance the course of liberalization because the organization has not exercised some of its economic oriented functions. Indeed, it continues to register and keep a record of all concluded BASAs.

IATA has served as forum "for setting various technical, operational and commercial standards" for airlines but has not been successful in ensuring that air transportation is liberalized. Actually, its traditional role of setting prices was anti- competitive and against the tenets of free market.

CHAPTER THREE: TRENDS IN LIBERALIZATION OF AIR SERVICES

3.0 Introduction

In order to overcome the restrictive nature of bilateral agreements in liberalizing international air transport, governments around the world have been taking steps to liberalize their aviation policies including negotiating liberal bilateral agreements among themselves.¹¹² For example, over the last decade the Kenyan government has partly privatized Kenya Airways and eliminated subsidies to the Kenyan carrier. Other countries have sought to liberalize various aspects of their bilateral arrangements and the United States of America's policy of "open skies" is a good example.

Countries in the European Union, South America, APEC and ASEAN have pursued liberalization on a regional basis, what is sometimes referred to as "plurilateral."

3.1 Unilateral Liberalization

Unilateral deregulations of air transport has been pursued by many countries and seem to have been started by the USA in 1978¹¹³ and commenced in Europe in the late 1980s.

In 1978 the US Congress passed the Airline Deregulation Act ("Deregulation Act") after the Civil Aeronautics Board¹¹⁴, the US domestic regulatory body charged with oversight of the economic growth of the US airline industry,

¹¹² Commonwealth of Australia, Productivity Commission's International Air Services Report No. 2, AusInfo, Canberra, 1998.

^{1.3} See <http://www.state.gov/e/eb/tra/index> (Last accessed on 30th September 2005).

^{1.4} The Civil Aeronautics Board was abolished in 1985 and the US Department of Transportation and Federal Aviation Administration inherited jurisdiction over aviation matters.

recommended that the airline industry be deregulated. The Deregulation Act was intended to ensure that market entry, pricing, and route designations were subject to market controls in an effort to promote competition. Following deregulation of its domestic airlines, the US sought to further liberalize its bilateral air transport agreements with other countries in an attempt to encourage liberalization of these countries' aviation markets. As a result, the US entered into eleven liberal agreements between 1978 and 1980¹¹⁵. These agreements shared common characteristics such as pricing flexibility, unrestricted capacity, multiple designations, access to interior US markets for foreign flag- carriers, some new Fifth freedom rights for US flag carriers, country of origin charter rules, and elimination of discrimination and unfair methods of competition.¹¹⁶

It should be noted that the US initiative to liberalize at this early stage "had no significant effect in the aviation markets of southern Europe, Asia, and Latin America."¹¹⁷ However, when the European Community commenced deregulation in the late 1980s, the significant effects were felt in the global aviation industry. Moreover, some authorities note that the US deregulation resulted in US airlines being even more globally competitive. Clancy notes that "by early 1990s, seats on U.S. airlines were on average 60% cheaper than their European counterparts."¹¹⁸

¹¹⁵ Some of agreements reached were with Australia, Belgium, Fiji, Finland, West Germany, Iceland, Israel, Jamaica, the Netherlands, Papua New Guinea, and Singapore.

¹¹⁶ See Edwards, A. "The International Legal Framework for Aviation Regulation," at <http://www.tech.purdue.edu/at/>. (Last accessed on 30th September 2005); Also see *supra* notes 72, 74 and

¹¹⁷ *Ibid.*

¹¹⁸ Clancy, M. "Domestic and International Sources of the Liberalisation of Commercial Air Transport," at <http://www.hatford.edu/> (Last accessed on 30th September 2005); Also see Johnson, P. "Air Transport," in Peter Johnson, ed., *European Industries: structure, Conduct Performance*, Aldershot, UK, Edward Elgar, 1993, pp 204- 29.

Europe lagged behind the US in deregulating air transport partly because of the Treaty of Rome, which treated air and sea transport separately from other markets.¹¹⁹ In addition, national carriers in Europe tended to be partially or fully State owned. The European Court of Justice ruled in 1974 that aviation was subject to the European Community competition laws, but this did not hasten deregulation until the Single European Act in 1986.¹²⁰ This Act made it easier to implement provisions for increased competition within the European Union.

In the US, domestic deregulation produced a small number of larger and more efficient carriers. In addition, formerly domestic carriers "now had a global outlook and the problem, from their standpoint, was that international markets remained highly regulated."¹²¹ Henceforth, the US government would play a leading role in advocating for liberalization of international air transport.

Privatization of government- owned airlines has also been a significant unilateral initiative in liberalizing international air transport. Some have argued that the trends towards privatizing airlines began in the 1980s¹²² and that privatization has led to greater efficiency and competitiveness of airlines.¹²³ A trend in privatization in Europe was set by the British Airways which was privatized in 1987. The Netherlands' KLM soon followed.¹²⁴

In Kenya, Kenya airways was making losses before privatization, but made a profit after privatization. This can be explained by the fact that the Kenyan

¹¹⁹ *Ibid.*

¹²⁰ See Meunier, S. 1998. "Europe Divided but United: Institutional Integration and EC- US Trade Negotiations since 1962. Ph.D. thesis, Political Science, MIT, pp 300- 28.

¹²¹ *Supra* note 97.

¹²² See Hanlon, P. *Global Airlines: Competition in a Transnational Industry*, Butterworth Heinemann, Oxford

¹²³ See Forsyth, P. "The gains from Liberalisation of Air Transport: A Review of Reforms," *Journal of Transport Economics and Policy*, Vol. 32 Part I pp. 73- 92.

