The Stagnation of Economic Regulation Under Public International Air Law: Examining Its Contribution to the Woeful State of the Airline Industry

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INTRODUCTION

Many of us take international commercial aviation for granted. In the industrialized world, we are accustomed to the convenience of flying to almost any destination in the world, virtually at a moment's notice. If planned far enough in advance, many of us can even afford it from time to time. The ability to go almost anywhere, at anytime, and with a reasonable assurance of arriving there within twenty-four hours has literally become a vital tool of international trade. When the convenience of dispersing freight and mail around the globe with similar ease and dispatch is added to the equation, our reliance on international commercial aviation becomes even more apparent.

It is human nature to take note of a problem only when it is too late to take remedial action. It is high time for the international community to seriously consider the warning signals coming from the airline and aerospace industries and realize that not everything is right with their world.[1] This is especially good advice today, because the recent momentum in international trade liberalization is built on the supposition that world markets will continue to expand.[2] Without a fast, reliable and affordable system of global transportation, which only commercial aviation can provide, that growth is far from assured.

1. *See* Timothy K. Smith, *Why Air Travel Doesn't Work*, FORTUNE, Apr. 3, 1995 at 42; *see also* Editorial Board, *Five-Year Outlook*, AV. WK. & SPACE TECH., Mar. 13, 1995, at 42 (presenting the annual review by the magazine's editorial board of the longer term prospects for aerospace/defence markets). (Several articles concentrate on the state of the commercial aircraft/air transport sectors).

2. The fact that exponential growth in international trade will be required to keep the consumption based economies of the western industrialized countries operating is evidenced by the proliferation of trade liberalization initiatives in the last two years e.g., the successful conclusion of the Uruguay Round of Trade Negotiations, the coming into force of the North America Free Trade Agreement, the decision to pursue a hemisphere-wide Free Trade Agreement of the Americas by the year 2005 at last year's Miami Summit, and the similar decision by the leaders of the Asia Pacific Economic Cooperation countries for a free-trade zone in the Pacific-Rim by the year 2020.

This paper is not intended to be a solution to the economic woes of the airline industry. Its scope is limited to reviewing economic regulation of scheduled international aviation services under public international air law. While most of the factors affecting the health and prospects of this industry result from the unique economics of commercial aviation, there is a correlation between the regulation of international aviation services and the state of the industry.[3] Decisions regarding who will fly where, how often, and for what kind of renumeration, form the most important *legal* issues affecting international air transportation. With this focus, this paper explores the extent to which the present system contributes to the industry's problems. It concludes with a discussion of current measures used to counteract over-regulation and suggests a modest, practicable approach which would build on the existing legal framework using recent advances in international trade law.

Economic regulation under public international air law primarily refers to the states' right to control access to the airspace over their territories by aircraft on commercial service.[4] This is done through the allocation of international routes, capacity, tariffs, and related rights, such as servicing and marketing which are ancillary to viable commercial access.[5] Due to the historically strict application of these rights, it has also come to include restrictions as to who can own and control airlines.[6] The rules that have developed over the last half century are a veritable jungle of confusing, sometimes contradictory regional and bilateral agreements. It consists primarily of the Convention on International Civil Aviation (Chicago Convention);[7] an almost incomprehensible web of over four

3. *See* Smith, *supra* note 1, at 45 (discussing how "empty core" theory in economics predicts that the airline industry, with high fixed costs, low marginal costs and a highly perishable product will never be able to settle down to a stable level of profitability); *see also* Paul Stephen Dempsey (hereinafter Dempsey), *The Prospectus For Survival and Growth in Commercial Aviation*,29 ANNALS AIR & SPACE L., pt. II at 163 (1994) (analyzing airline economics in-depth). Mr. Dempsey is no less pessimistic than Mr. Smith, but he attributes the industries problems to the lack of proper regulation, rather than fundamental economic theory.

4. *See* Bin Cheng, The Law of International Air Transport (The London Institute of World Affairs 1962); *see also* Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180-82, 15 U.N.T.S. 295-301 (Hereinafter Chicago Convention) (defining the legal basis for economic regulation under public international air law without the institutional provisions which establish the International Civil Aviation Organization in the combination of Articles 1, 5, 6 and 7).

5. *See* JACQUES NAVEAU, INTERNATIONAL AIR TRANSPORT IN A CHANGING WORLD, pt. III, ch.2 at 89 (1989) (showing how the unilateral granting of traffic rights by states is carried out in the bilateral system regulating access for international aviation services).

6. *See* Thomas D. Grant, *Foreign Takeovers of United States Airlines: Free Trade Process, Problems, and Progress*, 31 HARV. J. ON LEGIS. 63 (1994) (reflecting the view of most authors in this area, that airline economics and the restrictions on access imposed by public international air law are forcing carriers into closer cooperative arrangements, where they run into domestic limitations on foreign ownership and control).

7. *See supra* note 4.

thousand bilateral aviation agreements;[8] numerous Treaties of Friendship, Commerce and Navigation (FCN);[9] and most recently, the General Agreement on Trade in Services (GATS).[10]

To complicate matters further, there are now three distinct international bureaucracies on a global scale involved in economic regulation of international air travel: the International Civil Aviation Organization (ICAO);[11] the International Air Transport Association (IATA);[12] and most recently, the World Trade Organization (WTO)[13] in its capacity as the GATS Secretariat. There are also several organizations of regional scope,[14] not to mention the numerous trade and industry associations representing special interests most dependent on the airline industry.[15] When states are added to this picture, not just as owners of the rights of access, but also frequently as owners of airlines, it is not surprising that a question arises as to the legal framework's culpability for the industry's economic state.

This paper consists of four Parts. Part I briefly reviews the historical development of public international air law. While the focus is on the regulation of access, the issues of national security, technological development and international relations are also considered as factors that

8. *See infra* Agreement to Amend the Air Transport Agreement, as amended, and the Protocol Relating to the U.S.-Neth. Air Transport Agreement of 1957, as amended, October 14, 1992, T.I.A.S. No. 11976 (exemplifying the complexity created by the thousands of bilateral air transport agreements in existence, all being on deposit with the Legal Department of the International Civil Aviation Organization (ICAO), in Montreal).

9. *See* Standard Draft, *Treaty of Friendship, Commerce and Navigation*, Apr. 2, 1953 U.S.-Japan, 4 U.S.T., T.I.A.S. No. 2863. (containing provisions on most favoured nation status which are possibly inconsistent with the preferential nature of bilateral air transport agreements).

10. *See The General Agreement on Trade in Services* (hereinafter GATS), Multilateral Trade Negotiations; The Uruguay Round; The Legal Texts, CIS 1994 H78 0-2, Jan. 25, 1994.

11. *See supra* note 4 (creating the International Civil Aviation Organization (ICAO) in Pt.II). While intended to promote international air navigation and foster the development of international air transport, ICAO has been described as having "wide quasi-legislative and executive powers in the technical and regulatory field, [but] only consultative and advisory functions in the economic sphere;" *See also* Michael Milde, *The Chicago Convention - After Forty Years*, 9 ANNALS AIR & SPACE L. 119, 122 (1984).

12. *See supra* note 5, pt.II, ch.2 at 59 (describing the founding, objectives, functions, development and links to the Chicago Convention and ICAO of the International Air Transport Association). Through the system of bilateral air agreements, often involving governments which also own airlines, IATA has been drawn further into the regulatory web than is usual for industry associations which have the legal status of a private law cooperative association.

13. *See supra* note 10.

14. *See supra* note 5, pt.II, ch.3 at 67 (listing and describing the most prominent regional organizations).

15. *See World-Wide Air Transport Conference on International Air Transport Regulation: Present and Future, Montreal, 23 November - 6 December 1994*, Report Folder, AT Conf/4-WP/95 (containing interventions by numerous industry associations; e.g, Airports Council International; International Federation of Airline Pilots' Associations; International Transport Workers' Federation).

have helped shape today's picture. This holistic view highlights how far international law in this area lags behind the needs of today's economic, technological, and national security realities. Part II evaluates the extent to which the international legal regime is responsible for the current woes suffered by the industry. This entails an overview of the economic state of the international aviation industry, highlighting the influence that the regulation of access under current public international air law has on this situation. Part III examines the needs of the various stake-holders, and the devices that international organizations, countries and airlines use to circumvent the shortcomings of the present legal regime. In Part IV, this paper suggests that the possibility of changing the current regime is not likely. It is more fruitful, therefore, to focus on how the diverging approaches can successfully cohabit. In doing so, this paper sketches the parameters of an international legal regime that would permit and encourage a greater level of economic activity, and that can accommodate states in various stages of economic development.

I. THE ISSUE OF ACCESS UNDER PUBLIC INTERNATIONAL AIR LAW

From a purely legal point of view, it is difficult to understand why air law did not follow the long-standing precedent provided by the law of the sea. After all, starting with Hugo Grotius, the purpose of the freedom of the seas was to facilitate commercial access between states.[16] This basic right has been reinforced in numerous treaties of "Friendship, Commerce and Navigation" (FCN).[17] Following the 1982 United Nations Convention on the Law of the Sea, this right is now also conventional international law.[18]

In order to understand why public international air law developed differently to be subjected to absolute state sovereignty, it is important to note the prevailing historical and political circumstances that influenced its definition. The first concentrated attempt at international codification dates back to 1910, when the nation- state was becoming the paramount force in international relations.[19] The two successful attempts at codifica-

16. *See* H.A. Wassenbergh, *Parallels and Differences in the Development of Air, Sea and Space Law in the Light of Grotius' Heritage*, 9 ANNALS AIR & SPACE L. 163 (1984).

17. *See supra* note 9, especially Article II.

18. *See* United Nations Convention on the Law of the Sea, Oct 7, 1994, United Nations, New York, 1983.

19. *See* I.H.PH. DIEDERIKS-VERSCHOOR, AN INTRODUCTION TO AIR LAW, Ch. I at 2 (5th rev. ed. 1993) (describing the early development of public international air law, including the International Air Navigation Conference, Paris, 1910). While this attempt failed, the general tendency toward a restrictive, absolute national sovereignty regime for the airspace above a state's territory was already dominant. Historians will quickly point out that this was in the midst of the period when the nation-state was elevated to an almost mystical precedence. Thus,

tion on a global scale occurred in 1919 and 1944.[20]

The one reason most often given for governments' close control over access to national airspace was to protect fledgling airline industries.[21] Yet, what must immediately strike any reader about the 1919 and 1944 dates is that international aviation law was codified contemporaneously with the two greatest man-made catastrophes endured by humanity in this century. The devastation that military airplanes caused in these conflicts is a matter of record. It is no wonder that national security considerations played as great of a role as economic protectionism, in making absolute state sovereignty the basic legal premise of public international air law. Nor has it since been significantly unfettered by multilateral obligations.[22] Partially for this reason, the laws governing the use of airspace have tended to develop distinctly from those of other forms of transportation.[23] This leads to the question of whether aviation law should be regarded as *sui generis*, or also subject to laws governing other means of conveyance, or indeed other services.[24]

The answer is probably that some parts of public international air law, relating to the needs of safety, navigation and maintenance are so unique that the law has evolved to become *sui generis* by necessity. Other aspects, especially the purely commercial ones, are not distinct enough from other transportation services to be *sui generis*. Yet they have remained privileged only because they have been tied to the other aspects of international air transportation in international law.

International aviation law's economic components are, however, coming under increasing pressure to be subject to the same disciplines that govern other transportation services. This pressure is a result of changes in the original two reasons that shaped public international air law. First, commercial aviation is highly evolved, and has become so distinct from military aviation that national security reasons no longer justify strict economic control of airspace.[25] Second, the trend in the world to-

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the attitude of the delegates at the Paris Conference is entirely consistent with the prevailing international philosophy of the time.

20. *See id.* Chs. I & II (referring to the Convention Relating to the Regulation of Aerial Navigation, Paris, October 13, 1919, and the Chicago Convention, *See infra* note 4).

21. This is consistent with both the protectionist trade practices of the day, and the Convention for the Unification of Certain Rules Relating to International Carriage by Air (Warsaw Convention), Oct. 12, 1929, ICAO Doc. 7838, 9201.

22. *See* Cheng, *supra* note 4 (containing numerous provisions on safety, maintenance, navigation etc., which states do have to adhere to under the Chicago Convention in respect to regulating their airspace). When it comes to economic regulation, perhaps the only limitation is found in Article 5, which gives non-scheduled flights the right of overflight and non-revenue stops without obtaining prior permission.

23. *See* DIEDRICKS-VERSCHOOR, *supra* note 19, at 3.

24. *Id.*

25. With the exception of claims such as made by the former Soviet Union that KAL007

day is toward more liberalized trade, and industries that have long enjoyed domestic protection are increasingly forced to compete in the marketplace.[26] The following short review of economic regulation under public international air law shows how the law has failed to keep up with these trends.

