Chapter Three

SINGLE MARKET AVIATION

INTRODUCTION

The growth of aviation as a viable means of mass transport has largely taken place in the period since the creation of the European Community. Commercial jet airliner operations began in the early 1960s, and brought with them significant improvements in terms of the speed and range of aeroplanes. These changes, together with the subsequent development of wide-bodied aircraft, allowed a significant reduction in costs, and a consequent lowering of air fares, making air transport more accessible.

Initially, the aviation market evolved within a highly regulated environment. States kept close control on market access through the granting of traffic rights, the approval of air fares, and the designation of air carriers on domestic as well as on international routes. Consequently, the market was dominated by large state-owned national airlines - flag carriers - and most international routes were operated either as monopolies or as duopolies by the national carriers of each country, on the basis of bilateral reciprocal rights.

The impetus of developments in the US market

The impetus for increasing competition in the European aviation market came from several fronts. Firstly, in the US, the signature of the Airline Deregulation Act, under the Carter administration, led to the complete liberalisation of the previously heavily regulated US market, with domestic cargo services opened up from 1977 and passenger services from 1978. This prompted a period of intense competition within the US, and set a precedent for deregulation in a market representing, at the time, some 40% of the global total.

The Memoranda of 1978 and 1984

Secondly, there was pressure from inside the Community. The possibility of a joint air transport policy had already been brought closer by a 1974 Court of Justice ruling which confirmed that the basic rules of the EEC Treaty applied to air and sea transport, and not just to inland modes. Largely as a result of that ruling, the Commission adopted a Memorandum in 1978 listing future priorities for developing the EC's air transport market. It was not until 1983, however, that the Council made a first, cautious legislative foray into the sector, with the adoption of a Directive introducing a system of Community authorisations for inter-regional air services between Member States. The Commission subsequently published a second, more detailed Memorandum in 1984, together with a set of proposals which were later to form the basis of the first significant package of deregulation measures.

The landmark 1985 ruling, in which the Court of Justice upheld a complaint by the European Parliament that the Council had failed to take sufficient action in implementing the Common Transport Policy, did not apply directly to air transport. Nevertheless, by focusing attention on the transport sector as a whole, it added weight to the Commission's case for developing a Community strategy for aviation. In a further ruling, in the Nouvelles Frontieres cases of 1986, the Court specifically highlighted the need for a common legal framework covering Community aviation.

It was only following the signature of the Single European Act that the Council began in earnest to adopt measures aimed at gradually developing an internal market for aviation services. The goal was to remove regulatory barriers and create an environment in which competition could thrive, with new start-up airlines being able to challenge the hegemony of the old flag carriers. Such competition, it was hoped, would benefit consumers by introducing lower air fares and greater flexibility in reaching destinations.

The liberalisation of the Community aviation market was implemented in three basic stages, corresponding to three major packages of legislation. In order to give existing carriers time to adapt to the evolving marketplace, the changes were introduced over a ten year period. Having begun during a time of sustained capacity growth and profitability in the late 1980s, the legislative process was completed when the European industry was heavily affected by global recession, and problems resulting from the Gulf War in the early 1990s. With the market characterised by substantial overcapacity, and major carriers suffering heavy losses, the Commission called on a committee of 'wise men' to find solutions to the problems affecting the sector. Based on the committee's findings, the Commission drew up a Communication entitled "The way forward for civil aviation in Europe", in which it described the follow-up measures needed to maximise the benefits of liberalisation.

Chapter Three

This chapter examines the EU's attempts to develop a single market in aviation, focusing on the gradual process of liberalising air services themselves, and related issues, such as the allocation of capacity at airports and the reform of the groundhandling markets. It looks at the role of the Member States in restructuring monolith airlines to help them adapt to the new market, and the Commission's efforts to police the use of state funding. It also describes in some detail the progressive application of competition law to the sector, and the new regulatory problems thrown up by liberalisation, as well as the Community's responses to them.

THE THREE AIR LIBERALISATION PACKAGES

The first package of airline liberalisation laws

The first package of airline liberalisation measures was adopted in late 1987. It included a Directive and a Council Decision which together effectively gave the airlines some flexibility to increase capacity or adjust fares on EU cross-border routes without the need for bilateral negotiations between the two States involved. It also contained two Regulations on applying the competition rules to the air transport sector (see below). The package, first proposed in 1984, was initially opposed by a number of Member States, who were concerned over the potential impact of liberalisation on their national flag carriers. Even once these concerns had been overcome, the new rules were held back by tensions between the UK and Spain over Gibraltar (subsequently a recurrent theme in EU air transport matters), which were only resolved after the two sides agreed on a Joint Declaration concerning the use of the colony's airport. Adoption of the package, however, represented a breakthrough which allowed subsequent deregulation decisions to be taken more easily.

The ending of flag carrier monopolies on bilateral routes

The second package was adopted in mid-1990 and came into force later the same year. Widening the process begun with the first package, it included a Regulation which introduced more liberal provisions on market access, allowing any airline based in one Member State to carry passengers to and from another Member State (third and fourth freedoms). By doing so, it effectively ended the flag carriers' monopoly over bilateral routes (although traffic remained subject to Member States' capacity sharing restrictions). It also allows airlines to carry passengers between two third countries, provided this is done on a route with origin or destination in its home country (fifth freedom). Another Regulation gives air carriers the freedom to set fares on international routes within set "zones" of flexibility, and to use other fares subject to approval from both Member States concerned. The package was later supplemented with the adoption, in 1991, of a Regulation liberalising air cargo services.

The third package to complete the internal aviation market

The legal framework establishing the internal aviation market was completed in 1992 with the adoption of the third regulatory package, which entered into force in January 1993. It consisted of three Regulations, on market access, air fares and licensing of air carriers. Some resistance to the new measures came from a minority of States; coincidentally or not, these were largely the same States that subsequently requested significant amounts of aid for their national flag carriers. (In this context, it is worth noting that a several major recapitalisations were authorised between 1992 and 1994, and that the Commission only tightened up its state aid guidelines after a massive aid programme for Air France had been authorised - see below.)

Single aviation market not completed until July 1997

The first measure of the third package, Regulation 2408/92, says that "Community air carriers shall be permitted by the Member State(s) concerned to exercise traffic rights within the Community", and it bans States from imposing capacity limitations on air services. This law effectively opened up to competition all international routes within the EC. Domestic services, however, remained protected for a longer period: the Regulation authorised consecutive cabotage, carried out as part of an international journey (eighth freedom), but did not provide for the deregulation of stand-alone cabotage (ninth freedom) until July 1997. The single market was, therefore, only formally completed as of then.

Certain restrictions on market access do remain today. States retain the right to control traffic distribution within their airport systems, although they may not discriminate between air carriers, and the Commission is able to prevent measures it considers unnecessary. The use of traffic rights can be limited, subject in most cases to Commission approval, in situations where a reduction in air traffic is justified by serious congestion or environmental problems. Access to newly established low-density regional routes can be rationed for a two year period.

The Regulation also allows Member States, with the Commission's permission, to impose public service obligations on essential "scheduled air services to an airport serving a peripheral or development region" on their territory. In cases where obligations are imposed on a route which is not currently served by a carrier, governments can limit access to that route to a single carrier for up to three years. The provisions on public service obligations are used extensively, especially by

France, and standard notices concerning them appear regularly in the Official Journal. In 1994, though, following complaints from British Airways subsidiary TAT, the Commission took two formal Decisions regarding routes from Paris Orly to Marseilles and London to ensure non-discrimination for non-French carriers.

Conditional freedom for airlines to set fares

The second of the three Regulations gives airlines the freedom to set fares for both scheduled and charter services within the EU, without prior authorisation from Member State governments. This provision is qualified, however, by safeguards allowing Member States to "withdraw a basic fare which . . . is excessively high to the disadvantage of users in relation to the long-term fully-allocated relevant costs of the air carrier"; and to "stop, in a non-discriminatory way, further fare decreases in a market . . . when market forces have led to a sustained downward development of air fares deviating significantly from ordinary seasonal pricing movements and resulting in widespread losses among all air carriers concerned". It also contains a mechanism allowing the Commission to investigate complaints, and giving it the power to order specific fares to be withdrawn if necessary.

