IV. THE CHICAGO BERMUDA REGIME: 
A LIBERAL AVIATION POLICY

The Chicago Conference concluded with mixed results. The Conference is credited with the establishment of an international organisation to regulate civil aviation and the adoption of technical standards and the privileges of non-commercial nature. The chief unfinished task of the Chicago Conference related to the right to conduct trade. The Conference was expected to open up new horizons in the field of international civil aviation. Contrary to the expectations, the Air Transport Agreement failed to mobilise states for active co-operation in the area of international air services. Consequently, states reverted to bilateral agreements to establish commercial air services. Working on this line of action, the US signed a number of such agreements with various

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44 The US, failed in their efforts to liberalise international air transport by a multilateral treaty. The UK and other states failed to embody in the convention effective economic regulation or to endow the Organisation (ICAO) with economic regulatory powers. Thus ICAO was given regulatory authority only in the technical and operational field while the traffic rights in scheduled air transport have been left to bilateral agreements between states.

countries and maintained a liberal attitude. But the UK, on the other hand, continued with its regulatory provisions in its bilateral agreements. The differing attitudes of the US and the UK subsisted until they, finally, sought to resolve the crisis at Bermuda in 1946 and mutually accepted an Air Services Agreement to put an end to the stalemate. The agreement is popularly known as the Bermuda-I agreement. Some scholars prefer to term it a "compromise", for, it is a consequential outcome of two diametrically opposite philosophies of two major aviation powers, i.e., Freedom of the Air and Order of the Air.

The Bermuda Agreement comprises a Final Act, a Bilateral Agreement (Chicago Standard Form) and Attached Annexes. The textual content of the Bermuda Agreement may be summarised into two broad heads:

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66 See the Air Services Agreement between the US and the UK signed on 11 Feb. 1946, TIAS No. 1507 (1946), pp. 18-19 and 3 UNTS 254.


1) An exchange of routes and traffic rights between the contracting parties and privileges for Scheduled Air Services by their airlines; and

2) A system of regulatory devices for regulating the capacities that are granted.

The exchange of traffic rights under the Bermuda agreement includes the grant of an operating permission to the designated airlines, grant of transit rights, the grant of traffic rights and other auxiliary rights. As a matter of fact, the Bermuda Agreement touched upon all aspects of the five freedoms of the air that the Air Transport Agreement speaks of. But in the Bermuda negotiations, the third, fourth and the fifth freedom rights along with other relevant issues like the grant of routes, fixation of rates and capacity controls figured more prominently. The Bermuda bilateral agreement highlighted the following aspects:

1) The States agreed to establish scheduled air services with the objective of encouraging the distribution of the benefits of air-travel for the
general good of mankind at the cheapest tariffs based on sound economic principles.\textsuperscript{69} 

2) The air transport facilities thus provided should bear a close relationship to the requirements of the travelling public.\textsuperscript{70} 

3) There shall be fair and equal opportunity for the carriers of the two nations to operate on any route between their respective territories as covered by the Agreement and its Annex.\textsuperscript{71} 

4) The states agreed to grant each other's airlines the three 'commercial privileges' subject to certain 'general principles' on any route as defined in the agreement. These privileges should be exercised on the basis of the principle of fair and equal opportunity so as not to affect unduly the interest of the air carrier(s) of other states.\textsuperscript{72}
5) For the purpose of operating air services the Bermuda Agreement provides an elaborate chart containing routes, specified by the contracting States to be operated by the designated air carrier(s) of the other contracting state.  

6) The United States' accepted the UK proposal that the fares to be charged by the air carriers of the contracting states between their respective territories shall be fixed by the International Air Transportation Association (IATA), a non-governmental organization of scheduled air carriers. Initially, the Civil Aeronautics Board (CAB) a regulatory authority of the US, challenged the authority of IATA as a rate-fixing machinery. Later, it accepted the same to induce the UK to relax its control over capacity, frequencies and fifth freedom rights. The tariff agreements concluded through the IATA

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73 See Annexure Sec.I and Sec.III as amended Section IV of the Bermuda Agreement, 1946, n.66.

74 For a detailed study of Rate Conference machinery of IATA, see J.W.S. Brancker, IATA and what it does? (Leiden: Sijthoff Publication, 1977), pp.37-42; See Annex Section II of the Bermuda Agreement, 1946, n.66. On the question of rates, the British interpreted the rate making authority of IATA as Supernational organization. See Dierkx, n.47, p.829.

75 See Dierkx, n.47, pp.832-833.
machinery are further subject to the approval of the aeronautical authorities of the two contracting States. This system was called the 'Double approval system'. This agreement would also provide for an 'open rate system', in such cases where the aeronautical authorities are empowered to fix rates which are fair and economical.  

7) The UK gave up the tough stand of direct control of capacity and frequencies that it had doggedly held on to. Regarding the third and fourth freedom rights too, it abandoned the dogmatic stand of a 50/50 basis. Instead, it accepted the capacity-clause which shall be applicable based on the traffic demands between the country of origin and the country of ultimate destination of the traffic. In addition to this, the UK also conceded the Fifth Freedom rights to the US air-carriers on the routes specified in Annex III,  

76 See Annex, Section III, Clauses (d)(e)(f) and (g) of the Bermuda Agreement, 1946, n.66.  

77 See Marc L.J. Dierkx, n.47, p.817.  

78 See the Final Act Clause (6) of The Bermuda Agreement, 1946, n.66.
in accordance with the general principles of orderly development to which both governments subscribe. The "primary objective" of scheduling capacity on the specified routes must be the carriage of third and fourth freedom traffic. The capacity may be used to carry fifth freedom traffic as a "secondary right and shall also be subject to:

(a) the traffic requirements between the country of origin and the country of destination;
(b) the requirements of through airline operations; and
(c) the traffic requirements of the area through which the airline passes after taking account of local and regional services.\(^7^9\)

In case the contracting States failed to comply with the said instructions and provisions of the capacity-clause, the question in dispute could be

\(^7^9\) Ibid., and also see Model Clause for Bermuda Type, ICAO DOC on World Air Transport Colloquium, 1992, p.21.
reviewed ex post facto or referred to ICAO for an advisory opinion. This method of capacity-regulation, is commonly referred to as the "Bermuda I type" capacity principles.

The aftermath of the World War II had given a fillip to the growth of commercial air transportation at the global level. It was for this reason that during the Chicago Conference and later at the Bermuda Conference, commercial aspects of civil aviation figured quite prominently. But due to the acute political and ideological division among the allied nations, the economic aspects of international civil aviation were completely lost in the wilderness at the conference. To make matters even worse, the sovereignty clouds which had firmly set in across the horizon during the 1919 Paris Conference, reappeared on the scene to darken the 'open sky' on the occasion of the 1944 Chicago Conference. These developments, which count significantly in providing the basis for the current

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80 See Article 9 of the Agreement and 11(g) of the Annex of the Bermuda Agreement 1946, n.66.
international aviation law, shattered the hopes and intentions of the United States which was looking forward to a multilateral solution for the exchange of commercial rights in order to provide an extensive market for its fast growing giant airline industry. Resisting the US endeavours, the UK strongly advocated 'controlled competition' rather than 'free competition', to protect its own national airlines, which had acutely suffered from the war as well as the US monopoly. Left with no choice for the exchange of commercial rights, States resorted to bilateral negotiations. States with a liberal philosophy entered into liberal bilateral agreements with like-minded countries, whereas those who were ardent supporters of the philosophy of 'regulation and protectionism' opposed commercialism in international air transportation. However, the gap between the US and the UK positions narrowed down with the realization of the lucrative potential that the North Atlantic routes offered. In order to establish Trans-Atlantic Air Services and to get an access to the European market, it was necessary for the US to enter into an agreement with the UK. This proved to be a
turning point in paving the way for the Bermuda Agreement. During the Bermuda negotiations, the unequal size of the aviation industry and imbalance in the economic growth of both the countries gave an added advantage to the US over the UK. Not surprisingly, in the prevailing situation too, a State like the US with strong bargaining position, ultimately had the last laugh.

The Bermuda Agreement has, over the years, been used as one of the most restrictive agreements, as well as one of the most 'liberal' bilateral agreements, because of its flexible "ex post facto" control over capacity and frequency, thereby leaving ample scope for the exercise of the third and fourth freedom rights in conjunction with some considerations of the fifth freedom rights as well. The United States of America, by means of its bargaining capacity over the UK on the fifth freedom too, gained access almost to every point in Europe. Whatever the 'control or regulation' the UK was so fussy about, was accepted by the US only for the fixation of rates or fares. This should not be
misunderstood as a downright compromise or a give-in on the part of the UK. In fact, the UK succeeded in containing the scope and range of the US advances in the area of the exercise of the freedom rights. It lured the US into accepting the IATA rate agreements because the UK sincerely believed that uncontrolled fares would yield heavy losses to its flag-carrier rather than the liberal freedoms. "If the freedom of pricing were accepted even under a system of frequency control, BOAC with its ramshackle fleet of converted bombers and exotic flying boats could not be competitive to the American carriers." In this respect, therefore, the Bermuda agreement is not only a compromise of the philosophies of two major aviation powers but also a piece-meal arrangement for protecting one's national economic interests and policies. Henceforth, the Bermuda Agreement became a model for many bilateral air-transport agreements. Today, there are more than 2000 bilateral agreements prevailing all over the world.

81 See Marc L.J. Dierkx, n.47, p.839.
82 In fact, the US and UK jointly declared on 19 September 1946 that the Bermuda Agreement would be set as a standard pattern for all the agreements to be concluded by them.
governing the global air transport, mostly influenced by the Bermuda-I model. ^83

V. BILATERAL REGULATORY SYSTEM:
A PRELIMINARY OBSERVATION

A typical bilateral air-service agreement encompasses the following key elements:

(a) Grant of rights,
(b) Designation of airlines,
(c) Regulation of capacity,
(d) Regulation of route-schedule,
(e) Regulation of tariffs. ^84

The list is not exhaustive, since it includes various other issues such as the interpretation of terms, aviation-security, recognition of civil aviation authority, modification, suspension and termination of the agreement, dispute settlement mechanism, etc. The

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aforesaid issues, popularly called traffic rights, are of great relevance to commercial air transportation. The discussion which follows would reveal how traffic rights serve the commercial needs of air-transportation and also bear upon the shaping of the bilateral agreements.

A. Grant of Rights

The Chicago Convention and the subsequent Bermuda Agreement clearly propounded the principle that the scheduled air services shall be operated with the consent of the States agreed through bilateral negotiations. During the negotiations each contracting State would grant to the other contracting State rights to the extent described in the Annex to the said Agreement for the purpose of establishment of air services described therein. This implies that the parties in such negotiations would be given equal opportunity and the rights would be granted to the

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85 See Article 6 of the Chicago Convention 1944.
86 See the Preamble of the Chicago Convention 1944.
parties on the basis of reciprocity to safeguard their national interests and those of their national airlines. Further, the airlines designated to perform the scheduled international air services shall be given an "operating licence" by their own authorities and an "operating permit" by the other party "without undue delay" subject, however, to certain technical considerations. Now, the exchange of traffic rights under a bilateral air service agreement involves exercise of rights on three levels:

(a) Transit rights,
(b) Commercial rights,
(c) Ancillary rights.

Though the transit rights accepted under the multilateral air transit agreement 1944, find a place in all subsequent bilateral agreement to overcome any difficulty if one of the parties is not a member of the

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87 See Bin Cheng, n.68, p.289.
88 These considerations include recognition of certificate of air worthiness of aircraft; certificate of competency; Licenses for the aircraft personnel and the nationality of the aircraft. See Article 33 and 32(b) of the Chicago Convention, 1944.
said agreement. Hence the inclusion of transit rights under the bilateral agreement is merely a matter of confirmation.89

Regarding the commercial rights, the designated carrier of either Party shall retain, as their primary objective, the provision of capacity adequate to the traffic demands between the country of origin and the country of destination on the route(s) specified in the Annex to the agreement. In respect of the fifth freedom traffic, it confers on the designated airline the right to embark or disembark, on such services, international air traffic, destined for or coming from third countries at point(s) on the routes specified in the Annex to the agreement.90 However, this operation has to be carried out in accordance with the "general principles of orderly development". The exchange of commercial freedoms is applicable exclusively to international traffic and would not necessarily comprise the cabotage


90 See Clause (6) of the Final Act of the Bermuda Agreement 1946, n.66.
and grand cabotage.91 There would practically be no ostensible reason to restrict the exchange of commercial rights except in situations where the parties vie with each other to profit from the traffic.

Additionally, States specifically agree on certain services and facilities such as the charges for the use of airport, navigational and other facilities, procedure for the designation of airports and airways available for the operation of services and associated facilities and reciprocal exemptions from custom duties for aircraft fuel, spare parts, food and other catering items etc. These are ancillary to the international air navigation chiefly of administrative nature and, related mainly to the organisation of flight operations.

B. Designation of an Airline

Bilateral air agreements regulate the right to operate aircraft and carry traffic by the 'designated' airline. For this purpose, States parties to the

91 See Article 7 of the Chicago Convention 1944.
bilateral air service agreement designate one or more of their airlines authorised under its national laws, in accordance with the rights granted by the foreign government. In this regard, the designated airlines are also required to satisfy the aeronautical authorities of the contracting parties that they are qualified to fulfil the conditions prescribed by or under the laws and regulations normally applied by these authorities to the operators of commercial air carriers. \(^92\) Generally each contracting State designates as many of its airlines as it likes to operate on any specified route. However, majority of States prefer to limit the right to designate only one airline on each side, since the countries with a single international airline usually insists on designation of only one airline by each party to avoid unfair competition from multiple designations by the other party. \(^93\) Another major qualification for designation of an airline is that the said airline must be 'substantially owned and effectively controlled' by

\(^{92}\) See Article (2) Para (2) of the Bermuda Agreement 1946, n.66.

a national of the designating State. The "substantial ownership and control clause" is normally referred to in almost all air service agreements to overcome the problems arising out of the eventuality of leasing of aircraft from a third State for the purpose of operating international service. This is because, under the leasing arrangements where the relations between lessor and lessee will be governed by the terms of lease, the operation of air services by lessee is likely to be influenced by mercantile tendencies.

C. Regulation of Capacity

The bilateral air service agreements provide various methods and means for the regulation of capacity in exercise of traffic rights on the agreed route by the designated airline. It depends largely on the circumstances and the negotiating parties. The purpose of incorporating a 'capacity clause' in a bilateral agreement is to determine the scope and extent

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94 If one party insists for a particular method then the other party has no choice except either to accept the same or to break-up the negotiations.
of the exercise of traffic rights agreed upon mutually by the contracting parties. Capacity as a clause has been clearly understood as follows:

a) In relation to an aircraft: it refers to the payload of the aircraft available on the route or a section of the route;

b) In relation to a specified service: it means the capacity of aircraft used on such service, multiplied by the frequency operated by such aircraft over a given period and route or section of route.95 A majority of the bilateral agreements usually follow one of the following three systems for the regulation of capacity.

(a) Pre-determination: (totally restrictive)
(b) Bermuda I type: (controlled competition)
(c) Free-determination: (non-regulation).

The essential feature of any bilateral agreement regarding capacity control is the regulation of national

95 See Bin Cheng, n.68, pp.411-12.
traffic as the primary criterion and the traffic other than national traffic as just supplementary. The regulation of capacity involves various considerations, such as the need for development of national aviation, geographical position, traffic generating capacity and traffic attracting capacity etc., which vary from country to country and region to region. This necessitated the countries to follow strict guidelines which are laid down by the International Civil Aviation Organisation (ICAO) periodically, in reaching an agreement on the capacity clause in a bilateral agreement.⁹⁶

Though a different set of guidelines is enunciated for each of the different kinds of agreements, the criteria to be followed to achieve the objective of any agreement are common and are as follows:⁹⁷
(a) capacity should relate closely to demand in a flexible manner;


⁹⁷ ibid., pp.18-21.
(b) capacity to be provided should primarily be
governed by the demand for traffic between the
territories of the two contracting parties;
(c) 'equality of opportunity and mutual benefit' for
the carriers of both countries concerned;
(d) development and expansion of air transport on a
sound economic basis and in the public interest;
(e) match traffic with airport and airway capacity, to
make efficient use of human and material resources
and to protect the environment from air and noise
pollution;
(f) harmonise the provision of non-scheduled and
scheduled capacity in relation to total demand.

