

Council for Trade in Services

EXCERPTS FROM THE OECD DOCUMENT "PRINCIPLES FOR THE LIBERALIZATION OF AIR CARGO"

Note by the Secretariat

At the 28-29 September meeting of the Council for Trade in Services devoted to the review mandated under paragraph 5 of the Air Transport Annex, the Secretariat was requested to make available elements of the work undertaken in the OECD on the liberalization of air cargo.

The document attached provides excerpts from OECD document DST/DOT(2000)1, dated 6 June 2000 "Principles for the Liberalization of Air Cargo" and describes the main areas of work of the OECD with regard to air cargo.

The following documents issued by the OECD, which are available on its website, are also relevant:

- A very substantive background note: "Regulatory Reform in International Air Cargo Transportation", document DSTI/DOT(99)1, dated 7 April 1999 (103 pages);
- part two of the document "Principles for the Liberalisation of Air Cargo", DSTI/DOT (2000)1, dated 6 June 2000 containing on the one hand a draft protocol to be inserted in bilateral agreements and covering only "doing business" issues and on the other hand a draft plurilateral agreement on cargo services including hard rights (33 pages);
- two documents containing detailed comments by OECD Member States, the industry, the unions and the international organizations concerned¹ on those draft agreements arranged respectively by authors and by articles commented: DSTI/DOT/RD(2000)1, dated 18 September 2000 (49 pages) and DSTI/DOT/RD(2000)2, dated 18 September 2000 (47 pages);
- the minutes of the last workshop held by the OECD and containing detailed additional comments on the articles of the draft agreement: document DST/DOT/M(2000)1, dated 9 November 2000 (20 pages).

¹ Except the WTO.

I. ESSENTIAL PRINCIPLES FOR THE LIBERALISATION OF AIR CARGO SERVICES

1. Liberalisation of market access

1. Currently, the air transport aspect of air cargo services is predominantly governed by bilateral aviation agreements prevailing in all countries limiting air carriers ability to respond to market developments and to exploit the market potential by basing their operations on service demand at a global level. They cannot plan international route structures and develop services in full competition with each other (see 1999 OECD Study paragraphs 169-197).

(a) Air Traffic Rights

2. From a strictly economic “ideal” viewpoint, all categories of air carriers should be allowed to make use of the full range of traffic rights and have the same opportunities for unimpeded route design and network operations. A level playing field for all categories of cargo service providers should be created that allows them to respond adequately to the needs of the market. However, it has to be recalled that about 50 % of the overall amount of cargo is moved by air in “belly hold or combi operations” undertaken pursuant to rights to carry cargo set forth in a world wide web of bilateral air service agreements for passenger transportation. The ultimate goal is the removal of all remaining barriers so that air carriers are able to carry out transportation operations on the basis of commercial considerations alone. It does not seem politically feasible at this stage to alter existing bilateral air services agreements governing passenger transportation which provide the legal basis for “belly hold and/or combi cargo operations”. Model provisions governing market entry and thus the pure transportation aspects of cargo transported by air have therefore initially to be designed for all cargo operators.

3. Commercial operations should become more economically viable if all-cargo service providers could exercise 5th and 7th freedom traffic rights (carry freight between two countries on a route with origin/destination in its home country; carry freight between two countries by an airline of a third country on a route with no connection with its home country). For 5th freedom rights to be of practical value it is imperative that potential “beyond” countries also adopt liberal policies with mirroring 5th freedom traffic rights. By granting 7th freedom traffic rights, traffic possibilities between third countries could be improved, thus optimising carriers’ networks.

4. Awarding 5th and 7th freedom traffic rights would add flexibility to the planning of air cargo services, and would take into account that air cargo traffic flows are often one way. Triangular operations and better return traffic possibilities would address the “back-haul” issue and enhance the economic and commercial efficiency in air cargo transportation.

5. By ultimately allowing cabotage operations (to carry freight within a country by an airline of another country on a route with origin/destination in its home country), the market access for carriers from abroad will be improved and will provide opportunities for better network building.

