

## Future Trends in International Civil Aviation from a European Perspective

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It is a great honour for me to be present at this memorable and timely seminar in Seoul. Allow me to present my most sincere congratulations to Professor Doo Hwan Kim, who is celebrating his 60th birthday. It is most gratifying that his birthday has given rise to an intellectual exercise, gathering specialists of international air and space law from different parts of the world.

International civil aviation and space activities unite the people of the world. The international Institute of Air and Space Law at Leiden University in The Netherlands is flattered that it has been invited to make a contribution to the efforts which are being undertaken in Asia to think about and to attempt to establish regulatory regimes which meet the challenges of the coming decades. It should be mentioned that we signed an agreement of cooperation with the most distinguished Korean Association of Air and Space Law at an international conference last year in Tokyo. These days we have an excellent opportunity to implement that agreement in the spirit of cooperation and mutual understanding.

At present, there are several trends in international civil aviation. It is not sure what the results of these trends will be. More often than not are they opposing, even from a European perspective, leading to different

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ways of solutions. That is one of the reasons why I find the theme of this conference both timely and challenging.

There is, of course, the bad financial situation of international carriers, especially in Europe, and, maybe to a lesser extent, in North America. How to cope with this problem? Governments can either decide to privatize or to subsidize their 'national' airlines.

Privatisation may not be a 'healthy' solution at a moment when the financial situation of an airline is bad. It may be hard to find private investors who are willing to pay a more or less reasonable price for the shares of the company. Privatisation may prove to provoke an even more downward movement, in economic terms, of the airline.

The alternative is subsidization by the government. It is common practice through the world, and Europe is no definitely exception.

The EC Treaty contains rules on what is termed as "Aids granted by States".<sup>1)</sup> State aids are incompatible with the Common European market if they distort, or threaten to distort, competition by favouring certain undertakings. To assure fair competition between European, that is, EC companies, is one of the basic objectives of the EC Treaty.<sup>2)</sup>

It has taken some time before the EC Commission, the executive body of the European Community, became involved with air transport. The question was, in the eighties, if and to what extent the EC Treaty applied at all to air transport. EC law and policy were, in the first instance, concerned with economic activities and economic integration.<sup>3)</sup> Air transport was, for a long time, left out of this integration process.

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1) Articles 92-92 of the EC Treaty.

2) See also Articles 85-91, especially Articles 85 and 86 of the EC Treaty.

3) Article 2 of the EC Treaty.

The need for the establishment of an air transport policy for the European Community was recognized by the European Court of Justice. The decisions of this court gave rise to the involvement of the EC Commission with air transport.<sup>4)</sup> Ever since, the Commission has fully utilized its newly recognized powers,<sup>5)</sup> or is attempting to do so, for instance, in the field of external relations.

I will come back to this last issue later on.

The last stage so far was the adoption of the so called "Third Package"<sup>6)</sup> which came into force on January 1, 1993. This day coincided with the establishment of the internal market in the European Community.

Since this day, the financial situation of European air carriers has been far from attractive. No money is made by most of the carriers. The objective of the European air transport policy, as outlined above, is to make the European air transport competitive both at the level of the European market and in the global market place.

The latter objective, that is, competitiveness with carriers from other parts of the world, confronts European carriers with their relatively high cost structure. This is especially true when these cost structures are compared with those of Asian carriers. An essential factor here is that European carriers were, and, to a great extent, still are owned by governments. This made them vulnerable as bureaucratic organs of the state.

In short, the competitive inefficiency of these Community air carriers - as they are called in the official legal language - does neither meet the requirements of EC law and policy, nor those of the global market place.

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4) Cases 167/73 *French Seamen*, ECR, 1974, 369 and 13/83, *Parliament v. Council*, ECR 1985, 1532.

5) Cf. the Air Transport Packages of 1987, 1990 and 1992.

6) Published in OJ L240(1992).

That is why measures had and have to be taken.

Those measures are taken when it becomes clear that a certain carrier receives financial support from its government in order to be able to continue its operations. An example here of is Air France, the French national carrier.

The Commission issued two rather controversial decisions against this company. In each case the Commission arrived at the conclusion that no state aid was granted. An important criterion in these decisions was the fact that private investors might have taken the same decision to inject the air company with fresh capital. This consideration is, however, doubtful.<sup>7)</sup>

Other favourable decisions in the matter of state aids were taken in cases involving Sabena, the Belgium flag carrier, Iberia, the Spanish flag carrier and TAP, the Portuguese flag carrier. The essence of these decisions was that aid was justified by the need to develop certain economic activities or to develop certain economic areas. This forms an argument to be exempted from the prohibition against state aid.<sup>8)</sup>

We all know that, from a financial point of view, 1992 was a disastrous year for international carriers, especially from North American and from Europe. In the United States, a Presidential Commission, also called the Clinton Commission,<sup>9)</sup> advised to further the financial health of the airline industry and to review the financial condition of individual airlines. One of the most important recommendations concerned exemption of airlines from taxes, ranging from ticket taxes to transportation fuel taxes, in order to alleviate the financial burdens.

