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COMMUNICATION FROM THE EUROPEAN COMMUNITIES AND THEIR MEMBER STATES

The Review of the GATS Annex on Air Transport Services

The following communication has been received from the delegation of the European Communities and their Member States with the request that it be circulated to the Members of the Council for Trade in Services.

Introduction

1. The Council for Trade in Services is under an obligation to review periodically and at least every five years, developments in the air transport sector and the operation of the Annex with a view to considering the possible further application of the Agreement in this sector. The European Communities and their Member States welcome this opportunity to examine recent developments and to list to what extent this sector, which is crucial to the functioning of many other service sectors, should be better integrated in the multilateral framework provided by GATS. It will allow Members to scrutinise the outlook for the air transport industry and to assess what additional contribution GATS might make towards the further development of efficient and cost-effective air transport worldwide.

2. As an input for the first review session of the Council of Trade in Services scheduled for 28-29 September 2000, the aim of this communication is to supply information on recent developments in the air transport industry as seen from an European perspective. This may be followed up by additional submissions for the subsequent sessions of the review.

3. The communication builds on the information and suggestions put forward in the recent note from the Secretariat (S/C/W/163, part 1), and should be seen in the context of the earlier contributions from Members on the issue, in particular the documents on air transport from New Zealand, Chile, and Australia.

1. Developments in the sector - Liberalisation of air transport services in the European Communities and the effects on the industry

4. The period since the end of the Uruguay Round has seen fundamental changes in the EC air transport market. Legislation to fully liberalise internal air transport came into force in 1993. Today, the European Communities and their fifteen Member States, together with Iceland and Norway, as their partners in the European Economic Area, constitute one of the largest international aviation areas in the World. Inside this area all restrictions on market access and investment have now been removed allowing airlines from any of the Member States to fly any route according to market principles.

5. The EC has since been working with its neighbours to extend this area further. A liberal agreement has recently been concluded with Switzerland and is expected to enter into force in 2001. A further agreement with eleven of the candidate countries for EC accession is also being finalised. Within the coming years, the "European Common Aviation Area" created by this latter agreement will comprise almost thirty countries.

6. The European air transport industry has undergone several stages of transition from tight regulation, based on bilateral agreements and duopoly with limited competition, towards a single market. The final stage, the so-called 3rd package of air transport liberalisation resulted in the removal of discretionary powers over market access from the national authorities. It permitted EC carriers to decide, on the basis of economic and financial considerations only, the fares, routes, and capacity they would offer on the market. By extension this liberalisation also applies across the entire European Economic Area. The final restrictions on cabotage (flights between two points in a single Member State) were lifted in 1997.

7. Within the single market, common rules provide for licensing, market access, pricing freedom and the application of competition rules. Legislation is also in place governing the allocation of slots on a neutral, transparent and non-discriminatory basis, and liberalising access to the ground-handling market, while other rules ensure that technical and safety standards are maintained and that passengers are guaranteed a basic level of treatment from the airlines. Other initiatives are now being undertaken to improve the operating environment for airlines, such as suggestions to improve air traffic management.

Expansion of the European air transport industry

8. The last decade has shown a remarkable expansion of European air transport services with a yearly growth rate of around 5-7 % (measured in passenger revenue kilometres). This trend of high growth continued in 2000 - the July 2000 international traffic results showed an annual increase of around 8% for members of the Associations of European Airlines (AEA). The freight market grew by around 5% (revenue tonne-kilometres) on an annual basis.

9. There are no comprehensive statistics available, but a 1999 estimate of the total output of the industry will be around 725 million seat kilometres for AEA members, and an additional 300-400 million seat kilometres produced by airlines operating in the charter market.

10. Like demand for air transport, airlines' profitability is cyclical and volatile. It depends on the individual airline's ability to manage cost, fares and load factors in order to adjust to the changing conditions of the market. In the second half of the 1990s the performance of European companies, on average, has been good. This period has seen the privatisation process continue across the Community, with several flag carriers being restructured and placed once and for all on a sounder economic and management footing in order to withstand the increasingly competitive environment.