6. The ultimate goal, clearly, is the removal of all remaining barriers to all-cargo air carriers’ ability to serve markets on the basis of commercial considerations alone. Through gradually granting the full range of traffic rights, air cargo operations can be expected to become more competitively supplied, freely networked, and more cost-efficient. By adopting such a liberal policy, providers of air transport will gain better access to other countries’ domestic markets, and will be able to develop the supply of services solely on the basis of technological and economic viability. However, it is achieved immediately. The gradual implementation of arrangements with a high degree of flexibility,

and an agreed timeframe for a transitional period until the full range of traffic rights can be made available to all-cargo service providers, would be the most pragmatic solution. Governments considering the liberalisation of air cargo services pursuant to an instrument, as envisaged in Part III of this document, would have a menu of progressively open scenarios from which to choose. Thus, provisions should be suggested for the authorising of fifth freedom and seventh freedom rights and cabotage services.

7. Co-operation often serves as a substitute for mergers, acquisitions and cross-shareholdership as these traditional forms of co-operation are restricted by the ownership and control regulations of air service agreements. By jointly undertaking certain commercial activities, air carriers aim to rationalise their operations and achieve network efficiencies by expanding their market coverage. The issue of co-operative arrangements is not only relevant to cargo operations and combination services but equally to passenger air services. Combination carriers will continue to be subjected to traffic rights' limitations that will not apply to all-cargo flights, however the opportunity to enter into co-operative arrangements with other air carriers such as, but not limited, to code-share, to block space and to franchise would facilitate market access by combination carriers.

8. Some potential contracting parties have already negotiated bilateral agreements between them which are more liberal in some respects than the model contained in Part III of this document (or indeed any model that would be likely to obtain widespread support). It is therefore important that the envisaged agreement contains an article whereby accession to a plurilateral agreement does not represent a backward move for any Contracting Party.

(b) Right of Establishment

9. Traditional bilateral air service agreements require that the air carriers designated by a contracting party be substantially owned and effectively controlled by nationals of that contracting party.² This is done to safeguard essential safety requirements in order to avoid the emergence of substandard air carriers. Such requirements impede the flow of inward investment to contracting states and thus inhibit the development of the air cargo industries – precisely the opposite of the results the proposed principles are meant to encourage. For international air cargo services to become more efficient, restrictions on inward investment should be eliminated, and air carriers should be able to determine their ownership and control structures freely, based on capital and strategic business needs. This aim could be achieved by departing in the following manner from the ownership and control requirement entirely; first, a designated air carrier has to be incorporated and is required to have its “principal place of business” in the territory of the Contracting Party that designates it; and second, it is required that the designated air carrier be appropriately licensed by the Contracting Party that designates it.

10. Although the phrase “principal place of business” exists in both the Chicago Convention and EU law, there is no precise definition. ICAO’s Air Transport Regulation Panel suggests that, in assessing a carrier’s principal place of business, a state should take into account whether a carrier has a substantial amount of its operations and capital investment in physical facilities in the designating state, pays income tax and registers its aircraft there, and employs a significant number of nationals in

² This principle, inter alia, was adopted by the EU in its regulation of 1 January 1993, and was optionally suggested by ICAO in 1994. See ICAO, Report of the WorldWide Air Transport Conference on International Air Transport Regulation: Present and Future, Doc 9644, AT Conf/4 (1994) (hereafter “ICAO WWATC Report”), pp. 21-25).

managerial, technical and operational positions. These criteria should be used to apply the concept of “principal place of business”.

11. The requirement that each designated air carrier be licensed by the Contracting Party that designates it means that the provision cannot lead to a “flag-of-convenience” syndrome.

12. The issue of “free-riding” by carriers whose governments have not accepted the market-opening obligations assumed by the Contracting States may be a concern (see ICAO WWATC Report at pp. 24-25). The fear is that air carriers from non-signatory States would merely establish new headquarters in the territory of a Contracting Party and thus enjoy the benefits of the Agreement “free of charge.” One response is that such relocation is a non-trivial step for any air carrier to take, and seems relatively unlikely until the Agreement has attracted a large number of Contracting States. Another is that such a carrier might well put at risk its rights in third countries by so doing. Furthermore to counter any risks arising from a possible emergence of “flags of convenience”, safety rules need to be tightened. In particular, rules concerning the acknowledgement of Air Operation Certificates and Operating Licenses should be refined, strengthened and enforced.

(c) Operational Flexibility and Pricing Freedom

13. All cargo operators and, where consistent with existing bilateral air service agreements, combination carriers shall enjoy full operational flexibility in order to exploit business opportunities and to enhance competition among air transportation providers.

14. Existing restrictions should be lifted as regards: i) operations – operation of flights in either or both directions; combination of different flight numbers within one aircraft operation; omission of stops at any point or points – ii) frequency, type of aircraft and capacity to be used in conducting transportation services; and iii) the change of aircraft on any flight as well as iv) commercial agreements with other carriers including but not limited to blocked space agreements, codesharing and interline agreements.