¹²⁴ *Ibid* and *supra* note 97.

government restructured Kenya Airways in preparation for privatization. At the same time, the government assumed the debts accumulated before privatization. Since privatization, Kenya Airways has registered increased profits at the end of each financial year. Moreover, it has benefited from its strategic partnership with an established airline like KLM.

"Unilateral" liberalization by developing countries such as Kenya's was more often than not as a result of International Monetary Fund (IMF) conditionalities which stipulated that the government should not distort the market through unjustified subsidies to loss making State enterprises. The IMF stipulates such conditions to most of the developing countries especially those who require financial support. The same conditions led to the privatization some of Asia's airlines as result of Asia's financial crisis of the late 1990s.¹²⁵ Nevertheless, even after privatization, many governments continued to support their airlines by funding commercial losses.¹²⁶ It is important to note that although governments were privatizing their airlines, the ownership and control regime remained unchanged. That is, the government and or its nationals owned majority of shares in privatized companies. This is important in designation of an airline: a concept closely tied to national sovereignty and ownership. Equally, the privatized airline companies have to negotiate with other countries' carriers through their respective governments. A recent example is the negotiation between the Chinese and Kenyan governments to allow Kenyan Airways to fly to Shanghai, China.

¹²⁵ See Ballantyne, T., *et al* "Toughing it Out," *Orient Aviation*, February 1998, pp. 23- 29

¹²⁶ *Supra* note 91.

3.2 Open Skies

The term 'open skies' has no universally acceptable meaning, but it has come to symbolize certain liberal bilateral agreements between nations. However, the term has its origin in the US where on March 31, 1992, the then Secretary of Transportation, Andrew H. Card, Jr., announced a plan designed to liberalize "to the maximum extent" the aviation markets between the United States and Europe. He stated that "we (the US) will now offer to negotiate open skies agreements with all European countries willing to permit US carriers essentially free access to their markets."¹²⁷

The foundation for the Secretary of Transportation's statement was laid in 1990, when the US Department of Transportation (DOT) implemented what was called the Cities Program. This was a program designed to expand international air service opportunities to more US cities. It established a framework for granting eligible foreign air carriers expanded bilateral authority to provide service to communities in the US that did not have flights to their homelands. The intention was to supplement, and not replace, the negotiating process of the bilateral system. The Netherlands KLM Royal Dutch Airlines was allowed by the DOT to operate a scheduled international air service between Amsterdam and Detroit.¹²⁸ Thus, it was not a surprise that the Netherlands was among the first countries to sign an "open skies" agreement with the US. The US 'open skies' policy came as a result of successful domestic deregulation which had made America's airlines as the most competitive airline in the world.

The US DOT defined 'open skies' as composed of;

¹²⁷ *Supra* note 92. Also see Yergin, D. et al, 2000. "Fettered Flight: Globalisation and the Airline Industry," Cambridge Energy Associates Report.

¹²⁸ *Supra* note 95 and DOT Report.

- (i) Open entry on all routes;
- (ii) Unrestricted capacity and frequency on all routes;
- (iii) Unrestricted route and traffic rights, including no restrictions as to intermediate and beyond points;
- (iv) Pricing flexibility;
- (v) Liberal charter arrangements;
- (vi) Liberal cargo regime;
- (vii) Ability to convert earnings and remit in hard currency promptly and without restrictions;
- (viii) Open code- sharing opportunities;
- (ix) Self- handling provisions (the right of a carrier to perform and control its airport functions in support of its operations);
- (x) Pro- competitive provisions on commercial opportunities, user charges, fair competition; and
- (xi) Explicit commitment to non-discriminatory operation of and access to computer reservation systems.¹²⁹

Significantly, the US tied consideration of its antitrust immunity to an open skies agreement. The strategy was to encourage more carriers to enter into open skies agreements. Antitrust immunity was important to those carriers that would go furthest in their alliances, and would remove existing regulatory oversight on pricing, marketing, and related cooperation.¹³⁰

It has been argued that the open skies agreement between the US and the Netherlands was precipitated by the US desire to put pressure on the UK and to access the larger aviation markets in Europe, as "the domestic market of the

¹²⁹ *Ibid.*

¹³⁰ See *supra* note 97.

Netherlands does not have much to offer the United States."¹³¹ Other sources argue that it was the alliance between KLM and Northwest that was important as the carriers became partners rather than competitors. This is evidenced by the fact that KLM did not unilaterally extend its routes to additional US cities, but "upped its frequency to Northwest hub destinations such as Minneapolis and Detroit. Northwest in turn fed those passengers to additional US destinations. For the carriers, it was win- win."¹³²

Other European countries signed open skies agreements with the US as their carriers joined into strategic alliances with US carriers. Belgium, Austria and Switzerland reached open skies agreements as their national carriers cemented alliances with Delta, a US carrier. By 1995, nine more European countries had signed open skies agreements.¹³³ Given that the US has 40% of the world's aviation market¹³⁴, other countries scrambled to sign open skies agreements.

A number of Latin American and African countries reached open skies agreements with the US. In Asia and the Pacific, Korea, Singapore, Malaysia and New Zealand all signed agreements. Carriers in Africa could route passengers through Europe to hundreds of destinations in the United States seamlessly as a result of the alliances. In addition to open skies agreements they signed to facilitate entry into these alliances, several small countries have declared themselves open skies territories including Guatemala, Singapore and the United Arab Emirates.¹³⁵

¹³¹ Supra notes 95 and 97.

¹³²See Clancy, M. in supra note 97.

¹³³ See Meunier at supra note 99.