The Community licensing system for air carriers

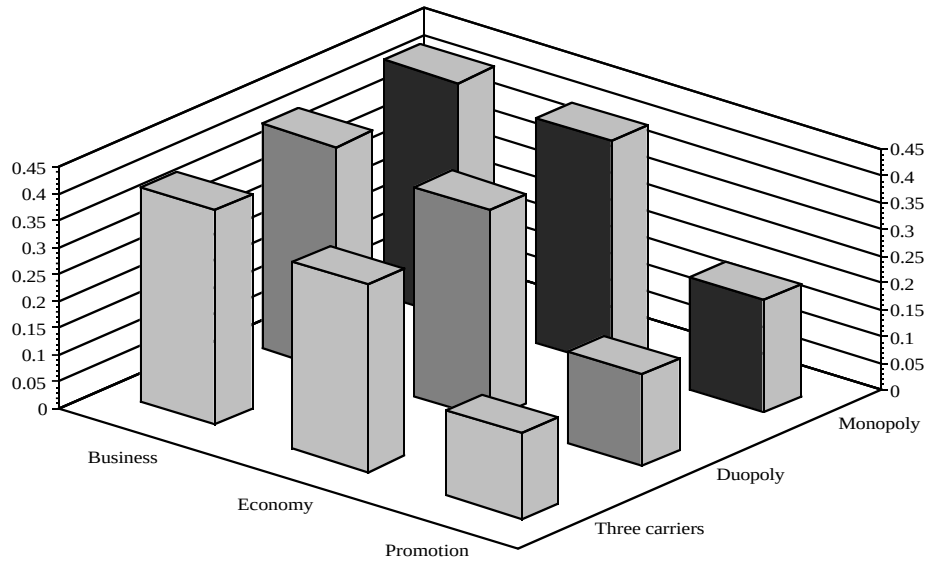
The remaining Regulation in the third package provides a Community licensing system for air carriers. It gives any undertaking the right to establish an airline, and use the rights provided by Regulation 2408/92, subject to certain criteria. A company, it says, must have its principal place of business located in a Member State, and must be owned and controlled, directly or through majority ownership, by Member States or Member State nationals. It must be able to demonstrate its ability "to meet at any time its actual and potential obligations, established under realistic assumptions, for a period of 24 months from the start of operations", and must submit a business plan to the relevant Member State authority. Other criteria cover the good repute of the air carrier's management, safety standards, rules on aircraft ownership and leasing, and insurance requirements. The Regulation also gives companies refused an operating licence the right to refer the matter to the Commission for review.

As of July 1994, the provisions of the third package were extended to the whole of the European Economic Area (EEA), to include Norway and Iceland in the single aviation market. Liechenstein, which joined the EEA later, was granted a derogation for civil aviation until 1999, and then to 2002.

Report describes progressive, not dramatic, liberalisation

An early analysis of the effects of the third package was made by the Commission in a Communication published in late 1996. Covering the period January 1993-January 1996, it suggested that the liberalisation process had been progressive rather than dramatic, in contrast to the experience of the US market. However, it claimed that, despite some positive results, the potential of deregulation had yet to be fulfilled. It observed that the development of new routes and services had been facilitated. Some 80 new carriers had begun operating, while 60 airlines had

Fares versus number of carriers per route* (Eur/km)



Source: COM/99/182

* average of all Community routes to main hubs and capitals, January 1997

disappeared. As a rule, it noted, the market share of flag carriers had fallen noticeably, while the charter market had grown. Moreover, the use of fifth freedom rights had doubled, but remained relatively insignificant, while seventh freedom rights (permitting an airline to carry passengers between two third countries) had been used only on a limited scale.

First review of third air liberalisation package

In terms of fares, the report indicated that liberalisation had had little effect on the routes operated on a monopoly or duopoly basis, which still represented the majority of those in the Community. In fact, despite a proliferation of promotional offers and discounting, fully flexible fares had generally continued to rise in many cases. However, the Commission noted, more positively, that there had been substantial fare reductions where a third carrier had begun operating, mainly on high-density routes.

The EP's call for uniform and transparent conditions

The European Parliament expressed a somewhat critical opinion of the report in a Resolution adopted in early 1998. It suggested that the Commission had failed to take account of the effects of globalisation in the aviation sector and their impact on the single market, and it insisted that competition between air carriers should be governed by "uniform and transparent conditions". The EP, in particular, expressed concern about the Commission's apparent lack of consideration of social issues connected to air transport, and emphasised worries over "the implications of the transfer of services to low wage countries, which leads to social dumping, to the detriment of employees and employment".

From single market to worldwide challenges

The Commission followed up the first review with a further Communication published in 1999, entitled "The European airline industry: from single market to worldwide challenges". It noted that the airlines had developed innovative strategies in order to adapt to a competitive environment, and highlighted, in this context, the development of hub-and-spoke networks and 'no-frills' low-cost services. It suggested, however, that while many airlines, particularly state-owned carriers, had restructured well, improving productivity, reducing costs and introducing more flexible forms of employment, they remained vulnerable to the cyclical profitability of the airline industry. It warned of "a widespread feeling" that the cycle was reaching its peak in 1998-99 and that a downturn might follow; and it emphasised that further restructuring would be needed to enable EU carriers to cope with external threats, notably from their US rivals.

Need for further restructuring to cope with external threats

Elsewhere, the Commission's Communication reiterated many observations made in the earlier report. There were more promotional fares and flexible tickets, it said, and there had been an increase in the number of scheduled airlines operating. However, it also remarked that airline company failures remained high. The report stressed that airport capacity problems and limited access for new entrants to slots remained among the key restrictions on competition. It noted that there had been a proliferation of loyalty schemes such as frequent flyer programmes and corporate discounts; and that there were significant differences in the attitudes of national authorities towards emerging competition.

Scheduled passenger airlines in the EU (1999)

	Operating in Jan 1993		Start up since Jan 1993		
	Still flying	Since withdrawn	Still flying	Since withdrawn	**Total still flying**
Austria	4	1	1	1	5
Belgium	1	1	3	2	4
Denmark	4	4	1	2	3
Finland	9	15	6	7	16
France	2	2	1	0	3
Germany	11	6	6	6	17
Greece	1	1	2	3	3
Ireland	3	0	1	2	4
Italy	6	2	12	9	18
Luxembourg	1	0	0	0	1
Netherlands	6	3	2	3	8
Portugal	3	1	2	0	5
Spain	1	2	7	7	8
Sweden	6	10	4	8	10
UK	11	7	9	24	20
Total	**69**	**55**	**57**	**74**	**126**

Source: AEA Yearbook 1999

In addition, the Commission suggested that its future role in the sector would be to use "all the tools at its disposal to ensure integration of the European market". This would include, it said, stringent application of competition law, the monitoring of public and private behaviour by undertakings, the elimination of technical obstacles to trade, and efforts to develop a genuine external relations policy.

THE GROUNDHANDLING DIRECTIVE FOR AIRPORT LIBERALISATION

Airline complaints about airport practices

By the time the Council had agreed the third package of measures for liberalising air transport services, attention had already turned towards airports and the market for groundhandling services (i.e. activities essential to air carriers but not directly related to air traffic operations). Although circumstances at Community airports varied widely, traditionally only the airport itself or the dominant national carrier had been allowed to supply such services, with other airlines being prohibited from carrying out their own groundhandling. The airlines found these practices anticompetitive. In 1992 and 1993, complaints - on subjects ranging from bans on self-handling to discriminatory charges - began to flood into Brussels (see below). The Commission responded in December 1994 with draft legislation.

During the negotiations in the Council, the Commission's proposal was significantly watered down by the Member States prior to its adoption in October 1996. Shortly after, in April 1997, the Commission published, for information purposes, a list of the airports covered by the Directive (see box). The legislation provides for a staged liberalisation of groundhandling services over the period 1998-2001, with the degree of market opening at each airport depending on its overall capacity. Different rules apply to 'air-side' activities (refuelling, baggage handling, ramp operations, freight and mail handling), and to 'ground-side' services (which include other activities such as ground administration, aircraft maintenance and surface transport).

Medium-sized airports opened to competition from 2001

All airports, regardless of capacity, have been obliged to allow airlines to carry out self-handling for land-side operations since April 1998. Airports with annual traffic exceeding 1m passenger movements or 25,000t of freight have also been obliged to permit self-handling for air-side services by the same date. The market for third party handling was opened up from January 1999 for airports handling at least 3m passengers or 75,000t freight annually, and will be opened from January 2001 for those catering for between 2-3m passengers and 50-75,000t freight.

The Directive does, however, allow third party handling at a given airport to be restricted to a minimum of two companies for each category of air-side service. It also stipulates that, as of 2001, at least one of the authorised groundhandling suppliers in an airport shall be independent of both the airport itself and of its dominant carrier, although airports are permitted to apply for a two year exemption from this stricture. Where airports or airport users also provide groundhandling services, the Directive insists they unbundle the accounts of their groundhandling activities from the rest of their core business, and it provides for independent examination of this provision.