15. Leaving pricing to be set by the marketplace without any governmental intervention would certainly be the ideal economic solution; in fact air cargo service providers are already free to set cargo prices in many countries so that the real world is ahead of the current traffic laws. However, given the long history of direct and indirect governmental involvement in pricing for air transportation a widespread agreement to such a provision may prove very difficult. If considered necessary, interventions by contracting parties should be limited to a bare minimum and should concern solely the transparent and non-discriminatory application of national competition law. Advance filing of tariff changes can be a mechanism of anti competitive co-ordination or even cartelisation, as has, for example, occurred in US passenger air transport. Requiring advance filing could immunize such conduct from prosecution under competition law. Contracting parties shall not require advance filing of tariffs but may require notification to its aeronautical authorities.

(d) Leasing/Safety

16. It is well recognised that the leasing of aircraft is a common practice in the airline industry. The leasing practice enhances the flexibility of the air transport industry for instance by developing cargo operations with limited capital. Leasing bridges temporary shortages of capacity and can reduce cost and debt levels. It can therefore contribute to the stiffening of competition because it allows smaller cargo operators to enter a market, which would have not been feasible without a leased aircraft.

17. For regulatory purposes it is important to distinguish between “dry leasing” where the lease involves only the aircraft, and “wet leasing” where the aircraft, together with the crew, will be leased. Despite some shared principles regarding the regulation of “dry leasing”, a common approach on how to deal with the approval of aircraft leasing has not yet emerged. The regulatory framework can be a source of significant uncertainty because regulations differ from country to country. Rules are discriminatory, as some countries do not allow “wet-leased” aircraft from any third country but benefit on a substantial scale from more lenient “wet lease” regulations in third countries.

18. Overall, regulators worldwide have imposed various conditions and limitations on the use of leased aircraft. This can be exemplified by rules stating that in order to be licensed as an air carrier, a company may be required to “own and operate” its own aircraft, and employ national citizens as flying personnel. Effectively, the air carrier is prohibited to lease foreign registered aircraft but could still lease aircraft owned/controlled by other national air carriers of the same country³.

19. The air cargo industry seeks greater standardisation and more flexibility—for wet leases in particular. The establishment of simple, agreed standards is needed.

20. In order to achieve a level playing field for air cargo service providers on an international scale, all cargo carriers should be authorised to contract freely for leasing operations with domestic/local carriers abroad. Since combination carriers remain subject to air traffic rights restrictions not applicable to all-cargo operators, “wet leasing” could be seen as one of the ways to provide access by combination carriers to guarded markets for which they do not have underlying route authorisation.

21. “Dry leasing” does not usually give rise to safety or regulatory concerns when the leased aircraft is registered in the State designating the air carrier. On the contrary “wet leasing” raises important safety issues, and has a social dimension as aircraft and personnel are licensed by third party aviation authorities. Safety issues come up because the aircraft is registered in a State other than the one designating the air carrier, and may be temporarily absent from the State of registry which is responsible for safety compliance. Regulatory concerns in certain countries originate from a notion that air carriers providing the “wet leased” aircraft are, in fact, using traffic rights to which they may not be entitled in their own right. Concerns have also been voiced about the impact of “wet leasing” on the labour market as flight crews oppose this, as they fear that core labour standards are being lowered and/or their jobs are at stake.

22. Worries about leasing practices can be adequately addressed by ensuring that safety and labour standards are clearly implemented and strictly met. To achieve this, the legitimate need of Contracting States to be assured of the operational integrity of both dry leased and wet leased aircraft registered in other countries has to be clearly recognised. Furthermore, while recognising that not all significant participants in the international air transport sector are signatories to the Chicago Convention (e.g., Chinese Taipei), it is imperative that an aircraft leased to designated air carriers or other air cargo service providers of a Contracting State meet standards at least *equivalent* to those promulgated by ICAO.

³ At the present time the United States prohibits its own airlines from using aircraft wet leased from foreign airlines, a rule that other governments see as an unjustified barrier to their own airlines’ ability to do business with U.S. carriers.

2. Liberalisation of Ancillary Services

23. Apart from market access issues, air cargo service providers are hampered by the regulatory environment applied to ancillary services; i.e. services considerably influencing the efficiency of seamless services offered by air cargo service providers. Ancillary services cover, for example, intermodal transportation, groundhandling, forwarding and warehousing as well as other issues related to air cargo business. From the regulatory point of view, the full range or selected ancillary services can be raised in conjunction with market access issues or can be dealt with on a stand-alone basis.