¹³⁴ Sourced from Clancy, M. at supra note 97.

¹³⁵ See Juan, E. 1997. "Aviation: The Politics and Economies of a Boom," *Foreign Policy* Winter 1997- 1998 pp. 141-54.

Though US Open Skies Initiative ushered in some of the most liberal agreements, it still incorporated many established elements of prior bilateral air transport agreements. For example, it failed to liberalize existing provisions regarding cabotage or foreign investment. Some have suggested that as long as cabotage prohibitions and significant restrictions on foreign investment remain, fewer than 10 airline families will act as "surrogate global multinationals to control global travel."¹³⁶

New Zealand has also adopted a more bilateral 'open skies' policy, agreeing on liberal arrangements with Brunei, Chile, Singapore, Malaysia, the United Arab Emirates and the United States. The New Zealand External Policy Advisory Committee stated to the Australia's Productivity Commission in 1998 that the New Zealand open skies model uses the US model as a basis and incorporates additional elements of liberalization which it sees as desirable. For example, New Zealand is prepared to negotiate seventh freedom passenger and cabotage opportunities. These rights are included in the New Zealand-Brunei open skies agreement.¹³⁷ The New Zealand-Singapore agreement permits greater flexibility in foreign ownership. It removes the requirement for majority national ownership of carriers, although it still retains the requirement for national control. New Zealand also has a very liberal arrangement with Australia under the two countries' Single Aviation Market arrangements, which provide for unrestricted capacity to and from and within each country including cabotage. However, restrictions on fifth freedom (beyond) rights for carriers remain. This kind of agreement is a positive step towards liberalizing BASAs and making them more market oriented. However, this effort is limited to New Zealand and few countries.

¹³⁶ *Ibid.*

¹³⁷ See Australia's Productivity Commission Report at *supra* note 91.

3.3 Regional liberalization

Some agreements negotiated in recent years have sought to liberalize air services on a regional basis or among a small set of countries. The propensity for countries to negotiate regional arrangements for international air services is partly a reaction to some of the restrictive elements of the bilateral system.

3.3.1 European Union

In 1986, member countries in the EU agreed to create a single European market for the exchange of goods, services (including air transport services), labour and capital. The date for the commencement of the single European market was 1 January 1993. The European Commission (EC) has primary responsibility for developing and implementing the regulations for the operation of the single market, including provisions relating to air transport.

The regulation of intra-EU air services was previously characterized by relatively restrictive bilateral arrangements between each of the member states. The EC introduced three packages of reforms between 1987 and 1993 to harmonize existing regulation of EU air services and to introduce greater competition for international air services between EU airlines. The measures included establishing common licensing standards, allowing airlines to set fares freely without requiring government approval, and removing restrictions on third, fourth and fifth freedom services.

Since 1 April 1997, EU airlines have faced no restrictions on cabotage, that is, the right to operate domestic services within any EU country. The changes essentially enabled airlines to be registered as 'EU airlines' and thereby to operate services unconstrained within and between EU member countries. The measures undertaken by the EU have so far been largely restricted to the operation of air

services between the member states. The air transport regulations have been extended to all European Free Trade Association (EFTA) states since 1994 as part of the European Economic Area.

Arrangements between individual EU member states and other countries continue to be governed largely by the bilateral framework. Despite EU airlines now registering as EU carriers, the capacity negotiated under bilateral arrangements between countries of the EU and countries outside the EU is not available to all EU carriers.

The EC is seeking to exercise its authority to negotiate aviation agreements as a single entity on behalf of all EU carriers.¹³⁸ In March 1998, the EC announced legal action against eight member states, which have concluded aviation agreements with the United States. The EC argued that these member states, by unilaterally granting US carriers traffic rights to and from and within the EU and obtaining exclusive rights for their own carriers to fly from their territory to the United States, have distorted competition and cut across the single market concept of the EU.

On 5th November 2002, the European Court of Justice¹³⁹ ruled that the member States had made commitments in areas where competence had been transferred to the European Community such as the computerized reservation systems (CRS), intra-Community fares and rates, and airports slots. The Court went on to state that member States had flouted one of the basic principles of

¹³⁸ See "EU Commission Takes Action to Enforce "Open Skies Court Rulings," at <http://www.tiaca.org/content/ACF2004-presentation/> (Last accessed on 30th September 2005).

¹³⁹ See European Court Decisions at <http://www.europa.eu.int/cj/en> (Last accessed on 30th September 2005). EC had initiated legal action against Austria, Belgium, Denmark, Finland, Germany, Luxembourg and Sweden.

the Treaty of Rome¹⁴⁰ namely the principle of non- discrimination; the nationality clauses in the agreements discriminate on grounds of nationality, which limits freedom of establishment of European Community companies'. The nationality clause was defined in the Commission -vs- Belgium Judgment as "the clause on the ownership and control of airlines does, amongst other things, permit the US to withdraw, suspend or limit the operating licenses or technical authorizations of an airline designated by the Kingdom of Belgium but of which a substantial part of the ownership and effective control is not vested in that member State or Belgian nationals."¹⁴¹ On the other hand bilateral type agreements limit the rights and privileges to airlines that are "substantially owned and effectively controlled" by nationals of the bilateral partners.