Airports included in scope of Groundhandling Directive

Airports whose annual traffic is not less than 3m passenger movements or 75,000t of freight

Austria: Vienna
Belgium: Brussels, Ostend
Denmark: Copenhagen
Finland: Helsinki-Vantaa
France: Paris-Charles de Gaulle, Paris-Orly, Nice-Cote d'Azur, Marseilles-Provence, Lyons-Satolas, Toulouse-Blagnac
Germany: Dusseldorf, Hamburg, Hanover, Frankfurt, Stuttgart, Munich, Berlin-Tegel, Cologne/Bonn
Greece: Athens, Thessaloniki
Ireland: Dublin
Italy: Rome-Fiumicino, Milan-Malpensa, Milan-Linate, Naples-Capodichino
Luxembourg: Luxembourg
Netherlands: Amsterdam-Schiphol
Portugal: Lisbon, Faro
Spain: Alicante, Barcelona, Grand Canary, Ibiza, Madrid-Barajas, Malaga, Palma de Majorca, Tenerife-Sur
Sweden: Gothenburg-Landvetter, Stockholm
UK: London-Heathrow, London-Gatwick, Manchester, Glasgow, Birmingham, London-Stansted, Edinburgh, London-Luton, East Midlands

Airports whose annual traffic is 2-3m passenger movements and/or 50-75,000t of freight

Austria:
Belgium: -
Denmark: -
Finland: -
France: Bale-Mulhouse, Bordeaux-Merignac, Strasbourg-Entzheim
Germany: Leipzig, Nurnberg
Greece: Rhodes
Ireland: -
Italy:Bologna-Borgo Panigale, Catania-Fontoanerossa, Palermo-Punta Raisi, Venice Tessera, Turin-Caselle, Bergamo-Orio al Serio
Luxembourg: -
Netherlands: -
Portugal: Porto-Sa Carneiro
Spain: Fuerteventura, Menorca, Tenerife-Norte
Sweden:
UK: Newcastle, Aberdeen, Belfast

Airports whose annual traffic is 1-2m passenger movements and/or 25-50,000t of freight

Austria: Salzburg
Belgium: Liege-Bierset
Denmark: Billund
Finland: -
France: Nantes-St-Nazair, Montpellier-Med, Pointe-a-Pitre-Le Raizet, Fort-de-France-Le Lamantin, St-Denis Gilot
Germany: Berlin-Schonefeld, Bremen, Dresden, Munster-Osnabruck
Greece: Chania, Kerkira, Kos
Ireland: Shannon, Cork
Italy:Verona-Villafranca, Cagliari-Elams, Olbia-Costa Smerald, Firenze-Peratola, Bari-Palese, Macchie, Pisa San Giusto
Luxembourg: -
Netherlands: -
Portugal: Funchal
Spain: Bilbao, Santiago, Seville, Valencia
Sweden: Malmo-Sturup
UK: Bristol, Belfast City, Leeds Bradford, London City, Cardiff, Liverpool, Prestwick

Number of other airports named (not including those with below 10,000 passenger movements)

Austria: 4
Belgium: 2
Denmark: 26
Finland: 23
France: 81
Germany: 21
Greece: 31
Ireland: 6
Italy:33
Luxembourg: -
Netherlands: 5
Portugal: 15
Spain: 24
Sweden: 43
UK: 22

Source: OJ/99/C61

More than half the Member States failed to transpose the Directive in time, and, during 1998, the Commission sent Reasoned Opinions (the final stage of an infringement procedure prior to placing a case before the Court of Justice) to eight States.

Wide range of derogations allowed

There are a large number of possible derogations built into the Directive, where "specific constraints of available space or capacity" apply. For example, Member States can ask to ban self-handling, or restrict it to a single airport operator for three years; to limit ground-side third party handling to a minimum of two suppliers for each category of service for three years; and to reserve one or more categories of air-side groundhandling to a single third party handler for two years, with a further two year exemption possible. Where such restrictions are in place, the Directive stipulates, suppliers must be selected according to "relevant, objective, transparent and non-discriminatory" criteria following publication of a call for tender in the Official Journal.

German applications for transition periods

Germany proved to be the Member State with most need of the derogation mechanism. The Commission reached Decisions on the first derogation requests in January 1998, allowing a very restricted exemption for part of Frankfurt airport, and a much broader derogation for Dusseldorf airport, because of space and capacity constraints caused as a result of a 1996 fire (parts of this latter derogation were likely to be extended for two years). In October 1998, the Commission adopted three more Decisions allowing strictly limited derogations for certain services at Stuttgart and Hamburg airports, but stating firmly that a proposed exemption for Cologne/Bonn airport could not be justified. In April 1999, it permitted a limited exemption for Berlin-Tegel, and also allowed exemptions for specific services in two terminals at Paris-Charles de Gaulle.

ACTIONS TO COMPLEMENT THE INTERNAL AVIATION MARKET

Not only has the Commission developed direct laws for the liberalisation of the airline and airport sectors, but it has also tried, with limited success, to ensure that the legal framework is fair and non-discriminatory. Throughout the second half of the 1990s, for example, the Commission has been unable to agree a policy on the allocation of airport slots. Moreover, a proposal for harmonising airport charge structures has not found favour in the Council. Other initiatives, aimed at protecting smaller operators and/or the consumer, such as those on computer reservation systems and airline liability, have made more progress.

The lack of availability of slot capacity at Community airports remains a major factor restricting the opening up of new routes and services in the single market. With the continued rapid growth of air transport, hubs such as Heathrow, Frankfurt and Schiphol have become increasingly congested. For start-up airlines, or those attempting to break into new Community markets, access to landing and take-off slots - particularly during peak times - is vital. It is an established tenet of Community policy, therefore, that a suitable mechanism should exist to ensure a fair distribution of slots, and to prevent carriers being elbowed out of the single market through an inability to obtain them.

The Commission's efforts to develop a policy on slots

Traditionally, capacity at congested airports has been divided between airlines according to voluntary guidelines drawn up within the International Air Transport Association (IATA), and applied on a self-regulatory and consensual basis. These guidelines evolved out of attempts by air carriers, in the era of restrictive bilateral air service agreements, to make the coordination of schedules easier, and were not designed to cope with market competition. Central to the guidelines is the principle of 'grandfather rights' under which a carrier is allowed to retain slots it has operated in the previous corresponding season on an indefinite basis. This system, however, naturally acts in favour of incumbent carriers.

Grandfather rights endorsed by 1993 slots Regulation

Prior to the adoption of the third package, the Commission proposed, in 1991, a broad liberalisation of the slot allocation process. However, the Member States proved completely unwilling to allow any real threat to the dominance of their flag carriers at national hubs - where they naturally held the lion's share of slots under the IATA system - or to the position of EU carriers in relation to foreign airlines. Consequently, the Regulation, when it was adopted in 1993, effectively gave legal force to the IATA system, maintaining the self-regulatory approach and endorsing the system of grandfather rights. The law does contain some measures to assist market entrants, such as the establishment of a slot pool for new, unused or surrendered slots, at least 50% of which must be reallocated to new operators, and a 'use it or lose it' rule which requires that a slot series must be given up if a carrier fails to use it more than 80% of the time in a given scheduling season. However, these measures have proved largely ineffective in practice because established carriers prefer to operate loss-making services rather than return potentially valuable slots to the pool; and crowded airports have been unable to supply many new slots.

Crucially, the Regulation allows slots to be exchanged but is unclear as to the legality of trading them. The Commission has consistently held the view that trading of slots is prohibited; but, nevertheless, an unofficial trade has developed throughout the 1990s.

In 1995, the Commission, as part of a review process required by the 1993 Regulation, contracted Coopers & Lybrand to carry out a study into how the existing rules could be modified to facilitate competition. The study identified two principle options. Firstly, it suggested, the use of grandfather rights could be restricted; this would probably involve forcing carriers to surrender slots, and erode the power of flag carriers at national hubs. Alternatively, a system for secondary trading of airport slots could be created, it said.

Internal Commission dispute over future airport slots policy

In a bid to improve the availability of slots, therefore, and at the same time to improve transparency, officials in the Commission's Transport Directorate-General chose the second option, and prepared a draft proposal to legalise slot trading. However, despite appearing on the Commission's work programme each year since 1997, no proposal for a revision of the slots Regulation had appeared by Autumn 1999, largely because of a fundamental difference of views between the then Commissioners for Transport and Competition, Neil Kinnock and Karel van Miert. In particular, van Miert was concerned that slot trading would allow large carriers to buy up slots, and so strengthen their market positions to the detriment of their weaker competitors. Moreover, he objected to the idea of airlines making money from assets for which they had paid nothing. The issue was further complicated by van Miert's investigations into a number of transatlantic airline alliances, which, he suggested, should be approved on the condition of unrewarded slot surrender at major airports (see below). With a new team of Commissioners in place in autumn 1999, the proposal may be put forward for negotiation in the Council and Parliament during 2000.

The Council's difficulties over airport charges

A further issue related to the establishment and running of the single aviation market is that of charges - such as for landing and take-off, and for the costs of lighting and safety facilities - over which airport operators have a natural monopoly. Concerns over excessive charging and discrimination between airlines led the Commission, in 1990, to propose a set of airport charging principles and a system for consultation between airports and airport users. These ideas, though, failed to find sufficient support in the Council and were soon made inappropriate by the entry into force of the third package of liberalisation measures, and the ratification of the Treaty on European Union in 1993.

The Commission continued to lobby its case. In the 1994 Communication on the way forward for civil aviation, it argued for a framework to ensure fair and equitable treatment for all airport users. In a Resolution, adopted during October 1994, the Council confirmed that an optimal management of airport infrastructure would help make European aviation more competitive.

The Commission put forward a new proposal for a Directive on airport charges in April 1997. It argued that charging systems were complicated, lacked transparency and tended to vary from one State to another, and sometimes did not always reflect the costs of the services provided. It noted the existence of active discrimination by some airports where cheaper rates were being offered for aircraft involved in national services than for those operating on international routes, including intra-Community flights, and where discounts were being offered to national flag carriers.