A. The Chicago Convention

The Chicago Convention still constitutes the basis of public international air law today.[27] In the arena of economic regulation, the document reflects the economic and political positions of the two leading delegations at the conference, the United States and the United Kingdom. The United States, envisioning a sizeable fleet of commercial aircraft at the end of World War II advocated complete freedom of competition.[28] The United Kingdom on the other hand, with far-flung possessions but without a fleet to match that of the United States, wanted an international organization to apportion and manage international air routes, frequencies, and tariffs.[29]

What emerged was a compromise. Beyond restating the absolute sovereignty principle in Article 1, there was no agreement on a multilateral granting of rights associated with access—the so-called freedoms of the air.[30] These varied rights were developed mainly because of the tech-

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was used for "spying," there is a real separation today between military and civilian/commercial air traffic, which was not the case in either 1919 or 1944. This, coupled with technological advances in detection and monitoring, means that national security considerations need no longer dictate the necessity of economic regulation. Excluded from this consideration is general aviation traffic, which under Article 5 of the Chicago Convention has access, but which is increasingly responsible for threats such as the transportation of narcotic substances.

26. *See supra* note 10 (including, for the first time, the liberalization of trade in services and such long-protected items as textiles). The movement towards a more rules-based international trading system is also evidenced by the proliferation of regional trade initiatives, including more and more commodities and sectors.

27. There have been no amendments to this Convention, nor has it been superseded by any other agreement. The thousands of bilateral air agreements are based on the rights defined in the Chicago Convention.

28. *See* Cheng, *supra* note 4, at 7.

29. *See id.* at 6.

30. *See* Cheng, *supra* note 4, at 9-17 (describing in detail the definitions of the freedoms of the air). These include:
First freedom: right of overflight;
Second freedom: right to make technical, non-revenue stop;
Third freedom: right to carry traffic from home state to granting state;
Fourth freedom: right to carry traffic from grantor state to home state:
Fifth freedom: right to carry traffic from the granting state to a third state (also known as beyond-right);
Sixth freedom: applies to the carriage of traffic between two foreign countries via the home state of the carrier. As such, it is really third and fourth freedoms, with different granting states, thus making its status as true right suspect;

nological limitations of the day. With aircraft of limited size, range and dependability, airlines needed to make frequent stops. Whenever possible, stops had to be justified on economic grounds. Thus, separate rights had to be negotiated for a variety of circumstances. They were included in separate agreements, of which only the first two rights, dealing with overflight and technical, non-revenue stops, received widespread, though by no means universal acceptance.[31] Yet access to the true, commercial rights of delivering and picking up passengers, mail and freight were left to states to negotiate on a bilateral basis.[32]

Three other aspects of this Convention, which negatively affect access by scheduled international carriers, should be mentioned. First, in continuing to maintain absolute state sovereignty over access, developing countries and commentators place considerable emphasis on a so-called underlying principle giving all states the right to participate in international air transportation on the basis of equality.[33] In spite of its insubstantial founding in law, this "principle" continues to be used to support the need for state control over access as the only way to ensure that all states will have an equal opportunity to participate in international aviation.[34]

Seventh freedom: right of a carrier operating entirely outside its home state to discharge or take on traffic for third state;

Eight freedom: right to carry traffic between two points within the territory of the grantor state (cabotage).

31. *See* Convention on International Civil Aviation, 61 Stat. 1180 (1944) Appendix III, (Two Freedoms Agreement) 84 U.N.T.S. 387 (being in force with a membership of approximately one hundred states).

32. *See* Convention on International Civil Aviation, 61 Stat. 1180 (1944) Appendix IV (Five Freedoms Agreement) 171 U.N.T.S. 387 (not in force).

33. *See* Chicago Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295; this argument appears more to be founded in oft-repeated rhetoric, which in time takes on the appearance of legitimacy, than in legal fact. The preamble, which is traditionally used to support this view states: "international air transport services may be established on the basis of equality of opportunity, and operated soundly and economically." Thus, the placement of this concept in the preamble makes it only a guiding, not mandatory principle. Furthermore, the language clearly gives economic interests the same weight as that afforded to equality of opportunity.

The only other place where this is found is in Article 44, which outlines the aims and objectives of ICAO. In particular, Article 44(f) states: "that every contracting State has a fair opportunity to operate international airlines." This is not a guarantee either, only direction to ICAO to create "fair opportunity". Furthermore, under subsections (d) and (e) respectively, ICAO is mandated to:

"Meet the needs of the world for . . . efficient and economical air transport."

"Prevent economic waste caused by unreasonable competition."

Again, the language gives economic considerations at least as much, if not more weight. Perhaps the only effect of this reference in Article 44(f) was to empower developing countries with a peg to hang their political hats on, and tied ICAO's hand in being involved in economic regulation of civil air services in a meaningful way.

34. *Supra* note 15 (containing references to numerous documents submitted mainly by de-

Second, the restrictions on access apply primarily to scheduled traffic, however, there are very few restrictions on non-scheduled (mainly charter) flights.[35] This aspect is partially responsible for the proliferation of charter service around the world. Finally, a system of flag state registration ensures that "flag of convenience" does not become the problem in international aviation that it has become in maritime law.[36] Yet this provision presents another barrier to more liberal access because it restricts aircraft registered in one state to fly only those routes negotiated by its country of registration.[37]

While it may appear that the Chicago Convention is singularly designed to make access to a country's airspace a convertible currency, it must be pointed out that this is just one part of the Convention. Yes, the compromise defining economic regulation has turned out to be ineffective because of its lack of balance. Complete state sovereignty over commercial access is not moderated by a basic set of trade rules. Only such a balance of rights and obligations could encourage multilateral cooperation to adapt to the inevitable changes arising from human development's increasing pace. Its lack is the source of our present dilemma: how can airlines adjust to today's vastly changed technical, economic, political and trade climate while encumbered by absolute state sovereignty? Yet the Chicago Convention continues to be a success in other areas essential to international aviation. Standards on safety, licensing, navigation and maintenance, just to name the most obvious, have helped make aviation the safest form of transportation in the world.[38]

The Chicago Convention is also the source of the principal international organization involved in the ongoing development of public inter-

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veloping countries, citing a right to "equal opportunity" to participate in international commercial aviation as the reason for maintaining the *status quo*, e.g. WP/67; WP/69; WP/71).

35. *See* Cheng, *supra* note 4, ch. 5 at 173 (outlining the differences between the Chicago Convention's treatment of non-scheduled international air service in Article 5, as opposed to the subjection scheduled service to absolute granting state authorization in Article 6).

36. ARNOLD KEAN, INTERCHANGE OF AIRCRAFT: ESSAYS IN AIR LAW, at 111 (1982) (outlining the obstacles found in the provisions of the Chicago Convention (see Articles 12, 17 and 30-32 inclusive) that prevent "flag of convenience" operations in commercial aviation). As airlines strive to cut costs and form close relationships with one another, they increasingly rely on each others' resources. While strict registration rules ensure a minimum uniformity in non-economic standards, they also make exchange of equipment difficult, denying airlines the opportunity to maximize resources.

37. *See id.* at 115 (describing how some national aviation authorities, e.g. those of the United Kingdom, have been able to facilitate the interchange of aircraft, on a limited basis, which are registered in one country but provide service in another).

38. *See Air Travel Still Safest*, AV. WK. & SPACE TECH., Jan. 2, 1995 at 30 (depicting airline travel as being approximately 30 times safer than travelling by automobile). The number of people killed in the United States in aviation related accidents averages about 100 per year, while 19,000 are murdered, 36,000 die in automobile accidents and about 5,000 are killed in boating related mishaps.

national air law. ICAO's charter, found in Part II, outlines the organization's aims and objectives, and makes several, clear references to economic regulation.[39] Yet, ICAO has been unsuccessful in this area, in contrast to its great success in the regulation of technical matters.[40] This lack of success is partially due to the conflicting way in which the ICAO mandate is defined in Article 44. ICAO cannot promote every contracting state's desire to operate international airlines, and simultaneously promote a system of efficient and economical air transport.[41] This dichotomy, along with the one-party, one-vote system, has made it possible for protectionist interests to effectively exclude ICAO from the economic regulation of international commercial aviation.

B. The System of Bilateral Agreements

There is nothing in the Chicago Convention that expressly establishes bilateral agreements as the way to determine the right of commercial air access from one country to another. The fact that bilateral agreements have become the vehicle for economic regulation under public international air law, is due to the unwillingness of countries to become parties to the International Air Transport Agreement (IATA). This agreement, which annexed to the Chicago Convention, envisioned a multilateral approach.[42] The ultimate result is that countries, with absolute control over the right to grant access to scheduled airline service, are able to use these rights as commodities in negotiating bilateral deals with other countries. Those countries, not signatories to the International Air Services Transport Agreement (IASTA), are even using overflight and technical stop rights in this way.[43]

As one can imagine, this huge number of bilateral agreements are widely varied in content. While in the first thirty years after the Chicago Convention, the so-called Bermuda I model (negotiated in 1946 between the United States and Great Britain) was widely used; the last twenty years have seen a proliferation in the scope and content of these agree-

39. *See supra* note 4, pt.II, ch. 7 to 23, arts. 44 to 66.

40. *See* Milde, *supra* note 11, at 122.

41. *See* Chicago Convention, *supra* note 33 (discussing the ICAO's conflicting mandate between providing a fair opportunity for parties to operate international airlines and meet the needs of economical air transport). Unlike some scholars who argue that ICAO's mandate in economic regulation is inadequate, this author believes that a close examination of Article 44 of the Chicago Convention shows a clear preponderance of economically oriented aims and objectives. The Organization's inability to play a role in the economic regulation of public international air law is more a result of absolute state discretion and control over the decision making in ICAO.

42. *See* IATA, *supra* note 32.

43. *See* IASTA, *supra* note 31.

ments.[44] It is not possible to analyze the more than four thousand bilateral air agreements, nor is it necessary for the purposes of this study. It is, however, useful to review the evolution of their basic components. This will assist in the later assessment of possible multilateral approaches.

The three most basic building blocks of any air bilateral agreement are specific understandings on capacity, fares, and routes. These form the inter-related aspects of the exchange of access rights.[45] Capacity reflects the volume of traffic borne by the designated carriers of each country. Under Bermuda I, each carrier was relatively free to determine its production on any given route, so long as the capacity bore a close relationship to public demand.[46] Under Bermuda II in 1977, this freedom was curtailed and governments agreed to exchange the operating programmes of their airlines six months in advance of each season.[47] Today, capacity clauses vary greatly, from restrictive Bermuda II models to wide-open provisions, such as the clauses under the U.S.-Netherlands "open-skies" type agreement.[48]

Fares, or tariffs, determine the charges that can be levied on each route for each class of service. For the first thirty-plus years after the Chicago convention, these were broadly determined by airlines working within IATA, the industry association representing the vast majority of the world's scheduled airlines through its Tariff Conference.[49] In the 1970s, airlines became reluctant to abide by the tariffs, due mainly to the increased competition of expanding charter operations and the mushrooming capacity from the introduction of wide-body aircraft.[50]

These developments were contemporaneous with a growing concern in a soon-to-be-deregulated United States over the anti-trust implications

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44. *See e.g.*, NAVEAU, supra note 5 pt.I, ch. 2 (describing the Bermuda I Agreement); and pt.IV, ch. 5 (outlining the factors that led to Bermuda II and the proliferation in the nature of bilateral air agreements).

45. *See* Cheng, *supra* note 4, at 229 (describing the building blocks of bilateral air agreements).

46. *See* NAVEAU, *supra* note 5, at 37-40 (describing how the capacity clause worked under the Bermuda I Agreement).

47. *See* NAVEAU, *supra* note 5, at 137.

48. *See* Daniel C. Hedlund, *Toward Open Skies: Liberalizing Trade in International Airline Services*, MINN. J. OF GLOBAL TRADE, Summer 1994 at 259 (allowing such open capacity as to enable Northwest Airlines, under the USA-Netherlands "open-skies" Agreement, to put enough capacity on its flights to Amsterdam to carry the entire population of Holland during one summer season). It is interesting to compare the considerations in this, and the Bermuda I Agreement, as both are only limited by traffic demands.

49. *See* NAVEAU, *supra* note 5, at 59 (discussing the way in which IATA, through its Tariff Conference, played a significant regulatory role up to the late 1970's).