11. Employment in the European air transport industry increased by around 12 percent to 490.000 employees in the period from 1988 to 1996. Airlines represented the major components of the sector's employment (72%), followed by airports (18%), airline caterers (7%) and ground handlers (3%). In the period 1988-1996, the rate of growth in employment had stagnated for flag carriers while it increased for other airlines (to 4-5 %). Second tier, regional and low cost carriers have emerged in most Member States and enjoyed considerable growth, often both taking market share from the majors and stimulating new demand. As a result, the sector has enjoyed net job creation in spite of major restructuring among the flag carriers. In related sectors, the overall annual growth rate of employment (1988 to 1996) was 1-2 % for airports, 7-8% for ground handlers and 5-6% for caterers.

Global development, competition and alliances

12. The global changes in the air transport industry and the World economy as a whole are putting pressure on airlines to become ever more efficient and competitive. To respond to the demand for comprehensive, reliable and cost-efficient air transport services, European airlines, like their counterparts all over the World, are increasingly seeking to build world-wide networks that will enlarge their reach and provide economies of scale. However, limited by the nationality restrictions of the bilateral system they remain dependent on commercial alliances and other marketing devices such as code-sharing and franchising. The increasing use of these arrangements might be seen as a sign that pressure is building within the industry for international liberalisation of the sort already experienced in sectors like telecoms and financial services.

13. In general, flights from the EC to markets outside the European Aviation Area continue to be governed by bilateral agreements negotiated between the individual Member States and third countries. The agreement between the EC and Switzerland is the first major bilateral aviation deal to be negotiated by the Community as a single entity, soon to be followed, it is hoped, by an agreement with the countries of Central Europe and Cyprus as mentioned above.

14. Due to the importance of the Transatlantic market, consideration is now also being given in the Community to proposals for the negotiation of a Transatlantic Common Aviation Area between the United States and the EU. This concept, which has the support of the major European airlines, would create an open transatlantic marketplace for air services. It would address the full range of issues that face airlines operating internationally including market access, ownership and control and competition rules.

15. The provision of Air transport services is strongly linked and integrated with numerous other activities in modern economies, including, but not limited to, the distribution of many high value goods and the transportation of passengers: obviously many activities relating to travel depends on air transport, but in addition other activities, such as for instance telecommunications or electronic commerce are related. In relation to GATS, it is important to note that the treatment of air transport in the multilateral context will also directly and indirectly affect the developments of negotiations in other sectors, such as the proposal for a cluster on tourism services.

16. The ongoing service negotiations for certain new sectors in the GATS, such as postal services, will also be of significance to those companies within the air transport industry that deal with air-cargo and use air transport to provide express delivery services. Generally speaking, air transport services are an essential facilitator of trade and actually a precondition for the expansion of other economic activities, and thus form, with other service sectors such as construction or telecommunication, the infrastructural backbone necessary for the development of any economy.

2. Operation of the annex - Clarification of coverage and classification issues

17. The present coverage of the annex resulting from paragraphs 2 and 3 may require some precision and clarification. Paragraph 2 of the Annex provides for exclusion of traffic rights and services directly related to traffic rights from GATS. The Annex does not give any precise definitions of such "directly related" services. The review is an opportunity to reach a clearer understanding of the services, that Members agree are not directly related to the exercise of traffic rights pursuant to paragraph 2 and are thus presumably covered.

(a) Paragraph 2 of the Annex

18. In this context it is clear, that a broad range of services sub-sectors, that are actually not related to the exercise of traffic rights themselves, but rather serve as supporting services: these sub-sectors (catering, refuelling etc) are self-contained activities already covered by the CPC, and already liberalised in many domestic markets. It is however true that they have traditionally been provided by the major airlines. These supporting activities could be either ancillary to all forms of transport (such as warehousing or some airport services) or already classified in another service category (for instance catering which is classified under tourism/restaurants). Within the industry, airlines have in recent years tended either to focus on core activities and divest themselves of many of their subsidiary support businesses, or alternatively have expanded these businesses and turned them into stand alone subsidiaries in their own right, providing services world-wide to a wide range of airlines. This suggests that the review could take a somewhat broader view of which services could now be considered independently of the exercise of traffic rights, and could confirm that paragraph 3 does not exhaustively list the services that may be covered by GATS commitments. Other related areas are also covered by the GATS, including areas such as catering and leasing of equipment.