24. A framework with transparent, non-discriminatory rules on ancillary services seems to be necessary to achieve a balanced, more efficient, broader and more innovative choice of the provision of air cargo services which in turn will benefit industry, shippers and consumers on a global scale.

(a) Intermodal Transport

25. Today, virtually all sectors rely on intermodal transport services. Air cargo in particular depends to a large extent on other modes of transport since goods are transported from the producers via airport-to-airport and are then channelled via different modes of transport to their final destination. In addition, air cargo is carried partly by other modes due to geographical reasons or to accommodate distribution networks. Air cargo transport serves as one piece in the logistical chain to ensure relatively new services, such as time definite deliveries and door-to-door integrated services, which are in high demand by shippers. The operation of intermodal transport services is therefore a unique feature of the air cargo industry.

26. The intermodal nature of air cargo services is insufficiently recognised by the regulatory bodies. A more common regulatory approach to intermodal issues should be striven for to counter the uncertainties and achieve more coherence as well as predictability for air cargo service providers.

27. As a consequence, modal boundaries imposed on air cargo service providers should be removed. All companies, whose transportation activities include air cargo, should be able to operate intermodal transport services (notably trucking services) abroad.

28. By creating an air cargo policy framework that comprises liberalised intermodal services, OECD economies can better facilitate the efficient, timely and safe movement and delivery of goods. The interlocking of modes of transport better responds to the changes in the global economy and industry's needs for seamless logistics, in particular in light of the growing e-commerce business. Although the granting of intermodal (surface) delivery rights improves carriers' market access, and advances service quality, concerns related to competitive distortions in the upstream or downstream markets need to be addressed by complementary strict competition rules.

29. One solution presenting "the smallest denominator approach" would be to allow all companies whose transport activities include air cargo to be able to transport goods in connection with or in substitution of other modes of their own choice within a certain geographical limit from and to the airport. This approach would take care of diverging regulations that apply to the different transport mode operators. However, inserting a geographical limit is one form of market access constraint that would impair air cargo service operators' flexibility and would incur substantial disadvantages in terms of cost, distance, and delivery time trade-offs. Therefore, intermodal services should be liberalised without geographic limitations to support air cargo service operations.

(b) Ground handling

30. Ground handling services play a decisive role in the processing of air cargo. Air cargo service providers recognise these services as being one of the key determinants ensuring the comparative advantage over other modes of transport. Ground handling services comprise *inter alia* ramp-handling, surface transportation, parcel dispatching and storage. These services have a direct impact on handling times, cost and reliability of air cargo deliveries.

31. In many instances, impediments to ground handling services are a serious obstacle for the air transport sector in general, and air cargo operators in particular, that can erode the competitive advantage of air transport. Often, restrictions on self-handling, together with a legislated operator monopoly, cause undue handling charges and low quality of handling services.

32. The existing differences in cost and quality of ground handling services are mirrored through varying regulatory frameworks. While some bilateral agreements already contain liberal standard ground handling clauses, a whole range of countries imposes restrictions on ground handling. Whereas in certain countries airport ground handling services are supplied by a monopolist, others have opted for competitive providers and some allow air carriers to perform their own ground handling services and offer this service to other air carriers.

33. Ground handling operations at airports should be made available to all air cargo service providers on an efficient, transparent, and non-discriminatory basis. Service providers should be permitted to select among different alternative ground handlers. They should be able to choose freely between providing their own ground handling, performing ground handling with other air cargo service providers, or selecting among competing ground handling service providers. Restrictions should only be permitted for reasons of security or infrastructure constraints arising from considerations of airport safety and should be applied on a non-discriminatory basis.

34. By introducing self-handling and/or competition among service providers, the swiftness of ground handling operations will be enhanced, and will have a positive influence on cost and quality of air cargo services.

(c) Diversification into other services

35. Any regulatory reform in the sector should take into account the need to establish a regime which enables all categories of air cargo service providers to respond adequately to the needs of the market. It is therefore important to give air cargo providers the opportunity to provide all kind of services related to air cargo business such as warehousing, freight forwarding, express services and any other related activity. Through this diversification, new forms of global cargo networks will be developed and new innovative services can be offered in accordance with business needs and technological strategies.