50. *See* Anthony L. Velocci Jr., *U.S. Airline Profitability May be Short-Lived*, AV. WK. & SPACE TECH., Mar. 13, 1995, at 45 (including a historical description and chart of the various boom and bust cycles experienced by the airline industry; what caused them and how the airlines reacted).

of how international air fares were determined.[51] IATA's control over setting international fares was broken,[52] and tariffs are now determined in the bilateral agreements. Under some of the most liberal agreements, there is a "double-disapproval" process allowing the airlines to set fares, which can only be revised with the agreement of both states.[53]

Routes, which are the points in each country which may be served by scheduled international air service, are typically included in annexes to bilateral air agreements.[54] From the earliest days of bilateral, routes to the territory of a party and the rights beyond that point ("beyond-rights") have been the subject of specific negotiations.[55] Only recently, with some bilateral agreements moving in the direction of the United States "open-skies" concept, has the issue of routes been left for the airlines to determine. Even in these cases, there is great divergence among the recent, more liberal agreements.[56]

C. The General Agreement on Trade in Services (GATS)

It is instructive to contrast the system of bilateral agreements determining the rights of access for international air service with the most recent development in global trade liberalization in this area. The divergence between the two concepts reflects the fact that five decades of trade policy development lie between them. Bilateral air agreements, by their very nature, are preferential and regulate trade through quotas. These agreements harken back to the days before GATT[57] and make no attempt to meet any of today's international trade standards.[58] Yet, as discussed previously, when it comes to the granting of economic rights,

51. *See* Naveau, *supra* note 5, at 162 (describing how the United States' Civil Aeronautics Board (CAB), disbanded with deregulation, issued Order 76-6-78, directing IATA to "show-cause" why tariff arrangements agreed to at the Tariff Conference were in the "public interest" and thus should be "immunized from the application of anti-trust laws").

52. *See* Naveau, *supra* note 5, at 62; *See also supra* note 15 (containing several references to interventions by IATA in the proceedings of the Conference). The IATA continues to play several other crucial roles. For example, it has a clearing-house operation for settling accounts among airlines and it provides advocacy on behalf of international civil aviation with governments.

53. *See e.g., Air Transport Agreement,* Feb. 24, 1995, Can.-U.S., 1995 WL 242919.

54. *See* Naveau, *supra* note 5, at 43.

55. *Id.*

56. *See* Naveau, *supra* note 5 (describing the provisions of the 1992 U.S.-Neth. bilateral air agreement on routes as allowing the airlines of each party access to "a point or points in the other country without limitation"). Contrast this with the recently signed Can.-U.S. agreement, which while also liberal, does contain limitations as to the routes in Canada that may be served by United states airlines, albeit the restrictions are temporary. There are also no beyond-rights in the latter agreement.

57. General Agreement on Tariffs and Trade, Oct. 13, 1947, T.I.A.S. No. 1700, 55 U.N.T.S. 187 (entered into force Jan. 1, 1948).

58. *See* William C. Yue, *Trade in Services under GATS and NAFTA*, Chair Ginger Lew,

the argument that public international air law is *sui generis* and, therefore entitled to its own set of rules, is under increasing doubt.

The most persuasive argument for holding international civil aviation to the same standard as other services is the inclusion of a General Agreement On Trade In Services (GATS) under the successfully completed Uruguay Round of trade negotiations.[59] Currently, air transport services are included only to the extent of so-called "soft-rights," such as maintenance, marketing and computer reservation systems.[60] However, the fact that services are now part of a global trade agreement indicates that for the first time in history there are international legal standards pertaining to trade in services.[61] If current trends continue in liberalizing more and more sectors, it is inevitable that pressure will mount also to include the so-called "hard-rights" (capacity, tariffs and routes) into GATS. In fact, GATS already contains two provisions that will speed up this process. First, exemptions to the application of GATS to "soft-rights" are strictly time limited. Second, future negotiations on expanding GATS are built into the agreement and are to begin not more than five years after its coming into force.[62]

GATS is not without controversy. While an in-depth analysis is outside the purview of this paper, it is useful to examine how its major components would effect the issue of access in public international air law. GATS is divided into two parts: 1) general obligations and disciplines and 2) specific commitments. Notably, the former contains most-favoured-nation treatment (MFN); a transparency requirement; reasonable, objective and impartial domestic regulation; and inclusion of GATS under the World Trade Organization's (WTO) Dispute Settlement Understanding (DSU).[63] The latter includes undertakings as to national

June 24, 1994, at 1 (outlining in detail the currently prevailing international trade standards in the services area, as evidenced by the most recent agreements: GATS and NAFTA).

59. *See* GATS, *supra* note 10, at 283.

60. *See* GATS, *supra* note 10, at 307 (containing the scope of application of GATS to air services in Article 1).

61. *See* Yue, *supra* note 58 (noting that while GATS has a limited application for international air services, in NAFTA air transport services are expressly covered in bilateral negotiations).

62. *See* John Gunther, *Multilateralism in International Air Transport - The Concept and the Quest*, 29 ANNALS AIR & SPACE LAW, 259, 270 (1994) (characterizing these provisions as the tools with which trade in this area will be liberalized, through the need for continuous and frequent negotiation). *Contra* Ruwantissa I.R. Abeyrante, *The Economic Relevance of the Chicago Convention - A Retrospective Study*, 29 ANNALS AIR & SPACE LAW 3, 27 (1994) (hereinafter Abeyrante) (citing the provision on periodic review as evidence of "lack of confidence" in GATS being able to regulate aviation services). It is only possible to fathom the latter author's comments if they are read in the context of the article, which advocates the continued governance of economic regulation of international aviation services by ICAO. It is not surprising to discover that the said author is a member of ICAO's secretariat.

63. *See* GATS, *supra* note 10, pt.II General Obligations and Disciplines.

treatment (NT) and market access in specific sectors. Unlike the general obligations, the latter would apply only in cases where specific commitments are negotiated between countries.[64]

While GATS will be revisited in part IV of this paper, it is apparent that there are a number of reasons why current bilateral air agreements are not compatible with either the general or specific obligations of GATS. In the broadest sense, as GATS is eventually intended to apply to all services, the widest possible disparity exists between the completely protected international civil aviation services and most other services.[65] This point is important because keeping up with the development of international law is one of the arguments that will be cited in this paper as an incentive for countries to depart from the present legal regime.

The issue of MFN, as it relates to trade in services, developed a separate controversy of its own, with potential to effect aviation services. One school of thought argues that MFN is an inappropriate mechanism to liberalize trade in services.[66] Designed for trade in goods, where it helped master a system of tariffs, it is feared that the imposition of MFN for services will deprive countries of the best tool to gain market access, that is, the threat of withholding market access on a bilateral basis.[67] A greater concern, however, for the liberalization of all aviation services is that "hard-rights" are not yet included in GATS, and the MFN obligation will undoubtedly make many countries wary of extending their most liberal bilateral air arrangements to all comers.

D. Treaties of Friendship, Commerce and Navigation (FCN)

There is yet another element in the patchwork of public international air law regulating economic access. For many countries, the backbone of their commercial relations with one another is the FCN Treaty. The standard United States FCN Treaty, in Article VII, provides national treatment to both parties' commercial activities of any sort carried out within the territory of the other party.[68] While the right to limit the extent of this provision to, *inter alia*, air transport is expressly provided, the same Article just as expressly accords MFN treatment to nationals of the other party "in any event."[69]

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64. *See* Yue, *supra* note 58.

65. *See* Yue, *supra* note 58, at 198 (leading to yet another strong argument for the future inclusion of "hard" aviation rights in GATS, since in an inclusive agreement with exceptions it is always easier to remove the exception than to extend the scope of the agreement).

66. *See* Warren L. Dean and Constantine G. Papavizas, *Veering Off Course*, Legal Times, Mar. 20, 1995, 6, 10 (reflecting an argument that is widely heard among practitioners of trade law).

67. *Id.*

68. *See supra* note 9, art. VII at 12, art. XIX at 36.

69. *Id.* The provisions of FCN Treaties often contrast to those of Treaties Concerning the

There appears to be a contradiction between these provisions of the FCN Treaties in force with numerous countries, and the provisions of bilateral air agreements with the same countries, which provide access on a preferential basis. It would be interesting to see what would happen if a country with which the United States had an FCN treaty, but which only had very restrictive bilateral air agreements of its own, sought more liberal air access to the United States based on its FCN Treaty's MFN obligation. Its offer to give the United States MFN treatment would, in this scenario, not be very appealing. Would the United States have a choice?[70]

II. The Legal Regime and its Contribution to the Problems of the International Commercial Aviation Industry

Does the lack of an up-to-date international regime for economic regulation of international aviation services contribute to the difficulties of the industry? Before looking at this question, it is useful to answer two others: first, why does it matter; and second, what is the state of the industry?

A. The Importance of International Commercial Aviation

As alluded to in the introduction, without the maintenance of a fast, reliable and affordable system of global transportation, it will be impossible to sustain the expansion of international commerce. At the geopolitical level, it is this continued expansion upon which the future peace and prosperity of mankind is staked. Yet, the strength of neo-isolationist and protectionist forces, even in the most liberal economies, are never far from the surface.[71] At the very height of the present upsurge in global trade liberalization, it took just one key developing country to fall victim to a financial crisis and have both financial markets and law-makers around the world running to retrench.[72] The long term benefits of the Uruguay Round and the NAFTA were enthusiastically opposed by so

Encouragement and Reciprocal Protection of Investment (BITS). In the latter, aviation services are expressly excluded from MFN treatment, leading to the question of whether FCNs aren't an anomaly.

70. Interview with Julie Oettinger, U.S. Department of State, Legal Advisor's Office, (Mar. 1995). The United States could always rely on the fact that bilateral aviation agreements are more specific, and probably later in time than FCNs.

71. The negative reaction of a large minority of United States lawmakers to the United States becoming parties to the NAFTA and Uruguay Round Trade Agreements is a prime example. Others include the position of many European Union countries on agriculture, and that of Japan of eliminating its numerous non-tariff barriers. In fact, protectionism is still the most prevalent characteristic of international trade.

72. One needs only to recall the Congressional reaction to the attempts by the Clinton Administration to assemble a financial assistance package for Mexico.

many for the sake of short term protection and political credit. This clearly underlines the fragility of continued trade expansion.[73]

If Mexico's financial difficulties can affect world markets to such an extent, then a crisis in the international commercial aviation industry, with its tremendous impact on global economic development, would be far more devastating and long-lasting. To give just one example, though arguably the biggest, airlines are essential components of the world's largest industry: tour and travel.[74] Accounting for more than 12.9% of global consumer spending, 7.2% of worldwide capital investment, generating more than $3.5 trillion of combined Gross National Product (GNP), and employing over 127 million people (one out of every fifteen workers), this industry is almost completely dependant on the veins and arteries provided by commercial aviation.[75]

Commercial aviation is also a fairly substantial industry in its own right. In the United States alone, it directly and indirectly employs twenty-one million people, and accounts for $750 billion of economic production yearly.[76] If this industry were a country, it would account for about 4% of the world's economic output, making it the seventh largest economic power, just ahead of Canada.[77] Therefore, its financial health has broader implications than just the service it provides to other economic enterprises, or indeed to continued trade expansion. In the case of Mexico, a financial crisis in the civil aviation industry would have global repercussions, but multiplied many-fold.

B. The Crisis in International Civil Aviation

If one looks only at the numbers, a crisis in commercial aviation may not appear to be that far away. The economic performance of the world's airlines, especially over the last two decades, can only be described as abysmal. This industry has never been highly profitable at any time in its history.[78] From 1977 to 1992, the global air transport industry

73. It should not be forgotten that up to the very day of the vote in the House of Representatives, there was no certainty that the NAFTA bill would pass. Nor the image of Ross Perot with his "great sucking sound" resonating throughout the U.S. political landscape. Or indeed, that the tirades in the Senate, that the WTO will mean a loss of U.S. sovereignty almost scuttled the Uruguay Round legislation. The truth is, that the commitment to trade liberalization in Congress, with a very few exceptions, is only as strong as the parochial interests of the individual lawmaker, and his or her prospects for reelection.

74. *See* Dempsey, *supra* note 3, at 163.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 165 (citing 2.8% as the best profit margin United States airlines achieved, and that was from 1955-77). It is estimated that the world's airlines need operating margins of 4% to service their debt, and at least 6% in order to generate enough profit to pay for fleet moderniza-

earned a net profit of 0.6% of revenue, on gross revenues of over $2 trillion.[79] Over the first four years of this decade, losses ranged from $6.7 billion in 1991, to an expected loss of around $1.5 billion for 1994.[80] These less than stellar statistics were achieved in spite of the fact that passenger traffic traditionally has grown at about 2.25 times the rate of Gross Domestic Product (GDP) growth.[81] It is argued that the 1990 Gulf War, with the resulting increase in fuel prices and contemporaneous global economic recession, caused this recent downturn. While probably true since at least the United State's industry has made a modest comeback in 1995, this still does not fully explain how international civil aviation can lose more money in a four year period than it made in all of its history and continue to survive unscathed.[82]

That is not even the whole story. Airlines today carry enormous debt burdens. The U.S. industry's debt alone in 1994 was in excess of $35 billion, which represents more than eight times the industry's total accumulated profit from the inception of commercial aviation.[83] At the same time, its capital needs are astronomical. Although the world's airlines spent $147 billion in the 1980s on capital assets, their projected requirements to the year 2000 are around $815 billion.[84] This does not include infrastructure spending for upgraded airport facilities.[85]

While it is not within the purview of this paper to delve into the pure economic reasons for this woeful state of affairs, some fundamentals must be discussed. The airline industry is capital, labor and fuel intensive. It is exposed to severe business risks due to high fixed costs, the cyclicality of demand, and intense competition.[86] It is acutely sensitive to the slightest political disturbance affecting international affairs. Its product is an extremely perishable seat or space in the cargo hold which disappears the moment the plane leaves the gate. Because of all this, and the requirements of the various legal regimes it must conform to, the airline industry prices its product in a schizophrenic fashion by attempting to fill to capac-

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tion. As the average profit margin for the last two decades is in negative figures, it is not difficult to see why the industry is in trouble.