These guidelines are considered as a sort of 'pious
homilies', left to the discretion of the negotiating
state.98

(a) Pre-determination Capacity

Under this method the contracting parties determine
the capacity clause well in advance, specifying the type

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98 See William E.O' Connor, Economic Regulation of the World's Airlines: A
of aircraft, frequency of services and in some cases the number of seats that may be available. While doing so, the contracting parties shall take into consideration, the reasonable load factors adequate to meet the traffic requirements between the territories of the two contracting parties. However, in certain circumstances the supplementary capacity will also be permitted according to the anticipated traffic requirements. The main objective of this method is to allow a fair and equal opportunity to the designated airlines of both contracting parties, to achieve equality and mutual benefit, usually by equal sharing of total capacity between the contracting parties. Thus, this method is intended primarily to protect one's own airline from the competition of stronger airlines.

(b) Bermuda I Method

Majority of the bilateral agreements follow this method, which prohibits the pre-determined limits and

\[ \text{See ICAO DOC.9297/AT Conf.2 (1980), p.15 and also see ICAO Circular on capacity clause, n.96, p.18.} \]
allows each airline the freedom to determine its own capacity based upon its analysis of market operations. However, it is subject to ex post facto review by governments through consultations. In its endeavour to provide a healthy competition, the designated airlines shall pay due consideration to the following general principles in drafting the capacity clause:

(1) The designated airlines of both the parties shall have a fair and equal opportunity to 'compete';

(2) The designated airline of each party shall take into consideration the interests of the other contracting party so as not to affect unduly their opportunity to provide service;

(3) The air transport facilities available to the travelling public should bear a close relationship to the requirements of the public for such transport.

\[100\] ibid., and also see Bin Cheng, n.68, p.426.

\[101\] See ICAO Circular on Capacity Clauses, n.96, p.21.
Regarding the entitlement of traffic, this method enables the carrier to offer capacity which is not only adequate to the traffic demands between the country of origin and destination, but also allows it to carry the third country traffic at a point/points specified in the route agreement.\(^{102}\) However, the embarkation and disembarkation of third country traffic is subject to the general principles, as provided in clause (6) of the Final Act of the Bermuda Agreement, 1946.\(^{103}\)

It clearly shows that the Bermuda-I type provides a regime of controlled competition instead of unfettered freedom to balance the competitive strength of each side. It was rightly said that, the Bermuda principles accommodate, to the general good, the legitimate economic interests of all nations engaged in international air transport.\(^{104}\)

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\(^{103}\) ibid., p.406; and also see ICAO circular on capacity clauses, n.96, p.21 and also see H.A. Wassenbergh, *Post-War International Civil Aviation Policy* (Dordrecht: Martinus Nijhoff Publications, 1962), p.54.

(c) **Free-determination Type**

Under this method the determinations regarding capacity and demand are left to the entire discretion of the airlines. However, the free-determination type, does not necessarily require that the capacity and demand should bear a close relationship with each other.\(^{105}\) Though the governments in pre-determination method agree to abrogate their direct control on capacity and unilateral restrictions on the volume of traffic, frequency, or regularity of service or type of aircraft, but they can still influence indirectly the airlines' determinations on capacity through various other issues such as designation, pricing, charters and consultations.\(^{106}\) The contracting parties in this type of agreements, assure the development and expansion of air transport on a sound economic basis and in the public interest relying on the free play of market

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\(^{105}\) See the ICAO DOC. on WATC, n.96, p.26.

\(^{106}\) ibid., and also see The Report of the Third Meeting of the Panel of Experts on Regulation of Air Transport Services (ATRF), (Montreal, 1978), p.18; and also see ICAO DOC. 9297 AT Conf./2, Special Air Transport Conference (SATC), 1980, p.15.
forces.\textsuperscript{107} Obviously, the public interest here denotes the consumer benefit rather than the viability of the airline. Hence, ideally this method is more advantageous and beneficial to the countries having strong airlines and possessing tremendous traffic potential instead of relatively weaker airlines with scarce traffic potential. This is the reason why only a few of the bilateral agreements have based themselves on this method.

D. Regulation of Route Schedule

Route specification in a bilateral air service agreement is another subject of great concern, that necessarily comes in the context of the consideration of capacity control. Here, each contracting party agrees to the specification of various points which would be served by the designated airline on the agreed route(s). It includes not only the point of origin and the point of destination within the contracting parties but also the intermediate points situated in third countries. It

\textsuperscript{107} ibid.
implies that the traffic rights that are granted to a contracting party can only be exercised on the agreed points on a specific route. It naturally restricts the airlines market operations to a particular route, a situation which may not be acceptable to the stronger airlines. Since, the position of the State, its market size and the competitive strength of the airline generally influence the allocation of route(s), the States in geographically disadvantageous positions with weak airlines usually resort to a restrictive route scheduling. The problem of route allocation is further complicated in regard to granting of a point beyond homeland of a contracting party or in granting point(s) of call reciprocally between the contracting parties. Usually these points will be granted, without granting the right to exercise traffic rights either to point beyond homeland and between two points of call in the territory of a contracting State. Either way such a practice may hinder the successful commercial operations.
E. Regulation of Tariffs

Levying of tariff is another area of disagreement about which the Chicago Convention is absolutely silent. It neither defines what the tariff is, nor specifies any clear-cut mechanism for fixing of tariffs. Eventually, States took up these issues as an exercise of national sovereignty. The establishment of the International Air Transport Association (IATA) in 1945 as a multilateral forum for tariff negotiations came as a great relief to States. Otherwise the actions of States in individual capacity would have resulted in a multitude of tariff arrangements. Tariffs agreed at the multilateral level or at the bilateral level or sometimes at the regional level are normally subject to the approval of relevant governments.

In practice, States during their bilateral negotiations generally resort to one of the following three types of bilateral tariff-clauses:

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108 See the ICAO Doc. on WATC, n.96, p.69.


110 See J.G. Gazdik, "Tariff Conference Machinery", IATA Bulletin, no.15, 1952, p.64; and also see ICAO Doc. on WATC, n.96, p.69.

111 See the ICAO Doc. on WATC, n.96, pp.69-75.
(a) **Double approval Clause**

Majority of the bilateral agreements incorporate a double approval of tariff clause, under which the tariffs to be applied shall be first agreed by the designated airlines of both contracting parties. The tariffs thus agreed by the designated airline shall be made effective only after the approval of both the government authorities. In case of any difference regarding tariffs, the bilateral agreement itself provides various consultative provisions which either party may invoke. In case of failure, the dispute may also be resolved by resorting to arbitration.

(b) **Country of Origin clause**

The tariff establishment under this clause is more flexible than under the double approval approach. The country of origin approach, regulates only those tariffs for carriage originating in the territory of the party concerned. Under it, each of the parties have no unilateral power either to prevent the implementation of
proposed tariff or the continuation of effective tariff, commencing in the territory of the other party.

The interesting feature of this approach relates to the consultation procedure in the event of disagreement over tariff. Usually a party can only disapprove tariff or carriage originating in its own territory, but either party may request for consultations. However, in the case of disagreement, the decision of the party in whose territory the carriage originates shall prevail, with no recourse to arbitration. This clause generally appears in the case of non-scheduled airline operations.

(c) Double-disapproval Clause

In contrast to the other two clauses, this approach is more liberal, as it provides absolute freedom to the designated airline or airlines of the contracting parties to fix tariffs. The tariffs thus agreed will be ipso facto regarded as approved unless the other contracting party disapproves the tariff and indicates its disapproval within a reasonable stipulated time. As
in the country-of-origin approach, under this clause
also no contracting party shall take unilateral action
to prevent the implementation of a proposed tariff or
the continuation of the effective tariff. Under this
clause neither party can disapprove a tariff even if it
appears to be objectionable and can request for con-
sultations. However, in the event of disagreement
between parties, the third and fourth freedom tariffs
prevail with no recourse to arbitration. The fifth
freedom tariffs will also prevail unless disapproved in
terms of the bilateral agreement.

Various bilateral agreements that followed soon
after the Bermuda Agreement became the basis for
international air service operations. In fact a wide
spectrum of bilateral agreements variously modified the
Bermuda language so as to fulfil their own policy
objectives. In other words these bilateral agreements
carried the letter of Bermuda agreement, but not the
spirit of it. The flexibility inherent in Bermuda
language and the lack of capacity control had enabled
the pragmatic view of the American carriers and
Government to prevail over the skepticism of the smaller airlines. States with larger air traffic market continued their expansionist tendencies at the cost of small countries, and the smaller countries wanted to protect their own traffic from being exploited by the former. Thus, the conflict between liberalism versus protectionism resurfaced, which ultimately pushed the Bermuda principles into obsolescence.

VI. BERMUDA-II AGREEMENT

The above confrontation between States which wanted more freedom and those who were unwilling to grant unrestricted freedom led to the denouncement of Bermuda I Agreement on 22 June 1976.\(^{112}\) The main contention of the UK was that the extensive US carrier traffic rights beyond London enabled US airlines to exercise unrestricted fifth freedom rights between London and almost all points in Europe, Asia and the Middle East, thus depriving British airlines of their passengers and

consequent profits to the advantage of the US carriers.\textsuperscript{113} Since there was no other alternative for the exchange of commercial traffic rights except through bilateral agreements, the US and the UK entered into a new bilateral agreement to resolve the existing crisis. Hence the Bermuda-II agreement, which was signed on 22 June 1977.\textsuperscript{114}

The following are the important features of the Bermuda II which brought about some fundamental changes in the existing regulatory structure.

(a) The new agreement has abandoned the system of multiple designation of air carrier. Under the new agreement the US was permitted to operate only two carriers, i.e. PANAM and TWA.\textsuperscript{115}

(b) Regarding the capacity provisions, the Bermuda II incorporated service restrictions especially on fifth freedom rights. The earlier agreement did


\textsuperscript{114} See the Air Services Agreement between the US and the UK signed on June 22, 1977, TIAS no.4782 as amended TIAS No.6796, as amended TIAS No.8642.

\textsuperscript{115} ibid., and see Article 3, paragraph 2(a) of the Bermuda 1977.
not have specific limits on capacity where the relevant airlines were given the freedom to determine the extent of exercise of specific rights subject to *ex post facto* review by the relevant States. Despite the excessive use of fifth freedom rights and over capacity under Bermuda I, the Bermuda II incorporated the same old principle.\(^{116}\) The efforts of UK to incorporate 'predetermination' capacity principle failed to gain support.\(^ {117}\) However, the significant achievement in the Bermuda-II is that it permits the governments to challenge the individual judgments of operators and to suspend within certain limits the increased capacity. For the first time under Section 5 of Annex I of the Bermuda II the Sixth freedom traffic has been sanctioned.

(c) As far as tariffs are concerned, the Bermuda-II reiterates the same 'double approval' system, with little addition. Under Article 12 of the Bermuda-

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\(^{116}\) *ibid.*, and see Article II of Bermuda 1977.

\(^{117}\) See Bridges, n.112, p.12; and also see P.P.C. Haanappel, "Bermuda II, A First Impression", *Annals of Air and Space Law*, vol.2 (1977), p.143.
II, each tariff shall, to the extent feasible, be based on the cost providing such service... which seems to be eminently reasonable. It also provides for a 'tariff working group' to make recommendations and other rate making criteria for the contracting parties in reviewing IATA tariffs by verifying financial and traffic statistics,\textsuperscript{118} based on reasonable load factors.\textsuperscript{119} Tariffs for the scheduled airline services shall be established "at the lowest level consistent with a high standard of safety and an adequate return to efficient airlines operating on the agreed routes."\textsuperscript{120} In the exercise of the fifth freedom traffic rights, acceptance of both the foreign states and the home state is mandatory for the approval of tariffs.\textsuperscript{121}

(d) With the imposition of heavy restrictions on capacity and on fifth freedom traffic rights,

\textsuperscript{118} See Annex III Paragraph (3) of the Bermuda 1977, n.114.
\textsuperscript{119} See Annex III, Paragraph (4) of the Bermuda 1977, n.114.
\textsuperscript{120} See Article 12, Paragraph (2) of the Bermuda 1977, n.114.
\textsuperscript{121} See Article 12, Paragraph (3) of the Bermuda 1977, n.114.
significant changes have been made regarding route allocation in the Bermuda-II Agreement.\textsuperscript{122}

Despite the best efforts, the Bermuda-II has been less successful in resolving differences. In the US, the Bermuda II has been criticised severely. The US carrier PANAM stated that "the new agreement transfers net economic benefits from the US carriers to the UK carriers".\textsuperscript{123} It was also argued that, "the US should terminate the air services rather than submit to the UK demands, realising how politically and economically severe the service cut off would have been for the British with the decrease in US tourism.\textsuperscript{124}

These criticisms of the Bermuda-II Agreement reflect the US frustrations on its failure to get more concessions so as to operate in a free environment especially over the North Atlantic Route. The detailed provisions regarding the exchange commercial rights on
the basis of 'fair and equal opportunity' principle and of tariffs in accordance with the tariff procedures approved by the US Civil Aeronautics Board (CAB) seem reasonable to the circumstances of 1977 and the expectations of the travelling public.\textsuperscript{125} The point of dissatisfaction with the Bermuda-II might be that it stipulates various conditions to exercise the above mentioned commercial rights. The restrictions later came to be used as a pretext by States to deviate from the Bermuda-II, so as to achieve the ambitious goal, i.e., free competition. Still it is doubtful whether the Bermuda-II will serve as a model for the subsequent bilateral agreements as the Bermuda-I. The answer appears to be in the negative. Unlike the Bermuda-I, the latter exclusively geared to the Anglo-American relations rather than to global aviation community.\textsuperscript{126}

The Chicago-Bermuda regime that provided a regulatory regime was rejected as a consequence of power

\textsuperscript{125} See Bridges, n.112, p.13.

\textsuperscript{126} See Haanappel, n.117, p.148.
struggle in bilateral negotiations.\textsuperscript{127} It is quite apparent that the efforts to evolve a liberal regime for shaping global aviation policies were vitiated by the individual interests of States to ensure a share of benefits arising out of air transport. These expectations and aspirations of each State figured in a renewed conflict between 'freedom of the air' and 'order of the air'. Ultimately, the equality of opportunity and sound economic operation of air transport have become the guiding principles for the 'order of the air' under the Chicago-Bermuda regime, which is in fact a basis for shaping post-war aviation relations. In the recent past, the bilateral regulatory regime was severely criticised because of its restrictive tendencies in operating international air services. The "bilateralism" based on the Chicago-Bermuda regime, drafted under different socio-political conditions and for different technological and economic frameworks, may not address the new legal challenges facing international civil aviation today. In the wake of

emerging new forces, the economic interdependence of States has become more critical which requires more global co-operation. The existing regime mainly intends to protect national interests of states and of their national airline, has lost its relevance in the present day context. S. Bhatt while sharing the same view declares that the basic principles of air law emanating from the beginning of this century seem somewhat outmoded for the requirements of contemporary international society.\textsuperscript{128} He opines that aviation law has not kept pace and does not seem to be geared adequately to the problems associated with mass air transportation.\textsuperscript{129} The factors which necessitated a change in regulatory regime and its impact in international air transportation will be the centre of focus in the following chapters.

\textsuperscript{128} See S. Bhatt, Aviation, Environment and World Order (Radiant Publishers, New Delhi, 1980), p.16.

\textsuperscript{129} Ibid.
CHAPTER III

DEREGULATION AND LIBERALISATION OF INTERNATIONAL AIR TRANSPORTATION

The establishment of international airline operations, as seen earlier, has always been regulated by an intricate network of bilateral air service agreements between States. Undoubtedly, the bilateral air service agreements, over time, have contributed to the sound, economic and orderly development of air transport while safeguarding the interests of States. The principal objective of these agreements has been to secure a fair share of traffic for the airlines of each State. This in fact underscored the importance of various regulatory measures such as control over capacity and the regulation of tariffs to be charged by the airlines. However, States have been dissatisfied with the process of bilateral negotiations, commonly referred to as 'horse trading' or 'exchange of restrictions' and consequently they resort to circumventing of the Bermuda Principles. The major
deviation from the existing system resulted in the relaxation of regulatory control on the North Atlantic routes, on other routes to and from the United States, and on certain routes in Europe.\(^1\) The basic argument in support of the 'change' is that the economic liberalisation, rapid transformation of aviation technology and enormous growth in the size of the traffic, require a more liberal aviation regulatory regime rather than a system of bilateral bargaining.