36. Business boundaries for air cargo service providers should be broadened and competition rules and safety provisions, associated with the emergence of these forms of new business, strengthened. Any abuse of a dominant market position is clearly objectionable and must be adequately dealt with by the competition authorities whose objective should be to ensure that all air cargo service providers compete on a fair and equal basis.

3. Trade Facilitation

(a) Customs

37. Industry experts have noted that customs clearance procedures account for as much as 20 percent of average transport time and 25 percent of average transport costs of imports in many Member States. While expedited customs clearance is a crucial issue for the express delivery services industry, reductions in the time and cost of customs clearance will benefit all air cargo service providers.

38. The prominent place in world trade and commerce enjoyed today by time-sensitive air cargo transportation – transcending the mere provision of conventional transport and becoming comprehensive providers of logistical services – has resulted in much greater pressure on customs organisations to find additional efficiencies. A set of Principles designed to assist the liberalisation of air cargo services would therefore be incomplete without concern for the freedom with which their cargoes can move about, within the global trading system. All commercial consignments crossing national frontiers are subject to the combined requirements of national regulatory regimes. These often draw their force and form from international conventions and other instruments.

39. The main constituent of these regulatory interventions is a set of Customs controls, mainly directed to raise duties and taxes, enforce trade policy, interdict illicit drugs and collect statistical information. It has been thought necessary and useful, therefore, to include in these Principles a set of Articles setting out certain basic elements of simplification of Customs procedures which are especially important to the aviation industry which must offset the relatively high cost of their services by relating origin-delivery timings as closely as possible to the key advantage of rapid air movement.

40. The draft identical provisions contained in Part II and III are based on the World Customs Organisation (WCO) Express Guidelines and the texts of the revised WCO Kyoto Convention and some more detailed references in Annex 9 of the ICAO Chicago Convention, which is, itself, in the process of review, to take account of Kyoto.

41. These proposals are restricted to a relatively small number of standards, mainly concerned with those Customs interests attached to the relatively short time during which they have physical control of the goods and aircraft. In a modern Customs service such requirements are separated from the complications of fiscal requirements, increasingly handled by post entry data submissions, from approved company computerised systems.

42. Some account is taken, however, of the extra facilitation which may result for the air cargo service provider if his customer is already entitled to premium Customs procedures, by reason of high-quality compliance records or other stipulated qualification. The primary requirement is rapid, preferably immediate release of goods on arrival. This has to take account of key Customs responsibilities. Provisions therefore call for appropriate, in practice automated, risk-management by Customs and high-quality information and operational reliability from carrier and customer. At the same time it is possible to reduce Customs intervention to a bare minimum for low-value consignments which might yield revenue which is less than or only about equal to costs of collection.

43. An additional objective is the convergence of official controls. All administrative interventions can be made at the same time and place, ideally by a single agency, preferably Customs.

44. Aircraft, themselves, encounter few Customs problems, but there are frequent difficulties in securing expeditious and trouble free delivery of spare parts. The EU Commission has identified the use of commercial certificates as a sound basis for Customs control. Substantial quantities of air freight depart and arrive outside normal business hours. It is essential that Customs attendance be available on fair and equitable terms.

45. Finally, in many countries Customs inefficiencies are compounded and sustained by low standards of professional integrity. It is impossible to legislate for honesty, but an important primary need is a clear, freely available statement of procedural requirements, with associated provisions for an independent appeal tribunal.

4. Documentation

46. The sort of procedural reforms suggested under Customs should also be reflected through “documentary” changes including risk-assessment, convergence of official controls and pre-arrival notice of intention to release. However, the term “documentation” is interpreted as any accepted means of conveying a piece of information or set of data. It should be noted that neither the Chicago nor the Kyoto Conventions define the term “document”.

47. It is essential to bear in mind that:

- virtually all Customs and other official control authorities still demand certain conventional forms. Many developing countries remain highly dependent on prolix paper documentation.
- while advanced countries may have transferred most Customs entries to electronic media, all sustain a possible requirement for supporting conventional documents, such as an invoice or certificate of origin. A new approach to the rapid clearance of urgently required spare parts is particularly desirable.
- acute documentary problems, in international trade and transport, can always be traced to procedural causes.

48. The procedural reforms suggested as interim until the coming into force of the WCO Kyoto Convention must be echoed by radical “documentary” changes. However, further efforts will be necessary to streamline documentary aspects given the rapidly growing e-commerce and the necessity for the industry to respond to such developments.