Principles of the draft Directive on airport charges

The draft Directive, which is based on principles laid down by the International Civil Aviation Organisation (ICAO), was prepared following widespread consultations with the aviation industries and regulators. Recognising that "harmonisation of existing Regulations in the Member States would be virtually impossible to achieve", the Commission proposed a general framework within which different States would be able to produce their own charging systems, based on the three concepts of transparency, cost-relatedness and non-discrimination. Moreover, it said, airports should levy the same charges for "equivalent intra-Community air services in terms of aircraft types and/or characteristics, the distance flown and/or the administrative and customs formalities". Such charges should be set "in a reasonable relation to the overall cost of the services and facilities which these charges are intended to cover", allowing consideration for infrastructure costs, financial charges, expenditure on operation and maintenance, administrative charges and various taxes, and "a reasonable return" on capital invested. Airports should also provide detailed breakdowns of charges to users, and should consult them before introducing changes to charging systems or levels.

By way of derogation from the provisions of cost-relatedness, the draft Directive proposes that airport managements should be able to vary charges to take account of the external environmental costs of air traffic and in order to manage demand at peak periods. Under pressure from certain

Member States, the Commission also included provisions to allow large airports to subsidise the charges of regional airports in the same Member State. Such support should come from sources other than airport charges, the Commission proposed, or from within the margin allowed by the reasonable relationship between charges and costs. However, if this should prove impossible, the Directive would allow a more flexible interpretation of cost-relatedness.

Dispute between airlines and airports

The proposal was relatively well received by the major European airlines, under the umbrella of the Association of European Airlines (AEA), which had long lobbied for action in this area. However, it was vehemently opposed by the Airports Council International (ACI), who regarded it as unnecessary. A row broke out between the two when AEA released a study which claimed to show that charges in the EU were far higher than those in the US or Japan. ACI claimed the study gave a misleading picture, partly because it had excluded the busiest US hubs, and partly because of the general low cost structures enjoyed by US airports.

Little positive support for airport charges Directive in the Council

The Council began discussing the proposal during the Luxembourg Presidency in the second half of 1997, but several Member States (including Sweden, Finland, Italy and Greece) were anxious to protect their regional airports and wanted greater flexibility over the question of cross-subsidies, while others (notably the Netherlands) wanted to limit such subsidies as far as possible. The Parliament supported the latter position in its Opinion, adopted in late March 1998, and put forward an amendment which sought to restrict cross-subsidies to "peripheral Member States". It also said the Directive should apply only to larger airports, with over 1m passenger movements annually, as opposed to the 250,000 threshold proposed by the Commission. With little positive support for the scheme in the Council and no clear line for a way of resolving the various opposing views, the dossier was put to one side by successive Presidencies in 1998-99.

Fair use of computer reservation systems

The liberalisation of air transport services has led to the introduction of new Community rules designed to protect the interests of customers, such as those relating to computer reservation systems (CRS). Such systems are widely used on a subscription basis, principally by travel agents, to provide customers with access to a range of information on air carriers' schedules and fares, and to make instant confirmed bookings. However, they are few in number - in most Member States a single CRS has a market share exceeding 80%, according to the Commission - and are controlled by the airlines and airline consortia which own them. An antitrust block exemption at EU level allows cooperation between airlines in this regard (see below).

In order to prevent anticompetitive manipulation of CRSs by their owner carriers, the Council agreed, in 1989, a code of conduct governing their use but covering only scheduled services. The code was then heavily reinforced in 1993, following the adoption of the third liberalisation package, and extended to cover non-scheduled (charter) services. It requires the legal separation of the system vendor and the parent carriers; provides for the external auditing of confidential information held in the systems; and lays down rules on access to booking information to ensure all CRSs are able to provide equivalent booking information.

Rail services brought within the CRS code of conduct

In February 1999, the Council further amended the code to provide for the integration, into CRS displays, of information on rail services. The Member States agreed this was necessary as a consequence of the development of high-speed rail networks and competition between rail and air routes, and to encourage multimodal travel. The 1999 amendments also extended the scope of the code to include not only the CRS owners but their subscribers - principally travel agents - who had not previously been covered. The Commission claimed this would further protect consumers from false, inaccurate or misleading information.

Compensation for passengers denied boarding

Air travel consumers are also protected by Community laws, albeit to a small extent, when it comes to being denied boarding on a booked flight. Given the prevalence of this problem, caused by airlines allowing overbooking, the Council adopted a Regulation, in February 1991, aimed at providing adequate compensation for passengers. However, the minimum compensation levels were soon eroded by inflation, and, besides, most passengers remained ignorant of their rights. A number of other problems with the Regulation also surfaced in the increasingly liberal market. These resulted from the popularity of code sharing agreements (which meant that a carrier selling a ticket and confirming a booking might be a different one from that denying boarding); the trend towards ticketless travel and telephone-only bookings; and the rise in seat-only bookings on charter flights, which were not covered by the 1991 rules.

In January 1998, therefore, the Commission proposed significant changes to the denied boarding rules. It suggested that carriers should be obliged to inform customers of their rights by means of notices at check-in desks, and that the thresholds for compensation should be raised, with passengers being entitled to an immediate payment of Ecu185 for denied flights of up to 3,500km and Ecu370 for longer flights. The compensation would be payable by the airline denying boarding, irrespective of whether or not it sold the ticket, it suggested, and charter flights would be covered by the same provisions as scheduled services. Further provisions to account for ticketless travel, and to prevent boarding being denied unless the entire capacity of an aircraft were filled, were also proposed.

The European Parliament debated the proposal at the July 1998 plenary and called for a number of amendments, not least the extension of the compensation scheme to passengers who suffered from cancelled flights. The EU's transport ministers discussed the proposals in June and then in December 1998, by which time the proposal was ripe for agreement. However, the Gibraltar question erupted again. Spain protested that application of the law to Gibraltar might imply EC recognition of UK sovereignty at the airport, because its provisions would be implemented by the Gibraltar authorities. This, in itself, was not a new problem: several previous pieces of aviation legislation, including parts of the third package, had been adopted following the inclusion of a 'Gibraltar clause' specifying that they would not apply to Gibraltar until such time as the 1987 Joint Declaration between Spain and the UK concerning Gibraltar had been implemented. However, in this case, the UK, having made concessions in the past, insisted that Spain allow the new rule to be applied to Gibraltar. Spain refused, thus delaying agreement on a Common Position. The dossier, like that on airport charges, continues to gather dust.

Council agreement on denied boarding delayed by Gibraltar problem

Updating the Warsaw System rules on airline liability

Accident liability levels for airlines have traditionally been established at international level according to the Warsaw Convention of 1929 and certain other international instruments, collectively known as the Warsaw System. Under the system, an airline is presumed to be liable, following an accident, but that liability is limited to roughly $10,000 per passenger. The carrier and the passenger can, however, agree to a higher limit by special contract. The carrier has the right, under the Convention, to defend itself against any further claims. If it can prove it has taken all necessary measures to avoid damage, it cannot then be held liable for such claims.

It has been widely accepted for years that the Convention no longer achieves its objectives. The level of presumed liability is too low, for example; and the need for the passenger to prove wilful misconduct on the part of the carrier in order to receive compensation above the $10,000 limit makes settlements less predictable, expensive and time consuming. The situation has become increasingly confused due to inter-carrier agreements, national laws and other various mechanisms which have been introduced to circumvent the inadequacies of the Warsaw Convention. In 1995, ICAO instigated a comprehensive global review of airline liability arrangements in a bid to rationalise the situation.

In response to concerns that the existing confused arrangements at national and international level could lead to a fragmentation of the Community's single market, the EU's Council of Ministers adopted a Regulation, in October 1997, establishing liability rules for carriers within the Community. It gives victims or their families the right to receive an immediate lump sum payment of the equivalent in Ecu of 15,000 Standard Drawing Rights (SDR) following an accident. The limit on presumed liability was set at SDR100,000 (roughly Ecu120,000). Beyond that figure, unlimited liability applies according to the terms of the Warsaw Convention, with the passenger obliged to prove negligence on the part of the carrier.

Regulation establishing EU rules for liability of air carriers

The Commission and the Member States continued to lobby within ICAO for the Convention to be modernised. In March 1998, however, the Commission proposed that the Community could take a stronger joint stance in the negotiations, ensuring also that EU laws were taken account of in the new Convention, if it, the Commission, were allowed to negotiate with a single voice. The Member States, however, were unwilling, for the time being, to relinquish any competence in this area. Instead, the March 1999 Transport Council merely adopted confidential Conclusions on the subject, which included general directives to be followed with a view to taking common positions in the negotiations. Ministers did, though, also accept the possibility of the Community joining a future modernised Convention.

Community membership of Convention possible in future

At the diplomatic conference, held during May 1999 in Montreal, the ICAO parties succeeded in signing up to a new Convention. Its key provisions are broadly compatible with the Community rules, providing for a limit on assumed liability of SDR100,000, with the possibility of unlimited liability thereafter, and for immediate payments comparable with those provided for under the Community

Regulation. The Montreal Convention, which also covers compensation for loss of, or damage to, baggage and cargo, was welcomed by the EU's ministers at the June 1999 Transport Council. The Convention's success, however, will depend on the number of government ratifications it attracts - previous attempts to revise the Warsaw system failed due to insufficient ratifications.

EU membership of the Montreal Convention proposed

In September 1999, the Commission put forward a proposal for the EC itself to become a signatory to the Convention, in view of the fact that the Convention covers areas of Community as well as national competence. Moreover, the Commission said, the Convention would receive "a major boost" if it was ratified by the EC and all its Member States simultaneously.