The existing regulatory system (bilateralism) has, nevertheless, strengthened government control over the operation of scheduled international air transportation thereby providing only a minimal opportunity for free competition. Moreover, it also denied the freedom of choice for the travelling public. It is rightly pointed out that the existing system protects the carrier and its interests rather than the passenger.\(^2\)

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Another major factor that induced a shift from the existing bilateral system, is the process of bilateral negotiations which is too cumbersome and has inherent constraints which are so formidable. States allowed their carriers to operate international air services according to a policy which best suited their interests. The question now is, why is there an increase in restrictions with the increase in growth of air transportation? A plausible reason is the lack of homogeneity in global economic growth which influences the aviation technology, aviation market and the utility of air transport. Consequently, given the unequal economic situation, countries with comparatively less efficient carriers would be in a disadvantageous position, if they did not impose restrictions or conditions on foreign competitors in order to protect their own national airlines. Today States require an adequately liberal regime in contrast to what they have under bilateral regulatory regime. However, it does not imply an absolute freedom or absence of restrictions to

operate international air services. In fact, it has never existed as such.⁴

The economic aspects shaping the future of international air transportation today, are largely influenced by two diametrically opposite philosophies, namely, the protectionist approach and the liberal approach.⁵ The former favours regulation intending to encourage equal share in the traffic while the latter prefers to allow free and competitive market forces to prevail. In the present situation, the liberal approach is gaining importance in a bid to rectify the perceived imbalances in the distribution of economic benefits, which States have identified under the bilateral regulatory regime. A major foreseeable consequence of this change coupled with other parallel developments, will be an acceleration towards a 'liberal multilateral regime' to operate scheduled international airlines on the basis of the principles of free market economy. It

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⁴ Freedom of the air has in practice denotes exceptions to the principle of non-freedom.

⁵ See the Report of the Session on Recent Developments in Air Law, conference held at Utrecht on 18 October 1984. cf. Air Law, vol.X, No.3 (1985), p.183. This conference was organised jointly by the Netherlands Institute of Transport (NVI) and Utrecht University (Post-Academical Education).
has been speculated that liberal multilateralism will provide an institutional vehicle which works equally for both large and small States. A basic issue which deserves consideration here is, why do States prefer a multilateral approach over bilateral regimes? Whether these changes will indeed serve the best interests of the travelling public as well as the industry or whether they will aggravate the difficulties of smaller airlines which are already experiencing hardship in developing States, is the key question. An analysis of various trends and their underlying reasons, therefore, is of particular importance in the changing scenario. This calls for examination of two categories of issues:

(a) The growing dissatisfaction with the existing bilateral regimes (Bermuda-I in the light of Bermuda-II);

(b) The development of new forces directing the international airline industry towards a free enterprise position.

I. THE DISSATISFACTION WITH THE EXISTING REGULATORY REGIMES

The existing regulatory system is based on the Chicago-Bermuda regime. The numerous bilateral agreements that followed after Bermuda, incorporated provisions even sometimes extraneous to the Chicago-Bermuda Regime, and in that sense deviated from it. The point of dissatisfaction is that the 'flexibility' which was the core of Bermuda-I contributed to certain misgivings which prompted States with nationalistic and restrictive philosophies to adopt a protectionist approach, while those advocating more freedom took a liberal approach. The following features of a bilateral agreement have become an enigma to States and are subjected to variant, mutually disagreeable interpretations:

A. The principle of equal opportunity;
B. The principle of reciprocity and quid pro quo basis;

C. The capacity clause and its control;
D. The problem of 'Beyond Rights'; and
E. The Regulation of Tariffs (fares and rates).

A. The Principle of Equal Opportunity

During the Chicago deliberations in 1944, States agreed to establish international air services on the basis of equality of opportunity and operate them on sound economic principles. Later this was reaffirmed in the Final Act of the U.S. and UK Bermuda Agreement. The main objective of the principle was to ensure an equitable exchange of overall economic benefits derived by operating scheduled air services by giving an equal opportunity for the airlines of both States to serve the interests of the public. The rationality of the principle should be adjudged against the totality of the agreement while taking into consideration the political, social, cultural and economic diversity between both the

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8 See the Preamble of the Chicago Convention 1944, ICAO Doc. 7300/6, TIAS No.1591, 15 UNTS 295.

9 See clause (4) of the Final Act of the UK and U.S. Bermuda Agreement 1946, TIAS No.1507 (1946), pp.18-19, and 3 UNTS 254.
States. Apparently the validity of the principle has never been challenged; nevertheless, it has been subject to varied interpretations. The uneven growth of air traffic market as well as the geographically advantageous position of some states and the increase in the air transport operations by many newly emerged nations, brought about significant changes in the application of the principle. States having a sizeable traffic market with a high traffic generating capacity, manoeuvred the principle in such a way as to capture a considerable chunk of the traffic in contrast to states with lesser traffic generating capacity. For instance, the U.S., one of the biggest air traffic markets in the world, interpreted the principle on similar lines. In the words of Harold A. Jones, the then representative of the U.S. to the ICAO, "the sacred Bermuda principles were fine in 1946 when we generated about 70% of the trans-Atlantic and trans-Pacific traffic and carried about 80% of it; ... and now these principles exposed the great U.S. traffic market to dozens of international airlines of the nations, many of which generated little traffic, are operating chiefly for reasons of politics
and pride and are dependent on American tourist dollar".\textsuperscript{10} Today many small countries are conducting operations in air transportation with very little traffic market and economic ability. For them national prestige and pride no doubt plays a substantial role in sponsoring national airlines, but this is subsidiary to the underlying economic rationale. Lowenfeld, generally a strong critique of Bermuda, holds that "it [Bermuda Principles] is no longer a holy writ" and in particular criticises the principle of equal opportunity as a rule "susceptible to misrepresentation".\textsuperscript{11} While clarifying the American interpretation, he opines that this principle amounts to be 'a discrimination' in essence and not an 'affirmative action' clause.\textsuperscript{12} He suggests that "the carriers of the contracting parties... shall have equal opportunity to compete for traffic... and no law, regulation or administrative action of either contracting party shall discriminate among carriers

\textsuperscript{10} See Jones, n.7, p.234.


\textsuperscript{12} ibid., p.5.
operation". The analogy on which he frames his suggestion seems relevant only in a situation where the two contracting parties are equally strong, and have equal market strength as well as equal resources. In the absence of such a situation, application of the equal opportunity principle to states not having equal ability to compete with each other is nothing but a travesty of justice. The interpretation of the equal opportunity principle as an "opportunity to compete" would definitely be an added advantage to the stronger and deny the weaker an equitable share in the benefits of commercial aviation.

B. Reciprocity or quid pro quo basis

The international air transportation has been conducted on the reciprocity based bilateral agreement. However, in certain cases the exchange of traffic rights have also been granted unilaterally. With the failure of the Chicago Conference to realize the five freedoms to operate international air services on a multilateral

13 ibid., p.6.
basis, States resorted to *quid pro quo* bilateral negotiations to exchange the commercial freedoms. Reciprocity here denotes the admission of a foreign carrier into the national market of a state in return for that state’s own carrier’s admission to the foreign market, i.e., strictly on a *quid pro quo* basis. The primary purpose of introducing reciprocity as an approach was to provide an opportunity to each partner in the negotiations to strike a balance between the rights to be exchanged while safeguarding their own interests and those of the national airlines.\(^\text{14}\)

However, as the recent trends indicate, reciprocal bargaining has been subjected to the influence of various factors such as:\(^\text{15}\)

- the bargaining power of the state,
- the volume of the air traffic market, and
- the potentiality of the national airlines.


While these factors certainly influence both liberal as well as protectionist states during the course of bilateral negotiations, neither of the states take into account the legitimate economic interests to give a reasonable interpretation to the Bermuda principles. A protectionist policy aimed at obtaining an equal share of the traffic on the route to and from the home country, whereas a liberal policy allowed commercial competition to determine market shares. The situation has become more complex by claims of ownership over air traffic by states, which served the dual purpose of protecting the national airline and promoting the international civil air transportation. Obviously, if we justify the ownership of the traffic by developing states in the light of the claims of a new international economic order the objective of promoting international air transportation will be under serious threat.16 At the same time, the commercial competition unleashed by market forces to a considerable extent, would be dominated by carriers which have an advantage of

efficiency and competency over the counterparts. Moreover, the scenario would be more unjust, wherein the very survival of the smaller airlines will be at stake, if the competition is not healthy, or is rather destructive, in the total absence of regulation. However, this does not automatically justify clamping down of protectionist policies if states impose too many restrictions. In other words, a measure of control is extremely essential in order to attain rational objectives and the possession of a national airline is an indispensable element of such control. Hence, the operation of international air services, from the point of view of the developing countries, where the technology is not so advanced, is still a matter to be determined by balance of benefits, mutually comparable and relatively beneficial in competition terms, if not proportional.

C. Capacity Controls

Regulation of capacity, as it is rightly pointed out by Stoffel, is another controversial factor yet to
be resolved. The bilateral agreements are not confined to any single pattern of capacity regulation. In fact, as discussed in the preceding chapter, the bilateral agreements encompass various kinds of 'capacity controls'. The majority of the bilateral agreements usually follow 'Bermuda I method' which is a compromise between the U.K.'s predetermination type and the U.S. liberal approach. The capacity regulation under the 'Bermuda method' is based on general principles, giving ample opportunity to the designated airline to determine the capacity and frequency of flights on their air routes. However, it is subject to ex post facto review, in the event of dissatisfaction in determining such capacity by the carrier. These general principles are subject to divergent views due to lack of consensus among parties as to the meaning and its application. The Bermuda agreement empowers the designated airline to retain as their primary objective

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18 See Chapter II, The Evolution of Bilateral Regulatory Regime in International Air Transportation, Section V, Sub-Section (C), pp.72-84.

the provision of capacity adequate to the traffic demands between the country of which such airline is a national and the country of ultimate destination of the traffic. This strictly implies that the carriers are primarily entitled to third and fourth freedom traffic, i.e., the origin and destination traffic and not the traffic from third countries. This principle holds good only when the two states have an equal traffic generating capacity. The stronger states claim for a share in the traffic equal to the amount of traffic it generates, while the weaker, in retaliation, resort to imposition of restrictions, to ensure a share of traffic for its own airlines. Thus, among unequal parties, it is difficult to foresee an agreement that guarantees mutually proportionate benefits for both the parties. This ultimately has led to deviations from the Bermuda-I method. As an alternative, the predetermination of capacity was put into practice. This granted eligibility for a 50-50 share in the traffic, which was not accepted by States upholding liberal aviation

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policy. The United States, a staunch supporter of open competition, reaffirmed its faith in the Bermuda capacity principles and criticised the predetermination of capacity as it was against the liberal development of international air transportation. The problem was further complicated with the recognition of 'beyond rights' in international air transportation.

D. The Problem of Beyond Rights

Stoffel defines 'beyond rights' as "the rights granted in a bilateral air agreement for carriers of one or both parties to fly to a point in the country granting the right and beyond to points in any other country". These rights are usually categorised as fifth freedom rights. Under a typical Bermuda bilateral agreement, the carrier is primarily entitled to the traffic between the countries of origin and destination.

21 See Ralph Azzie, "Second Air Transport Conference and Bilateral Agreements", Annals of Air and Space Law, vol.5 (1980), pp.8-10, which provided the objectives and guidelines for predetermination capacity regulation. For details see Chapter II, n.18, pp.75-87.

22 See Stoffel, n.17, p.130.

23 See ibid., p.128.
(i.e., 3rd and 4th freedom traffic). Regarding the traffic between third countries *en route*, the carrier of a given state on the specified route has only a "secondary entitlement". This traffic shall be subject to the general principles of capacity laid down in the agreement.²⁴

This clearly implies that the Bermuda capacity principles, though prohibiting predetermined limits on capacity, permit capacity restrictions on secondary justification traffic. It is primarily due to the involvement of third parties for the carrying of secondary justification traffic and secondly, the varied interpretation of the Bermuda capacity formula regarding what constitutes fifth and sixth freedom traffic. The fifth freedom traffic denotes the carriage of traffic between two foreign countries without touching the home country. The invention of long-range aircraft eliminated the need to land in intermediate points, thus reducing the need for fifth freedom rights 'en route'.

²⁴ See Bermuda Agreement 1946, TOIAS No.1507 and 3 UNTS 253, Final Act, Para (6) and also see Andreas F. Lowenfeld, n.11, p.17.
It, however, increased the need for feeder traffic to/from the starting point of a long-haul service, which is sixth freedom traffic, and to/from the terminal point of the service for additional third and fourth freedom traffic.

The bilateral agreements between the U.S. and foreign governments which have been taken up for reconsideration during 1950-62, primarily aim at preventing the carriage of excessive volumes of traffic under fifth and sixth freedom rights, especially with Germany, Australia and the Netherlands. In all these cases, the U.S. carriers complained that the U.S. "received less than it gave away" and considerations extraneous to the exchange of traffic rights had entered into the agreement making process.25

In another instance, especially on the North Atlantic route the U.K. allowed the U.S. flag carrier to exercise the fifth freedom rights under Bermuda I

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Agreement. In this connection the U.K. strongly protested against the excessive exercise of fifth freedom traffic rights by the U.S. carriers from London to almost every point in Europe, thus depriving the British carriers of "their" market. In the British view, the abuse of the exercise of fifth freedom traffic rights by USA was mainly due to the liberal philosophy of the Bermuda-I approach and hence the UK denounced the Bermuda I on 23 July 1977.

Generally, the traffic which is fifth freedom to one country is third and fourth freedom to the two foreign countries concerned. Hence, it has been rightly pointed out that the granting and denial of fifth freedom traffic is extremely difficult and the limitations imposed thereon depends on how much this may impair the third and fourth freedoms, constituting the primary interests of other parties.

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26 See Aviation Week and Space Technology (New York), July 5, 1976, p.29.
28 See Khairy El-Hussainy, n.15, p.129.
Another aspect of the "third country" rights is the sixth freedom traffic which refers to the carriage of traffic between two foreign countries via the home country. This right is referred to as "behind" - country traffic. The crux of controversy regarding sixth freedom lies in its meaning. Bin Cheng opines that the sixth freedom is merely a combination of fourth and third freedom secured from two foreign countries, producing the same effect as fifth freedom vis-a-vis both foreign countries.\textsuperscript{29} This implies that the sixth freedom rights are a qualified version of fifth freedom rights and as such subject to Bermuda-I capacity restrictions. In fact, the U.S. interpretation also followed the same lines, where it considers this traffic as fifth freedom,\textsuperscript{30} whereas States like the Netherlands and Belgium treat sixth freedom as, fourth freedom for traffic coming into their homeland and third freedom while leaving.\textsuperscript{31} The U.S. interprets the sixth freedom traffic as a mere fifth freedom and thereby brings such

\textsuperscript{29} See Bin Cheng, n.14, p.13.

\textsuperscript{30} See Stoffel n.17, p.130 and also see the ICAO DOC.7586 C/863, June 24, 1955, p.65.

\textsuperscript{31} ibid.
traffic within the perview of Bermuda restrictions under the category of "secondary entitlement traffic". 32 The pragmatic approach of the U.S. is also based on its geographical location, where the liberal approach is not advantageous to the terminal market, while it is usually beneficial to the transit states. For instance, the agreement between the U.S. and the Netherlands allowing KLM to carry sixth freedom traffic, in 1966, earned KLM an estimated amount of $9,273,000 from the U.S. as opposed to the $53,000 earned by the U.S. carriers from the Netherlands. 33 Hence, the excessive use of sixth freedom by European carriers was severely criticised by the US, which argued for an equal sharing of economic benefits on the basis of the equal opportunity principle. 34 The US for a moment ignored that a liberal approach cannot be based on a $ for $ exchange.

The European carriers refuted the American charges concerning the sixth freedom and termed sixth freedom

32 See Lissitzyn, n.25, p.256.
33 See Wassenbergh, n.20, p.20.
34 See Wassenbergh, n.20, pp.47-48.
traffic as a combination of fourth and third freedom traffic with respect to the carriers of home country and therefore not covered by the Bermuda restrictions. While supporting this argument, Wassenbergh explicitly states that "the traffic carried from or to a point not specified in the route schedule attached to the air agreement (off-route point), via a point on the route as specified, to or from the territory of the other contracting party, only for its on-route portion falls under the traffic to be considered when reviewing the capacity requirements which exists on that route". He in fact, questions the feasibility of using the so called "true origin and true destination" of traffic as criterion for the distinctions between the freedoms of the air.

Capacity regulation under Bermuda-I will depend largely on circumstances and vary from country to country. The constraints or restrictions of the Bermuda capacity clause mainly purports to shield the local

35 See Lissitzyn, n.25, p.256.
airlines against powerful trunk airlines (such as those of the U.S.) and generally against foreign competitors who in practice use predatory tactics. Moreover, the difficulties inherent in the language of the Bermuda capacity clause such as the difficult inherent in the language of the (a) the lack of precise definition regarding what constitutes traffic of origin and of destination, and (b) the lack of proper guidelines regarding the nature and carriage of traffic at stop over or intermediate points, forced states to apply strict controls on capacity to contain the imbalance in the distribution of benefits which would otherwise result. In contrast, the artificial restrictions will adversely affect movement of traffic, stifling the growth of tourism and depriving the travelling public of a freedom of choice.