19. Each of these – and possible other areas as well - may be considered with a view to clarify the coverage, identify unclear definitions in existing commitments, and to be related to the recent development of the industry.

20. Leasing of aircraft is an essential service for the modern air carrier, notably since it ensures that air carriers have the flexibility to provide additional or replacement air services at short notice. Dry leasing is already covered by the GATS and classified under business services, but wet leasing of aircraft remains difficult because of the rules and restrictions on nationality and the link with traffic rights which leads to an exemption under the Annex. During the review, consideration could be given to how negotiations could facilitate wet leasing, while ensuring that appropriate levels of safety, management control and employment conditions are maintained.

21. Catering services have in many traditional instances been an internal activity of airlines, but the industry has increasingly seen growth and consolidation of providers that are not directly dependent of core-airline activities. The review may reveal if there are cases where further development of the catering industry is limited by regulatory barriers.

(b) Need for enhanced commitments under paragraph 3 of the Annex

22. Paragraph 3 of the Annex lists three sectors of air transport services where measures are subject to the GATS.

(i) *Aircraft repair and maintenance services*

23. Access to maintenance and repair is critical for airlines, not only for the direct costs involved, but also because it is one of the factors to determine aircraft availability. The industry in Europe has seen annual growth rates of around 8%. Many European airlines have downscaled their in-house maintenance activities or focused it on niches, while others have developed their businesses further. Independent providers have consolidated over the same period and in some cases also become more specialised.

24. Ongoing convergence of rules and practices between the Community and other major civil aviation markets as well as the mutual recognition between the Member States and these markets (both through co-operation of the JAA and the FAA) have characterised the regulatory framework. This is reflected in the total number of about 3000 maintenance organisations that has received

approval of the JAA (the so-called JAR 145 certification), of which 65% are in Europe, 35% in North America and 5% in the rest of the world.

25. Around 25 members outside the European Aviation Area and the neighbouring countries have taken commitments for maintenance. European services providers have in some instances – including when operating in countries with commitments in the sector – met barriers and practises that have impaired a full development of activities on a commercial basis. In the review members could therefore consider exchanging experience on how to secure an effective and diversified supply of maintenance activities, and may include views on an expansion of the coverage into elements of line-maintenance (service on an aircraft not withdrawn from operations). The on-going convergence of regulation and mutual recognition in this area may be of specific interest for developing countries, as the air transport industry itself has sought to move labour intensive repair and maintenance operations outside its home bases.

(ii) *Computer Reservations Systems*

26. The GATS covers computer reservations systems (CRS) as defined in paragraph 6 (3) of the Annex as services that contain information about carriers schedules, availability fares and rules, through which reservations can be made. The market for traditional CRS has been dominated by a handful of large providers¹ and has developed so that CRS services are now available in most countries.

27. Around 25 members outside the European Aviation Area and the neighbouring countries have taken commitments in this area.

28. Two main developments have taken place since the early 1990s when the definition of CRSs was drawn-up: the reduction of the ties between the CRS system and their airline owners, and the development of new Internet distribution channels. The on-going detachment of CRSs from their airline proprietors has taken place in Europe as part of the general process of focussing on selected core activities under direct management control. The costs of using CRS providers are high compared to the alternatives of direct sales via telephone or on-line distribution. At the same time, tighter regulations to ensure fair participation has limited the necessity for airlines to have a direct say in the running of a CRS.

29. Internet based CRS systems are of growing importance, and they may take the form of offshoots of the traditional CRS-systems providing reservations for a wide range of airlines direct to the public, or they may be the result of co-operation between a more limited group of airlines who have banded together to create a multiple-airline portal. It is not yet exactly clear how the latter type will operate and develop, but because they are likely to appear to the public as a neutral sales channel and have the direct backing of several major airlines, there will be a need, as there is with the traditional CRSs, to ensure that the information provided to consumers is genuinely neutral and that the controlling airlines do not abuse their position by excluding other carriers. Direct sales via an airline or alliance's own web-site are by definition not a neutral sales channel and would appear to be more akin to sales and marketing activities like a physical sales force selling tickets to the public.