THE DRAWN OUT END TO STATE AID FOR FLAG CARRIERS

State financing of airlines was relatively uncontrolled during the era of national regulation, state ownership and bilateralism. Although a certain measure of competition between carriers did exist, the potentially distorting effects of subsidies to this competition were overshadowed by the rules on fares, market access and capacity sharing laid down in government-to-government bilateral agreements. This situation began to change in 1984 when the Commission published its second Memorandum on civil aviation, laying down a strategy for liberalisation. The Memorandum contained a set of guidelines and criteria for assessing subsidies on the basis of the Articles 87 and 88 of the Treaty (Articles 92 and 93 at the time).

The Commission's state aid decisions in the early 1990s

Early Decisions regarding aid for Sabena and Iberia

With the implementation of the internal aviation market, however, the guidelines looked increasingly anachronistic, and the Commission began to take a tougher stance, despite the downturn in the aviation industry, caused in part by the Gulf war. In 1991, it took a formal Decision on state aid for Sabena, requiring the Belgian government to abide by certain conditions. Similarly, with regard to Iberia, the Commission approved, in 1992, a capital injection of Pta120bn under the following conditions: it would be the last capital injection involving state aid; the resources would not be used to to acquire shares in other Community airlines; and the Spanish government would replace the nationality clause in Iberia's statutes with a Community clause conforming to the third package of air liberalisation measures.

Also in 1991 the Commission began a detailed assessment of the various aid schemes, and, in 1992, presented an evaluation report to the Council and the Parliament. The report looked carefully at the amounts and mechanisms for aiding national carriers in every Member State. It noted that aid was granted not just in the form financial injections (through capital increases, and preferential tax or loan guarantee schemes) but also through grants for operation of certain routes. By calling on the Member States to provide more thorough details on all these schemes, the Commission signalled its determination to take a much more rigorous approach to state aid

Aid Decisions regarding TAP, Aer Lingus and Olympic Airways

Evidence of a further tightening of the Commission's policy emerged after the adoption of the third liberalisation package. The Irish government's attempts to provide a capital injection of Ir£175m for its ailing flag carrier, Aer Lingus, were rigorously contested by Brussels. Approval for the payment was eventually given in December, but was made subject to a number of exacting conditions, more stringent than those imposed on any carrier before, relating to the restructuring of the company. They included limits on the airline's capacity, restrictions on commercial acquisitions, management reforms, and requirements for cost reductions. Similar conditional approvals were later made with respect to a substantial aid package for the Portuguese carrier TAP in July 1994, which included a capital increase of Esc180bn, and to Dr54bn in subsidies for Greece's Olympic Airways in October the same year.

Green light for FFr20bn in aid to Air France

In an apparent setback to its tough line, the Commission proved unable to resist political pressure from Paris: in July 1994, it approved a massive FFr20bn aid package for the ailing flag carrier, Air France. Nevertheless, it did impose strict conditions on the French government, including, among others, the adoption of a wide-ranging restructuring plan designed to restore the airline to financial health; restrictions on the airline's commercial freedom to compete with other carriers on price; and a prohibition against favouring the airline in terms of traffic rights. In a separate Decision, which was adopted at the same time, the Commission fired a warning shot at France. It declared that the subscription by the French public entity CDC-Participations to Air France bonds worth FFr1.5bn in 1993 constituted illegal state aid, and it ordered the funds involved to be recovered. This Decision was subsequently contested unsuccessfully by Air France in the Court of First Instance.

The 1994 guidelines on state aid for airlines

Fearing that state aid might be used by Member States as a prime means of protecting the interests of their flag carriers in the deregulated marketplace, the Commission adopted, in November 1994,

more restrictive guidelines with the main aim of phasing out state aid altogether. Under the guidelines, subsidies could be granted, in a period to 1997, for loss-making carriers under certain specified criteria:

- the aid should be part of a comprehensive restructuring programme enabling the company to regain viability without further aid;
- the aid should be the last in conformity with EC law; thus an air carrier having received aid, would not be allowed further aid unless in exceptional circumstances, unforeseeable and external to the company;
- capacity reductions to be included, if necessary;
- the aid and the related programme would not aim to increase capacity to the detriment of other EEA carriers;
- no interference by government in the management of the company for non-commercial reasons;
- the aid must only be used for the purposes of the restructuring programme and must not be disproportionate to its needs;
- the company must refrain from acquiring shareholdings in other carriers;
- the aid must neither be used for anticompetitive behaviour or purposes nor be detrimental to the implementation of Community liberalisation rules (third package in particular);
- the aid must be transparent and should be controlled.

Specific criteria for allowing state aid to airlines

Otherwise, under the guidelines, aid can only allowed under exceptional and unforeseeable circumstances, or because it meets the exemption conditions - such as those for public service obligations and social requirements - laid down in Article 87 of the Treaty.

The market investor principle versus state aid

The revised guidelines were successfully applied in the case of the Spanish flag carrier Iberia. The Commission told Spain, in early 1995, that, as a result of the 'last capital injection' commitment in 1992, it could not authorise a requested Pta130bn subsidy without very restrictive conditions. Iberia, consequently, decided to seek a commercial solution to its problems. The Commission was subsequently able, in January 1996, to approve a payment to Iberia of Pta87bn (not Pta139bn as requested) from the state holding company, Teneo, on the grounds that it was behaving as a market investor. The Commission's long and detailed Decision was based on five considerations: the divestment of Iberia's Latin American interests; a limit on the amount of the capital injection; a clear use of the funds only for redundancy payments and a reduction of excessive gearing; commitments on reducing employment levels, fares, and fleet reductions; and preparation of Iberia for involvement with private partners. It also stated that a further capital injection of Pta20bn in 1997 could be justified on commercial grounds. In fact, this latter amount was approved by Brussels in August 1999, again on the grounds that the state was acting as a legitimate market investor.

Five key conditions for approval of market investor aid to Iberia

This case was later cited by Italy when, in July 1996, it notified a restructuring plan for Alitalia including a L1,500bn capital injection from the state holding company IRI (as part of a larger investment package). Italy claimed that the funding should be cleared as consistent with the market investor principle. However, the Commission concluded that the restructuring plan was not sufficiently stringent to guarantee a commercially acceptable rate of return on the investment, and, therefore, it needed to be considered under the state aid rules.

Following lengthy talks with Rome, the Commission finally authorised, in July 1997, a capital injection of L2,750bn (to be paid in three tranches) provided that Italy fulfilled 10 conditions: to adopt the behaviour of a normal shareholder; not to grant Alitalia any further aid; to ensure the aid was used for restructuring the company and not for acquiring shares in other companies; not to give Alitalia any preferential traffic, slots or groundhandling advantages; to insist on seat and seat-kilometres limits until December 2000; to ensure Alitalia used a route-sensitive accounting system; to ensure Alitalia did not undercut competitor's fares on equivalent journeys, also until the end of 2000; to insist that Alitalia disposed of its holding in the Hungarian airline Malev; to ensure Alitalia fulfiled all conditions of its notified restructuring plan; and to make sure Alitalia submitted regular reports to the Commission.

Wrangling between Brussels and Rome over Alitalia aid

The Commission's Decision, however, did not stop the wrangling over the aid package and its approval conditions. In November that year, Alitalia took the case to the Court of Instance claiming the Commission had made an error of judgement, and that the payment was indeed a market investment. Furthermore, rival airlines, including Air One and Lauda Air, complained to Brussels that the Italian flag carrier was engaged in price leadership on certain routes, and was still being given priority in the awarding of traffic rights. The Commission investigated the complaints with an implied threat that it might block payment of Alitalia's second tranche. When Italy made further commitments, payment of the second tranche was authorised in May 1998. The same political dance was carried out in 1999, when Alitalia again breached some of its aid package conditions, and again made sufficient commitments to convince the Commission it should authorise the third instalment.

In mid-1996, though, the Commission blocked payment of a second, Dr23bn tranche of the Dr54bn aid agreed for Olympic Airways in 1994. Although the company's restructuring was progressing satisfactorily, the Commission said, Greece had undermined the objective of making Olympic a viable company by granting it further aid and failing to give it adequate management independence. A solution was reached in July 1998. The Commission agreed to unblock the second tranche, but only on the understanding that the original conditions attached to the payment, due to expire in 1997, were adhered to until 2002, and that a revised restructuring plan was carried out. In addition, the total overall amount of aid authorised was reduced from Dr54bn to Dr40.8bn to take account of the unauthorised subsidies, worth Dr13.2bn, which Greece had earlier granted the company, in breach of EU law. However, by mid-1999, when payment of the third tranche became due, the aid conditions were still being abused. Nevertheless, noting that Olympic had recruited British Airways' consultancy arm, Speedwing, to advise on the restructuring process, the Commission chose not to reopen the state aid procedure immediately, but rather to observe the results of the new partnership.