In this regard, one remedial approach would be to collect and maintain adequate and consistent statistics

to aid the assessment of any discrepancies between capacity provided and that required on international routes. 38

E. Regulation of Tariffs (Fares and Rates)

Under the Bermuda regime the bilateral air service agreements contain the system of governmental approval of tariffs through the instrumentality of International Air Transport Association (IATA) for the setting of scheduled international air fares and rates. In fact, though IATA fixes fares, it is a non-governmental organisation, being an association of member airlines and what they decide in the tariff conferences is subject to government approval. Tariffs for scheduled air services "shall be established at the lowest level, consistent with a high standard of safety and an adequate return to airlines operating on the agreed routes, and shall be based on the costs of providing a particular service "assuming reasonable load factor". 39

38 See the article "Obstacles to development defined, remedies proposed", ICAO Bulletin, (Montreal), July 1986, p.37.

39 See Annexure II, Para (h) of the Bermuda Agreement (1946), n.9.
Such tariffs shall first be agreed upon between the designated airlines from both states and followed by the approval of both governments. This system is called the double approval system. This system induces increased intervention of governments in the fixing of fares thereby curtailing the freedom of carriers to decide the establishment of fares. Moreover, it was specifically mentioned in the Bermuda tariff clause that the agreed tariffs should be pegged on the cost of operations. The cost of operations differs from country to country, region to region, and even airline to airline. For instance Switzerland refused to approve People’s Express’ low fares. The spectacular growth and performance of jet aircraft have reduced the costs of operation of world airlines especially in the long haul services by one and half.40 Despite the sharp reduction in costs, the IATA normal prices were increased several times.41 This led to a ‘tariff war’ between the U.S. and IATA, since low fares is an added advantage

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41 ibid.
to the wide bodied jet aircraft especially on the lucrative routes such as the North Atlantic. This indirectly encouraged the supplementals, permitted split charters and introduced various 'classes' in the service, just to circumvent the requirements on the North Atlantic routes thereby exposing oneself to price competition. As an obvious development, in retaliation, states refused to accept a fare structure thereby preventing the introduction of new classes, such as business class or charter class which they perceived would adversely affect their national carriers. For instance, Venezuela refused to permit PANAM to offer business class fares in U.S.-Venezuela market since Venezuelan national carrier was unwilling to offer such

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42 The Statistics of ICAO shows that, the improvement in the performance of jet aircraft during 1960-70 has reduced the costs of operation of world airlines by one and half. See Review of the Economic Situation of Air Transport 1960-70, ICAO Circular 105-AT/26, 1971, p.42.

43 The split charter is a charter involving more than one charter where the capacity of the chartered aircraft is shared or split. See Manual on the Regulation of International Air Transport, ICAO DOC.AT Conf/4-WP-5, Section 4.6-7.

44 See Alexander T. Wells, Air Transportation - A Management Perspective (Belmont, California: Wordsworth Publishing Co., 1984), pp.493-494. The price competition is in fact more beneficial to the consumers rather than price regulation. K.G.J. Pillai, while referring to the price regulation, expresses that, "consumers would be better off if the airlines deprived of the protection granted by the CAB rate regulation." He also opines that "the actual operating costs of the US carriers are considerably less than their ZATA counterparts. If the international fares are brought into reasonable relationship with the cost of US carriers the public would be able to travel of one half of the price than they are now paying. See K.G.J. Pillai, "Consumer Protection in Aviation Rate Regulation", Journal of Air Law and Commerce, vol.32 (1972), pp.224-25.
service. Today the US no longer recognises IATA as tariff setting machinery on the North Atlantic route as in the eyes of the Americans, IATA was a cartel. Consequently, a different sets of air fares applied to North Atlantic routes. One of these was meant for the U.S. carriers, i.e., individual filings purely based on their merits and IATA fares for non-U.S. carriers. Today, in the wake of new trends and developments in global aviation, States have employed the double disapproval system. Under this system, approval of fares by the designated airlines is sufficient to hold. The control by governments under this system can only be possible if excessive or predatory pricing is feared. This system is referred to as "free pricing" and "price leadership" by Wassenbergh, who suggests that this system be allowed in those markets where all competitors operate under similar conditions and all have such price leadership rights; otherwise a carrier may be forced to match the tariff of a carrier enjoying such price leadership rights, where the tariff is unnecessarily too

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high or too low for it to make a profit.46

Another major anomaly in setting fares and rates lies with respect to the incentive scheme offer to passengers by many airlines.47 Some states hold the opinion that such incentives are part of international tariffs and require approval in accordance with bilateral air service agreements whilst some others do not favour any such approval.48 For instance, SAS prevented North West from offering first class accommodation to business class passengers. In this regard, the precise guidelines regarding what should constitute the concept of an "international tariff" is crucial. Various other issues such as "zone pricing system" and "currency conversion system"49 are still awaiting appropriate solution at the IATA. These issues, unless resolved, would undermine the viability of the already established and approved tariff

46 ibid., p.30.
47 Incentives such as frequent flyer programme, hotel discounts and discount on air fares.
structure. It is rightly pointed out that "the logic of tariff coordination and even the desirability of multilaterally agreed tariffs under the prevailing bilateral regime could not be ignored without doing substantial damage to the integrated network of airlines of different nationality."\(^{50}\)

No doubt, the incentives such as frequent flyer programmes [FFPs] will enable the airlines to utilise seats which would otherwise be flown empty and thereby reduce the operation costs, which in turn, would lower the air travel cost. But the FFPs in fact hook the passengers to the carrier, which reduces the intensity of competition and may lead to elimination of small competitors thus keeping the general level of fares above competition level.

The ever-increasing restrictions on the commercial rights in air transportation, was marked by growing discontent of countries over the bilateral regulatory regime. The main contention of the states against

\(^{50}\) See Wassenbergh, n.45, p.30.
regulation has been that it caused air fares to become considerably higher than they might otherwise have been. This further denied the consumers the range of price and service options which they would prefer to have, and the heavy bargaining power, on the basis of *quid pro quo*, stifled the growth of international air transportation. It is also argued that the global interests should be given predominance over the national interests and that the national aviation policies should be framed in such a way as to promote globalisation in the air transport sector rather than cartelisation. To achieve these goals and objectives, the process of 'liberalisation' and/or 'deregulation'⁵¹ of airline industry has been given a new thrust. The move presupposes that free market conditions will provide efficient air services, that meet the needs of the consumer. The choice between 'liberalisation' *vis-a-vis* 'Protectionism' appears to be cumbersome in the given geopolitical scenario. However, the process of liberalisation has gained considerable

momentum on the eve of new developments or changes in the international aviation. The following changes have essentially given a new dimension to the existing regulatory regime.

II. RECENT DEVELOPMENTS IN AIRLINE INDUSTRY

A. Domestic Developments in the U.S.

Since 1944, the U.S. has strongly favoured a policy of liberalisation and free-trade approach. This long cherished aspiration was realised with the promulgation of the Airline Deregulation Act 1978,\textsuperscript{52} It was Alfred Kahn, the then Chairman of Civil Aeronautics Board [CAB], who initiated the policy of deregulation. The Deregulation Act, which came into force after 1978, led to the winding up of the CAB, a regulatory authority for both domestic as well as international air transportation.\textsuperscript{53} The Deregulation Act provides that the CAB would no longer have authority over route-entry


\textsuperscript{53} It applies only to commercial aviation. It does not mean that the competency to fly any aircraft and certification of the safety of the aircraft are no more required. Such matters are still governed by FAA.
or exit, nor over airlines fares, and that the CAB itself was to be dissolved on 31 December 1984. With the suspension of CAB as an organisation, the U.S. Congress passed an enactment by which the regulation of air transportation was brought within the purview of U.S. Anti Trust Laws. Basically, the U.S. Anti-Trust laws were meant for regulating the commercial enterprises and industries. Hence under the now customary practice prevalent in the U.S., air transportation like any other commercial enterprise is

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55 Air transportation within the United States and between the United States and other countries until 1978 had been extensively regulated by the CAB under the Federal Aviation Act of 1958. The Federal Aviation Act was amended twice with the Promulgation of Airline Deregulation Act 1978 and again by the International Air Transportation Competition Act of 1979. The former was enacted for the purpose encouraging the deregulation of the domestic aviation industry, while the latter, for promoting competition in international air transportation, providing greater opportunities for the US air carriers and establishing goals for the US international aviation policy. Later, the Civil Aeronautics Board Sunset Act of 1981 (Sunset Bill) finally abolished the CAB no later than 1 October 1983 and transferred the regulatory authority, which is not eliminated, to the Department of Transportation. With the dissolution of the CAB, its authority to investigate and prohibit "unfair trade practice" was also eliminated. The exemption of foreign carriers from the operation of the Federal Trade Commission Act was repealed. The CAB's authority to conclude bilateral air service agreements between or among US air carriers and foreign carriers and to confer immunity from the anti-trust laws with respect to such agreements was transferred to the Department of Transportation [DOT] rather than the Department of Justice as under the Airline Deregulation Act of 1978. As a result, the Federal Trade Commission under Federal Trade Commission Act, is empowered to investigate and prohibit "unfair methods of competition or unfair trade practice". Thus under the deregulated environment, as expected, the Anti-trust laws are applicable to all foreign carrier operations, at least insofar as they affect the commerce of the US, unless those operations were conducted pursuant to an agreement approved by the Department of Transportation and specifically immunized from the Antitrust Laws. The three basic Antitrust Statutes are the Sherman Antitrust Act, 1890, the Clayton Antitrust Act, 1914 and the Robinson-Patman Anti Discrimination Act, 1936. For further details regarding these Acts see George N. Tompkins, Jr., "The North Atlantic - Competition or Confrontation: The Potential Impact of US Antitrust Law on International Air Transportation", Air Law, Vol.VII, No.1 (1982), pp.48-63.
subject to the pro-competition and free market principles.

The main aim of deregulation has been to provide the consumer with an improved service at the lowest possible fare. The principle underlying the assumption is that, under regulation the government protects the airlines and not the consumer, on the other hand under deregulation, the market forces must protect the consumer.\textsuperscript{56} It clearly means that increased competition among carriers would help to extend high quality and a large variety of services to the consumer at competitive costs.\textsuperscript{57} But, in fact, the one-and-a-half decade of deregulation experience of the US has produced, at best, mixed results. This will be evident, if one glances over the present scenario of the deregulated environment in the United States.


1. The Price Discrimination

Price discrimination is the primary and most conspicuous consequence of the deregulation era. The supporters of deregulation have argued that greatest success of deregulation lies in the decline of air fares.\textsuperscript{58} The chief architect of deregulation, Alfred Kahn, has held that average fares per passenger mile declined over 30 per cent in real terms between 1976 and 1987, and as a whole the industry was now very profitable;\textsuperscript{59} whereas some other supporters of deregulation have estimated that the actual fares during the 1977-86 period averaged 18\% below the level that would have prevailed under CAB regulation.\textsuperscript{60} The main basis for these assumptions was that deregulation brought in cost based pricing. However, in air transport, usually the economies of scale are associated with two elements. One is the distance flown by the


carrier and other the aircraft capacity. While calculating the increase in returns, there is no economic significance in calculating average fares on the basis of unit cost, i.e., total expenditure per revenue passenger mile throughout the network. Since the airline could be considered to be a multiproduct company offering a specific product in the form of employing an air carrier on a particular route, it incurs common costs for the different products. In a given situation, to calculate average fares (on the basis of cost) while taking into consideration the entire route network is quite unrealistic, since cost-based pricing varies from route to route and market to market. For example, in 1984 a distance of 296 miles between New York and Norfolk cost $38, while it costs $162 to travel between Saint Louis and Cincinatti, a distance of 307 miles.\textsuperscript{61} It shows that there could be little uniformity in the fares, though there is a substantial similarity in the basic elements of the products offered by the competing carriers. The main argument which goes in the favour of

deregulation is that it would involve a substantial lowering of the airfares with the increased competition and would actuate a cost based pricing. But, in fact the reality is something contrary to the predictions. The concept of low airfares is in fact, available only on those routes which are dense and economical, whereas abnormally high fares are a reality on uneconomical routes especially catering for small communities. In other words, the trends indicate that the fares have lowered in highly competitive markets whereas they have risen substantially in less competitive markets, thereby causing a lack of fairness and equity to the consumer. For instance, in 1982, it cost $77 to fly between New York and Miami, but $168 to fly 500 fewer miles between New York and Myrtle Beach, South Carolina.62 So also, in the same year the cost to fly from New York to San Francisco was $99, a distance of 2,500 miles, while it cost $268 to fly 1,800 miles from Memphis to San Francisco.63 It has been rightly pointed out that

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under deregulation, pricing seems to reflect the level of competition in any market, not costs, since a positive correlation could be drawn between more competition and lower fares and between fewer competitors and higher fares. This is simply because, the deregulation provides an absolute freedom to the carriers to increase or decrease air fares, of course, subject to the cost of operation. However, the situation where the carriers face a very high degree of competition, drives them into price wars resulting into an undercutting of fares for fear of losing passengers to competitors.

The cut-throat competition coupled with fares below the operating costs results into severe financial losses and sometimes drives the weak competitor out of the market. Once competitors are successfully driven out of the race and the pressure of competition slowly eases, the prices automatically shoot up. For instance, when Braniff Airlines went bankrupt, American and Delta

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raised fares sharply in markets originating from Dallas (Braniff's former hub).\textsuperscript{65} Similarly when Continental abandoned and TWA reduced its service in the Chicago-Los Angeles market, the United and American Airlines raised fares dramatically.\textsuperscript{66} Hence the scenario set forth by the proponents of deregulation which preferred overall benefits to the consumer with considerably low air fares was in fact beneficial to a chosen few of the carriers. Discrimination in air fares is today's reality which is definitely undesirable by all standards and proves detrimental to the consumer as well as to the airlines.

2. \textbf{Industry Concentration}

The increased competition with a rise in cut-throat price-wars, has considerably reduced the number of competitors to a meagre few; most of them thrown into disarray through a wave of mergers, acquisitions of control and bankruptcies. At the time of deregulation, it was predicted that airline industry had relatively

\textsuperscript{65} See P.S. Dempsey, n.62, p.44.

\textsuperscript{66} See \textit{Airlines Forbes} (London), January 5, 1981, p.144. cited in Dempsey, n.62, p.44.
few barriers to entry, that the resources were highly mobile, that the demand was reasonably elastic, and that therefore there was little reason to fear that deregulation might result in industry concentration.\footnote{See P.S. Dempsey, "The Rise and Fall of the CAB, opening wide Flood Gates of Entry", \textit{Transport Law Journal} (New York), No.11 (1979), p.91.} It is undoubtedly true that deregulation promotes a sizeable increase and induction of new carriers, since the freedom to enter and exit in markets is at the heart of deregulation. But the market Darwinism followed by deregulation led to a wave of bankruptcies as shown below.
### Airlines that went Bankrupt in 1978-1989

<table>
<thead>
<tr>
<th>Origin and Name of the Carriers</th>
<th>Began service operations</th>
<th>Year</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Braniff (Trunk)</em></td>
<td>pre-1978</td>
<td>1982</td>
<td>Ceased operation due to bankruptcy</td>
</tr>
<tr>
<td>+Eastern (Intra-State)</td>
<td>1979</td>
<td>1989</td>
<td>-do-</td>
</tr>
<tr>
<td>Air Florida</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Charter carriers)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>1979</td>
<td>1984</td>
<td>-do-</td>
</tr>
<tr>
<td>World</td>
<td>1979</td>
<td>1985</td>
<td>-do-</td>
</tr>
<tr>
<td>(New Carriers)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Air Atlanta</td>
<td>1984</td>
<td>1986</td>
<td>-do-</td>
</tr>
<tr>
<td>Air One</td>
<td>1983</td>
<td>1984</td>
<td>-do-</td>
</tr>
<tr>
<td>American International</td>
<td>1982</td>
<td>1989</td>
<td>-do-</td>
</tr>
<tr>
<td>Frontier Horizon</td>
<td>1984</td>
<td>1985</td>
<td>-do-</td>
</tr>
<tr>
<td>Hawaii Express</td>
<td>1982</td>
<td>1983</td>
<td>-do-</td>
</tr>
<tr>
<td>North Eastern</td>
<td>1982</td>
<td>1984</td>
<td>-do-</td>
</tr>
<tr>
<td>Pacific East</td>
<td>1982</td>
<td>1984</td>
<td>-do-</td>
</tr>
<tr>
<td>Pacific Express</td>
<td>1982</td>
<td>1984</td>
<td>-do-</td>
</tr>
<tr>
<td>Sun World</td>
<td>1983</td>
<td>1988</td>
<td>-do-</td>
</tr>
</tbody>
</table>

* Braniff resumed its limited operations in 1984 and finally went bankrupt in 1989.