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7) See also John Balfour, *The Control of State Aids in the Air Transport Sector*, XVIII(4/5) AIR & Space Law 199-204(1993).

8) Article 92(3) of the EC Treaty.

9) The National Commission to Ensure a Strong Competitive Airline Industry, *Change, Challenge and Competition* (1993).

Europe followed suit with the report by the *Comité des sages*, the Committee of Wise Men.<sup>10)</sup> The most concrete recommendations of this Committee were taken in the field of state aids. This may illustrate how European policy makers are concerned with that problem. I quote the main recommendations in this respect :<sup>11)</sup>

— In the interest of consumers and of the airline industry itself, financial injections to air carriers in whatever form, should, as a rule, be disapproved if they are incompatible with normal commercial practices. What “normal commercial practices” are will be clarified in a minute.

— The European Commission is urged to strictly enforce the EC Treaty provisions concerning state aids and to elaborate clear guide-lines for evaluating any exceptional application of state aid. So far, this has not been done.

— For a brief period, however, approval of state aids may be considered when this aid serves the Community’s interest in a restructuring that leads to competitiveness. In this context, support for the transition of an air carrier to commercial viability may be in the Community’s interest if the position of the competitors is safeguarded.

The Committee of Wise Men then gives a few concrete conditions for approval which could be thought of :

— A clear and genuine ‘one time, last time’ condition. In other words, if the injection is approved, no other injections will be allowed.

— The submission of a sound restructuring plan leading to economic and commercial viability within a specified time frame, and which is proven by access to commercial capital markets. The plan must attract significant interest from the private sector and ultimately lead to privatisation. I may refer in this context to the Commission decision in the *Air France* case which was cited before. In other words, it must be competitive from a

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10) A Report by the *Comité des Sages* for Air Transport to the European Commission, *Expanding Horizons* (1994).

11) At 21-22 of the Report mentioned sub 9.

commercial and financial point of view. Moreover, the restructuring plan must be understood so as to encompass the restructuring of the company, and the attracted money may not be used to buy shares into other carriers or to purchase new aircraft.

—In general terms, governments must withdraw from financial and commercial decisions which must be taken by the airlines themselves.

—There must be acceptable proof that the interests of other Community carriers are not negatively affected. This condition may be said to refer to the creation of a level playing field inside the Community.

It may be clear that these conclusions are based on liberal views. It met opposition from the less liberal countries, such as France, Italy, Spain, Portugal, Greece, and also Ireland. If these conclusion are implemented, these carriers fear to loose the grip on their flag carriers. It may result in their disappearance by take-over by another Community air carrier or bankruptcy.

It is not surprising, therefore, that the French Minister Bosson was one of the first persons to criticize then report. He said that “the European Community is not simply a free trade area with the sole and unique value of the laws of the markt : it must include a social vision, respect for individuals, for the values of planning, equal opportunity and public service that profitability disregards.”<sup>12)</sup>

The report has just been issued, and it is to be awaited how the European Commission will proceed. It may be clear that some fundamental decisions are called for when these policy suggestions are implemented. They will touch upon the very heart of the air transport industry : to what extent can it be said to be a public service as opposed to a commercial operation ? I will come back to this question in the last part of my presentation.

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12) 6166 *Agence Europe* 9 (9/2/94).

So far, it has been made clear that, when an air carrier is not able to acquire enough financial resources to survive on its own, it could request its government for financial aid. There is, however, another way that might help : cooperation, national or international. I will briefly discuss an international attempt to cooperation between airlines, and analyze why that went wrong.

Early 1992, the Executive Directors of KLM, SAS, the Scandinavian carrier, Swissair and Air Austria set up a project for cooperation between the four carriers under the name Alcazar. The cooperation would involve six nationalities : the Netherlands, Switzerland, Austria, Sweden, Norway and Denmark.

The agreement consisted of the setting up of a joint venture between the participating airlines as a daughter company. This daughter company was to be filled with more and more activities coming from the six mother companies, to begin with, for instance, catering of air services, maintenance of aircraft, joint selling and distribution networks etc.

The intention was that this joint venture would gradually replace the six different companies, which would be merged into one company. This single, and multinational, company would also be the designated carrier of the six participating countries for the exercise of traffic rights. The process was to be completed in 1997/1998.

There were, of course, a lot of questions which touched upon national sensitivities. What is the value of a participating company in terms of shares and control in the new company, where are the headquarters going to be located, who is going to be the topmanager etc. ?