State aid to Olympic Airways blocked

The Commission's Air France Decision and its Court challenge

Perhaps the most controversial state aid case has been that concerning Air France. The Commission became concerned during 1996 that several of the conditions attached to the 1994 approval had been broken. There was also uncertainty over the progress of the company's restructuring plan. When payment of the final FFr5bn tranche of the FFr20bn package became payable in July 1996, therefore, the Commission required that FFr1bn be placed in a blocked account until a report on the progress of the restructuring had been completed and the infringements - relating to price leadership on some routes and traffic distribution at Paris Orly airport - had been ended. The report was delivered in February 1997. In April, the Commission stated it was satisfied that the 16 conditions attached to the 1994 aid package had been fulfilled (especially with regard to price leadership, management of Orly airport, and voluntary redundancies). Therefore, it authorised release of the frozen FFr1bn.

Soon after the 1994 Air France Decision, an unprecedented challenge was made in the Court of First Instance by six European airlines - British Airways, SAS, KLM, Air UK, Euralair, and TAT - which brought one case, and by British Midland which brought a second case. The airlines claimed, among other arguments, that the Commission had made a number of errors of assessment and law in reaching its Decision, thereby allowing Air France to receive aid in excess of the amount required for its restructuring, and that the reasoning contained in the Decision itself was defective.

Air France Decision overturned on two points of law

The Court ruled on the case in June 1998. It dismissed the bulk of a wide array of arguments put forward by Air France's rivals, and agreed with the Commission on virtually every point. However, it upheld complaints on two matters of law. Firstly, it noted that the Commission had allowed part of the aid (FFr11.5bn) to go towards investments in new aircraft, allowing Air France to modernise its fleet. Because such investments formed part of the company's normal operating expenditure, they should have been considered as operating aid, the Court said. Such subsidies are not normally authorised. Because the Commission did not say, in the text of the Decision, why it had gone against normal practice, the Court was unable to say whether its actions were legal or not. The Court also observed that the Commission had taken adequate account of possible effects of the aid on competition within the European Economic Area, but had not mentioned possible effects on third country routes, or on feeder services to such routes. Because it had not done so, the Court said it could not be sure that the Commission had based its Decision on a sufficiently thorough analysis of the potential effects of the aid on the aviation market. It had no choice, therefore, but to annul the Decision on the two counts of defective reasoning.

Commission obliged to issue new Air France Decision

The Commission responded immediately by reconfirming its original Decision, and putting forward new reasoning to take account of the Court's observations. It was justified in moving away from normal state aid practice by authorising operating aid (i.e. investments in new aircraft), it said, because the acquisitions formed part of a credible restructuring programme and because payment was only made subject to strict conditions. Moreover, because the funds were provided to allow old aircraft to be replaced with new models, they would not allow Air France to increase its capacity. It went on to note that it had not imposed capacity or pricing restraints on Air France where third country routes were concerned because, due to the more restrictive nature of these markets, there was less potential for the aid to distort competition. Moreover, the conditions imposed on the airline within the EU would restrict its capacity and therefore prevent significant expansion outside the EEA, it said.

With the entry into force of the full provisions of the third package in April 1997, the subsidy 'window' provided for under the guidelines ended. Moreover, the period of financial austerity

which characterised preparations for economic and monetary union changed Member States' attitudes towards major airline subsidies. Nevertheless, state aid does continue to be granted regularly, for particular routes under the provisions for public service obligations provided for within the guidelines; and, provisions for aid of a social character and regional aid remain valid.

CONTROLLING MONOPOLY ACTION AND ABUSES OF DOMINANT POSITIONS

In addition to keeping a tight control on state aid, the Commission has needed to extend its regulatory action to ensure that the benefits of liberalisation and increased competition within Europe are not lost through excessive concentration and monopoly action, or through major carriers abusing their market positions. The framework for the Commission's antitrust activities is laid down in two Regulations adopted as part of the first package of liberalisation measures in 1987. The first of these, Regulation 3975/87, controls the application of the competition provisions of the Treaty, under Articles 81 and 82, to air transport services, and allows the Commission to investigate suspected infringements, take decisions and where necessary impose penalties or confer individual exemptions. The second, Regulation 3976/87, authorises it to adopt block exemptions from the competition rules in a number of specific areas where cooperation between companies produces benefits for consumers which outweigh any negative effects on competition.

Block exemption on computer reservation systems

Two block exemptions have been adopted by the Commission under the terms of the latter Regulation. The first was introduced in 1991, was renewed in 1993 and expired in June 1998. It allowed cooperation between airlines for developing computer reservation systems, on the understanding that few individual European undertakings would have the wherewithal to make the necessary investments on their own.

Tussles with IATA over block exemption rules

A further, more broad-ranging exemption was introduced in 1993, which covered the joint planning of schedules, the joint operation of air services on certain routes, the distribution of slots at busy airports, and consultations on passenger and freight tariffs. In adopting the exemption, the Commission showed some concern over the implications of allowing cooperation on tariffs in particular. Nevertheless, it chose to allow consultations on both freight and passenger rates on the grounds that such discussions could facilitate interlining between airlines, and thereby benefit both carriers and users.

IATA surcharge on air freight movements withdrawn

The exemption had the effect of authorising consultations within the IATA Tariff Coordinating Conferences. However, when IATA adopted resolutions, on two occasions during 1993, providing for the imposition of a worldwide fixed surcharge on all air freight movements, the Commission objected. IATA argued that the surcharge fell within the scope of the block exemption because it would facilitate interlining. The Commission said the aim of the surcharge was to raise revenue (estimated by the Commission to be worth up to Ecu100m for air carriers), would not facilitate interlining, and should not benefit from the block exemption. The Commission noted, in its annual competition report for 1993, that, as a result of its objections, IATA withdrew the surcharge. The same year, the Commission also reported an objection to an IATA resolution which restricted the freedom of passengers to purchase tickets outside the country of origin. The IATA resolution was subsequently modified so that the provisions were no longer applicable to travel within the EC, Norway and Sweden.

Some aspects of 1993 block exemption extended to 2001

The Commission withdrew the exemption for cargo tariff consultations (i.e. that provided by the 1993 block exemption) as of July 1997. It justified the action on the grounds that the rate of cargo interlining in the EU had declined rapidly, while the permitted consultations were producing recommended tariffs which were higher than market rates and which were encouraging carriers to raise their prices. In response, IATA notified the Commission, in January 1997, of a revised framework for such consultations within the European Economic Area, and applied for an individual exemption under Article 81-3 (Article 85-3 at the time). The new system, to provide for a single recommended per-kilogram rate, would, it said, facilitate interlining without harming competition.

The 1993 block exemption itself expired in June 1998 and the Commission launched what it described as "intensive investigations" to examine whether the various concessions should be renewed. Having consulted industry and having held talks with a Member States' advisory committee on agreements and dominant positions in air transport (established under the competition Regulation 3975/87), it concluded, in May 1999, that the provisions on joint planning and scheduling and joint operations could no longer be justified because there were "hardly any such agreements currently in force". However, the clauses relating to slot allocation and passenger tariffs were extended until June 2001 pending further investigation by the Commission.

Chapter Three

Policing airline mergers and cooperation alliances

As a consequence both of the liberalisation process in Europe and the US, and of general trends towards globalisation within the sector, many airlines have sought to strengthen their positions in the single market by acquiring shareholdings in another carrier. All the European flag carriers have acquired subsidiaries, or stakes in other airlines, a trend accelerated by EU legislation conferring management independence on the airlines and by the erosion of Member States' own shareholdings. Such concentrations have been used mainly to allow carriers to gain control of their domestic markets, as occurred with Air France's takeover of Air Inter, and Austrian Airways' acquisition of Tyrolean; and to gain a foothold in another Community market, as demonstrated by British Airways' activities with regard to Deutsche BA, TAT and Air Liberte.

Merger approvals linked to commitments on slot releases

The Commission's main instrument for ensuring concentrations do not harm competition is the Community merger Regulation. In 1995, for example, the Commission approved the acquisition of a 49.5% stake in Belgian carrier Sabena by Swissair, but, because of the scale of the transaction, it insisted that Swissair sever its connections with a major existing European carrier alliance. It also obtained commitments from Switzerland and Belgium that airport slots and traffic rights would be made available to other carriers wanting to operate flights between Switzerland and Belgium. In August 1999, the Commission approved a merger, to take place progressively, between Alitalia and KLM. The partners, however, agreed to make up to 224 weekly take-off and landing slots available for new market entrants on the routes from Amsterdam to Rome and Milan. They also made further commitments on reducing flight frequencies and making interlining agreements with any new entrants.

The extent of the major airlines' shareholdings in one another remains relatively restricted, however. Aside from the reluctance of certain Member States to allow more than a partial privatisation of their flag carriers, there remains the issue of nationality clauses in their bilateral air services agreements with third countries: if control of an airline from a given Member State, carrying out services between that Member State and a third country under the terms of a bilateral agreement, comes under the control of nationals of a different country, it loses the traffic rights conferred by that agreement. This issue has become interwoven with the Commission's campaign to wrest control, from the Member States, for certain competences over external relations (see below).

Other forms of alliance operate at a purely commercial level, without the partners acquiring shareholdings in one another. These include, for example, code sharing arrangements under which carriers operate services carrying both their own passengers and those of their partner carrier, and sell tickets for flights operated by both companies. While various forms of cooperation, notably arrangements which promote interlining or which support services on routes with low passenger densities, are permitted under the competition Regulation 3975/87 and its block exemption, more complex or far-reaching arrangements which are likely to distort competition must be approved by Brussels. The Commission has the power, for example, to investigate suspected breaches of competition law, and to confer individual exemptions upon request, subject if necessary to conditions.