+ Declared bankruptcy in 1989 but conducting limited operations under Texas Air Corporation.

Whatever may be the reasons for bankruptcies, whether it is the financial crunch or unfair

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* See Donald Pickrell, n.60, p.18.

133
competition, the harsh reality is that a number of viable competitors in the industry fell abruptly. The main thrust of the deregulation phenomenon has been to promote competition and reduce the operating costs by increasing productivity. But the discouraging factor is that the stronger airlines which could best absorb the losses incurred in cut-throat price competition successfully, eliminated competition from weaker ones, especially from the new entrants. In the table shown above, out of 17 new entrants during 1978-1989, a total of 50% ceased to carry out airline operations as they went bankrupt.

Another growing tendency of deregulation is the mergers, consolidations and acquisition of control by the strong of the weak airlines which ultimately led to certain developments whereby the airline operations have become, in the words of Alfred Kahn, 'an uncomfortably tight oligopoly'. The following table shows a host of merger transactions that took place in the United States in the recent years:

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### AIR CARRIER MERGERS AND CONSOLIDATIONS SINCE PROMULGATION OF THE AIRLINE Deregulation Act of 1978

<table>
<thead>
<tr>
<th>Air Carrier Mergers and Consolidations</th>
<th>Market Share*</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Airlines</td>
<td>16.6</td>
</tr>
<tr>
<td>Air Cal</td>
<td></td>
</tr>
<tr>
<td>United Airlines</td>
<td>16.2</td>
</tr>
<tr>
<td>Pan Am (trans-pacific routes)</td>
<td></td>
</tr>
<tr>
<td>Texas International Airlines</td>
<td>15.9</td>
</tr>
<tr>
<td>Continental Airlines</td>
<td></td>
</tr>
<tr>
<td>New York Air</td>
<td></td>
</tr>
<tr>
<td>Frontier Airlines</td>
<td></td>
</tr>
<tr>
<td>People Express</td>
<td></td>
</tr>
<tr>
<td>Brits</td>
<td></td>
</tr>
<tr>
<td>PBA</td>
<td></td>
</tr>
<tr>
<td>Braniff (Latin America)</td>
<td></td>
</tr>
<tr>
<td>Eastern Airlines</td>
<td></td>
</tr>
<tr>
<td>Rocky Mountain Airlines</td>
<td></td>
</tr>
<tr>
<td>Delta Airlines</td>
<td>13.3</td>
</tr>
<tr>
<td>Western Airlines</td>
<td></td>
</tr>
<tr>
<td>Northwest Airlines</td>
<td>9.6</td>
</tr>
<tr>
<td>North Central Airlines</td>
<td></td>
</tr>
<tr>
<td>Republic Airlines</td>
<td></td>
</tr>
<tr>
<td>Southern Airlines</td>
<td></td>
</tr>
<tr>
<td>Hughes Airwest</td>
<td></td>
</tr>
<tr>
<td>TWA</td>
<td>7.2</td>
</tr>
<tr>
<td>Ozark Airlines</td>
<td></td>
</tr>
<tr>
<td>US Air</td>
<td>7.2</td>
</tr>
<tr>
<td>PSA</td>
<td></td>
</tr>
<tr>
<td>Empire Airlines</td>
<td></td>
</tr>
<tr>
<td>Piedmont Airlines</td>
<td></td>
</tr>
<tr>
<td>Benson</td>
<td></td>
</tr>
<tr>
<td>Pan Am</td>
<td>5.9</td>
</tr>
<tr>
<td>National Airlines</td>
<td></td>
</tr>
<tr>
<td>Ransome</td>
<td></td>
</tr>
</tbody>
</table>

**Market Share**

<table>
<thead>
<tr>
<th>1989</th>
<th>1988</th>
<th>1987</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.6</td>
<td>15.2</td>
<td>13.8</td>
</tr>
<tr>
<td>16.2</td>
<td>16.2</td>
<td>16.9</td>
</tr>
<tr>
<td>15.9</td>
<td>19.3</td>
<td>19.0</td>
</tr>
<tr>
<td>13.3</td>
<td>12.0</td>
<td>12.2</td>
</tr>
<tr>
<td>9.6</td>
<td>6.9</td>
<td>10.3</td>
</tr>
<tr>
<td>7.2</td>
<td>7.4</td>
<td>8.2</td>
</tr>
<tr>
<td>7.2</td>
<td>7.2</td>
<td>7.1</td>
</tr>
<tr>
<td>5.9</td>
<td>7.1</td>
<td>6.3</td>
</tr>
<tr>
<td>7.2</td>
<td>7.2</td>
<td>7.1</td>
</tr>
</tbody>
</table>

* Percentage of market share as measured by revenue passenger miles as of July, 1989.

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These mergers and consolidations enabled the major airlines to create dominant hub and spoke systems which resulted in hub concentration\(^1\). By 1989, four airports (hub) in the U.S., i.e., Chicago, Atlanta, Dallas-Fort Worth and Denver were dominated by only two carriers, i.e., duopoly. In some other hubs, it was a monopoly of a single carrier. The following comparative table of pre and post deregulation traffic share by carriers reveal single carrier concentration at major airports: \(^2\)

<table>
<thead>
<tr>
<th>Airport</th>
<th>1977</th>
<th>1987</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baltimore/Washington</td>
<td>24.5% US Air</td>
<td>60.0% U.S. Air</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>35.0% Delta</td>
<td>67.6% Delta</td>
</tr>
<tr>
<td>Detroit Metropolitan</td>
<td>21.2% Delta</td>
<td>64.9% North West</td>
</tr>
<tr>
<td>Houston Intercontinental</td>
<td>20.4% Continental</td>
<td>71.5% Continental</td>
</tr>
<tr>
<td>Memphis</td>
<td>40.2% Delta</td>
<td>86.6% North West</td>
</tr>
<tr>
<td>Minneapolis/St Paul</td>
<td>45.9% North West</td>
<td>81.6% North West</td>
</tr>
<tr>
<td>Nashville Metropolitan</td>
<td>28.2% U.S. Air</td>
<td>60.2% American</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>43.7% U.S. Air</td>
<td>82.8% U.S. Air</td>
</tr>
<tr>
<td>St. Louis Lambert</td>
<td>39.1% TWA</td>
<td>82.3% TWA</td>
</tr>
<tr>
<td>Salt Lake City</td>
<td>39.6% Western</td>
<td>74.5% Delta</td>
</tr>
</tbody>
</table>


Today, the major six airlines account for 80% of the domestic traffic in the United States, which clearly indicates that the new competition emerging from deregulation led to the dominance of the largest carriers. At least on this point, Alfred Kahn while admitting the effects of air carrier mergers and concentration, has criticised the Department of Transportation [D.O.T.], for permitting the mergers indiscriminately. 73 At the same time, he argues that the demise of a few airlines did not mean that the game (deregulation) was lost, since the number of airlines serving individual routes were numerous and that this matters significantly under deregulation. 74 The optimism, will prove too costly if a similar trend continues, and the survival of incumbent airlines and the new entrants will be at stake, unless some steps are taken well in time to prevent the concentration. It has been rightly pointed out that the high level of

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73 See Alfred Kahn, "Airline Deregulation - Mixed Bag, But a clear Success Nevertheless", Transport Law Journal, No.16 (1986), p.229; and also see Andrew Goetz and Dempsey, n.54, p.219; and also see Dempsey, n.64, p.147; Alfred Kahn, n.59, p.4 and "Clip the Wings of Mega Airlines", New York Times (New York), 10 February 1988, p.17.

concentration could be tolerated in pre-deregulated era where a monopolist could not reap a monopoly-profit from market for reasons of regulated fare-levels but in a post-deregulated environment the high level of concentration would prove inimical and therefore, be a matter of great concern. 75

3. Services to Small Communities

Another major anomaly of the deregulation phenomenon, as already seen, was that its impact on air services to small communities was difficult to speculate. The sanguine expectation of deregulation was that it would lead to a potential competitive environment with improved services by limiting government regulation; thus providing ample freedom to the airlines in making a choice, ranging from any route to any market. As a natural consequence, the airlines are tempted to render their services on more profitable routes and withdraw service drastically from less profitable routes. In this process, the consumers got

75 See Andrew R. Goetz and P.S. Dempsey, n.54, p.941.
more air services than required, on some popular routes and less or none at all on others. To avoid this obvious imbalance, the Deregulation Act, under Section 419, provided for Essential Air Services programme to serve the small communities by offering special subsidies to the airlines for a period of ten years. In the post-deregulated environment, whether Section 419 of Airline Deregulation Act has ensured the continuous air service to small communities is still a question to be conclusively answered. The supporters of deregulation has argued that the services to small communities have increased with the increased number of departures. They mainly attributed this to the subsidized Air Services programme and held that not a single community that enjoyed a minimum level of certificated service before deregulation has lost it. While the CAB report to the U.S. Congress in 1984 emphasized that between 1978 and 1983, the number of departures of Essential Air

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78 See Alfred Kahn, n.73, p.17.
Services (EAS) points actually increased by 5.2%, although the number of seats in these markets decreased by 13.7%.\textsuperscript{79} From these statements it can be inferred that

(a) the number of departures to the small communities increased because of subsidized EAS Programme and not new services as such, and

(b) the number of available seats have decreased considerably.

If we accept this explanation, the increased departures with decrease in number of seats show that under deregulation, a majority of small communities are receiving services quantitatively. But, the claim of substantial increase of air service to small communities under deregulation is clearly a travesty of truth. On the other hand, the opponents have argued that under deregulation small towns have suffered deterioration in air service.\textsuperscript{80} The U.S. General Accounting Office


\textsuperscript{80} See James S. Meyer, n.77, pp.154-156.
noted that between October 1978 and October 1984, the Scheduled Air Services network shrank from 632 cities to 541, as the number of non-hub (small towns) communities with scheduled air service decreased by 91 (23 communities gained service during the period while 114 lost service).\(^8^1\) While admitting the figures *prima facie*, Kahn clarifies that whatever the quantum of loss of air service the small communities have incurred under deregulation, is in the form of uncertificated (unregulated) carriers and that these losses have had absolutely nothing to do with either regulation or deregulation.\(^8^2\)

Recent statistics show that in 1978, non-hubs accounted for 23% of all departures, by 1987, they accounted only for sixteen percent.\(^8^3\) In fact, Kahn himself accepts that the generalisation of latest figures may conceal the fact that smallest towns


\(^8^2\) See Alfred Kahn, n.73, p.26. He also said that 137 towns suffered a similar fate during the decade before deregulation.

\(^8^3\) See Andrew R. Goetz and P.S. Dempsey, n.54, p.946; and also see Dempsey, n.62, p.366.
(non-hubs) have witnessed a slight decline while the towns in the small hub category have experienced a large increase. Furthermore, decrease in aircraft size serving small communities is due to the replacement of large sized jetliners with commuter airline turboprop aircraft. It is arguable that operation of jet services to the small cities incurs high operational costs and thereby leads to the price-hike. For this reason, smaller aircraft could be employed to provide efficient service to small towns. But such services are not often in conformity with the Federal Aviation Authority Safety Standards, and thereby exposing the consumers to much less comfort and safety.

Another interesting feature of deregulation, as already discussed, is, the provision of a subsidised Essential Air Service Programme under Section 419 of the Deregulation Act which in itself implies that without such an allurement the services to small communities would have been a serious disaster. To avoid such a

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84 See Alfred Kahn, n. 73, p. 26.
situation the Local Airline Service Action commuters lobbied to obtain a 10 year extension of the Essential Air Services Programme (from 1988), with new standards for aircraft and incentives for improved services.86

4. **Air Safety**

The U.S. deregulation and its experience, so far discussed above relate only to the economic issues. Prior to the commencement of the Deregulation Act 1978, the Civil Aeronautics Board (CAB) had been the sole organisation to control the economic issues such as airfares, routes, frequencies and certain other issues. With the promulgation of ADA (Air Deregulation Act) CAB was abolished and thereby control on economic issues were lifted. 'Safety' is a subject under the jurisdiction of Federal Aviation Authority and it has nothing to do with the Deregulation Act, since deregulation does not apply to the FAA. Hence there is only economic deregulation and not safety deregulation.

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and the Deregulation Act has no direct relation on airline safety. However, deregulation has an indirect effect on safety, if not a direct effect. The following are the several ways in which the wide margin of safety may be compromised in the deregulation environment.

Primarily, deregulation has a tendency to reduce manpower and finance which would cause a reduction in FAA activities. A reduction in manpower or financing may force the FAA to take short cuts in an effort to maintain its activities in the area of aircraft inspection, supervision and the other related contents.

In this context it was reported that during the first six years of deregulation, the amount of resources utilised by airlines to the cause of aircraft maintenance fell miserably to thirty per cent during first six years. It was also found that the airlines

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in the cost-cutting process reduced their labour costs - some temporarily and some permanently; thereby reducing the required personnel for proper maintenance or inspection of the carrier. It was further accentuated by the reduced number of hours for thorough vigilance due to increased frequencies. The various factors such as the reduced maintenance costs, reduced personnel with reduced hours of inspection collectively exposed the travelling public very often to great risks by narrowing the wider safety margin.

Secondly, the freedom of effective utilization of markets under the Deregulation Act, resulted in a dramatic rise in the number of new carriers; thereby increasing competition. Increasing number of flights, coupled with the industry’s practice of adopting hub and spoke route systems led to congestion of major airports during peak hours. The heavy traffic congestion coupled with the outdated navigational facilities at airports caused the number of near hits to go up. If

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89 See Goetz and Dempsey, n.54, p. 957; and also see Dempsey, n.62, p.118.
90 See Goetz and Dempsey, n.54, p.975; and also see Alfred Kahn, n.73, p.26.
this trend continues without an expansion of infrastructure facilities, in future, the near misses might become real hits.

Though deregulation does not purport directly to affect air safety, the alarming pace at which the competition has intensified is likely to cause serious financial constraints (due to low-profit-margin). This leads to obvious tendency on the part of the operator to save on safety, as on other aspects of the airline operations.

In the backdrop of the above observations, it is highly inappropriate to conclude that deregulation has been a clear success. The terrific rise in competition and an abrupt reduction in domestic scheduled airfares on certain routes (where there is more competition) are obviously, the consequent merits of deregulation. However, it does not promise impressive results for future, unless some measures are taken to control mergers, in order to maintain the atmosphere for free and fair competition and also to check the increased concentration. In other words, the optimum level of
competition which is the backbone of the deregulation will be reduced drastically and the end result will be either monopoly or oligopoly, in the absence of some regulation. It would be beneficial neither to the consumer nor to the industry as a whole. Another feature that requires attention is, the marketing strategies followed by the stronger incumbent airlines through Computer Reservation Systems [CRSs]. The lack of a global coordination for the distribution of CRSs may lead to excessive manipulations. Since the CRSs are owned by airlines but operated by travel agents (Sabre by American and Apollo by United), the agents may show a tendency of goading passengers into the flights of the companies who own the system. The anti-competition tendencies such as cartelisation and takeovers are inevitable in any free market environment; and the deregulated US domestic market is no exemption. On the

91 For a question "can we improve the operation of markets for international air transport by liberalizing the regulatory environment? Simpson said, "The answer is not regulation" He expressed that - "I still see some necessity for minimal regulations and policies, continuing regional negotiations by governments, and industry cooperation as necessary elements of my liberalized environment. The invisible hand of Adam Smith does not exist in air transport - we need a very visible hand to guide us." See Robert W.Simpson, "The Economic rationale for Regionalism" paper presented to an International Conference on Regionalism in International Air Transportation : Cooperation and competition, organised by the massachusetts Institute of Technology, held at the Amman Chamber of Commerce, Jordan, April 19-21, 1983, p.27.
infrastructural front, the already existing congestion and consequent delays are further aggravated by deregulation. Though the process of deregulation is entitled to claim credit for its own merits, but without proper air traffic control systems and adequate airport capacity, it may prove to be an imposing barrier to the new incumbents. Hence a proper code or a set of guidelines is a desideratum to reserve certain slots for new entrants and at the same time to apportion the requisite slots among the existing incumbents properly. Unless there is an improvement in the infrastructure facilities indicated above, the deregulation will prove futile in its efforts.