Even if these essential problems had to a large extent been resolved, there still was the issue of the chosen American partner. KLM has links

with NorthWest, Swissair with Delta. It appeared that foreign international relations between the Netherlands and the United States could be affected if KLM would have dropped Northwest. Swissair found Northwest too risky a partner from a financial point of view. This proved to be a major stumbling block.

Then, there was the air policy side of the project. It involved 2 Community air carriers, namely, KLM and SAS, and 2 non-Community air carriers, namely, Swissair and Air Austria. A Community air carrier is defined as an air transport undertaking which :

- has its principle place of business and its registered office in a Member State of the Community, *and*
- which is owned, directly or through majority ownership, by Member States or their nationals, *and*
- which is effectively controlled by such Member States or their nationals.<sup>13)</sup>

If these conditions are applied to Alcazar, it can be seen that it was partly a Community air carrier and partly not. The target year of 1997/1998 was fixed because it was expected that, at that time :

- the non-Member States, namely, Switzerland and Austria would have become a Member of the European Community and of the European Union ;<sup>14)</sup>
- a common external aviation policy would be conducted by the Community.

Whether or not these expectations were realistic, is not relevant any more. A point which may be touched upon in this context is, of course, the acceptance of third countries of the multinational carrier.

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13) Article 4(1) and (2) of Council Regulation 2407/92, OJ L240(1992).

14) Of the three Scandinavian countries, only Denmark is a Member State. Nevertheless, the air transport regulations of the EC also applies to SAS by special agreement between the Community, on the one hand, and Sweden and Norway on the other.



For that purpose, bilateral clauses would have to be changed, as nationality clauses in the present bilateral air services agreements do not foresee in the possibility of designation of a multinational carrier. This requires, of course, the consent of the bilateral partners involved, each time one of the six countries wishes to replace its national carrier by the Community carrier set up in the Alcazar project. This is a matter of policy rather than of law : international law is flexible as long as the consent of the parties involved with the change can be obtained.

Allow me, your excellencies, distinguished ladies and gentlemen, to make some concluding remarks.

It has been noted that there are several trends in international civil aviation :

- concern for the financial well-being of the national carriers ;
- political, financial and legal protection of the national carrier ;
- the development of air transport into an economic activity ;
- privatisation of air carriers ;
- multinational cooperation.

This list, is not exhaustive, but it may serve to attempt to look into the 21st century.

The most immediate concern, for the present decade, is, for national governments, to make their national carriers as competitive as possible. The field in which national carriers play is not determined any more by their governments : the instrument of state aid and other forms of national support is under ever heavier attack. That is why it is ever more urgent that these governments make their carriers lean, efficient and service oriented.

This is not necessarily an easy task for most of the European carriers.

They are faced with heavy burdens, inherited from the past. The more and the sooner will it become necessary for them to become competitive.

Once this process has been completed, the trend towards privatisation and multinationalization will be the next step. Cross-border alliances, with Alcazar as an example of such a future trend, may become a reality, and this will require a change in the regulatory system.

That does not necessarily mean a modification of the Chicago Convention. Indeed, the Chicago Convention is primarily concerned with the safety and security aspects of international civil aviation. No provision of the Chicago Convention prevents the contracting states to that convention from setting up more liberal regimes, involving privatization and crossborder cooperation.

Obviously, it is more likely that these trends will grow on a regional basis. The European Union has already formed a framework for this purpose. Another example is the North American Free Trade Agreement, which, however, thus far excludes civil aviation from its scope. Then there are the Asean countries in South East Asia and the Andean Pact in Latin America.<sup>15)</sup>

Inter-airline cooperation is encouraged by the Chicago Convention.<sup>16)</sup> Air Afrique is one of the most recognized efforts in this respect. SAS, a consortium constituted by the three national carriers of Norway, Sweden and Denmark, although not formally falling under the heading of Joint operating organizations and pooled services,<sup>17)</sup> has already been mentioned.

Nevertheless, regional cooperation should not be seen as an end in itself, but as a means to contribute to a more efficient organization of international

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15) Involving Bolivia, Columbia, Ecuador, Venezuela and Peru.

16) See Chapter XVI of the Chicago Convention.

17) Cf. note 15, *supra*.

civil aviation world-wide.<sup>18)</sup> It is my opinion, therefore, that regional cooperation will be no more and no less than a trend, which may be overtaken by the speed at which international air transport evolves once a level playing field has been created among the carriers world wide. This level playing field presupposes privatisation of carriers and a regime according to which carriers do not operate according to their nationality, but according to their ability to serve markets in all, or as many parts of the world as they can efficiently serve.

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18) See Dr. Pablo Mendes de Leon, *Cabotage in International Air Transport Regulation* 134 (1992).