Conditions imposed on link-up between Lufthansa and SAS

The link-up between Lufthansa and SAS, which the Commission approved in early 1996, was one such case. At the centre of the arrangement was a joint venture which became the sole vehicle for both airlines with regard to services between Scandinavia and Germany. However, the alliance also provided for significant cooperation between the two carriers on other routes. Investigating the agreement, the Commission concluded that it would strengthen the position of EU aviation on a global scale, and would bring significant benefits for consumers, but would also have anticompetitive effects within the EU. Consequently, it chose to authorise the partnership for a ten year period, but only subject to a number of conditions. The airlines were obliged, for example, to make available to would-be competitors numerous slots at Frankfurt airport, and to limit flight frequencies. They were also ordered to conclude interlining agreements with new market entrants, to let such carriers participate in frequent flyer programmes, and to end some of their cooperation agreements with other airlines.

Regulatory difficulties over transatlantic alliances

More controversial, and more difficult for the Commission to handle, however, has been the issue of transatlantic alliances. The transatlantic trade represents a vital source of revenue for the major EU carriers, accounting for roughly half the long-haul traffic - and 30% of the overall traffic - for the carriers belonging to the Association of European Airlines. With the US domestic markets

closed to non-US carriers, the EU's airlines have sought ways in which to offer their customers access to a range of destinations beyond the gateway airports they fly into. The potential for gaining access to the market through shareholdings and acquisitions, however, is also minimal because of legislation limiting foreign ownership of US carriers to a maximum of 25% (conversely, the EU allows up to 49% foreign ownership of its carriers).

The strategic alliance has, therefore, become the preferred form of partnership between EU and US carriers, allowing them to build up large international hub-and-spoke networks. Initially these alliances - pioneered by the early links between KLM and Northwest, which began to develop in earnest in 1992 - tended to be based on code sharing agreements. By the mid-1990s, however, more far-reaching partnerships were being concluded which effectively provided for the partners to act as a single entity on certain routes - with joint logos and advertising - and to abandon competition between themselves, while remaining legally autonomous. Approval by the US government for such alliances was made conditional on the conclusion of bilateral open skies agreements with the individual Member States (see below).

The Commission's growing sense of frustration

The European Commission watched the development of such alliances (and its linked objective of an EU-US open skies agreement - see below) with a growing sense of frustration. Prior to the adoption by the Council of competition rules covering air routes within the EU, as part of the first legislative package, it had argued that they should also cover routes going beyond EU borders, but the Council had opposed the idea. Then, in 1989, the Commission again put forward proposals aimed at Community regulation over extra-Community routes, but was again rebuffed.

Brussels spurred into action by BA-AA proposal

In July 1996, when British Airways (BA) announced a major new alliance with the US carrier American Airlines (AA), one which would have a market share of over 70% on the key London-New York route, and even greater control over the London-Boston and London-Chicago routes, the Commission lost patience. It announced three separate procedures.

Three separate investigations into EU-US alliances

Without any specific provisions for applying Articles 81 and 82 (Articles 85 and 86 at the time) to the proposed agreement, it decided to use the discretionary powers provided under Article 85 (Article 89 at the time) to open an investigation into air services between the EU and the US. It also opened an investigation, based on Regulation 3975/87, into air transport services within the EC; and, it opened a third enquiry into non-transport services (such as CRS), under Regulation 17 (Chapter Two). Other alliances were drawn into the same three investigations: Lufthansa/SAS and United Airlines (later to become the foundation of the worldwide Star Alliance); Swissair/Sabena/ Austrian Airlines and Delta Airlines; and, later, KLM and Northwest. In early 1998, it also opened investigations into separate cooperation agreements between Air France and, respectively, Continental Airlines and Delta, but these were subject only to a procedure relating to the transatlantic services.

Commission attempts to regulate external routes

During the course of its investigations into the transatlantic air alliances, in May 1997, the Commission put forward two draft Council Regulations designed to address the regulatory problem: i.e. the lack of an instrument for applying EC competition principles to cooperation between airlines on extra-Community routes. The first of the two proposals aimed simply to extend the existing framework (under Regulation 3975/87) for applying the Treaty competition rules to airline agreements within the Community, to cover routes going beyond its borders. This would give the Commission the right to examine alliances and to grant individual exemptions on a case-by-case basis. The proposal also sought to allow the Commission to negotiate with third countries on antitrust investigations of mutual interest, or in the event of them adopting national laws or rules affecting competition on air routes involving the Community. With the second draft Regulation, the Commission sought Council approval to adopt or withdraw block exemptions for various forms of cooperation between airlines on extra Community routes, in much the same way as Regulation 3976/87 allows it to do within the EU. As with the Commission's earlier attempts to gain competence in this area, however, the Council failed to respond.

Unhappy at the Commission's interference in the airline alliances, the UK and German governments opened their own parallel national investigations under the provisions of Article 84 (Article 88 at the time), a rule which applies when the Commission has no established competence in a particular area. While the German government chose to cooperate with the Commission, however, the UK Conservative administration of the time insisted that its own vetting of the BA-AA alliance had legal priority. As a result, a major dispute arose between the UK and the Commission concerning the conditions under which the alliance should be approved.

As in its earlier Decision regarding Lufthansa/SAS, the Commission wanted to use compulsory slot surrender - this time at London's main airports - as a tool for limiting the alliance's impact on competition. The UK agreed with the general approach, but the two sides were way apart on the number of slots to be surrendered: the UK's competition authority had suggested the partners should dispose of 168 slots, which they should be allowed to sell; the Commission, by contrast, insisted that they should surrender 350 slots, without compensation. The dispute reached its nadir when, in January 1997, the then Competition Commissioner Karel van Miert wrote to the UK threatening action in the Court of Justice if the alliance was approved under conditions it regarded as too lenient.

Dispute between Brussels and London

Stringent conditions imposed on BA and Lufthansa alliances

Following the election of a less belligerent left-wing administration in the UK in May 1997, cooperative talks behind closed doors replaced the previous high profile public posturing. British Airways, though, complained it was being treated more harshly than airlines involved in other transatlantic alliances, and threatened to abandon the alliance if the conditions imposed were too severe. The Commission reached preliminary verdicts on both the BA-AA and Lufthansa/SAS-United alliances in June 1998. It decided that both alliances could be cleared, as expected, subject to strict conditions, two in particular. Firstly, it said, the alliances would have to reduce their frequencies on hub-to-hub routes carrying over 120,000 passengers annually, if asked to do so by a competitor during a six-month period following approval of the alliance. This proviso covered BA-AA's services between London and Dallas, and between Miami and Chicago; as well as Lufthansa/SAS-United's direct flights between Frankfurt and Washington and Chicago.

Key provisions on surrendering of slots

The second, more controversial condition related to slot surrender. Under the Commission's terms, BA-AA would be forced to make a maximum of 267 weekly slots in London (mostly at Heathrow but also at Gatwick) available to rival airlines who wished to launch or expand services, and who had been unable to obtain the necessary slots through the pool system established under the Community slot allocation Regulation. The Lufthansa/SAS-United alliance would have to cede a maximum of 108 slots at Frankfurt and Copenhagen airports. In both cases, the slots (and additional related facilities) would have to be given up "without compensation". The surrendered slots themselves, the Commission stressed, could only be used by rival airlines wishing to launch a competing service on the same routes for which the slots had previously been used.

A number of supplementary conditions were attached to the provisional approvals. These related to frequent flyer programmes, CRS displays, relations with travel agencies and corporate customers, and interlining. Furthermore, the Commission stipulated that the UK, German, Danish, Swedish and Norwegian authorities must give traffic rights to all EEA carriers on routes between themselves and the US under conditions of tariff freedom. It would then, it said, "on the basis of the position taken by the US authorities, assess whether the US authorities will authorise the operation of services by EEA carriers to ensure a sufficient degree of competition on the markets concerned" - in other words, the extent of competition would depend on the traffic rights awarded by the US.

Status of the various EU-US alliances

By autumn 1999, although the Commission had yet to give final approvals, the Lufthansa/SAS-United partnership had received US antitrust approval and was operating, as planned, at the heart of the multi-carrier Star Alliance. The KLM-Northwest and Sabena/Swissair/Austrian-Delta partnerships remained under investigation (although by autumn 1999 this latter partnership looked troubled with Austrian Airlines switching to the Star Alliance and Delta linking up with Air France), and the Commission had yet to reach a preliminary verdict on them. The Commission's consideration of the BA-AA link-up, however, had effectively been suspended at the end of 1998 due to the failure of the UK and US governments to agree on an updated version of their existing, somewhat ancient, bilateral air services treaty. This is because US antitrust approval for the alliance had been inextricably linked to the conclusion of a new accord, but the talks had floundered over the issue of access to Heathrow Airport. The future of the proposed alliance was made more uncertain, in July 1999, when the airlines withdrew their application for US antitrust approval. However, the two carriers had already begun cooperating to a lesser extent within the Oneworld grouping.