79. *Id.* at 164.

80. *Id.* (noting that United States airlines alone have a cumulative net loss of $7.7 billion since deregulation of the U.S. domestic industry in 1978). In 1994, the U.S. industry made a profit for the first time since 1989. It was approximately $200 million, but this came about only because the industry was exempted for two years from the 4.3 cent fuel tax included in the 1993 budget.

81. *Id.* at 168.

82. *Id.* at 165.

83. *Id.* at 164.

84. *Id.*

85. *Id.* (citing ICAO forecasts that "the world will require between $250 and $350 billion in new airport infrastructure spending by the year 2010").

86. *Supra* Dempsey, note 3, at 165.

ity, undercut competition and charge as much as possible, all at the same time. If an airline is further burdened by government involvement, then it must also conform to the needs of non-business goals, such as "showing the flag" or "full employment." The net result is that for most airlines, average annual load factors even at the best of times never quite reach 70%, while 90% of passengers can end up paying only 30% of the full fare.[87]

These challenges have to be overcome by airlines, a majority of which have to cope with balance sheets burdened with the enormous debt discussed earlier. For most United States airlines, debt-to-capital ratios already exceed 65%.[88] Yet with Stage-3 noise regulations looming in 1999 and 2000 for airlines flying to the USA and to Europe respectively, and with increasingly aging fleets, airlines are faced with the necessity to replace, re-engine or at least hush-kit large numbers of aircraft.[89] The capital for this will have to come from a combination of banks, leasing companies, aircraft and engine manufacturers; and in the cases of airlines with government equity participation, the taxpayer.

There is little question that this capital will be made available and in most cases further deteriorate the financial positions of airlines. This is partially due to the already large commitment made by suppliers of capital and the vested interest that lessors, airframe and propulsion manufacturers have in fuelling demand for their products. In addition, in many countries, the national airline, like a large bank, is considered too big and important to fail. This is not the case in the United States, where there is sufficient depth in the industry for carriers to fail without leaving gaps in service. Others would quickly pick up the pieces, especially the more lucrative international routes.[90] Virtually everywhere else however, there is just one airline, often a national carrier, engaged in international service.

Most governments up to now have not allowed such airlines to fail. In the historically reinforced belief that money will eventually come from somewhere, these airlines have continued to push the envelope of financial instability.[91] Yet there are trends that point toward an end to the "soft-life." These include: the already discussed relentless drive toward trade liberalization; the widespread realization by more and more gov-

87. *Id.* at 165, 170.

88. *Id.* at 171. *See also* Anthony L. Velocci, *supra* note 50 at 45. (noting that airlines have one of the most damaged balance-sheet structures in the U.S. economy). Another commentator describes airline debt issues as junk bonds only because there is no lower category.

89. *See* Velocci, *supra* note 50, at 46.

90. Witness, for example, the scramble over Pan American's North Atlantic routes, or Eastern's Latin American and Caribbean routes. Their demise has not lessened service to these areas.

91. *See* Velocci, *supra* note 50, at 45.

ernments that they are reaching the limit of taxation acceptable to their populations; and the fact that governments must face their debt burdens and the need to free up revenue for this purpose through expenditure reduction. It is only a matter of time before government backing of commercial aviation succumbs to these trends, forcing hereto dependent airlines to face fiscal realities on their own.

C. The Contribution of International Law to this Problem

Whether airlines' economic performance is affected by the way access is regulated today under public international air law depends on the extent to which this legal regime contains the necessary elements required to create an economically favourable regulatory environment. These basic elements include: *elasticity* (giving commerce some scope of action, but not to the extent where it damages either the industry or the consumer); *predictability* (enabling realistic planning as regulation is based on standard, transparent rules); and *flexibility* (having the ability to change the rules if they prove to be unworkable or become outdated). The current system of bilateral, based on absolute national sovereignty with little recognition of trade practices that have become the norm in other industries, does not fit this bill.

As discussed earlier, this is mainly because the Chicago Convention followed its absolutist predecessors and failed to strike a balance between the protectionist and security concerns of the day and the needs of international commerce and communication. In fact, the system of bilateral air agreements that have developed can be criticized as being the worst of all worlds: neither providing a predictable regulatory framework or possessing the elasticity and flexibility of the open market. Only with the conclusion of the Uruguay Round and the coming of GATS, has the door to the multilateral economic regulation of international aviation services been pushed ajar. Yet, with GATS only applicable to "soft-rights," with an exemption available to parties, and with the vital obligations of national treatment and right of establishment not being generally binding, this development cannot be considered more than a toe-hold.[92]

The international community's realization that the legal framework governing economic access was inadequate to meet the needs of the marketplace dates back to the 1960s.[93] By that time, a number of factors had

92. *See* Abeyratne, *supra* note 62, at 27 (down playing the effects of GATS on the regulation of international commercial air services at the present time). The argument is valid, as far as it goes, but shows a lack of imagination, or perhaps faith in the inevitable progress of international law. Soft-rights refers to: aircraft repair and maintenance; the selling and marketing of air transport services; and computer reservation system services.

93. *Supra* Naveau, note 5, pt. IV, ch. 3, at 116 (describing the emergence of disruptive factors in international commercial aviation, starting in the early 1960s).

emerged which put the Chicago structure into question. These included: technological developments like the coming of the jet age; the resulting excess in capacity and the consequent growth of charter operations (themselves caused, *inter alia*, by the strict regulation of scheduled traffic) which led to reduced fares and profits; the multiplication of scheduled airlines as former colonies gained independence and exercised their "right" of equal participation in international commercial aviation; and the numerous changes in the world economy.[94] In fact, the industry has gone through a series of seven boom-bust cycles between 1960 and the present, with some or all of the above factors contributing to these wild fluctuations.[95]

There have also been attempts by the international community to address the situation. Going back as far as the mid-1970s, ICAO began what has become a series of World-Wide Air Transport Conferences, designed to resolve the various crises multilaterally, with perhaps even a hope of improving upon the Chicago regime.[96] The world, however, had become accustomed to the bilateral system. With the exception of the Carter administration, which experimented with the deregulation of the domestic airline industry, until recently few others have been interested in reform.[97]

Because of the ongoing debate in the United States since deregulation, there is a vast array of literature available on how and to what extent air transport services ought to be regulated. Apart from the respective merits of more or less regulation, there does not appear to be a dispute on what benefits each system offers. More regulation lessens the chances of destructive competition, and provides a degree of certainty about the rules.[98] In an industry which is prone to indiscriminate competition and where fleet planning is at least a two-to-five year proposition, these are vital requirements.[99] Less regulation opened up the United States domestic market, reduced many fares and increased some services. It did not, however, do away with the evils of overcapacity and destructive competition, which eventually reduced the number of airlines serving

94. *Id.* at 117.

95. *See* Velocci, *supra* note 50, at 45.

96. P.P.C. Haanappel, *Multilateralism and Economic Bloc Forming in International Air Transport*, 29 ANNALS AIR & SPACE L., pt. I, 279, 302-05 (describing ICAOs efforts at reforming the legal regime).

97. Adam L. Schless, *Open Skies: Loosening the Protectionist Grip of International Civil Aviation*, 8 EMORY INT'L L. REV. 435, 443 (1994) (outlining the role of the United States in efforts to liberalize the international legal regime governing aviation services).

98. *Supra* Dempsey, note 3, at 209-11 (comparing the effects of the previously regulated U.S. environment with the post-deregulation situation).

99. *See* Anthony L. Velocci, *Short term Forecasts Pose Biggest Industry Challenge*, AV. WK. & SPACE TECH., Mar. 13, 1995, 47-48.

the market to far fewer than during the preceding period of regulation.[100]

Taken in these terms, the current international regime of individual, highly detailed, bilateral agreements can only be described as one of the strictest regulations. Yet, because these agreements do not adhere to any international trade rules, they lack the benefits regulation usually offers, having neither a defined structure nor real predictability.[101] At the same time, as rigid as this system of bilateral is, it has not stopped destructive competition in some of the most lucrative markets.[102] Thus, it resembles a less regulated system without the elasticity of the free market[103] appears to be the worst of all worlds.

Not only does the present bilateral system fail to provide the benefits of either regulation or deregulation, but it is difficult to see how it can be improved in its current form. It is, for example, impossible to apply the trade liberalizing provisions of GATS to a system of bilateral agreements. Each bilateral, after all, is a preferential trade agreement with restrictions and quotas that would make any trade policy expert cringe. Nor has it proven possible thus far to change this system within the Chicago Convention framework. While most believe that formal amendment of the convention would probably not be necessary, there continues to be an unwillingness on the part of the international community for change.[104] ICAO has called four international conferences since 1975, all without tangible results.[105] For now, it appears that too many states have too great an interest in the present system to concede that the time for change has arrived.

Thus, there is, in addition to the lack of predictability and elasticity in the present international legal regime, a lack of flexibility in adapting to changes when the need arises. Yet, the need has certainly arisen, as the

100. *Supra* Dempsey, note 3, at 209-10 (highlighting the negative impact of deregulation on the domestic aviation industry).

101. The sheer numbers of bilateral air agreements add to the uncertainty. Any number of these agreements are under negotiation at any given time. It is also costly to monitor government regulators at home and every other country.

102. *See* Naveau, *supra* note 5, at 125 (showing how the cost of an airline ticket linking North America and Europe dropped from over 200 hours of work in 1957 to around 40 hours in 1978, even before the deep discount fares were introduced. At the same time, airline profits fell from 10% to 2%).

103. To further complicate matters, bilateral air agreements are negotiated by governments which often have an equity interest in their national airline. As in any negotiation, the result is usually a compromise, and ends up restricting the various rights of access. Thus, in most cases, bilateral air agreements are not elastic enough for the industry to benefit from the freedom of an open market.

104. *Cf.* Werner Guldimann, *The Chicago Convention Revisited: Possible Improvements After 50 Years*, 29 ANNALS AIR & SPACE L. 347, 349 (describing how the difficulty of amending the Chicago Convention hampers legal regulation, rather than fostering it).

105. *Supra* Velocci, note 50, at 45.

state of the international commercial aviation industry demonstrates. What is not certain, however, is how much the industry itself realizes this need. The rhetoric that comes from even the most liberal, market oriented airlines continues to demand the kind of protection that only bilateral agreements can provide, regarding their markets at home and abroad.

III. Possible Solutions Under Consideration

What do the various vested interests, especially the airlines, want? Is it possible to meet these requirements? If so, can they be met under a system of bilateral air agreements? If not, is there a way of adapting the present legal regime to make it elastic, predictable and flexible enough to help the industry, while keeping the changes within the boundaries of what is politically possible?

A. Defining The Vested Interests And Their Needs

A basic list of direct vested interests involved in international aviation consists of ten players. These are:

1. Consumer (both business/leisure travellers and industry which relies on air cargo).
2. Travel, tourism and related leisure industries.
3. Independent airlines in scheduled international service.
4. Government owned or controlled airlines.
5. Governments not involved in airline ownership.
6. Governments with equity participation in airlines.
7. Commercial aircraft, engine, avionics and other subcontract manufacturers.
8. Aircraft leasing and financial institutions.
9. Airport communities with or with possible international service.
10. International civil aviation and trade bureaucracies.

Suppose each vested interest is presented with the information in the previous section, and then asked what constitutes their bottom-line interests in international commercial aviation. A common-sense analysis of their requirements would likely indicate the following:

The consumer is primarily interested in low fares and secondarily in frequency and convenience (including comfort) of service. Primarily the business traveller also looks for incentives by way of bonuses, such as frequent-flyer miles. The travel, tourism and related industries' main interest is to get as many people travelling and thus using their facilities as much as possible, which also means affordable fares with convenient and frequent service.