30. Because of the concentration of CRS systems in a handful of operators, the risk of dominant positions being abused and cartel operating is real, especially in the light of the growing importance of internet transactions. In these circumstances the review should consider the merits of pro-competitive

¹ Including the 4 global players (SABRE, GALILEO, AMADEUS, and WORLDSPAN), one regional (ABACUS), and two notable local systems (INFINI and TOPAZ). All, including the global provider show notable variance in their regional dispositions and markets shares.

principles and/or safeguards and the experience of the telecom reference paper is worth exploring in that respect.

(iii) Selling and marketing of air transport services

31. European airlines are among the most advanced users of internet distribution channels and electronic ticketing. Notably, several of the more recently established low-cost carriers now sell a large proportion of their seats on the internet – one even now regularly makes over 70% of its sales online. By bypassing CRSs and travel agents, these carriers are making enormous savings in their distribution costs. Unsurprisingly, the more established European carriers have mounted ambitious strategies and investments to develop their direct on-line sales (an example is British Airways, which has set a goal of 50% of tickets to be sold online by 2005).

32. In the context of the review of the Annex the consequences of E-commerce for the air transport industry should be carefully examined, in particular the implications for the current coverage of CRS services, and selling and marketing services. In this respect, the EC will refer to the position that it expressed in the work programme on Electronic commerce, in particular the need to exercise the technological neutrality of the existing commitments undertaken by WTO members.

33. As for reservations systems, the new forms of sales and marketing need to be considered in the review in order to secure a suitable coverage of these dynamic service areas, and with a view to expand commitments beyond the 25 members outside the European Aviation Area and the neighbouring countries that have currently taken commitments in these areas.

3. Consideration of the possible application of GATS to the sector: Making air transport more efficient - elements for the review

34. With efficient air transport becoming more and more important for trade in both goods and services, it is essential for WTO Members to consider ways to simplify and stimulate operations in this sector. Independent of the debate on approaches for a general regulatory regime - including the bilateral framework of air transport agreements - there remains considerable scope to improve the conditions under which air transport services can currently be provided by extending the scope of the Annex and liberalising more services in the mutual interest of the WTO members.

35. Air transport services are dependent on a range of supporting services, legal rights and regulation. Continuing restrictions in areas such as ground-handling, other ancillary services and leasing make it difficult for air carriers to take advantage even of their existing traffic rights. Restrictions also make air transport services more costly for consumers, in particular slowing down the development of tourism and reducing the competitiveness of exports. The review is an opportunity to consider the possible effects of broadening the scope of the Annex by the adoption of commitments in new areas, and reflect on how the development of air transport services could be assisted.

36. The EC and their Member States find that the following areas could be examined and discussed during the review:

(a) Ancillary Services for passenger and cargo transport

37. There could be scope for extending coverage of the Agreements to more ancillary services that support the provision of air transport services. For services to be performed efficiently, air carriers must have access to competitive ground-handling services for dealing with passengers, their baggage and cargo. Also, efficient catering services, airport operation services and other supporting services must be available.

38. The provision of such services inside the European Communities is already relatively open to service suppliers from other WTO Members. There is a certain amount of legislation, especially on ground-handling, which ensures that air carriers can establish operations to handle their own aircraft and that large airports must end their ground-handling monopolies. This seeks to ensure that services at airports are cost-effective and gives air carriers the chance to choose the most suitable service provider for their needs. The review is an opportunity to exchange views on best-practices and consider possible implications for further coverage under the Agreement.

39. More generally, the CTS should review those services which support air transport, to passengers and cargo handling service, including those which relating to the preparation of the aircraft (refuelling, cleaning etc) and consider whether it would be appropriate to constitute a cluster of these services in order to facilitate negotiations on coherent liberalisation for these supporting services.