The Court ruling means that matters, which are often covered by the provisions of bilateral air service agreements, now fall within the exclusive external competence of the European Community. This is a boost to the EC policy on international civil aviation by resolving the question of shared competence between member States and the Community.¹⁴²

In response to the Court's ruling, the EU Commission requested member States to undertake two remedial actions: grant the Commission a mandate to open discussion with the US and remove the legal problem identified by the Court by terminating their existing bilateral agreements with the US. As a result, the EU Commission has been negotiating with the US and the basic framework of an agreement is in place including provisions that would remedy the legal issues identified by the Court by removing all discrimination between EU airlines giving

¹⁴⁰ Article 52 of the Treaty of Rome.

¹⁴¹ See the Commission -vs- Belgium at <http://www.europa.eu.int/ci/en> (Last accessed on 30th September 2005).

¹⁴² See <http://www.zsrlaw.com/publications/newsletters/AA> (Last accessed on 30th September 2005).

them equal opportunities to fly on any transatlantic route between the EU and US.¹⁴³

3.3.2 Asia Pacific Economic Cooperation

The leaders of Asia Pacific Economic Cooperation (APEC) economies¹⁴⁴ signed the Bogor Declaration in November 1994, in which they agreed to work towards the goal of free and open trade and investment by 2010 for industrialized economy members and by 2020 for the developing economy members.¹⁴⁵ In November 1995, member economies agreed on the Osaka Action Agenda which outlined a range of liberalization, facilitation and economic and technical cooperation initiatives designed to give effect to the Bogor Declaration.¹⁴⁶

Some APEC governments, such as New Zealand, are of the view that the Bogor Declaration implies that air services within the APEC region must be liberalized by 2010 (or 2020 for less developed countries).¹⁴⁷ If this is accepted as a valid interpretation of the Bogor Declaration, APEC governments will need to remove all restrictions on trade in air services and on investment in airlines, consistent with these timeframes. Whether such restrictions would need to be lifted against APEC members only or against all countries is not clear. The full implications of Bogor remain unclear for air services, and indeed appear not to have been

¹⁴³Sourced from <http://www.europa.eu.int/comm/transport/air/international/> (Last accessed on 30th September 2005). Also see News Release No. 37/03 June 5, 2003 at <http://www.eurunion.org/news/release> (Last accessed on 30th September 2005).

¹⁴⁴ Members economies of the APEC are; Australia, Brunei, Canada, Chile, China, Indonesia, Japan Malaysia, Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, Republic of Korea, Taiwan, Thailand, the United States. Peru, Russian Federation and Vietnam became were admitted as APEC member economies in 1997.

¹⁴⁵ APEC 1994, APEC Economic Leaders Declarations of Common Resolve.

¹⁴⁶ Ministry of Foreign Affairs and Trade (Japan) 1995, The Osaka Action Agenda.

¹⁴⁷ See Australia's Productivity Commission at *supra* note 91.

addressed in APEC fora. Nevertheless, under the liberalization and facilitation and economic and technical cooperation components of the Osaka Action Agenda, members agreed on a number of initiatives on transportation.

These included resolutions with respect to air transport. The Air Services Group of the APEC Transportation Working Group has identified prospects for liberalizing international air services in eight areas:

- (i) Air carrier ownership and controls;
- (ii) Tariffs;
- (iii) "Doing business matters" related to commercial operations of airlines;
- (iv) Airfreight;
- (v) Multiple airline designation;
- (vi) Charter services;
- (vii) Airline cooperative arrangements; and
- (viii) Market access.¹⁴⁸

The APEC Transport Ministers in 1997 endorsed further consideration of the scope to apply APEC commitments to these eight areas. The Transportation Working Group reconvened the Air Services Group to develop these options further. However, there has been little tangible progress in developing air services liberalization options in this forum.¹⁴⁹ Australia has strongly advocated to APEC members the separation of freight and passenger capacity and the removal of constraints on freight. It has proposed to develop a set of standard APEC airfreight clauses for adoption in bilateral or plurilateral agreements. Despite

¹⁴⁸ See www.apec.org/apec/ (Last accessed on 30th September 2005).

¹⁴⁹ See Australia's Productivity Commission at *supra* note 91.

freight being one of the less contentious issues, these suggestions have met with little response from some APEC members.¹⁵⁰

Despite APEC being a forum under which the liberalization of air services could progress, the consensus required and the sensitivity of air services issues are likely to make substantial progress through APEC difficult in the immediate future.¹⁵¹

3.3.3 Association of South East Asia Nations

The Association of South East Asian Nations (ASEAN) member countries agreed in 1992 to adopt the Framework Agreement on Enhancing ASEAN Economic Cooperation. This included a commitment to 'enhance further regional cooperation to provide safe, efficient and innovative transportation and communications infrastructure network.'¹⁵² One of the major outcomes of this Summit is the decision to set up the ASEAN Free Trade Area within 15 years. Member Countries also signed the Agreement on the Common Effective Preferential Tariff Scheme which is the main instrument establishing ASEAN Free Trade Area. Further to this commitment, in 1997 ASEAN member states agreed to an implementation program for the ASEAN Plan of Action in Transport and Communications. The program sought to introduce a regional competitive air services policy within the ASEAN member countries, including the removal of restrictions on frequency, capacity and aircraft type for point-to-point services between and within member countries. It was proposed that the liberalization of air services within ASEAN member countries would occur on a sub-regional basis

¹⁵⁰ *Ibid.* Also see Australia's Department of Transport and Regional Development Submissions to Air Freight Export Inquiry, House of Representative Standing Committee on Communication, Transport and Microeconomic Reform, August 1998, Canberra.

freight being one of the less contentious issues, these suggestions have met with little response from some APEC members.¹⁵⁰

Despite APEC being a forum under which the liberalization of air services could progress, the consensus required and the sensitivity of air services issues are likely to make substantial progress through APEC difficult in the immediate future.¹⁵¹