Independent airlines are, however, schizophrenic. They want maximum freedom to set routes, tariffs, capacity and associated services. At

the same time, they insist on the protection of regulatory benefits, especially (but not exclusively) from foreign government owned or controlled airlines.

The interests of government owned or controlled airlines are more closely tied to broad governmental policies. These include concerns other than commercial aviation, such as job creation and domestic production. Functioning in a less market-oriented environment, they rely much more on the protection of regulation to gain favourable access.

Governments with a commitment to liberalizing aviation services want to see the industry run primarily by market forces, based on predictable trade rules. Yet, even these governments recognize the need for some involvement to prevent destructive competition or to "level the playing field," especially when dealing with subsidized competition.

Governments with equity interests in airlines have a dilemma: do they work for the benefit of the airline or the body politic? A coherent policy is almost impossible, because these two interests do not often coincide. A prime example of this dilemma is the choice between liberalizing a route to gain frequency and lower price at the risk of subjecting the national carrier to competition from more efficient airlines.

Manufacturers are primarily interested in selling more of their products. Market conditions that maximize public demand for aviation services without destructive competition offer the best such climate.

Lessors and financial institutions are concerned about the state of indebtedness of the industry. While especially the former benefit from a situation where airlines do not have quite enough capital or credit to purchase aircraft outright, both are likely to prefer more predictability and profitability than presently exists in this industry.

Airport communities are after increased service, sometimes offering incentives to get it. Only those centres which are already congested would seek extra benefits from apportioning access.

The various international bureaucracies, by their very nature are interested in gathering or keeping or gathering as much of the economic regulation of international aviation under their auspices as possible.

While the above synopsis is not based on empirical study, the author believes that it is a common-sense analysis of the primary needs of the principal stake-holders in the international air transport industry. It reveals that only countries with equity interest in their national carriers and their airlines stand to benefit from the present, tightly controlled system of bilateral agreements. By contrast, almost all other participants would stand to gain from the greater flexibility offered by trade liberalization tempered by adherence to the evolving norms of international trade law.

At the same time, none of the stake-holders would benefit from a totally deregulated environment, even if such a thing were possible. It would appear, therefore, that some regulation is necessary and would be insisted to prevent destructive competition, while ensuring as level a playing field as possible. Such a system would also create a more predictable environment. This would permit longer-term planning by airlines, enabling them better to match resources to the needs of the market and thus lowering their costs. Benefits would flow to the other vested interests through increased demand caused by lower fares, more predictable service and steadier demand for equipment.

Yet any radical, near-term change is unlikely. While many solid reasons for this pessimism will be explored in the following pages, the foremost is the control of the international decision-making apparatus by governments with national airlines and which owe their continued survival to the present bilateral system. In spite of this, there are efforts that continue to circumvent the present regime's shortcomings at all levels, and just as many suggestions on how a more workable system could evolve.

B. The Multilateral Institutions

In spite of the partial application of GATS to aviation services, the multilateral institution which still claims sovereignty over the economic regulation of international commercial aviation is ICAO. As noted earlier, since the mid-1970s, ICAO attempted four times to spark interest among the international community to undertake a review of this system, but to no avail. The most recent and most serious of these attempts was the 1994 World-Wide Air Transport Conference on International Air Transport Regulation: Present and Future.[106] Thus, this effort is most useful to focus on. Preparation for this conference began in 1992 with a Colloquium and the establishment of a Group of Experts on Future Regulatory Arrangements (GEFRA) which was to prepare a report for the ICAO Secretariat on possible regulatory changes.[107] These preparatory efforts were doomed from the outset because the inquiry's terms of reference were limited only to parameters that could be broadly accepted by the ICAO membership.[108] Thus, changes in the regulatory structure were

106. *See generally* World-Wide Transport Conference *supra* note 15.

107. *See* Vijay Poonoosamy, *Developing Countries in the Wake of Aeropolitical Changes*, 29 Annals Air & Space L., pt. II, 589, 598 (1994) (providing that the mandate of GEFRA was to "examine future regulatory arrangements for international air transport").

108. *See id.* at 599-600 (outlining the topics of GEFRA's focus, within its mandate as:
(1) the objectives states would have to agree to new arrangements;
(2) the equitable delineation of market access;
(3) broadened criteria for airline use of such access;

explored only to the extent that they remained compatible with the notions of absolute state sovereignty, equitable delineation of market access, and the requirement of formal designation of national carriers.[109]

The various Working Papers prepared by the ICAO Secretariat, based on the GEFRA study for the 1994 Conference were, nevertheless, innovative. The suggestions for new regulatory arrangements were premised on the main objectives of "participation," or meaningful involvement on a reliable and sustained basis, and "adaptation" or compatibility with a dynamic world environment.[110] There were also three lesser objectives of "enhancement" of quantity and quality of service; "simplification" of regulatory arrangements; and "flexibility" to meet changing requirements.[111] A package of interrelated new regulatory arrangements were introduced, predicated on mutual, unrestricted basic market access and progressive liberalization through foreign investment in national air carriers.[112] A safety-net was also suggested in case of unforseen contingencies, somewhat akin to the emergency measures available under GATT.[113]

Some of these modest and sensible proposals are worth examining in greater detail even if their inability to garner the support of the international community underlines the control that current vested interests possess. Unrestricted market access was limited only to service touching the

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(4) the safeguards required to ensure fair competition;
(5) potential impediments, such as subsidies and physical (not legal) constraints on access;
(6) relationship with broader regulatory environment;
(7) the treatment of "soft-rights").

109. *See id.* at 600 (listing the assumptions within which GEFRA had to work as:
(1) regulation would continue within the framework of the Chicago Convention, which would not need to be amended to accommodate the proposed new regulatory arrangements;
(2) basic objectives for entering into new arrangements have to be broadly shared among states;
(3) states are to continue to exercise sovereignty over airspace and access to transport market;
(4) states are to continue to enter into agreements with each other to exchange market access;
(5) each party to an air agreement is to continue to designate carrier(s) to use the market access;
(6) access is to be granted, with denial possible only for agreed upon reasons.

It is possible to see that especially assumptions 3, 4, and 5 would lead to the continuation of the present bilateral system, based on absolute state sovereignty. It is therefore difficult to see how GEFRA could possibly come up with recommendations that would make worthwhile changes. This mandate is representative of the narrow flexibility the ICAO Secretariat has, given the views of the majority of the parties.

110. *See id.* at 603-04.

111. *See id.* at 601. It is interesting to note the contradictory nature of these objectives. "Participation" and "adaptation" may be mutually exclusive, when international air services are viewed in a broad, dynamic world environment. For example, the participation of some carriers and countries in international air transport may clash with modern trade law principles.

112. *See* World-Wide Transport Conference, *supra* note 15 (containing a summary of the Secretariat's suggestions, as well as the responses of states, interested organizations and the outcome of discussions).

113. *Id.* (referring to Agenda Item 2.2.3.2).

territories of both parties, with the remaining freedoms continuing as options for bilateral negotiations.[114] The safety net was made available for "rapid and significant" decline in one party's market share, and like in GATT, would be available for only a finite period and renewable only once.[115] The system contemplated several ways in which market access could be liberalized progressively. These included individual bilateral air agreements, starting with separate functional blocks such as cargo or non-scheduled services through the reduction or elimination of restrictions on foreign ownership of national carriers, or through a right of establishment.[116] While there were no concrete proposals for how either of the latter two would work, there was a very useful expansion of what could constitute a "designated carrier" eligible to access another's market.[117]

In this author's opinion, a vital component of any future system of economic regulation is a mechanism to ensure that destructive competition does not negate the advantages of liberalization. The ICAO Conference Working Papers contained a proposal for a "Code of Conduct," obliging parties to refrain from destructive practices involving prices, capacity dumping, predation, discrimination, high pricing or capacity insufficiency.[118] There were also proposals concerning competition laws and subsidies. Regarding the former, the mere suggestion by the Secretariat for "appropriate safeguards" was met with a call by most participants for continued exemption or immunization from national anti-competition laws for multilateral airline activities, especially tariff coordination.[119] Concerning the latter, the proposals to take "transparent and effective" measures so that state aids or subsidies do not adversely impact on competition were met by arguments from many states that these were required for "meaningful participation in the international air transport system."[120]

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114. *Id.* (referring to Agenda Item 2.2.3.1).

115. *Id.* (referring to Agenda Item 2.2.3.2).

116. *Id.* (referring to Agenda Item 2.2.3.3).

117. *Id.* (referring to Agenda Item 2.3.3.1). This included not just those carriers that are owned or controlled by nationals of the designating state, but also those with their headquarters or principal place of business located in that state.

118. *Id.* (referring to Agenda Item 2.2.4.1). The usefulness of "Codes of Conduct" have often been debated. While the question of enforceability is very valid, in the present circumstance, with the level of opposition to almost any change, such a device would be a good first step.

119. *Id.* (referring to Agenda Item 2.6.3.1). In the discussion, some states also raised the problem that greater liberalization would lead to increased use of competition laws in an attempt to ensure fairness. Because of the international nature of the subject matter, this would lead to the extraterritorial application of such laws, with the resultant conflict and controversy among states. Thus, competition policy has to be developed in step with any regulatory changes in the current regime, in order to minimize the negative effects of possible overreaction, while still allowing states to ensure a competitive environment.

120. *Id.* (referring to Agenda Item 2.5.3.2).

Despite the tentative, mostly non-binding nature of most of these proposals, no concrete agreement emerged from this Conference. In fact, the countries and interests supporting changes to the existing system were in the minority. The group of developing countries, those European states with considerable government involvement in their airlines, and surprisingly even Japan consistently backed the *status quo*.[121] While a great deal of expectation preceded the conference, it appears that there was insufficient realization of the potential magnitude of the problem facing the industry to generate the political will required for multilateral action at ICAO.

Still, there is hope on the multilateral front. For the last fifty years ICAO has been the sole multilateral guardian of all air transport services. On January 1, 1995, it was joined by a potential rival in the form of GATS. As discussed earlier, GATS only applies to the "soft-rights" of air transport. Nevertheless, there has been considerable speculation as to the potential for applying even these basic trade policy rules to aviation services' "hard-rights." It was impossible for this issue not to surface at the 1994 ICAO Conference, as some believe that GATS could serve as a multilateral alternative to the current regulatory arrangement.[122] However, this suggestion was not raised seriously. Instead, lip-service was paid to cooperation between the two agencies at the Conference, and in the final text, ICAO was urged to exert leadership in the area of economic regulation.[123]

The irony is that ICAO was trying to do just that at the 1994 Conference, but ran into the brick wall of multilateral decision-making. This was not lost on potential reformers and there were questions whether economic regulation of international aviation services is not better housed with GATS.[124] Yet this is not the only hurdle that would have to be overcome, if ICAO was to relinquish sole control of economic regulation. For example, GATS, a multilateral agreement, would have to apply to the entirety of aviation services. According to Article 6 of the Chicago Convention, however, the permission of the grantor state is required for aviation services to be operated in that state. Thus, GATS could only be made applicable if the bilateral system were abandoned in favor of a mul-

121. *Id.* (containing summaries of interventions from participating countries and organizations). Each Agenda Item is also accompanied by a summary of the discussion, indicating the flow of opinions.

122. *Id.* (referring to Agenda Item 2.6 Trade Agreements and Arrangements). For example, IATA noted that GATS could be extended.

123. *Id.* (referring to Agenda Item 2.6). The discussion reveals some concern that ICAO was not exerting an "active and effective role in developing future regulatory arrangements in the economic area." It was also realized that there would be increasing pressure to include more air transport services in GATS.

124. *Id.* (including Secretariat Working Paper WP/13 at Agenda Item 2.6.16).

tilateral, or at least a plurilateral regime. While this is precisely what will be explored in Part IV of this paper, the failure of the 1994 ICAO Conference in this regard demonstrates the world is not there yet.

C. The Regional Option

Multilateralism means general international participation while plurilateralism contains the added notion of countries joining with various degrees of commitment. Both theories have been suggested as alternatives to the current system of air bilateral agreements. A plurilateral agreement is considered more possible, as it offers participation without taking on full obligations at the outset by every party. It provides for a period of adjustment. Yet in looking at the future of the regulatory process, the ICAO Conference found that there is too great a disparity in economic and competitive situations for any form of global, multilateral agreement at the present time.[125] It was somewhat more optimistic on the prospects of liberalized agreements on regional and sub-regional basis.[126]

There is a longstanding philosophical debate among practitioners and academics working in the field of international law on whether regionalism is a useful step on the road to accomplish global agreement. Some argue that the formation of blocks leads to the continuation of bilateralism only between bigger players. This potential problem seems to have been mostly avoided up to now in the area of international trade, primarily because global and regional agreements have been progressing relatively contemporaneously.[127] Yet in spite of the speculation in relation to international aviation, there seems to be little regulatory cooperation in the industry on a regional basis.[128]

The one outstanding exception to this is the European Union (E.U.),

125. *Id.* (referring to Agenda Item 3.4.1(b) on Future Regulatory Process and Structure).