(b) Multimodal cargo activities

40. For cargo transport implying more than one kind of transport modes, the actual transport element of the service is much devaluated in both value and effectiveness unless it is accompanied by efficient handling and delivery of the goods on the ground. For this reason, it could be beneficial to consider all the ancillary services required by carriers of cargo: from the entry of the cargo into the airport at the point of departure – to the delivery of the cargo at the destination. The coverage of the GATS could be considered to extend to all services involved such as ground-handling and warehousing/storage. Members could consider the relationship with other transport modes to ensure that the multi-modal chain of transport operates as efficiently as possible. This could support efforts on trade facilitation of transport of goods, mainly through the simplification of procedures for handling international cargo.

(c) Transit

41. In order to exploit international traffic rights effectively, air carriers must be able to transit the airspace of other countries and be certain that, if necessary, it will be possible to make technical landings. These are the so-called “first and second freedoms of the air”. As part of the review of the Annex, it could be considered how the GATS could guarantee these rights – in accordance with ICAO charging principles - to all air carriers from all other WTO Members. This would ensure that an aircraft would be able to take the most efficient routes between their point of departure and destination, subject to any restrictions needed for safety or security reasons.²

4. Traffic rights: Review of the bilateral regulatory framework and examination of approaches for further development

42. Airlines competing on the global market have already met the limits of the existing framework of bilateral agreements. The framework has been stretched to cover more issues and provide broader market access in terms of freer designation on routes, more frequencies etc, however, limitations remain, and only very few countries allow full market access unilaterally. The major players have been seeking to cope with these limitations by establishing different ways of co-operation; the most significant of which is the global alliance. Bilateral agreements normally limit the rights to provide traffic to specific airlines, or – through limits on foreign ownership and control of

² There is a provision of this type to ensure such freedom in Article V of the GATT. It mentions that shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport.

airlines – impair airlines from following strategies for growth and investment based on commercial considerations.

43. The EC has no firm views at this stage but wishes to consider a number of possibilities that have been brought to its attention in discussions with operators in this sector. The review of the Annex is an opportunity for members to exchange ideas and to foster a better understanding of the issues at stake, without prejudice to any commitment to future negotiations, or to any position in such negotiations.

44. The review could consider the differences between the principles of the bilateral system, which is based on reciprocity and national ownership, and those of the GATS-system which is built on the MFN principle. The EC would support an open-minded discussion on the respective features of the bilateral framework and the multilateral structure provided for by GATS.

45. The MFN principle is central to the GATS. However, given the specific characteristics of the air transport sector it may be necessary to reflect on whether GATS rules could be applied to air transport services in a conditional or plurilateral manner pending a broader agreement with more comprehensive or full membership.

46. The review could also explore the possibility of extending the coverage of the agreement to specific parts of the air transport industry. In air-cargo services, for example, the limits of the existing framework are tested by a growing customer-driven demand for more quality in the international services delivered. A total of 20 % of EU exports (measured by value) use air cargo. Air cargo regulation is already quite liberal in some respects, but the fact that air cargo is carried both by dedicated services and in combination with passengers raises difficult questions.

5. Focus of the Review

47. The European Communities and their Member States consider that the review of the Annex on Air Transport Services offers a major opportunity to address the tension between an increasingly globalized market and the limitations of the current regulatory framework. It should sustain development of initiatives that can improve the conditions under which air transport services are provided, enabling air carriers to be more efficient, and thereby bring considerable benefits to the wider economy.

48. The review should examine the experiences of members with the air transport services currently covered by the Annex, including the problems relating to clarifications of classification issues, and limits of the current commitments. Based on the elements mentioned above, the review could also focus on the identification of a number of more pragmatic steps that could be taken to make air transport services more efficient than within its existing regulatory framework.

49. In addition, the review renders an opportunity for a much broader analysis of the possibilities and prospects for more thorough and ambitious liberalisation to be taken forward in a longer time-span.

50. For the European Communities and their Member States, the analysis of the present situation of air transport, based on the documents prepared by the WTO secretariat and the various submissions forwarded by WTO members already clearly indicate, that there is a need for negotiations to consider the further application of GATS to the sector. One concern will be how this can be achieved in line with the calendar agreed for the negotiations of the other service sectors.