3.3.3 Association of South East Asia Nations

The Association of South East Asian Nations (ASEAN) member countries agreed in 1992 to adopt the Framework Agreement on Enhancing ASEAN Economic Cooperation. This included a commitment to 'enhance further regional cooperation to provide safe, efficient and innovative transportation and communications infrastructure network.'¹⁵² One of the major outcomes of this Summit is the decision to set up the ASEAN Free Trade Area within 15 years. Member Countries also signed the Agreement on the Common Effective Preferential Tariff Scheme which is the main instrument establishing ASEAN Free Trade Area. Further to this commitment, in 1997 ASEAN member states agreed to an implementation program for the ASEAN Plan of Action in Transport and Communications. The program sought to introduce a regional competitive air services policy within the ASEAN member countries, including the removal of restrictions on frequency, capacity and aircraft type for point-to-point services between and within member countries. It was proposed that the liberalization of air services within ASEAN member countries would occur on a sub-regional basis

¹⁵⁰ *Ibid.* Also see Australia's Department of Transport and Regional Development Submissions to Air Freight Export Inquiry, House of Representative Standing Committee on Communication, Transport and Microeconomic Reform, August 1998, Canberra.

¹⁵¹ *Ibid.*

¹⁵² ASEAN 1992, Singapore Declaration, found at <http://www.asean.or.id/summit/> (Last accessed on 30th September 2005).

initially, with the ultimate objective of an 'open skies' policy within the ASEAN region.¹⁵³ Some progress has been made on a sub-regional basis. For example, in the South East Asian region, Brunei, Indonesia, Malaysia and the Philippines have liberalized air services within and between their less well-developed provinces to stimulate trade and development in the East Asian Growth Area.¹⁵⁴ However, Australia has argued that this arrangement has not been a major stimulus for the market in the ASEAN region because it is not connected under liberal arrangements with major traffic markets.¹⁵⁵ Nevertheless, in November 2004, ASEAN members adopted the Action Plan for ASEAN Air Transport Integration and Liberalization 2005-2015 which provides strategic actions to further liberalize air services in ASEAN region and promote an enabling environment for a single and unified air transport market in ASEAN countries. In line with the 2003 Bali Concord II which aims to achieve integration of the eleven priority sectors, including air travel, by 2010, ASEAN members also endorsed the Roadmap for Integration of the Air Travel Sector. The Roadmap sets specific actions and milestones for greater integration and liberalization of ASEAN countries' air freight and passenger services.¹⁵⁶

3.3.4 The Yamoussoukro Declaration

The Yamoussoukro Declaration concerning the Liberalization of Access to Air Transport in Africa¹⁵⁷ (hereinafter the Declaration) was adopted by the Conference of Heads of State and Government of the Organization of African

¹⁵³ ASEAN 1997, Integrated Implementation Programme for the ASEAN Plan of Action in Transport and Communications, at <http://www.asean.or.id/economic/patac/> (Last accessed on September 2005).

¹⁵⁴ See Australia's Productivity Commission Report at *supra* note 91.

¹⁵⁵ See Australia's Department of Transport and Regional Development presentation at the Productivity Commission *supra* note 91.

¹⁵⁶ See Joint Statement of the Tenth ASEAN Transport Ministers Meeting held in Phnom Penh, Cambodia on 23rd November 2004. Available at <http://www.aseansec.org/6614.htm> (Last accessed on 30th September 2005).

Unity in July 2000 with expectations that it would progressively eliminate non-physical barriers relating to:

- (i) The granting of traffic rights and particularly those falling under the Fifth freedom which enables an African country's airline to carry passengers between destinations in another African State;¹⁵⁸
- (ii) Remove restrictions hitherto imposed by States regarding capacity whereby passengers had difficulties in finding places on the available regular flights;¹⁵⁹
- (iii) Tariff regulation to minimize lengthy approval procedures at the country level;¹⁶⁰
- (iv) The designation by States of operational arrangements. Despite the increase in passenger traffic, the noticeable development of Africa's air transport industry, and the sophistication achieved over the years, extremely protective policies persisted at the country level, and these were in favour of the national carriers;¹⁶¹
- (v) Air freight operations especially where restrictions on air freight which leads to agricultural commodities being spoilt through biodegradation when no alternative means of transportation was available or where costs became too high.¹⁶²

The Declaration takes into account the different levels of development of the air transport sectors of various African countries, and so it provided for progressive

¹⁵⁷ Available at <http://www.unece.org/itca/vamoussoukro/> (Last accessed 30th September 2005).

¹⁵⁸ Article 3 of the Declaration.

¹⁵⁹ See Article 5 of the Declaration.

¹⁶⁰ See Article 4 of the Declaration.

¹⁶¹ See Article 6 of the Declaration.

¹⁶² See Article 5 of the Declaration.

liberalization¹⁶³ over a two-year period as from July 2000. Pursuant to Article 10 of the Treaty establishing the African Economic Community (the Treaty of Abuja), the Declaration came into force in August 2000.