126. *Id.* at 3.4.1(c)

127. This is a reference to the continuing development of the GATT structure through the various "Rounds", while trade liberalization was also progressing regionally in Europe, North America, and planned expansion in both the Americas and the Pacific Rim.

128. There are the exceptions that prove the rule. The European Union (E.U.), with its customs union, is now entering an era of regional cooperation, as will be demonstrated. Historically, there have been a few regional alliances which have tried to combine to strengthen the effectiveness of their international aviation services. Of those still in existence, Scandinavian Airlines Systems (SAS) and Air Afrique are the most well known. The reason that there are, and have been so few such alliances, is because in addition to overcoming their domestic hurdles, the Chicago Convention is also an obstacle. While Article 77 expressly permits joint operations, these have to performed in conformity with all the other rules in the Convention. This same article permits cooperation among airlines, which will also be looked at in this paper. But these must be distinguished from a group of countries providing economic access to one another other than on a bilateral basis. Only the E.U. fits that format. Even NAFTA specifically excludes aviation services.

although to even count it seems somewhat unfair since it holds a unique and distinct advantage due to its status as a customs union. Originally, air and sea transport, (unlike road and rail which were without significant external implications to Europe) were not explicitly placed under Commission competence.[129] Yet, since the 1970s, the European Community (now Union) Commission (the "Commission"), and the Council of Ministers (the "Council") have been looking at liberalizing this industry without success.[130] A step towards liberalization occurred when the European Court of Justice, in the *Nouvelles Frontieres* decision[131], recognized that the anti-competitive behaviour of European airlines can be policed by the Commission, not under competence over aviation, but under competition rules.[132] The Council finally exercised jurisdiction in the aviation field by adopting a liberalization package in 1987, and a second in 1990, which relaxed regulation on market access, capacity sharing, and fares.[133]

It was the third such package in 1993 which established a framework for an internal market. It included: freedom of establishment, allowing nationals of member states to establish and own up to 49% of airlines in other member states; removed capacity restrictions; and created traffic rights for all E.U. airlines on substantially all E.U. routes.[134] Further, by 1997, the 49% limit will be removed and E.U. airlines will be permitted to engage in cabotage—the right to fly a domestic route in another E.U. country.[135] There are also plans to extend these policies to the European Free Trade Association (EFTA).[136]

The E.U. has not stopped there. The 1994 report of the *Comite des Sages*, or "Wise Men" to the Commission on the future of air transport in Europe, also addressed the deeper issues of nationality, subsidies and external aviation policy.[137] While being critical of the European airline industry for still being "oriented towards outdated national boundaries," it

129. *See supra* note 48, at 287.

130. *See* Jeffrey Platt, *European Community Cabotage,* 22 TRANSP. L. J. 61, 70 (1994).

131. Cases 209-213/84, Ministere Public v. Lucas Asjes, 32 E.C.R. 1425, 3 C.M.L.R. 173 (1986).

132. *See supra* note 48, at 288.

133. *Id.* at 289.

134. *Id.* at 290.

135. *See supra* note 130. The relatively small size of european countries, and the fact that the vast majority of commercial air traffic is between states somewhat lessens the significance of the notion of a "cabotage area". Nevertheless, because of the wording of Article 7 of the Chicago Convention, obliging parties "not to enter into any arrangements which specifically grant . . . privileges on an exclusive basis," it is still within the purview of non E.U. countries to challenge the legality of a "European cabotage area."

136. *See supra* note 48, at 290.

137. *See* Report by the Comite des Sages for Air Transport to the European Commission, *Expanding Horizons*, on file with the Delegation of the European Commission, Washington,

also recognized a long-argued uniqueness associated with commercial aviation which requires national pride to be considered along with economic rationality.[138] The "Wise Men" reluctantly gave in to a "last time, one time" injection of state aid for heavily indebted, inefficient European carriers, and called for a Community approach to external aviation by 1995.[139]

These last two points are especially important. First, the unprofitability of most European airlines are due to factors associated with government control. More money alone will not make these airlines profitable without the structural efficiency needed to take advantage of the new opportunities offered by liberalized commercial aviation in Europe. Second, the question of whether external aviation policy falls under Community competence is still before the European Court of Justice.[140] In spite of this, there is a real fight brewing between the Commission and the Council caused by the policy of the United States to offer liberal bilateral agreements to the smaller E.U. and EFTA countries, thus hoping to "divide and conquer" the bigger ones.[141] This second point emphasizes that externally even Europe, the one example of regional cooperation, has not taken on the vestiges of a regional entity.

D. Initiatives by States

There are a few initiatives at the national level to liberalize the present system. They come from countries that have either deregulated their domestic airline industries or from those that are moving away from government equity ownership and control. These countries were in the minority at the 1994 ICAO Conference in pushing for regulatory reform and were not able to achieve change at the multilateral level. Some of their initiatives *vis-a-vis* one another have, however, led to useful innovation on a bilateral level.

The United States has been a pioneer in this area. Being mostly

D.C. (containing a full range of recommendations for achieving a Single Aviation Market in the E.U.).

138. *See id.* at 5.

139. *See id.* at 21. It is interesting to note that since the "one time - last time" recommendation, some European airlines have received government "bailouts". These include Air France, Olympic, and Iberia. Even more interestingly, some of these, like Iberia, are already back again, for yet more assistance. Air France have not yet asked again, but will eventually have to.

140. *See supra* note 130, at 63.

141. *See* Hedlund, *supra* note 48, at 292. While this is covered later in the paper, it is noteworthy that the United States had, at one time, wanted to negotiate a "bilateral" air agreement with the E.U., hoping that the progressive voices of the U.K. and the Netherlands will soften the resistance of the more protectionist countries like France, Spain, Italy and even Germany. The fact that the United States has changed tactics, and is choosing to "divide and conquer," even when the Commission is now, belatedly, arguing for a unified external air policy suggests that the protectionists continue to be in the driver's seat in the E.U.

alone in the pursuit of a more liberal international regime, its attitude has been important because it is the largest, most important, aviation market in the world.[142] The United States had deregulated its domestic airline industry in 1978 with mixed results. While generally lowering fares and increasing service in some sectors, deregulation has also caused cutthroat competition, a gradual concentration in the industry, and ended, reduced or diminished service to many smaller destinations.[143] Even a consolidation of service through the "hub-and-spoke" system has failed to make most U.S. airlines profitable on domestic service.[144] It is probably fair to say that the U.S. example has contributed somewhat to the reluctance with which other countries view complete deregulation of their domestic air services. It has also not helped sell this U.S.-style deregulation for international aviation services. Yet, with what appears to be a single-minded initiative of trade liberalization pursued by most of the Administrations over the last two decades, the United States has become a virtual *Don Quixote* in its attempts at improving access to international markets.[145] Unlike Cervantes' hero, the United States has lately "made some windmills yield."

It must be pointed out that the various U.S. airlines were only behind the government to the extent of their immediate, individual interests. For example, in any initiative, be it expanded access or an opportunity for foreign investment in the U.S. industry, the airlines variously supported or opposed the initiative depending on their individual bottom lines.[146] This has significantly contributed to the lacklustre result that almost two decades of work and the lure of greater access to the U.S. market has been able to produce.

The United States first began to work towards more "open" bilateral agreements by prohibiting government intervention on fares, except by mutual agreement.[147] The first such agreement was the Protocol Relating

142. *See The World of Civil Aviation 1993-1996*, International Civil Aviation Organization, Circular 250-AT/102 (containing statistical data on global aviation services).

143. *See* Dempsey, *supra* note 3, at 209.

144. *Id.* at 174.

145. *See* David Hughes, *ICAO Delegates Shun U.S. Free-Market Stance,* AV. WK. & SPACE TECH., January 2, 1994 at 37.

146. There are a myriad of examples of excessively heavy legal and political pressure exerted on the Administrations by airlines in protection of their interests on specific issues, without much regard to any consistency with positions take on previous occasions. As mentioned earlier, a number of airlines opposed the KLM-Northwest, British Airways-USAir deals, while in bilateral air negotiations airlines with privileged positions do not want to liberalize access. One good example is the United States-Japan bilateral, where neither Northwest nor United, with lucrative beyond-rights, has any interest in allowing other players to have a piece of the pie.

147. *See* Hedlund, *supra* note 48, at 269. In more recent agreements, such as with Canada, the system employed is known as "double-disapproval," with airlines being free to set their own fares unless both parties agreed to object.

to the United States-Netherlands Air Transport Agreement of 1978.[148] *Inter alia*, it contained: almost unrestricted capacity (except that it had to bear a close relationship to the needs of the public); fares were to be set by the airlines with government intervention limited to the prevention of predatory or discriminatory practices; and protection of the airlines from monopoly power and unfair competition due to government support. This arrangement was further liberalized by the United States-Netherlands Open Skies Agreement of 1992 by giving the right to each party to designate as many airlines as it wished to unlimited route rights; allowing no restrictions on destinations, capacity or frequency; and granting liberal side arrangements including dispute settlement.[149]

This was the first of a slowly growing number of bilateral air agreements predicated on the United States' concept of "open skies."[150] The Netherlands agreement to liberalize aviation services along the U.S. model was a strong factor in the U.S. Government's agreement to allow KLM to hold 49% of Northwest Airlines' equity (though not voting rights), in spite of the standard 25% rule.[151] This flexibility was not because any U.S. airline had any interest in the Dutch domestic market, or that extraordinary beyond-rights possibilities existed. Rather, it was because the United States wanted to encourage other bilateral partners to liberalize international access.[152] While perhaps not to the same extent, the United States has since negotiated a few other liberal bilateral agreements. It is pursuing similar agreements with a number of small Euro-

148. *Id.*

149. *Id.* at 270.

150. *See U.S. International Aviation Policy Statement,* November 1, 1994, U.S. Department of Transportation, Docket# 49844 (containing United States' concept of "open skies"). Although "open skies" has been subject to several interpretations, and has gone through some modifications, the basic elements remain intact. These include:

(1) open entry on all routes;

(2) unrestricted capacity and frequency on all routes;

(3) unrestricted route and traffic rights (including no restrictions on intermediate and beyond points, change of gauge, routing flexibility, coterminalization and fifth freedom traffic);

(4) double disapproval pricing in Third and Fourth Freedom markets;

(5) liberal charter arrangements;

(6) liberal cargo regime;

(7) conversion and remittance arrangements;

(8) open code-sharing opportunities;

(9) self-handling provisions;

(10) procompetitive provisions on commercial opportunities (e.g. intermodal rights);

(11) non-discriminatory operation of and access to computer reservation systems.

151. *See* Hedlund, *supra* note 48, at 274.

152. The best example of this that a planned $700 million investment in USAir by British Airways was disallowed by U.S. authorities, partially due to the protests of other airlines, but mainly because the United Kingdom would not negotiate to liberalize its air bilateral with the United States.

pean countries.[153]

The United States has, however, been unable to bring any of the large European or Asian aviation countries to the "open skies" table. This is probably partially due to the fact that the United States' version of "open skies" is too close to complete deregulation of international routes. This engenders a fear in these countries of contamination by the chaos that deregulation has brought to the U.S. domestic aviation market. At one point, the United States thought to liberalize air services through negotiation with the E.U. *en bloc*. Ironically, it is now the E.U. Commission that is eager for such negotiation. Their aim, however, is not to liberalize the market, but to protect those members adhering to the old protectionist external policy from the "divide and conquer" policy of the United States.[154]

E. What Airlines Are Doing

The link between more liberal access and relaxed ownership requirements highlights the crux of this issue for airlines. Liberalization of the basic elements of access: capacity, routes and tariffs, along with their ancillary "soft-rights" provides a way to, but not necessarily *into* the target market. There are also a myriad of legitimate reasons why seeking "cabotage" rights in the target country may be the least effective way to gain such access. These include the legal and regulatory problems of taking an aircraft and crew, subject to one system of safety, labour, health, taxation and other laws and standards in one country, and also trying to operate them in another.[155] Not to mention the virulent opposition of airlines involved in domestic service in that country.

Airlines have demonstrated their belief that the best available way of entering another market is through equity participation in carriers already operating there. Yet this option is usually quite limited, with strict nationality requirements for both ownership and control in place in most

153. *See* James Ott, *U.S. Targets Europe for Free Trade Pacts,* Av. Wk. & Space Tech., November 7, 1994 at 34 (commenting on United States discussions with several European countries, including Sweden, Denmark, Norway, Finland, Belgium, Luxembourg, Switzerland and Austria, with a view to expanding those agreements that are already liberal, or liberalizing traditional bilateral air transport agreements).