B. Liberalisation of Air Transportation in EEC

In late 1970's, global aviation witnessed a major liberalisation trend on the European continent. The air transportation system in Europe like any other region of the world was highly regulated. The growing dissatisfaction among passengers over the service in respect of quality, punctuality and prices, provided on
scheduled routes within Europe, exerted a great pressure for liberalisation of the aviation market in Europe.

A liberal policy for air transport was further favoured for various economic reasons. It was a long cherished dream among European countries for a regionally co-operative arrangement; which led to the establishment of the European Civil Aviation Conference (ECAC) at Strasbourg in April 1954.\footnote{See Eugene Sochor, "Air Transport in the European Community: The Hard Core Problem", \textit{ICAO Journal}, Dec. 1990, p.15.} Though the ECAC rendered yeomen service for the development of air transportation, its attempt to liberalise air transportation foundered on the non-cooperative attitude of member-states due to their divergent philosophies, and also the consensus among 23 member states over any one aspect was difficult to achieve.

The crucial factor that brought forth aviation liberalisation in Europe, was the endeavour towards a free market economy within the European community. It began with the establishment of the European Economic
Community (EEC) which was an outcome of the Treaty of Rome signed in March 1957 and in force since 1 January 1958. The underlying objective in establishing EEC has been to achieve "economic integration" for the benefit of all the peoples of Europe through the creation of a large economic area. The focal point of economic integration was the common market, in which the member states combined to create a unified economic territory by elimination or harmonisation of internal tariffs, quantitative restrictions and a variety of non-tariff barriers to intra-European trade and commerce. The Common Market rested on the pillars of four fundamental freedoms, namely the free movement of goods, persons, capital and freedom to provide services.
However, the main shortcoming within the EEC was in the enunciation of general community rules\textsuperscript{96} for development of free competition leaving ambiguous provisions for air transportation. The Treaty itself separated the continental means of transport from sea and air transport.\textsuperscript{97} It specified that the measures relating to sea and air transport are subject to future rulings of the EEC Council. A fresh impetus for further liberalisation of air transport was received by the EC, when it successfully adopted a proposal known as Civil Aviation Memorandum No.1 in July 1979.\textsuperscript{98} This proposal was mainly expected to bring gradual changes without disrupting the existing structure. The Memorandum No.1 proposed\textsuperscript{99}

(a) to increase possibilities for market entry,

(b) to introduce various forms of cheap fares,

\textsuperscript{96} See Arts.74 to 84 of the Rome Treaty 1957.

\textsuperscript{97} See Art.84(2) of the Rome Treaty 1957.

\textsuperscript{98} See the DOC. No.8139/79, Memorandum by the Commission on the contribution of the European communities to the development of air transport services. See also Emily Tegelberg-Aberson, "Freedom in European Air Transport, the best of both worlds", Air Law, Vol.XII, (1987), p.284. Also see Kenneth Button and Dennis Swann, "Aviation Policy in Europe" in Kenneth Button, n.60, p.114.

\textsuperscript{99} EC Bulletin 1979, Suppl.5, dated 4 July 1979 and also see Kenneth Button and Dennis Swann, n.98 p.114.
(c) to develop new cross-frontier service connecting regional centres within the community,
(d) to apply competition rules directly to air services,
(e) to develop a policy on state aid to airlines and
(d) to ensure council action for the right of establishment applied directly to airlines, since practical and political obstacles would otherwise exist.

Encouraged by the positive results of the first Memorandum the Commission issued a Second Memorandum in March 1984. This Memorandum was more liberal than the earlier one, incorporated the following proposals:

(a) A flexible zonal pricing system was established.
(b) The dominance of flag-carrier under the existing bilateral system was not changed but recommended to provide the unused operating rights and routes to other airlines.
(c) In case of 50-50 division of traffic between two

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100 DOC. COM (84) 72 Final, 15 March 1984 and also ibid., p.115.

152
states, one could not oppose to other state a build-up of traffic, until its own traffic had fallen below 25%.

(d) Reposed the faith in the existing bilateral regulatory system and ruled out the US type of deregulation in the European context.

(e) The Commission was empowered to exempt the airlines from full rigour of competition rules, if the relevant states agreed to reduce controls on capacity and tariffs.

The Second Memorandum met with little success due to the divergent attitudes of states; one for an all out liberalisation was favoured by some states (Netherlands, UK, Luxembourg, etc.) preferring a flexible regime, while others (France, Italy and Spain) were down right reluctant in accepting any form of liberalisation.

States who favoured liberalisation were not satisfied with the progress in EEC and consequently entered into various liberal agreements with the like minded countries. Concurrent to this development, the
U.S. followed an 'open sky policy' for scheduled air transportation. This eventually brought them together and eventually facilitated the signing of various liberal bilaterals between the U.S. and various European states such as the Netherlands and Belgium. Within the EEC, the UK and the Netherlands entered into a very liberal bilateral agreement in July 1984.\textsuperscript{101}

The liberalisation at bilateral levels within the European community and with states outside the EEC, clearly demonstrated the need for the EEC to try and achieve also the setting up of a common aviation market. Certain landmark judgements of the European Court of Justice gave a further impetus to the liberalisation process in the EEC. The judgments in fact empowered the European Commission also to devise a common air transport policy [sea and air transport was specifically reserved for the decision of Council under Article 84(2)]. Article 8A of the Single European Act,

1986 amends the Second Paragraph of Article 84 of the Rome Treaty, substituting the 'rule of unanimity' by the 'rule of qualified majority' for decisions taken by the Council. The following judgments in fact influenced the Council to adopt various measures (through packages) affecting air transportation.

1. **Nouvelles Frontieres Case**

   This was a case referred by a Paris Court to the European Court of Justice asking (1) whether the condition of government approval of fares to be based on tariff agreements between undertakings (Tariff agreement concluded under IATA), was contrary to the Article 85 of the Rome Treaty, (2) whether the competition rules of EEC, i.e., Rome Treaty (Articles 85-90), were applicable to air transport.

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104 Undertakings here denotes airlines, since the number of airlines are state owned in various member states of Europe.

105 For detailed text, see the Rome Treaty 1957, 298 UNTS 3.

**Article 85**: forbids agreements, decisions, and concerted practices of undertakings which prevent, restrict or distort competition.

**Article 86**: prohibits the abuse of dominant position by an undertaking in so far as it affects trade between EEC member states.

**Article 87**: deals with adoption by the Council of the European communities (legislative body) of regulations to give effect to the competition rules.
Regarding the second question the court came to an affirmative conclusion on the lines of French Seamen case.\textsuperscript{106} Article 84(2) did not have any objective other than to exclude the application of the provisions of the Transport Title of the Rome Treaty.\textsuperscript{107} In other words, Article 84(2) served merely to exclude, so long as the Council has not decided otherwise, sea and air transport from the rules of the Title on transport, but making the competition rules applicable to air transport. The court reasoned that no other provision in the Treaty except, Article 74, were inapplicable to air transport. The objectives of the Treaty should be pursued by member states within the framework of the Common Transport Policy, i.e., Article 3(f), namely, the institution of a system ensuring that the competition in

\begin{itemize}
\item Article 88: deals with the enforcement of these competition rules by national authorities of EEC member states pending the adoption of the implementing regulations under Article 87.
\item Article 89: deals with investigation by the Commission of the European communities (administrative body) of infringements of Articles 85 and 86.
\item Article 90: deals with a number of special rules applicable to certain public undertakings.
\end{itemize}

See Retrench Merchant Seamen EC Commission V France, 167/73(1974), 2 CMLR.216, where it held that sea and air transport remain, on the same basis as other modes of transport subject to the general rules of the Treaty, unless the general rules contain a specific exception for transport.

the market is undistorted, and equally applicable to the air transport sector. And Article 61 provided that freedom to provide service in the field of transport is governed not by the provisions of the chapter on services but by the provisions relating to the common transport policy, which applied to the transport sector subject to the adoption of a common transport policy.

Hence, the court held that sea and air transport like inland transport are subject to the "general rules" of the Treaty competition rules.

On the first question of the consistency of air tariff approval on the basis of an agreement reached, between the airlines the Court held that the legality of this condition should be judged by examining various provisions of the competition rules regarding the transport policy. According to Article 85, undertakings are under an obligation not to enter into agreements which may distort competition within the Community. But this provision is qualified by certain other provisions relevant in this context. It is to be noted that
neither regulations and rules have been adopted for air transport by the Council under Article 87 nor had actions been taken under such rules (adopted under Article 87) either by the national authorities under Article 88 or by the Commission under Article 89 to give effect to Article 85. In other words, to annul the agreements under Article 85 of the treaty which are contrary to the obligations of EEC member States (Articles 3(f), 5 and 85 of the treaty), first of all there should be rules adopted by the Council under Article 87 and in pursuit of this an appropriate action should have been taken under Articles 88 and 89 of the Treaty. Since there were no such rules under Article 87 nor actions under Articles 88 and 89, the Court did not find any illegalities with the air tariff agreement in the Nouvelles Frontieres case. It, however did with respect to the French Act requiring inter-airline agreement as a condition for tariff approval.


109 Article 5 of the treaty provides that, the member-states shall carry out the obligations arising out of Rome Treaty to facilitate the achievement of the community's aims.

Article 3 (f) of the treaty deals with the establishment of a system ensuring that competition shall not be distorted in the common market.
However, under Article 88, member states were under an obligation to enforce the competition rules, pending the adoption of regulations under Article 87.110 Article 89 empowers the Commission to investigate the infringements of Article 85 and 86. Hence it was rightly pointed out that, as soon as action on the basis of either Articles 88 or 89 was taken, the inter-carrier agreements concerned in the action would become void and that the government which reinforced the effects of the agreement, contravened the EEC Treaty.111 Eventually, this judgment influenced the adoption of the first phase of liberalisation on 14 December 1987.112

2. The Saeed Case113

In this case, two travel agents in Germany bought


111 See E. Tegelberg-Aberson, n.98, p.290.


113 Ahmed Saeed Flugreisen et. al. V. Zentrale Zur Bekampfung Unahler Wettbewerbs e.V., case 66/86.
two tickets for an international flight, the tickets referred to Lisbon as the boarding point. But in practice, the tickets were used in Germany by passengers boarding at Frankfurt. The reason why they bought the tickets in Portugal was that the prices Lisbon-Frankfurt-Tokyo were cheaper by 60% than approved tariffs for Frankfurt-Tokyo. The prices for the tickets had been fixed by the airlines multilaterally under the auspices of IATA.

On the basis of facts, the German court put the following questions to the European Court of Justice, namely: 114

1. Whether the bilateral or multilateral agreements on tariffs by a member state were automatically void under Art.85(2) of the Rome Treaty, even if the competent authorities had not acted under Articles 88 and 89?

2. Whether the approval of such tariffs by a member

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state would be incompatible with the Community Law (Articles 5 and 90) and thus be automatically void, even when the Community had not objected to such approval?

3. Did the exclusive application of such tariffs involve the abuse of a dominant position (Article 86)?

It is important to note here that, before the European Court delivered its judgement in 1989, the Council had adopted the first package of rules (3975/87) laying down the procedure for the application of the rules on competition (Articles 85 and 86) to undertakings in the air transport sector; thus bringing the provisional regime largely to an end. However, these rules would apply only to international air transport between EEC member states and apply without prejudice to the application of Article 90 of the treaty.\footnote{Article 90(1) of Rome Treaty 1957, lays down that the national authorities must not enact or maintain in force measures contrary to the competition rules.}

161
The automatic nullity in the first case applied to those agreements to which the procedural regulation (adopted by Council in 1987) was applied irrespective of the situation whether the actions had been taken under Articles 88 and 89. Since the scope of such regulations are confined only to member states and not extended between a member state and a third country, the bilateral or multilateral agreement regarding tariffs between a member state and a third country automatically becomes void under Article 85(2) only if either national authorities or the Commission acting under Articles 88 or 89, decides that the agreement was incompatible with Article 85(1).

Referring to the second question, the European Court said that Articles 5 and 90 must be interpreted in the sense that, "they prohibit national authorities from favouring the conclusion of tariff agreements and thereby approving airfares would be contrary to Article 85 and 86." Hence under Article 5 of the Treaty which obliged member states not to adopt or maintain such measures (tariffs which are contrary to Articles 85 and
86), which tended to eliminate the useful effect of competition law. Thus, the approval of tariffs by national authorities, is not compatible with Community law, in particular to Article 5 read with Article 90.\[116\]

The third question, in fact, was the only new issue raised before the Court. The first two questions had already been covered by *Nouvelles Frontieres* Case. The Court held that, when an undertaking in dominant position, succeeded in imposing on the other transport undertaking the application of excessively high or low tariffs or single tariff on same line, that would constitute an abuse of dominant position in the market concerned. This decision has in fact far reaching implications especially on the agreements between member states of EEC and third states. It was contended before the Court, that Article 85 was applicable only between

\[116\] Article 90(2) of the Rome Treaty 1957 provides that undertakings entrusted with the operation of services of general economic interest are subject to the competition rules in so far as the application of such rules does not obstruct the performance, in law or fact, of the particular tasks assigned to them. Article 90(3) of the Rome Treaty, 1957 obliges the commission to ensure to application of the provisions of Article 90 and gives it to the competence to address directives or decisions to member-states where appropriate, without excluding the application of Paras (1) and (2) where the commission is inactive.
member states and not to air carriage between a member state and a third country, but still remained subject to the transitional provisions laid down in Articles 88 and 89. On the other hand, Article 86 had limited application and could not apply to international flights. The Court firmly rejected the contention and confirmed that since no exemption from Article 86 was available, the prohibition was fully applicable to all international air travel, whether confined to the EEC or beyond EEC.

With the pronouncement of Ahmed Saeed case, it became very clear that Article 86 was fully applicable to the whole of the air transport sector. Eventually, this led to the adoption of a second package of liberalisation.

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117 In fact, this is the view of both commission as well as British government as intervener in the case. See G.L. Close, Case 66/86-Ahmed Case in P.D. Daytoglou (ed.), n.110, p.51.

118 ibid.
3. **Wood Pulp Case**\(^{119}\)

In this case, the Court went a step further to give an extra-territorial effect to the EC competition rules. Though this is a non-aviation case, its decision has far reaching effects for the future, especially with regard to various agreements (tariff agreements, inter-airline agreements) between the EEC and third countries. The case involved various pulp producers from Canada, the U.S., Finland and various other pulp exporting nations who were, in fact, fined by the Commission for Price Coordinating Tactics in selling the wood pulp in common market, which was a violation of Article 85 of the Treaty. The pulp producers referred the case to the European Court of Justice, asking for relief from fines imposed by the Commission. The Court held that "an infringement of Article 85, such as the conclusion of an agreement which has had the effect of restricting competition within the common market, consists of two elements, the formation of the Agreement and the imple-

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mentation thereof." In this case, the producers implemented their pricing agreement within the common market. It is immaterial in that respect whether or not they had recourse to subsidiaries, agents, sub-agents or branches within the community in order to make their contacts with purchasers within the community."

No doubt, this decision will affect the air-tariff agreement concluded by IATA (members and non-members) and also the inter-airline arrangements between EEC and non-EEC members etc. But the Court ruled out any infringement of public international law, for the Community was not claiming extra-territorial application of its rules but regulating anti-competitive behaviour within its territory. But the judicial pronouncements of European Court of Justice apparently show that the Community provisions on air transport adopted by the Council apply only to international air transport services between Community airports. It is also clear that, in its judgment in Wood Pulp case the Court itself

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120 ibid., Paragraphs, 16-17.
used the word 'global dimension', but its application did not cover the domestic transport within the Community member state, and the international air transportation between community and third countries (non-EEC).

Pursuant to these judicial pronouncements, the Council of the European Community adopted three packages in various phases to complete the process of liberalisation from the beginning of 1993. The following table shows the various measures adopted by the Council in each package so as to give effect to liberalisation of air transportation.
Traffic Rights:
3rd and 4th freedoms are permitted between Hub airports and regional airports. Any carrier can fly any route operated on any route between any point in EEC be it Hub or regional. Rights are excluded, subject to certain condition, until 1 April 1997.
Fifth freedom is allowed between a hub and regional and between regional airports but not between two hubs. Domestic services are excluded until 1 April 1997.

Designation:
Multiple designation was permitted on a country. Pair basis with few exception on city pair basis.

Airfares:
Retain the traditional rule that international fares must be approved by the aeronautical authorities of both states concerned (dual of double approval or single disapproval). Airlines are free to set fares without government approval subject to safeguards such as double disapproval was not accepted and left for 3rd package.

Capacity:
The tradition 50:50 sharing capacity was further reduced to 75:25% by 1 April 1992. Capacity limits are phased out.