Overall, the Declaration is a major and far-reaching regulatory development in the history of African civil aviation, both in its depth and magnitude. It creates an ambitious framework for a regional regulatory regime that would liberalize the African skies when fully implemented, by encouraging subregional and regional organization to pursue and to intensify their efforts in the implementation of the Declaration.¹⁶⁴

Under its Article 2, the Declaration takes precedence over all bilateral and multilateral air transport agreements resulting from the Chicago Convention and are not in conformity with it. This was of course intended to establish a uniform form of bilateral and multilateral agreements across the African continent. These sub-regional economic groupings, as the building blocks of the African Economic Community, provide the institutional framework for the implementation of the Declaration within the meaning of Article 88 of the Abuja Treaty. In terms of that article, the African Economic Community is to be built through the co-ordination, harmonization and progressive integration of the activities of the sub-regional economic groupings by gearing such activities to the final objective of the establishment of the Community. As a result, parties are required to harmonize and co-ordinate the implementation of the Decision at the level of their respective economic groupings. Strengthening of the sub-regional economic groupings will improve the chances of success of the implementation of the Declaration, without which an institutional vacuum may be created.

¹⁶³ See Article 2.

¹⁶⁴ See Article 12.2.

Therefore, the Declaration endeavours to institute a regional framework for the exchange of market access devoid of a priori government management of capacity and pricing, as part of the overall efforts at regional economic integration. It relies heavily on the principles of liberalization.

Pursuant to that objective, various regional groupings have undertaken steps to implement the Declaration. The Central African Economic and monetary Community (CEMAC) and the Economic Community of West African States (ECOWAS) signed a Memorandum of Understanding committing themselves to the implementation of the Declaration and appealed to partners to furnish the necessary support.¹⁶⁵ In Southern and Eastern Africa, the Southern African Development Community (SADC) and the Common Market for Southern and Eastern Africa have facilitated the formulation of the necessary regulatory instruments for implementation of the Declaration by among others establishing a regulatory council on air transport, harmonizing air transport policies including the rules governing civil aviation, and carrying out familiarization missions to States with the aim of understanding the true position of aviation industry in member States.¹⁶⁶ Other regional groupings have also undertaken actions to implement the Declaration.

The Economic Commission for Africa (ECA) has summarized achievements towards liberalization as follows:

- (i) Some States have applied agreements on liberalization of traffic rights on bilateral basis;

¹⁶⁵ See ECA/RCID/023/02/Rev.I "Report on the Implementation of the Yamoussoukro Declaration" by the Economic Commission for Africa, <http://www.uneca.org/eca-programmes/trade-and-regional-integration/> (Last accessed on 30th September 2005).

¹⁶⁶ *Ibid.*

- (ii) Frequencies between African States have been enhanced thus streamlining the movement of people;
- (iii) Users can now count on more frequent services and a broader choice of tariffs;
- (iv) An element of competitiveness has been introduced into the African aviation market, bringing about an improvement in services and the emergence of a broader range of tariffs;
- (v) The private sector has begun to invest in Africa's air transport sector by participating in the capital of the new airlines;
- (vi) Cooperation arrangements between airlines are emerging in some of the subregions;
- (vii) New routes have come into use; and
- (viii) Africa's air transport markets are on the path to unification.¹⁶⁷

Nevertheless, the ECA Report highlights impediments to the implementation of the Declaration. First is the issue of visa restrictions resulting to aeroplanes flying half empty even after liberalizing. The ECA thus recommended relaxation of visa procedures. Secondly, some airlines have tended to unfairly eliminate other airlines in order to monopolize the market. Therefore, the subregional organizations like COMESA, SADC and EAC formulated competition rules in a liberalized environment. Thirdly, member States have accepted the Declaration in a piecemeal manner as dictated by economic and political convenience, and lastly ECA pointed out the discordance between the Declaration's conflict resolution mechanism which is built mainly on bilateralism while it (the Declaration) envisages situations where more than two States are involved.¹⁶⁸

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid* at para 45.

3.3.5 Multilateral liberalization

As stated in the preceding chapters of this study, the General Agreement on Trade in Services (GATS) and ICAO have to date had some limited influence on international liberalization of air services. GATS was negotiated in the Uruguay Round of multilateral, multisectoral trade negotiations which concluded in 1994. The Round resulted in the establishment of the World Trade Organization (WTO), which encompasses among other agreements, the GATS and the General Agreement on Tariffs and Trade 1994. GATS defines trade in services as the supply of a service:

- (i) From the territory of one Member into the territory of any other Member;
- (ii) In the territory of one Member to the service consumer of any other Member;
- (iii) By a service supplier of one Member, through commercial presence in the territory of any other Member; and
- (iv) By a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.¹⁶⁹

Under GATS, each WTO Member agrees to treat the services and service suppliers of any Member no less favourably than it does for like services and service suppliers of any other country. This is known as the Most Favoured-Nation principle.¹⁷⁰

¹⁶⁹ See Article 1 of the General Agreement on Trade in Services.

¹⁷⁰ Any exceptions to Most Favoured Nation had to be specified at the time the WTO came into operation in January 1995.

All WTO members are required to accept GATS and GATT (1994) as parts of the 'single undertaking' outcome of the Round. Nonetheless, Members have discretion over the industry sectors to which many GATS provisions apply. The GATS has some limited application to air transport services. The Annex on Air Transport Services specifically excludes the application of the GATS to air traffic rights, however granted, and services that directly relate to the exercise of traffic rights. However, there are three services related to air transport to which the GATS does apply. These are aircraft repair and maintenance services, the selling and marketing of air transport services and computer reservation services. The application of many GATS provisions to these services is restricted to the extent that the services are listed or scheduled by members.

The Annex on Air Transport Services provides for periodic reviews of at least every five years of developments in the air transport sector and the operation of the Annex.