154. *See Of Airlines and Airwaves*, The Economist, March 18, 1995 (describing efforts by E.U. Transportation Commissioner Neil Kinnock to halt discussions by Austria, Belgium, Denmark, Finland, Sweden, and Luxembourg with the United States on international aviation services). The fear is that due to Europe's compactness, by gaining access to the smaller but still well located centres, the U.S. carriers will still have access to "Europe" and lucrative beyond rights. They can fly to Brussels, Vienna and Amsterdam, and bypass Frankfurt, Paris and Rome for the discretionary and Fifth Freedom traffic.

155. Interview with Warren Dean, Attorney, Dyer, Ellis, Joseph & Mills, (March 1995).

countries.[156] Still, there is a growing recognition that the airline industry, like others, needs the injection of capital that in this increasingly interdependent global marketplace only foreign investment can offer. The lack of foreign investment opportunities has undoubtedly been a factor in retarding the development of the industry. It is ironic that those who expect this industry to carry the expansion of international trade do not recognize the need to deal with the limitations of its current compartmentalization.

Precisely because of these limitations, the last decade has seen an explosion of imaginative, cooperative activity among many of the world's leading airlines. They were almost forced into these measures to meet the growing globalization of trade, including that of capital markets, because the restrictions placed on the industry, *inter alia*, by the stagnant legal regime regulating access, had closed other avenues. Airlines involved in scheduled international service have developed several levels of interaction. At one end of this scale are joint frequent-flyer programs and selective code-sharing arrangements. These are primarily used to encourage the customers of one airline to take the flights of another when there is a choice in the marketplace.[157] With the restriction on cabotage, this is currently one of the most practical ways in which international carriers which do not desire closer cooperation can feed traffic to one another.

One step beyond this is a code-sharing relationship, or its first cousin, the blocked-space arrangement. In the former, airlines jointly list their flights throughout some or all of their networks, almost making it appear to the travelling public as if there was one carrier providing seamless service. In the latter, airlines actually buy blocks of space on each others' flights and market them as their own.[158] While to be valid, these provisions have to conform to the terms of bilateral air agreements, they can be seen as attempts to compensate for the lack of flexibility in these agreements which prevent airlines from freely setting routes, capacity and tariffs.[159]

Alliances are also formed in the area of "soft-rights." While airlines have performed ground-handling and maintenance functions for one-an-

156. *See* Cheng, *supra* note 4, at 67 (detailing United States law and regulation governing foreign ownership and control of United States airlines). In a nutshell, these stand at 25% maximum, though there are exceptions, as seen in the KLM-Northwest case. As mentioned earlier, under the Third Aviation Directive, ownership and control rules have been relaxed within the E.U., to give a maximum of 49% to nationals from other E.U. countries.

157. *See* Dempsey, *supra* note 3, at 196.

158. *Id.*

159. *See* James T. McKenna, *Code-Sharing Creates Hurdle in Pilot Talks,* Av. Wk. & Space Tech., April 24, 1995 (outlining some of the difficulties one airline, American, is having integrating this concept with its labour relations).

other for some time, it is in the marketing area that most of the recent innovation has taken place. The most important of these is an airline's decision as to which computer reservation system to market its services on.[160]

At the other end of the scale are the equity alliances, which most often also involve at least some of the above methods of joint operation. As participation is the only sure way to ensure the penetration of a market, and as cabotage is not, and will not likely be an alternative, airlines are more and more drawn to the limited equity participation currently available.[161] Even with the severe restrictions on foreign ownership and control, this allows a certain amount of cross-fertilization of investment and ideas, in return for which the investor airline gets a tenuous foothold. If many airlines' fortunes continue along the present downward trend, the relaxation of nationality requirements for ownership or control will become an increasingly attractive alternative to bankruptcy or more state aid.

IV. The Art of the Possible

With the legal issues being only one factor affecting airlines' fortunes, and with the many ways stakeholders are already getting around the shortcomings of the system, it may well be asked why is there a need for change. After all, there are optimistic forecasts for the growth in demand for international commercial aviation.[162] Many airline executives believe that they have turned the corner on achieving a stable industry through severe cost cutting.[163] Even the airlines themselves seem to be of two minds when it comes to liberalizing access or keeping the protection of the bilateral system. Countries, too, are divided between those few who want to see aviation services governed by modern trade law concepts, and the majority who still see aviation as primarily a source of national pride and job creation.

Yet, there are other signs which indicate that modernization of this aspect of public international air law is past due. For one, there is the enormous debt burden carried by the world's airlines, which will eventually have to be paid by the public, one way or the other. As most airlines

160. *See* Dempsey, *supra* note 3, at 191.

161. *See generally* Dempsey, *supra* note 3 (detailing the extent of U.S., European and global equity alliances).

162. Anthony L. Verlocci, *Short-Term Forecasts Pose Biggest Industry Challenges*, Av. Wk. & Space Tech., Mar. 13, 1995, at 48 (detailing the prognosis of average annual growth of scheduled passengers by region).

163. Edward H. Phillips, *Lower Costs Key to Airlines' Survival,* Av. Wk. & Space Tech., Mar. 13, 1995 at 66 (outlining the mostly successful steps, primarily U.S. airlines are taking to reduce and keep down their operating costs).

make a large proportion of their profit on their international service, its liberalization would mean that more of this debt would be paid by those actually using the service.[164] For another, there are other stake-holders involved in international commercial aviation, whose interests are not governed by narrow and often outdated considerations of airlines and governments.[165] Neither of these mean that international air service is close to collapse, nor that improving international economic regulation alone is the answer. Rather, the inefficiency of the present regulatory system creates waste that the industry can ill afford, and offers false succour to those trying to avoid the momentum towards trade governed by the rule of law, not the rule of individual interest.

It has been shown that multilateral attempts at updating the international legal framework have met with repeated failure due largely to the control of the decision-making process by those states protecting their "right" to participate in international commercial aviation. Nor does regionalism seem to offer a solution, since the only slowly emerging model is found within the world's only significant customs union. This is not surprising, as Europe is also the only area where geographic proximity goes hand in hand with advanced economic and technological development, elements which appear to be needed in combination for successful regional cooperation. Finally, in spite of the efforts of the United States to offer open access to the most lucrative aviation market in the world, there have been very few significant takers to liberalize international aviation services on a bilateral basis.

A. Reshuffling Existing Norms To Overcome Stagnation

Considerable ink has been spread in the pursuit of ideas as possible solutions to the current impasse. As often as not, even more ink was used to dispell them as either ineffective or unworkable. At the bottom of most of these ideas lies a concern that, unless there is a multilateral solution (however unlikely the prospect), the various regional or bilateral possibilities will result in the air transport world having to function under a system of "cohabitation."[166] This could easily create have and have-not countries, regions and airlines, mirroring the unfortunate North-South divide that is the legacy of post-industrial decolonization. As it appears inevitable that divergent approaches are already resulting in divergent opportunities for stakeholders in different parts of the world, it is necessary to focus on making the cohabitation of these varied solutions work.

164. *See* Dempsey, *supra* note 3, at 165.

165. *See supra* discussion text pt. III, sec. A for an analysis of the needs of other stakeholders.

166. *See supra* note 96, at 315.

This is more urgent, and may also be more achievable, than any quest for the "holy grail" that modernizes international air services. Thus, the proposal in the next paragraphs draws together the diverging strands of economic regulation, anchors it to existing international legal structures (old and new), and suggests that this combination will offer a marginal improvement over the present system. It may also have a chance of acceptance by the international community.

It is first necessary to recite the "givens" based on the previous analysis. It is given that the Chicago Convention and the subsequently evolved system of bilateral air agreements is now solidly rooted in international law and practice. Regrettably, it is further given that this system has neither the elasticity of operation, overall predictability, or flexibility to adapt to changing circumstances to provide an ideal economic climate for international commercial aviation. Thus, it is given that these shortcomings contribute to the difficulties experienced by the international aviation industry. It is also given that developments in international trade law have bypassed this system, which is still based on pre Breton-Woods economic notions. Finally, it is given that wholesale improvements are out of the question because of the unique nature of the industry, the insistence on participation in international commercial aviation by most countries, the schizophrenia of the airlines, and the difficulties involved in changing the system due to the problems inherent in multilateral decision-making.

While it is conceded that it is not possible to amend the Chicago Convention or do away with the system of bilateral, the regime somehow has to be made more elastic, predictable and flexible. It must also begin to catch up to international trade law, within the parameters permitted by the uniqueness of the industry and the special role it plays in the lives of nations. In the absence of any hope for a multilateral agreement, it has been suggested that the best way to make gradual changes while preserving the *status quo* for those attached to it as long as possible is by multilateralizing the current system of bilateral air agreements.[167] At first blush this already appears to be accomplished. The bilateral are, after all, based on the Chicago Convention, and are all registered with ICAO (See Appendix A). However, neither the Convention nor the Organization

167. *Id.* There are any number of commentators and practitioners who believe in the "multilateralization" of bilateral air agreements. There is more of a disparity on how and if this can be accomplished. Some of the obstacles include the catalyst that would start the process, the incentive that would draw countries together, and the process by which a change in the system can be made, without actually changing the system. Yet, precedents do exist. For example, the device used to enable the coming into force of the 1982 United Nations Law of the Sea Convention was a combination of a General Assembly Resolution urging parties to become parties on the basis of "an understanding" circumvented the political impossibility of amending the Convention.

exerts any regulatory uniformity on this body of laws.[168] Thus, in order to ensure the cohabitation of the varyingly liberalized aviation relationships around the world, bilateral air agreements must become anchored to "something more" than the few provisions of the Chicago Convention that merely play at economic regulation. At the same time, this "anchor" must be something that is already part of international law in order to stand any chance of acceptance by the international community.

Two questions arise immediately. First, what improvement does the mere multilateralization of bilateral agreements offer? Second, what constitutes the "something more," that must be added to the Chicago Convention to form the basis of this agreement?

In response to the first, the reader is asked to picture the thousands of bilateral aviation agreements, with varying levels of obligations flowing between the parties. While there is nothing to prevent countries from giving better treatment to some than to others, each country usually has a certain general level of openness or protection that it finds comfortable.[169] If the various bilaterals were displayed on a chart of concentric circles, with each circle representing a different degree of openness or protection, each country would find its aviation agreements on this chart grouped in an area which reflects its comfort level *vis-a-vis* liberalization of access (See illustration under Appendix B).

The reader is asked to think of this series of concentric circles as forming the basis of a framework agreement that each country wishing to become a party, joins. This agreement would also include a grandfathering proviso that no country's commitments need exceed those with which it is currently comfortable, until it chooses to liberalize. Thus at the outset, there would be no alteration to any country's rights or obligations *vis-a-vis* its present level of protection/liberalization. The only change would be that instead of the bilateral residing in the vaults of ICAO's legal department, they would become annexes to (and be consistent with) the terms of the underlying framework agreement. In other words, a plurilateral agreement would emerge, with parties having varying degrees of reciprocal obligations to one another.

So far this would be no more than the multilateralization of the existing bilateral system. Yet already it has one advantage over the present

168. *See supra* note 96, at 302. As discussed earlier, while the Chicago Convention places economic regulation in the hands of ICAO, the organization has proven ineffective in carrying out this mandate.

169. While this is obviously a generalization, countries are subject to trends. For example, the United States has almost consistently pushed for liberal bilateral agreements for the last two decades. The E.U. countries are now *ad idem*, at least on how they behave towards one another. Developing countries for the most part tend to protect their flag carriers, and use access rights as a source of hard currency.

regime. It offers uniformity of future development. And while there is little chance of modernizing a disparate system of bilateral agreements, there is at least some hope for future evolution if they are anchored to a common basis. This may be a small improvement, but it is an important point. This may be the only avenue for developing countries, faced with isolation should industrialized states strike liberal deals among themselves, to join a global system.

The second question refers to the "something more" to form the basis of the framework agreement, upon which the bilateral would be "anchored." To be worthwhile, such advancement should: increase opportunities for access to and into markets; generate greater uniformity and predictability in the regulation of such access; and raise the flexibility of the system to make it more adaptable to changing circumstances. Yet to be acceptable, it cannot disturb the pillars upon which the present system is built. Neither the Chicago Convention or the role of governments can be altered. The Convention is unalterable because the amendment process is difficult and would likely meet with international disapproval. Governments would resist passing economic regulation to an international bureaucracy, especially in a field where they have held on to it as tightly as in international aviation services.