Anti Competition Laws:
Immunity from EEC competition rules are extended to air transport operations. Another council regulation on licensing concerns the requirements for the issue and withdrawal of operating licenses by members states to air services established in the community. Community air carriers are free to operate on all inter-community i.e. international routes only.

Prepared after examining various issues in first, second and third packages published in Working Documents and Official Journals of EEC.
Thus the EEC has adopted gradual liberalisation, unlike the U.S. policy of deregulation. For various reasons it was stated that the American style of deregulation was not acceptable to the EEC.¹²² Primarily, majority of the European air carriers were international airlines and cross-border in operations. Second, most of the European airlines were (more than 85%) owned by their governments,¹²³ whereas private investors had a stake of nearly 70% in KLM and 50% in SAS, with the only exception of British Airways which was totally privatised. Third, the charter operations have a significant role in European market and a substantial portion of the traffic have been carried by non-scheduled carriers. Fourth, in a considerably small geographic area, the aviation sector in Europe provided scope for great competition in lieu of the efficient intermodal transportation which were heavily subsidised by the governments. Lastly, even the little changes


¹²³ These airlines are Aer Lingus, Air France, Alitalia, Iberia, Olympic Airways, and Lux Air.
contemplated in the existing regime would, have had dampening effects not only on member states within EEC but also on external relations with third countries. These factors cumulatively influenced the EEC in adopting a phased liberalisation process which was accomplished with the adoption of the third package, which took effect on January 1, 1993.

These packages were designed to achieve "internal market", contemplated under Article 8A of the Single European Act which entered into force in July 1987. This article provided that "the community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992." It also provided that "the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty." Moreover, the creation of an internal

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125 ibid., and also see Joanne W. Young, "What will be the effects of EC market unification on intercontinental air services after 1992", ICAO Journal, Jan. 1990, p.25; and also see Maurice Doz, n.115, p.34.
market preludes the development of a common transport policy as it was envisaged under the Rome Treaty.126 It is, however, to be mentioned that the date for completion of internal market has been fixed by 31 December 1992, but there is no such specific date for the completion of common transport policy.127 But the question is, whether the common transport policy include sea and air transport or only inland transportation [Art.84(2)]. However, in this light of the European Court's jurisprudence which confirms the applicability of general rules of the EEC Treaty to air transport even in the absence of a decision under Article 84(2) of the Treaty, it is to be deduced that the common transport policy includes air transportation.128

These developments within EEC would have broader implications on the existing relations between member communities on one hand and with third countries on other:

126 Under Article 3(e), which states that the activities of the community shall include "the adoption of a common policy in the sphere of transport".


(a) Relations between Member Countries within EEC

As said earlier, with the adoption of third package beginning from January 1993, the European Union (EU, formerly EC - European Community) theoretically achieved complete liberalisation. The member states of the EU and their airlines were now free to set fares without government approval, subject to safeguards against over or under-pricing. In case of any discrepancies among the member states the involvement of the Commission was authorised under the revised draft of the third package. In fact, there was criticism that the fare regulation replaced private price setting with a political system of price control which was not necessarily advantageous to the public and could be used to concert political compromises to protect flag carriers against lean and mean operator.129

The airlines of the member-states within the EU had free market access which could lead to the initiation of new services to fly between any of the EU cities that

129 For a detailed analysis, see Cranes, n.122, p.223
were outside their home country. For instance, British Airways started service between Paris and Munich, whereas SAS introduced a Copenhagen-Brussels-Lyon route. But in course of time these services were withdrawn since they proved to be unprofitable.\textsuperscript{130} Yet this helped to prove the point that the EEC airlines had unfettered fifth freedom rights (from its home base) on all intra EEC air routes as well as freedom to operate services from any airport in one member-state to any other airport in another member state (without touching the home base).

Regarding licensing regulations, the measures adopted under the third package introduced the concept of community ownership as a prerequisite for granting of an operating licence. Thus common financial, technical and safety standards applied in granting licence, with no discrimination against carriers based in other member countries within the EU. Nevertheless,

\footnote{See the report of the Swiss Air's competitiveness in the European or Global Environment, 1994, p.3. [Prepared by the Swiss authorities for internal circulation only.]}
the requirements of "ownership and effective control" continue to apply and has to be reckoned with in granting operating licences. These measures, as said earlier, applied only to air transport between community airports. Regarding the domestic operations, an agreement to this effect was finalised in 1993 by the ministers of member-states and it was decided that the freedom for airlines to compete on each other's domestic routes would come into force in January 1997. This shows that EEC is close to achieving a true internal market.

(b) Relations between Member Countries of EEC with Third Countries

This issue involves two elements. One is a relation between EEC and non-EEC members within Europe, and other, between the EEC and third countries (non-Europe). The EEC market is comparatively smaller than the European market in geographical terms, since Europe is divided into various territorial groupings

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131 For the definition of ownership and effective control See Cranes, n.122, pp.217-218.

132 See Garrick Holmes (ed.), Research Report of the EIU (European Intelligence Unit), European Year Book 1993-94 (London, Feb. 1994), p.3, and also see Cranes, n.122, p.221 where he pointed out that the cabotage may be disallowed until 1 April 1997.
such as EEC, ECAC, EFTA and CEFTA countries. Any concerted action to co-ordinate the policies between EEC and any other group involves a host of legal and political intricacies. This is primarily because common EEC view is yet to be worked out on the formulation of air transport relations with third states. As a first step in this direction, the Council during its second phase of liberalisation, adopted a measure authorising the Commission to open up negotiations with Norway and Sweden (EFTA members). Eventually this led to the creation of an European Economic Area in January 1994, linking the 12 EU members and five EFTA members (Austria, Finland, Iceland, Norway and Sweden). This was primarily aimed at extending the EEC aviation regime to the non-EEC/ECAC members so that the widened European market could provide the Commission an advantageous position while bargaining with third countries.


134 See Holmes (ed.), n.132, p.5. The opening of this group was delayed for one year due to the last minute defection of Switzerland.
These developments bring us to a fundamental question regarding the legal basis for Commission to negotiate with third countries. In general the Rome Treaty embodies certain provisions from Articles 74 to 84 under the title 'Transport' which includes both inland, sea and air transport. Under Article 74 of the Treaty the member states are under an obligation to pursue the objectives of Treaty within the framework of the 'Common Transport Policy' envisaged in Article 3(e). However, as the sea and air transport are specifically excluded from the purview of 'common transport policy', the Council has considerable discretion to decide whether and to what extent these rules will apply to air transport.\textsuperscript{135}

Apart from the Council decision under Article 84(2), the Rome Treaty does not confer any specific powers to the Commission regarding its external competence. However, as already noted, the application of competition rules to the air transport has been

\textsuperscript{135} See Art. 84(2) of the Rome Treaty 1957.
justified by the recent pronouncements of European Court of Justice.¹³⁶

In one particular case the European Court more directly held that in achieving the objectives of the Treaty of Rome, including Article 3(e) on common transport policy, the Community would enjoy the authority to establish relations with non-member states regarding transport matters, subject to the decision of the Council.¹³⁷ Notwithstanding the Council decision, the Court went a step further, and confirmed that the general rules of the EEC Treaty did apply to transport even in the absence of a decision under Article 84(2).¹³⁸ But the Court neither upheld the application of these rules to air transport within a member state (cabotage) nor to the transport between member states and third countries. Unless there is a decision under Article 84(2), the Commission has no

¹³⁶ See the Nouvelles Frontieres Case, 209-213/84(1986) 3 CMLR 173.
¹³⁷ See Re European Road Transport Agreement, EC Commission V EC Council, Case 22/70 (1971), CMLR, 335.
external competence in aviation relations under Article 74 read with Article 3(e) i.e. a common transport policy.

Due to the prevailing laxity in the direct provisions, an attempt has been made under Articles 111(2), 113 and 114 to authorise the Commission to negotiate with third countries. These provisions are related to the Chapter on 'commercial policy' where the commercial aspects of aviation is brought within the legal scope of Article 113 i.e. part of a common commercial policy and leaving non-commercial activities to the scope of Article 84(2). Under Article 113 the Commission has got exclusive external competence, which the commission wants to extend to air transport by bringing it within its scope. This shifting of the legal basis for community competence has been criticised as an "intellectual shortcut", which the Commission has tried to take for policy reasons which proves on a proper legal analysis, to be impassable.\textsuperscript{139} It is

further stated that, the European Court upheld the application of 'general rules' to the transport sector in the absence of an express provision, which did not even include the sectoral policies such as common commercial policy (Art.113) within the meaning of general rules.\textsuperscript{140} However, with regard to air transport sector, the court held that the community has no exclusive competence pursuant to Article 113 to conclude international agreements\textsuperscript{141} In other words, the court specifies that only cross-frontier supplies are covered by Article 113 of the Treaty and that international agreements in the field of transport are excluded from it.\textsuperscript{142}

As a solution to the thus created impasse, Wassenbergh has suggested that multilateralism (internally) and unilateralism (externally) are the workable alternatives for the time being, since the application of free trade principles (GATT) within EEC

\textsuperscript{140} ibid., p.299.

\textsuperscript{141} See opinion 1/94 of the ECJ, dated 15 November 1994, Para.51, p.I-112.

\textsuperscript{142} Ibid., Para 53, p.I-112.
is more acceptable than at global level (ICAO).\textsuperscript{143} However, this could materialise only if the member States agreed to the extent possible. In an endeavour to adopt a Common External air transport policy it would be imperative to know how many States would be really interested to forego their authority to conclude individual bilateral agreements and would be ready to surrender their national 'identity' (political if not economic) to the Commission. In a recent report, some of the flag carriers such as Air France, Alitalia and Sabena while rejecting the proposals for continued liberalisation demanded forcefully for a roll back of the EU liberalisation programme.\textsuperscript{144} The existence of such differing attitudes between flag carriers/member

\textsuperscript{143} See H.A. Wassenbergh, "Opening the Skies – the EEC and Third Countries, EEC External Civil Aviation Competence and GATS", \textit{Air Law}, vol.XV, No.5/6 (1990), pp.310-14.

\textsuperscript{144} This report is popularly called as 12 Wise Men Report appointed by the European Commission in 1993, to assess the critical state of European airlines, reported at the end of January 1994. The report broadly calls further liberalisation and ultimate privatisation as a solution to the industry's woes. Its recommendations are as follows:

(a) The Air Traffic control and airport infrastructure should be improved.  
(b) A common external aviation policy should be introduced by June 1995.  
(c) The National flag carrier should not be given special treatment.  
(d) The state aid to flag-carriers should be stopped; permitted only in exceptional circumstances.  
(e) Bilateral agreements between air carriers should be negotiated to deal with the over-capacity, but this should be done on normal commercial terms rather than by the intervention of member governments.  
(f) The member states should not interfere in the pricing policy of individual air carriers.

States towards liberalisation, a multilateral external approach by the EEC, could hardly be expected for the time being. Moreover, before embarking on any such regional multilateral approach, the EC should come out with a coherent and well thought out common policy regarding certain legal and aero-political issues which will eventually arise in the evolutionary process of the single internal market. These issues between member states and third countries, under the existing multilateral system represented by the Chicago Convention 1944, relate to transfer of sovereignty (Article 1), the mutual grant of cabotage rights (Article 7) and a redefinition of the nationality of aircraft (Article 17), etc. Secondly, the consequences which are expected with the advent of liberalisation under a unified aviation policy are increasingly alarming. Issues such as the replacement of 'effective control and substantial ownership' by 'community air carrier', the replacement of international air transport between

\[145\] For a detailed study, see Weber n.133, pp.227-287.

\[146\] For detailed study, see Cranes, n.122, pp.221-222.
member states by community wide cabotage like area\textsuperscript{147} and the initiation of new services to third countries from any of the EC gateways other than home bases\textsuperscript{148} would fundamentally disturb the existing balance of benefits between member states and third countries. These will continue to remain as mind-boggling issues unless there is a well thought-out common external aviation policy for which the deadline of June 1995 was fixed.\textsuperscript{149} However, no agreement in the council of Transport Ministers could be reached in 1995.

C. Liberalisation Trends in Other Regions

The process of deregulation in USA and liberalisation in the European Community (EC), paved the way for a number of countries opting for liberalisation. A glimpse of these developments in Australia, New Zealand, Africa and Latin America would be useful in

\textsuperscript{147} For detailed analysis, see Jeffrey R. Plant, "The Creation of a Community Cabotage area in the EC and its Implications for the U.S. Bilateral Aviation System", Air Law, vol.XVII, No.4/5, 1992, pp.183-198; and also see Weber, n.129, pp.285-286.

\textsuperscript{148} See Young, n.125, p.26.

\textsuperscript{149} See Garrick Holmes (ed.), "European Trends: Key Issues and Developments for Business", European Intelligence Unit (EIU) Regional Monitor, (II Quarter, 1994), p.22.
assessing the world scenario in regard to liberalisation and globalisation of international air transport.

1. Australia:

For nearly more than three decades the Australian government had followed a 'Two Airline Policy' which heavily regulated the airline industry, and controlled the import of aircraft as well as the airline operations such as restrictions on entry, capacity, route and control on tariffs. Apart from a fringe of smaller airlines, Australia had two major trunk airlines for domestic transport; one, the government-owned Trans-Australian Airlines and the other the private owned Ansett. From time to time the government under its Two Airline Policy encouraged competition between the two for better performance, i.e., duopoly rather than monopoly, by placing the two airlines on an equal footing. In other words, the policy regulated the market share between two airlines [50/50 share

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approximately] which prevented the carriers from further expansion and resulted in being a major constraint for the growth of the industry. At this juncture, the airlines (especially Ansett) after a careful assessment of U.S. deregulation policy, strongly felt that the regulatory system was no longer required which restricted competition in domestic air transport. This apart, as stated below various other reasons persuaded the government to incorporate new changes in the existing policy: 151

(a) the existing regulatory system denied the freedom of choice to the travelling public;

(b) the considerable rate of returns guaranteed under existing policy multiplied the strength of the airlines, viewed the deregulation environment as an attractive choice to enter new markets and shelving its rival markets;

(c) the strong hold on air traffic market with an extensive CRS and preferential access to airports,

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151 See Peter Forsyth, ibid., pp.57-67; and also see Hamish Mcdonald, "Change in the Air, Australian Airlines face prospect for Deregulation", Far Eastern Economic Review, vol.135, No.4, 22 January 1987, p.46.
the incumbent carriers felt an edge over new entrants in a deregulated environment; (d) the prevalence of serious absurdities in parallel scheduling under existing policy; and (e) a thorough change in the public policy.

These eventually led to the announcement of domestic deregulation in October 1987, with the notice of abolishing the existing regulatory system under 'Two Airline Policy', commencing from October 1990. Accordingly, it brought considerable changes, thereby eliminating the restrictions on entry, routes, and capacity determinations. However, under deregulation the airlines are subjected to Trade Practices Legislation which controls mergers and predatory pricings. Under the new system, new entrants such as the East-West, Compass Airways, Capital Airlines, Trans Continental Airlines and Southern Cross Airlines have started their operations but the Compass has already gone out of business, whereas some others have run

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into serious financial problems.\textsuperscript{153} In such circumstances, the potential of new entrants to challenge the entrenched positions of the existing two major trunk airlines was rightly questioned.\textsuperscript{154}

Regarding other developments it is too early to make any assessment. Ansett, until recently, is the only Australian domestic airline to enter the New Zealand market in a big way [Ansett-New Zealand].

The domestic developments have necessarily moved the authorities to bring certain changes in the international air transport too. One of the most recent developments in Australia's international aviation was the adoption of "The International Air Services Commission Act" which came into effect on 1 July 1992. The purpose of the Act is

(a) to foster greater economic efficiency in airline industry,

\textsuperscript{153} "New Australian Carriers Face Financing Problems", \textit{Asian Aviation}, May 1990, p.10.

(b) to increase competition between Australian carriers,

(c) to increase the airlines' responsiveness to the needs of consumer,

(d) to promote Australian trade and tourism, and

(e) to increase the strength of the Australian carrier to compete effectively with the foreign carriers.

Pursuant to this Act, the Ministerial Policy Statement made on 1 July 1992 established an Air Services Commission with wide powers in allocating traffic rights. The new policy recognises the multiple designation to operate international scheduled air services. Under this clause the monopoly of the sole designated carrier of Australia, the Qantas on international routes was taken away and the Ansett, once a domestic airline already applied for extensive operations on international route.\(^{155}\) Regarding the capacity provisions, the Commission is empowered to

\(^{155}\) See Tom Ballantyne, "Ansett tames its Ambition", *Airline Business*, June 1994, p.19. Ansett expected to launch five services from Melbourne to Osaka's new Kansai international airport thrice a week to Hong Kong with two 747-300 Boeings leased from SIA from September 1994. With the given financial debt to a tune of A $2.1 Billion (US $ 1.5 Billion) may further delayed the operations, which may lead to have a tough time with International Air Service Commission.
allocate capacity, subject to certain criteria such as benefit to the consumers, promotion of tourism and international trade, etc. As regards the allocation of route the government in its policy adopted that the foreign airlines will be granted rights on routes which are not served by Qantas. In fact, developments in Australia have not brought any radical changes in the existing scenario except the transferring of the authority to establish international air services from Department of Transport and Communications to an independent body, i.e., the Commission.