Apart from GATS, ICAO has provided a forum for discussing issues related to international liberalization of air services. In particular, the 1994 Worldwide Air Transport Conference canvassed a number of important issues including:

- (i) The prospects for eliminating, replacing or modifying ownership and control criteria for designated carriers;
- (ii) The future regulatory process including the scope for multilateral agreements on air services;
- (iii) Structural impediments to air services created by various forms of state assistance and physical restrictions on access through, for example, slot allocation;

- (iv) The interrelationship between air services and the broader regulatory environment, for example, competition and environmental laws, taxes on air traffic, and trade agreements and arrangements; and
- (v) Regulation of 'doing business' matters such as airport ground handling arrangements, currency conversion and remittance of earnings, non-national personnel and the sale, marketing and distribution of air services including CRSs.

3.4 Conclusion

This chapter has explored various ways in which countries have liberalized BASAs. These attempts have not been successful, as they tend to affect a certain region and not others. Other attempts like the Open Skies policy have been championed by individual countries to further their economic interests. The latter attempt is limited in that very few countries have enough individual economic clout to push their agendas. Regional attempts are also limited in that expansion of international air transport within a region is limited. Furthermore, individual countries within a region tend to pursue own aviation policy thereby causing disharmony within that region and countries that trade with that region. The next chapter concludes the study and recommends solutions to liberalizing international air transport.

CHAPTER FOUR: CONCLUSIONS AND RECOMMENDATIONS

4.1 Conclusions

This study has explored development of international air law and BASAs since the law was concretized in the 1919 Paris Convention. It has shown how BASAs were executed between States before the World War II and after the Chicago Convention. It is still open to discussion whether negotiating parties at both the Paris Convention and the Chicago Convention could have agreed on a more liberal legal framework had negotiations been conducted on the background of peace rather than war. May be then the contracting States could not have been desperate to maintain control of air traffic.

Chapter Two of this study has shown that failure at the Chicago Conference to agree on a multilateral based legal framework for international air transport led to the modern BASAs which rely on goodwill of two contracting States as each State was granted sovereignty over its airspace, and then given authority to determine what "substantial ownership and effective control" meant in the "two side agreements." The effect of these provisions was to restrict international air transport at the whims of national governments who could- still do- determine which of their airlines can trade with an airline of another State.

States are more interested in protecting their airlines from competition when negotiating BASAs or when deciding to conclude one with a certain State purely on economic reasons rather than their concern for national sovereignty. It can therefore be stated that the concept of sovereignty as compounded by the provisions on substantial ownership and effective control has served to maintain a protectionist economic policy in the international air transport.

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Chapter Three considered various attempts to make international air transport more liberal within the BASA framework. While these attempts have made tremendous gain, they are yet to transform international air travel into a free trade as States still have the power to dictate terms on how airlines operates. In addition, these attempts have been either unilateral, like the US driven policy on 'open skies' and thus of limited application in the global context or regional in nature. The latter restrict benefits of liberalization within a certain region, say the EU or the APEC and thus lack global application. Moreover, individual States within these regions still retain exclusive sovereignty over their airspace and therefore can decide to grant traffic rights or not. These States also have their own laws on what constitute 'substantial ownership and effective control' of airlines.

At the same time, since the European Court of Justice ruled that BASAs as concluded by individual States within the European Community with third parties contravened European laws, the European Union has been trying to have a common approach to no avail. This shows how other States' BASAs might be negatively affected if members of a certain region do not comply with their regional laws.

Because of the uncoordinated nature of regional liberalization, it is possible to have a region with efficient airlines relative to other regions, and eventually, it will want to expand to other regions, but cannot do so if other regions do subscribe to similar policies. In effect, regional groupings transfer protectionist policies of individual States to the regional level.

Nevertheless, this study concedes that recent trends toward liberalization of air transport have been increasingly beneficial to the consumers and it is a positive step towards developing a free market oriented international air travel.

This study has shown that various countries, airlines and other organizations are increasingly demanding that international air service be liberalized not only to bring the aviation industry into the era of liberalized businesses, but also in order to improve efficiency and benefits to the consumers. However, disagreements exist within States on how best to proceed with reforms in international air transport.

In a nutshell and from the preceding chapters of this study, the flaws inherent in the BASA regime can be summarized as follows:

- It encourages negotiations to take a mercantilist approach to international air services negotiations;
- It encourages States to narrowly focus on advancing the business interests of flag carriers;
- It has restricted the growth of efficient airlines and imposed unnecessary costs on travelers throughout the world;
- It restricts ownership and control of airlines thereby enabling States to impose uncompetitive policies in the air transport industry;
- Airlines from economies with less-developed capital markets are often forced by the BASA system to rely on high levels of debt to fund their operations and equipment. They simply cannot find local equity investors;
- It helps to create and maintain a pool of under-capitalized, debt-dependent and inefficient airlines; and
- It does not encourage foreign investments especially to the developing economies which lack capital to invest in high technology industries like the airline industry.

As a result, the BASA system has come under intense pressures to reform. These pressures include:

- (i) Strong growth in air services globally;
- (ii) Deregulation of many domestic air services;
- (iii) Growing consumer and business demands for better, seamless air services;
- (iv) The use of codesharing, charters and alliances to overcome constraints inherent in the BASA structure;
- (v) US driven bilateral 'open skies' policy;
- (vi) Low profits of most airlines and growing reluctance of governments to continue subsidizing their airlines;
- (vii) Privatization of airports and airlines;
- (viii) Global capital markets and the pressure they apply to both publicly and privately owned airlines to perform; and
- (ix) Emergence of a number of regional or plurilateral agreements, particularly developments in the European Union.

In addition, world trade in most other goods and services is increasingly being liberalized in a multilateral framework. This is producing demonstrable gains to economic welfare, and making it difficult to justify a different system for international air services. The regional commitments of such groupings like COMESA, APEC, EU, and the ASEAN among others to achieve free and open trade and investment may also have important implications for regulating international air services.