Given these narrow parameters in which to manoeuvre, a framework, plurilateral agreement would have to continue to include, but also supplement, the Chicago Convention. In the view of this author, this supplement should be a modified GATS. This appears to be the most plausible way to ensure that the framework agreement is both anchored to existing rules of international law and is well placed to keep up with future developments in this area. The modifications should start with expanding GATS' Air Transport Services Annex to include both "soft" and "hard" rights. Additionally, where the Chicago Convention and GATS are not compatible, the changes to be discussed in the following paragraphs would be necessary. A framework agreement would emerge within which all parties would be free to negotiate bilateral air agreements, so long as they adhered to both the rules of the Chicago Convention and an aviation-specific GATS. There would be no requirement to grant more liberal access. However, when any access is granted, it has to be done in conformity with the rules of the framework agreement (see illustration under Appendix C).

This approach has the advantage of allowing aviation services to catch up to the present level of development in the international trade law. In addition, most of GATS' provisions are directly beneficial for the progressive liberalization of economic regulation. These include transparency, rights on payments and transfers, objectivity in domestic regulation, and a modern dispute settlement mechanism. At the same time,

GATS retains the exceptions for public safety and national security. This combination produces the greatest available elasticity and predictability.[170] The fact that "national treatment" is only applicable if specific commitments are made by the parties actually suits the proposed framework agreement because it makes it more saleable.[171] The provisions for limitations on the period states can exempt themselves, and the commitment to future negotiations to begin no later than five years, ensures continued flexibility.[172]

Yet as alluded to earlier, GATS in its present form may not be consistent with the Chicago Convention, nor is it entirely helpful to the liberalization of aviation services. Some modifications are proposed to end up with a workable and acceptable framework agreement that could perhaps be called the General Agreement on Aviation Services (GATAS). The first, and possibly biggest change that must be made is the modification of MFN to work on a reciprocal basis. This is because the MFN concept may well be contrary to the provisions of Article 6 of the Chicago Convention, requiring the permission of the grantor state for all scheduled commercial air traffic.[173] Since "GATAS" is to be based on both the Chicago Convention and a modified GATS, it must be consistent with both. It has already been pointed out that formally amending the Chicago Convention is not practicable. More importantly, MFN in an aviation context would actually deter countries from liberalizing their policies on access, because once more liberal access was offered to one country, it would have to be offered to all. If, on the other hand, this provision were made reciprocal, a country would only need to extend rights on an MFN basis to another, if that country also extends MFN rights to it.[174] This at least would not be an automatic deterrent to gradual liberalization.

The second change involves the provisions on "market access" and "national treatment." They are to be found in the "Specific Commitments" portion of GATS, and are thus already not mandatory in nature.

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170. *See* GATS, *supra* note 10, pt. II at 286.

171. *Id.* pt. III at 298.

172. *Id.* pt. IV at 298.

173. *See generally* Abeyrante, *supra* note 62. (With MFN, if the grantor state gave certain access rights to one state, it would automatically have to extend the same rights to all other states, which may not correspond to Article 6 which states ". . . without the special permission or other authorization . . . .") It may be that "other authorization" could be stretched to include a grant under MFN, but given the energy with which access rights are guarded by states, it is not an argument that is likely to meet with a lot of sympathy.

174. There is a debate among some practitioners whether MFN is, by its very nature, a right with only a universal application, or whether it is capable of having qualities such as reciprocity. For the present circumstances this debate is largely academic. If MFN is only universal, then it is inappropriate for the liberalization of aviation services, and the reciprocal right of extending the best "deal" a country gives on access to any other country willing to do the same can be called something else. After all, a rose by any other name will still smell as sweet.

Yet it should be made clear that these provisions would also have to operate on a reciprocal basis. While not imposing a blanket requirement, and thus not scaring away potential parties, this would encourage a gradual liberalization based on market opportunities. Regarding "market access" specifically, some further modifications may be required in the provision on foreign ownership and control.[175] This would ensure that the present provision against limitations on foreign involvement are tempered (at least temporarily) in order to encourage the gradual relaxation of these requirements. The reason for this need is that cabotage is not a likely option in the near term anywhere but among E.U. states. The only realistic form of market access, therefore, is equity participation in another country's airline(s). This must be fostered to provide the needed cross-fertilization of capital and ideas.

There is another suggestion that will make "GATAS" more successful. This is the incorporation of a "Code of Conduct," that each party to "GATAS" would be encouraged to adopt. The ICAO Secretariat draft for the 1994 Conference, discussed earlier, could serve as a useful model.[176] It is admitted that it would be impossible to make its adoption mandatory by the parties' designated carriers. Still, such a code would take an admittedly tentative, but positive, first step away from practices that have resulted in destructive competition. More importantly, its incorporation could embolden those states, fearful of such business practices, to join the proposed agreement. Yet another reason for its inclusion relates to the fact that increased liberalization will inevitably lead to the use of competition laws to protect domestic industries in the name of promoting fair competition. If history is a guide, the extraterritorial effects of such laws are bound to cause problems. A Code of Conduct, along with the WTO dispute resolution mechanism that comes with GATS, should go a long way towards minimizing, if not solving this problem efficiently if it arises.

The bureaucratic structure for a future "GATAS" is almost as important as its contents. As we have seen, the international administration of economic regulation under public international air law presently lies with ICAO. It is recognized that as successful as ICAO has been in all other aviation matters, it has not had similar accomplishments in the area of economic regulation. This paper has speculated that this is at least partially due to ICAO's structure. While there are calls for ICAO to give up this function in favour, some suggest, of the WTO, others quite correctly point out that in the present international climate, this is not a realistic

175. *See supra* note 10, pt. III, art. XVI, 2(f) at 297.
176. *See supra* note 15, Agenda Item 2.2.4.1, WP/10.

option.[177] Rather than seeing an eventual "turf-fight" between these two organizations, this author would rather propose that an initiative for a "GATAS" type agreement come from both ICAO and the WTO. After all, "GATAS" would have its origins in both the Chicago Convention and GATS. It is further suggested that once negotiated, GATAS be jointly administered by both bureaucracies.

The difficulty of getting two international bureaucracies to cooperate long enough to launch such a venture, let alone jointly administer it, is not lost on this author. Yet, in the absence of creating a new international bureaucracy, it is inconceivable that either ICAO would relinquish its role under the Chicago Convention or that the WTO would do the same for GATS. Furthermore, some precedents do exist for cooperation among international organizations, with overlapping mandates, in bringing forth multilateral conventions.[178] Should this or a similar idea ever see the light of day, the fact that it deals with economic regulation means that time will inevitably push major considerations towards GATS and the WTO, necessarily diminishing ICAO's role.

CONCLUSION

It is not the intent of this paper to suggest that we are in danger of losing international commercial aviation. Its conclusions do not even point to the problems of economic access under public international air law as being the principal reason for the poor financial health of the airline industry. Yet it is hoped that it demonstrates that strict bilateralism, born more from national security than economic considerations over the last five decades, has retarded the development of the industry. Perhaps more importantly, it does not offer the legal climate which could help facilitate the development the airline industry needs today. As the end of the twentieth century approaches, trade laws governing international aviation services lag behind those of its sister service industries.

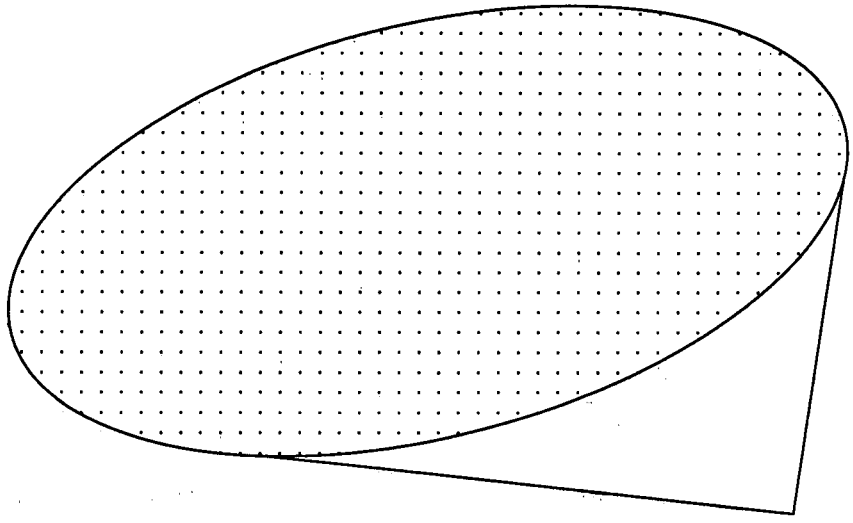
The allure of commercial aviation is like the magnetism of show business. There will always be people with money to invest in this industry, whether profitable or not. We have all heard the joke about how one makes a small fortune in the aviation business: It is by starting out with a

177. Abeyrante, *supra* note 62, at 28.

178. *See generally The History of UNCTAD, 1964-1984*, [1985] U.N. Doc. UNCTAD/OSG/286. (detailing how the United Nations Conference on Trade and Development, UNCTAD, coordinated its work on international shipping legislation in its second session in 1968 with the United Nations Commission on International Trade Law, UNCITRAL, which resulted in the United Nations Convention on the Carriage of Goods by Sea, the Hamburg Rules). It is inevitable that one organization becomes the real custodian of the Convention, while the other's presence is more nominal. Yet, as anywhere else, saving face among international bureaucracies is very important.

large one. It should not be forgotten, however, that if this industry continues to be unprofitable, someone will eventually have to pay the enormous debt burden it has built up. Therefore, it is incumbent upon today's decision-makers to look at *all* ways in which the industry can be helped. This includes making enough useful, achievable changes to the legal regime that has kept international aviation compartmentalized and underdeveloped, to ensure that the different approaches in play today are able to cohabit in harmony and have the ability to evolve together. While the world is not ready for a wholesale overhaul of the current regime, the modest changes suggested in the preceding paragraphs may be possible with only a little political will—before we all end up footing the bill.

APPENDIX A

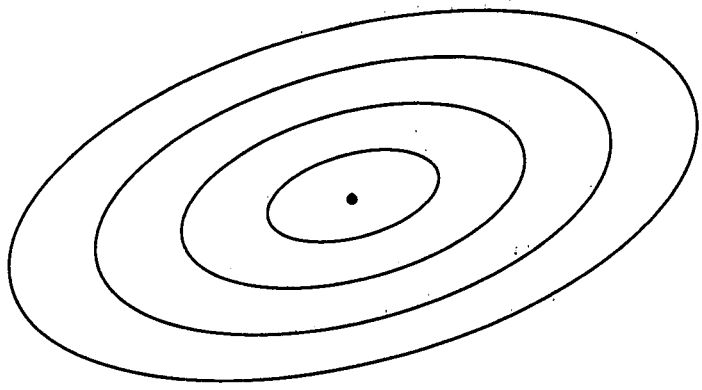


Chicago Convention

- This diagram represents the current state of affairs, wherein thousands of bilateral aviation agreements exist independently bounded only by the provisions of the Chicago Convention.

- As the Chicago Convention stands for absolute state sovereignty in economic regulation, any adherence to international legal norms is purely illusory.

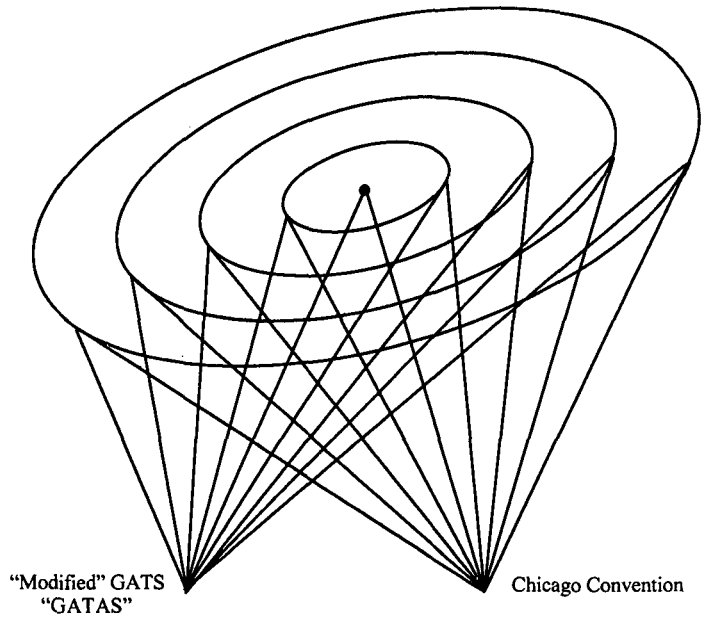
APPENDIX B



- Each circle represents an increasing level of liberalization. Thus, if the centre point is absolute control of economic regulation by a state even to the extent of not being a party to the "two-freedoms" agreement, the widest circle would represent a United States style "open skies" agreement.

- With the thousands of aviation bilaterals in existence, there would be as many circles as there were levels of "openess".

APPENDIX C



- This diagram shows how bilateral aviation agreements would be "anchored" to underlying rules.

- The innovation in this proposal is that in addition to the provisions of the Chicago Convention, states negotiating bilateral air agreements would also have to adhere to GATS, with the modifications proposed in the text.