2. New Zealand

Developments in the Australian aviation policy have had a positive influence in guiding the New Zealand aviation policy. After the initial process of deregulation New Zealand opened its domestic market even to foreign airlines. Accordingly, the Australian-owned carrier Ansett was allowed to operate in New Zealand domestic market and Air New Zealand, was allowed to fly on domestic routes of Australia as part of a proposal to
create a Single Australian air market by 1994.\textsuperscript{156} Regarding international air transportation, a joint study made in June 1991, indicates the significant economic gains that would accrue of a single market and the feasibility of exercising beyond rights.\textsuperscript{157} Under this new liberal policy, Australia accepted the New Zealand proposal to operate a direct Auckland-Taipei route with freedom to pick up and put down passengers in Australia. This would further facilitate both the countries to operate service from any point other than a point in home country when the single market becomes a reality. This would lead to a similar predicament on aeropolitical problems, as was the case in the single internal market of EEC. It must be mentioned that this development in Australia-New Zealand aviation relations is part of growing trans-Tasman economic relations.

3. Latin America

The proposition of launching a deregulation process in Latin America could largely be attributed to various


social, political and economic crises that prevailed in the region. To counter the effects arising out of these problems, states liberalised their trade policies, which spurred the growth of their economies. In aviation sector, the process of liberalisation was prompted by the conclusion of various liberal bilaterals between the countries within the region as well as the recent developments in Western Hemisphere. Another move to augment the idea of liberalisation was initiated by the Andean Pact States (Bolivia, Columbia, Equador, Peru and Venezuela); Mercosur Agreement in the Southern part of the region covering Argentina, Brazil, Paraguay and Uruguay and on similar lines newer developments too sprung up in other regions of the subcontinent. The first major breakthrough was the adoption of open sky policy by the Andean Pact States signed in Caracas in May 1991.158 Under this agreement, member states accepted that all freedoms of the air would be granted among the member states within the sub-region by December 31, 1991. Thus, it was sought to improve,

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expand and modernise the capacity of infrastructure and the efficiency of transport and communication services whose present inadequacy and high cost hindered the establishment of fast, reliable links between the centres of production and centres of consumption.\textsuperscript{159}

The open skies resolution lays down the following propositions, that:

(a) Individual member states designate multiple carriers to serve any other city in the sub-region;

(b) Member states agree for a multiple access by providing third, fourth and fifth freedom rights for all carriers in the sub-region in scheduled and non-scheduled, passenger and cargo services;

(c) Regarding the issue of price fixation, member states accept the country of origin system; and

(d) Member-states also grant the fifth and the sixth freedom rights, without any restrictions, by the end of 31st December 1992.

\textsuperscript{159} See the Decision No.297 of the Commission of Cartegena Agreement attached to the pact, ibid., pp.2-3.
Thus it is apparent that from January 1993 onwards the Andean States would negotiate *en bloc* with third countries on a multilateral basis. Even the remaining states in the region such as Argentina, Brazil and Chile in southern region and Panama, Costa Rica and El Salvador in central region have adopted a very liberal "air transport policy". The common feature of all these countries lie in the privatisation of their flag carriers and various cooperative marketing agreements with other airlines so as to enhance the competitive strength of the carrier in the market.\(^{160}\) By the end of 1993, of the 23 carriers fully owned by their governments in 1989, only seven remained under governmental control.\(^{161}\) It indicates that, the commercial aviation in Latin America once regulated and dominated by the government owned national carriers gradually metamorphosised into a competitive market, predominantly dominated by private airlines.

Undoubtedly, the change that Latin America has


\(^{161}\) See James Ott, "Latin Carriers Display Rare Signs of Unity", *Aviation Week and Space Technology*, June 27, 1994, p.68.
witnessed, owing to a sudden increase of 47 new carriers by the end of 1993 speaks of the volume of traffic growth in scheduled passenger. The traffic growth was expected to rise by 5.9% in 1993 and nearly 8% for 1995.\textsuperscript{162} Moreover the nascent tourism industry within the region in 1989, could play a major role in 1990s due to stabler political situation as well as an open commercial attitude of states through the privatisation of public enterprises.\textsuperscript{163} It is still not clear, how far the Latin American countries would go into the implementation of the open skies principles, so that the Latin carriers could reap the gains of economic deregulation.

Presently, the situation in the region seems not to augur well with the possibilities observed above. In the midst of economic boom, the Latin carriers have suffered a setback in terms of a poor market-share and utility on commercial basis, whereas the powerful U.S. carriers are reaping the benefits of liberalisation. The

\textsuperscript{162} ibid.

\textsuperscript{163} ibid., p.69.
Latin American carriers have suffered an acute loss of the US-market share which fell from 52% in 1989 to 45% in 1991 and dropped further in 1992-93, amounting to a net loss of US $2 billion in 1990-92.\textsuperscript{164} This was mainly because of the expansion of American Airlines, and the United Airlines.\textsuperscript{165} With EEC getting more powerful, its domination in Latin America was a setback for the already fragile Latin American air transport sector. The Latin American carriers are now facing stiff competition from both the US and the European carriers. Measures like privatisation of airlines and added incentives to the travelling public, though capable of circumventing the problem in the short term are not the ultimate solution to overcome them, since these marketing tactics can prove effective and fruitful only when the carrier is efficient, expansive and having a powerful network. On the contrary, the region is flooded with a host of small carriers leading to the problem of overcapacity in a confined market. Afflicted

\textsuperscript{164} See Kead Jennings, "Winning their Share Back", \textit{Airline Business}, March 1993, p.29; and also see Ott, n.161, p.68.

with these maladies, the airlines of the region need to strive to be commercially potential and economically sound on the domestic sector. This is possible only through the formulation of commercially-oriented aviation policies. Moreover, the carriers would need to develop a common hub within the region (just as Miami for some of the U.S. carriers) to compete effectively with US mega carriers. Unless there is a co-ordinated arrangement among the carriers such as "Latin Pass" at sub-regional level and a regional set up covering the whole Latin America, the survival of carriers will be at stake in the continued process of liberalisation.

4. The African Scenario

The air transport developments in African countries are in sharp contrast with the developments of the countries belonging to many other parts of the world. This is mainly due to the poor state of economic development directly affecting the growth of air transportation which is a capital and technology intensive industry. States managed to make only
tentative attempts to develop air transportation since the economic backwardness of the region as a whole had forced them to realign their priorities, thus demanding the allocation of their scarce resources to much needed fundamental problems of poverty and social development. The paucity of economic resources to support basic infrastructural facilities for the successful operation of airlines, rendered the entire lot of airlines of the region underdeveloped and unprofitable. A sense of economic insecurity ripped the entire region. This situation in fact pressurised the African authorities to attach great importance to the strict regulation of air traffic between African states and foreign partners. Owing to the inherent difficulties in the existing system the liberalisation trends in the EU and the experiences of the U.S. Deregulation, too brought a bandwagon effect on African civil Aviation. But the majority airlines of Africa did not perceive liberalisation as a panacea for their existing


167 For a detailed study see Khairy El-Hussainy, n.15. pp.117-143.

problems. While criticising the liberalisation trends in the African region, it was stated that, it did not provide immediate solutions to countries which were poor in resources, and deprived of expertise and infrastructure facilities. On the issue of liberalisation, even the Commission of African Civil Aviation (AFCAC) urged the African States to replace the 'rule of disorder', by a more equitable order intended to correct rather than to accentuate the anarchonisms of the current economic system. The African authorities contended that, too much liberalisation in international air transportation was highly detrimental to the survival of small African airlines and useless without strong inter-regional airlines. Consequently, States emphasised the need for cooperation among themselves and accordingly framed their policies to serve a dual purpose: one, to protect the national airlines exposed to strong foreign competition, and two, the liberal inspiration, aimed at

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developing into African Libs, mustering the spirit of co-operation between the African countries. A significant development seeking to achieve these ends, was the 'Yamoussoukro Declaration' 1988 which enumerated the following points:

(a) regional co-operation to withstand the potential detrimental effects of US deregulation and liberalisation policies in Europe;
(b) inter-airline co-operation to improve the management of airlines in order to turn them more competitive; and
(c) regional integration (to be worked out at individual level).

Accordingly, the following multinational regional airlines were formed in 1989 in Africa:

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171 ibid.

172 The Yamoussoukro Declaration was adopted by the Ministers of African Civil Aviation Conference held in Ivory Cost on 6 and 7 October 1988. The representatives from 38 African countries, 9 inter governmental organisations and two world organisations took part in this conference. See Folliot, n.169, p.24.
(a) African Joint Air Services: Air Tanzania, Uganda Airlines, and Zambia Airways.

(b) Air Maghreb: Algeria, Libyan Arab Jamahiriya, Mauritania, Morocco and Tunisia.

(c) Air Mano: Guinea, Liberia and Sierra Leone.

The Yamoussoukro Declaration thus talks about the integration of airlines and stresses the need for sub-regional cooperation.

By the end of 1992, there were innumerable instances where states encouraged inter-airline associations and joint venture plans such as common use of aircraft, joint training facilities and flight equipment, and pooling agreements on equipment and service. Air Botswana went a step ahead by suggesting the adoption of a common logo among the airlines of Southern African Development and Co-operative Council (SADCC). However, many scholars were pessimistic about the regionalisation and integration of the African

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market in the wake of divergent philosophies, 'unpredictable political climate' and 'fragile political institutions'.

Among the inter-African airlines the grant of fifth freedom rights has also become exceptional, despite the AFCAC conference recommendation to grant all the five freedoms to African Airlines in order to enable carriers to open new routes. However, the privatisation of national airlines which is viewed as a major component of the liberalisation process, was not accepted. Though privatization was perceived as a means not only of making airlines more efficient but also of ensuring their survival, it is still a question, whether it will guarantee the survival of weak African airlines.¹⁷⁴ Unless there is an improvement in financial situation to effect modernisation of fleet, improvement in service and quality it is in possible to make the African airlines viable and competitive, in an era of liberalisation. The proposal to establish a regional air

transport regime to safeguard the community interests, seems to be an approach in the right direction to fully realise the benefits of liberalisation. However, for the implementation of such a regime, Henaku calls for close cooperation and harmonisation of many incompatible local regulations to ensure an study development of African air transport.\textsuperscript{175} He also suggests establishing a body composed of aeronautical authorities but not ministers to execute the Yamoussoukro Declaration.\textsuperscript{176}

The chief motive for liberalisation and deregulation of international air services has been the increasing tendency of states to restrict market access and competition. Obviously, these protectionist measures which were once upon a time justified, have now turned obsolete and meaningless for countries with expanding airline industry. It was believed that bilateralism impeded the growth of the national airline industry as well as the ability of the national carrier, especially in exchanging of traffic rights on the basis of quid pro


\textsuperscript{176} ibid.,
As a countervailing measure, efforts have been made worldwide, to liberalise the airline industry. The alleged success of the U.S. deregulation measures prompted other states, to follow suit. It was not only because of the virtues inherent in it but also due to some obvious reasons such as carrot and stick policy.

A major outcome of the U.S. deregulation is cut-throat competition, price wars, mergers and concentration, and single carrier hub domination. In fact, it has brought mixed results. A number of small carriers have lost their existence. A majority of small airlines are now falling under the umbrella of major carriers and even the big three airlines today, are making not profits but are running into losses year

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177 'Carrot' - access to a large traffic base and 'stick' - traffic diversion through adjacent liberal gateways. See Daniel M. Kasper, Deregulation and Globalisation: Liberalising International Trade in Air Services (Massachusetts: Ballinger Publications, 1988), p.113.

178 While answering a question "can the (airline) industry provide adequate service (public utility) while continuing to satisfy its appetite for cut-throat completion", wheatcraft say "The question has acquired a sharper edge from the early returns on deregulation, which include generally much higher fares, mindless competition and dislocation in air service". Further elaborating he says, "If may be too soon to know what or perhaps even how to think about deregulation. Its darwinian logic might eventually work to the advantage of both the industry and the public by strengthening some airlines and pushing the less fit towards mergers or oblivious. Or deregulation may, as a growing number of people connected to the industry suspect it will, bread chaos and, sooner or later, some form of regulation". See Stephen F. Wheatcraft, "competition, Innovation and Regulation in Regional Airline operations", n.91, p.19.
after year.\textsuperscript{179} While reacting to the sluggish nature of today's U.S. airline industry, Alfred Kahn, himself one of the great proponents of deregulation, declared that "I probably would have been very reluctant to abandon price ceilings entirely had I had the choice".\textsuperscript{180} He does not reject the idea of re-regulating the prices at least on single carrier hub domination.\textsuperscript{181}

Another significant achievement of the increased efforts of liberalisation is the regionalisation of air transport. In fact, regionalisation immutably the best approach, serves a dual purpose.\textsuperscript{182} On the one hand it best safeguards the national interest of a country and provide an easy access into the market of other countries within the region. On the other hand, it

\textsuperscript{179} See Wendy Zellner, Andrea Rothman and Erich Schine, "The Airline Mess: Is American's Bob Crandall Part of the Problem - or the Solution?", \textit{Business Week}, July 6, 1992, p.49.


\textsuperscript{181} See Khan, "Chip the wings of mega airlines" n.73, p.17.

\textsuperscript{182} Regionalism - either it can be market based or geographically oriented. The underlying idea, however, is not only the internationalisation of air transport, but also the development of the regional air transport situation, which has been held as the ideal solution for developing countries. See ICAO Assembly Resolution A 24-12.
enhances the strength of the airline with regional base to compete with the mega carriers in international market. An apt example in this regard is the EU-US situation. Regionalisation has a tendency to impose barriers by building fortresses or blocs, thereby, preventing access to the foreign airlines market within the region which would foster confrontation rather than cooperation. It will not be surprising if EU demands domestic rights (cabotage) in a foreign country in return for allowing the foreign airline to exercise fifth freedom rights,\(^{183}\) e.g., Community cabotage. Any regional arrangement has little relevance on international market unless there is a well accepted coordination of all states within the region\(^{184}\) on issues such as domestic operations, common ground handling facilities, uniform airport facilities, common currency and common air traffic control systems.

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\(^{184}\) For instance, in EC market we will see the diverse tendencies, such as strong Germany on one side. More liberals such as UK and Dutch on the other and in between France and Italy are still supporting Government control and State Aids. Where Greece and Spain are likely to fight for exemptions in EC competition rules. See Gunter Endres, "Air Europe Opportunistic Outlook", \textit{Interasia Aerospace} Review, September 1990, p.732; and also see Sochor, n.92, p.16.
The process of liberalisation was further activated by economic recession and poor financial performance of the airlines in some countries, forcing these states to privatise their airlines and stop government funding. This eventually led to the acceptance of foreign investment even by compromising the 'ownership and control' clause. This, no doubt, improves the financial strength of carriers and thereby ease out the government burden of infusing more subsidies in the foreseeable future. However, privatisation requires constant review and careful execution by states, which treat their airlines as an instrument of national policy to cater for various needs such as national security, and public utility services. 185

Another major outcome of globalisation is airline alliances and cooperative ties. The nature and purpose of such alliances and economic viability besides the question of sustainable longevity. If it is purely of commercial nature with a view to make profits, then it neither promotes the market growth nor does it ensure

185 See Kasper, n.177, p.70.
any vigorous competition. The huge trans-atlantic alliances formed today are bidding for global supremacy which is uncalled for. It is rightly predicted that, if this trend continues, there will probably be seven global super-megas each with 10% share of market, leaving the rest of the industry to fight over the remaining 30%. 186 In this backdrop, it is suggested that the process of liberalisation and globalisation should address the growing complexities in commercial air transportation, keeping in view the prevailing economic dichotomy between stronger and weaker aviation states. It should ensure the sustained involvement of all states in the development of world air transport. 187 Efforts have already been made to achieve globalisation through a multilateral approach instead of liberal bilateral air service agreements. In fact, multilateralism at regional level has already been set in motion. One such instrument, i.e., GATT has been chosen as the multilateral platform to further liberal-

isation of the trade in air services. Whether multilateralism is a panacea for the existing problems, shall be the principal focus of the next chapter.