Despite these pressures, the BASA system has proven to be quite resilient. Liberalizing BASAs is a process that has taken decades and is still far from complete. Where bilateral arrangements have been liberalized, it has led to

substantial economic gains. On balance, liberalization of trade and investment in international air services is likely to bring substantial benefits to consumers, tourism and other industries reliant on international aviation as well as efficient airlines.

4.2 RECOMMENDATIONS

Of all the BASAs constraints on efficiency and competition, probably the most fundamental and thereby intractable problem is the requirement that national flag carriers be locally owned and controlled. Restrictions on ownership and control in national designation of airlines lie at the heart of the constraints on competition in the BASA system. They provide a foundation for both the current system wherein nearly every country has its own international airline, and an array of protective measures that support it. Such restrictions on corporate structure and investment increase the costs to airlines. Airlines are now finding ways of overcoming some of these restrictions, for example by forming alliances or establishing ownership arrangements.

The justification for these restrictions is that each country should exercise its entitlements under the BASA arrangements through its own flag carrier(s). However, this reduces the ability for economies to specialize in the production of those goods and services in which they are relatively efficient and have a comparative advantage.

REGULATION OF SAFETY

Local ownership and control is not a necessary condition for BASA to function. It is national designation, rather than ownership and control, that is necessary. Some form of designation will always be required to ensure that governments

can effectively regulate safety and other technical aspects of aviation. Currently, designation is also required in order to assign rights to airlines because they are not negotiated on a non-discriminatory basis and countries have different sets of rights.

This study recommends that there be compulsory universal safety standards which individual countries or airlines can choose to exceed if they wish. However, national ownership is not required for the regulation of safety, as long as a rigorous form of designation is applied and safety regulations are effectively enforced by the designating country. The best way to prevent poor safety standards and the development of flags of convenience is to develop more rigorous safety accreditation procedures.

DESIGNATION

Although reform of ownership and control requirements for designation are critical for liberalization of the BASA system, options are limited because the provisions are actively monitored and enforced by various countries. Because designated airlines must be recognized by bilateral partners, it is risky for any individual country to change the criteria for designation of its airlines unilaterally. The United States showed that it was prepared to deny Aerolineas Argentinas status as an Argentinian carrier once it was no longer majority Argentinian-owned. This instance highlights the risks to countries from unilaterally changing designation criteria.

If a country could designate an airline domiciled elsewhere, then it could *improve its air services and free up scarce capital and technical resources* for other more productive uses. This will enable those countries with efficient airline industries to expand while the rest will be able benefit from access to capital intensive, high technology industries like the modern international airline industry.

For example, if Kenya designated some US Airlines as "Kenyan Airlines," Kenya will access US's aviation technology and other attendant benefits.

The study recommends that designation should be based on a less restrictive test that does not require ownership, and possibly even effective control, by nationals. Options for reform include basing designation on place of incorporation, principal place of business or other evidence of commitment to providing air services for the country. Ownership could be removed as a criterion for designation; regulation of foreign investment could be aligned with that for other industries.

MULTILATERAL APPROACH

Another option to liberalize ownership and control criteria for national designation would be for regional groupings to develop an all-encompassing approach. Each country would still negotiate its own BASA, but the airlines could be owned by citizens of any country in the group. An example of this arrangement is found between Australia and New Zealand. Their Single Aviation Market (SAM) arrangement already has liberalized the ownership provisions for designation to develop the concept of a SAM airline. A SAM airline must be majority-owned by citizens of either Australia or New Zealand. While the model is progressive, it has limited application within a certain region and thus would not meet the criteria for multilateral approach.

A liberal multilateral agreement which covers all or most countries would allow air services to develop in response to market pressures. Efficient carriers would replace inefficient carriers and the removal of regulatory barriers to entry would enhance competition. A multilateral system would be easier to administer and comply with than the current bilateral system. It should be recognized that there is little difference between aviation services and other traded goods, it could potentially bring trade in these services in line with the general trend in the trade

in services (such as is occurring under the jurisdiction of the WTO). It would also provide a mechanism for pulling more conservative nations along the deregulation path. A multilateral framework would also increase competitiveness.

Extending non-discriminatory, MFN treatment to air services would prohibit countries from discriminating among WTO members except in the context of a trade agreement such as a free trade area or a customs union. This absence of discrimination means that under the GATS, the nationality of airlines, and the national designation of airlines as under the present BASA system, would be less relevant. A country would still be able to restrict access to its airspace and to its domestic traffic, but it could not do so in a manner that discriminated among foreign airlines, except in the context of agreements for economic integration. Nor could the controllers of airspace, or the operators of airports, discriminate among foreign airlines on the basis of nationality.

This study recommends that the Annex to the GATS that explicitly excludes international air services from the WTO should be amended so as to enable the international air services to be negotiated under multilateral framework of WTO.

This study is convinced that the WTO has accumulated experience in the international administration of trade liberalization and, therefore, it is the best forum to achieve liberalization of international air transport. It is in that light that this study prefers amending the Annex to the GATS so that the MFN principle can be applied in such a way that every WTO member should be required to offer all members the elements of its most favourable BASA, on the basis of reciprocity. This would represent an improvement upon existing BASAs because the opportunity to enter into liberal bilateral arrangements would be available to all members on the basis of mirror reciprocity. A country could no longer

choose to be liberal with some partners and illiberal with others or partly liberal exchange for completely liberal access. This approach would set in motion mechanism for progressive multilateral liberalization.

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