Controlling anticompetitive behaviour at airports

Since the early 1990s, the Commission has seriously sought to prevent distortion of competition at airports from jeopardising the internal aviation market. Airport operators, by their very nature, wield substantial power over activities within the airport perimeter, and are only subject to competition from other airports. Many European airports are still run by state firms, leading to situations where airport services are manipulated to benefit the national flag carrier. To prevent

this happening, the Commission has pursued an active policy, focusing on two key issues: groundhandling and airport charges.

In the case of groundhandling, a large number of complaints over unfair and discriminatory practices led, ultimately, to the adoption of a Directive designed to break down the monopolies at the heart of the problem (see above). However, that Directive will not be fully in force until 2001. Otherwise, the Commission has considered distortions of competition largely in the light of Article 82 of the Treaty, which forbids abuses of a dominant market position, and Article 86, which binds Member states to disband measures, applying to public undertakings or those granted "special or exclusive rights", which are likely to distort competition illegally.

Monopoly abuses at Spanish and German airports

In 1992, the Commission reacted to two cases of what it perceived as unfair monopoly action by Member States. Firstly, it ordered Spain to disband a system of discounts on groundhandling charges at Spanish airports which only benefited Spanish carriers, and to remove measures obliging the state carrier Iberia to provide third party handling services far more cheaply to Spanish carriers than to their foreign rivals. Spain initially failed to comply, forcing the Commission to apply further pressure. Secondly, it responded to complaints from British Midland over Germany's refusal to allow it to buy groundhandling services from the Scandinavian carrier SAS during stopovers at Frankfurt. The ban stemmed from German laws stipulating that foreign airlines could only provide services if German carriers were given equivalent rights in those airlines' country of origin. The Commission informed Germany that the reciprocity requirement was illegal, forcing it to back down.

Unlawful groundhandling practices at Athens, Frankfurt and Paris airports

In 1994, the Commission opened infringement proceedings against Greece over the exclusive rights, enjoyed by national carrier Olympic Airways, to provide third party groundhandling services at Athens airport. This investigation came in response to complaints from carriers that Olympic's monopoly had led to poor quality services and non-transparent tariffs. The Commission concluded, in 1996, that Olympic Airways was indeed abusing a dominant position, informed Greece accordingly, and called for the situation to be remedied. The case was not closed until late 1997 when Greece agreed to a wholesale reform of airport practices, including improvements to the Athens terminal used by foreign carriers, and amendments to the laws on temporary work (which had previously prevented Olympic from recruiting seasonal personnel). Greece also agreed to allow a competitor to provide handling services as of January 1998, as well as ramp services as of January 1999.

A more recent Decision - and one which did not involve a state monopoly - concerned Frankfurt airport. Complaints were lodged, under Article 82 (Article 86 at the time), by Air France, KLM and British Airways that the Frankfurt operator was abusing its dominant position by not granting airlines the right to provide their own groundhandling services, or to buy them from other airlines. The Commission concluded, in June 1998, that the monopoly could not be justified on the grounds of space or capacity constraints, as the airport operator had argued, and it ordered the company to present a detailed plan as to how it would to open up the groundhandling market (at the same time, however, it allowed Frankfurt a partial derogation from the terms of the Groundhandling Directive).

AdP not fined because the case involved a new situation

In June 1998, meanwhile, the Commission took a Decision which reflected the changes brought about by the Groundhandling Directive, and the different issues raised by the legislation. The Decision related to Paris Orly, where the Air France groundhandling subsidiary, Orly Air Traiteur, was already in competition with the private in-flight catering firm Alpha Flight Services. The latter complained to the Commission that the airport operator, Aeroports de Paris (AdP) was charging lower commercial fees to its rival. The Commission subsequently found that AdP charged higher fees to firms conducting third party handling than to airlines carrying out self-handling. However, as the case involved a new situation, created by the opening up of the market achieved under the Directive, it did not impose fines.

Discriminatory airport charges in Belgium, Portugal and Finland

Like groundhandling services, airport charges have also required close scrutiny by the Commission. A key case in this respect involves Brussels Zaventem. Following complaints from an airline, the Commission decided, in 1995, that a system of discounts on landing charges, provided for under national law, unfairly benefited the Belgian carrier Sabena. It concluded that the system constituted an illegal state measure which threatened to distort competition between airlines. Belgium was ordered to withdraw the system. Despite launching a case in the Court of Justice, the Belgian government was obliged to dismantle the system pending a judgement. By

early 1997, Belgium still had not done so and the Commission itself went to the Court. A short time later, Belgium disbanded the discount systems, and the Court cases were withdrawn.

General investigation of landing charges

In the wake of the Zaventem case, the Commission launched a general investigation of landing charges, which resulted, in February 1999, in two further Decisions, one aimed at Finnish airports and the other at Portuguese airports. With regard to Finland, the Decision noted that domestic flights benefited from a discount of 60% as compared with intra-Community flights, for no objective reason - the Finnish civil aviation authority (FCAA) was unable to demonstrate any cost differential between the two types of flight. The Commission said this Decision was the first dealing with the cost of access to airport facilities to be taken under Article 82 (Article 86 at the time) of the EC Treaty. In view of that fact and the positive attitude by the FCAA (it had dismantled part of the system of discounts and reduced the gap between charges for domestic flights and those for intra-Community flights), the Commission said it would not impose a fine.

The Decision aimed at Portugal, taken under Articles 82 and 86 (Articles 86 and 90 at the time), concerned the charges levied for services such as the maintenance and operation of runways, and approach control, provided by the Portuguese airports administrator Aeroportos e Navegacao Aerea (ANA). The Commission said two charges - a 50% discount on landing charges for domestic flights compared with intra-Community services, and a volume-based discount ranging between 7% and 32%, depending on the number of monthly landings - should be abolished. As in the Finnish case, the Commission said, discrimination in Portugal between domestic flights and other flights had the effect of artificially modifying the cost structure of certain airlines, without any objective justification. It suggested all other airports in the EU adopt pricing policies in line with these two rulings, "in order to avoid significant fines".

The Commission's intervention over capacity allocation at Malpensa

The Commission has also acted to prevent discrimination in the allocation of airport capacity. In September 1998, it outlawed Italy's plans for redistributing Milan's air traffic away from Linate airport to a new international hub at Malpensa (under the terms of Regulation 2408/92 - see above), on the grounds that they would give an unfair advantage to the flag carrier Alitalia. The latter, it explained, would retain the right to operate feeder services to its Rome hub from Linate, while other airlines would be forced to operate their own feeder flights out of Malpensa, which was considerably further away from, and had inadequate surface transport connections with, the city centre. Italy subsequently agreed to operate a transitional strategy, leaving a proportion of traffic at Linate until the necessary surface infrastructure had been built. The Commission authorised, by a letter sent in October 1999, a final plan for transferring all the flights to Malpensa during December and January 2000. However, even in December, airline complaints about the Malpensa facilities, which had initiated the original enquiry, were still continuing.

THE EXTERNAL DIMENSION OF THE INTERNAL AVIATION MARKET

In a global industry such as aviation, it is impossible to consider the effective functioning of the internal market without examining the external dimension. Routes to and from third countries are among the most profitable operated by Community and EEA carriers, and account for a very substantial proportion of the larger operators' trade. However, strict regulation and bilateralism continue to affect external traffic, with significant repercussions for the single market itself.

The absence of a common external policy

The principal problem created by bilateral agreements with third countries is where they give foreign carriers the right to operate within the EU, and to compete with EC carriers, while only the airlines of the state operating the agreement have any reciprocal rights. The Commission is concerned that, with the demolition of internal restrictions, the competitiveness of individual airlines is dictated by the contents of bilateral agreements rather than by their efficiency. In its 1996 report on the impact of liberalisation, it commented: "*The absence of a common external policy leaves the internal air transport market in a fragile state and at the mercy of positions acquired through bilateral agreements concluded between the Member States and third countries. Because of the diversity of these agreements, the Member States and their air carriers have to work with non-harmonised systems and rules in their dealings with non-member countries. These rules are in some cases even incompatible with the internal market.*"

Bilateral agreements inhibit useful merger restructuring

In its 1999 Communication on the European airline industry, the Commission highlighted the fact that nationality clauses in the bilateral agreements (which stipulate that traffic rights under each agreement are only awarded to companies majority owned or controlled by nationals of the signatory countries) have restricted potential changes in ownership for fear of the loss of traffic rights. It noted that "as a consequence, the air transport industry, unlike other industries, cannot pursue integration and scale economies through the merger and takeover process". The

Commission suggested this factor was contributing to the continuing relative frailty of EU airlines when compared with their US rivals.

In the report, the Commission maintained that Member States' bilateral treaties in areas affecting the single market were not only undesirable but illegal. It backed up its claims with a reference to the 1970 AETR ruling of the Court of Justice, in which the Court held that Member States did not have the right to assume obligations towards non-member countries, if they affected the internal market and resulted in discrimination or distorted competition.

The Commission's attempts to bring an EC dimension to external policy

Nevertheless, the Commission's attempts to establish a Community external relations policy in the aviation sector have been repeatedly undermined by the persistent efforts of Member States to guard their own interests. A 1980 Council Decision established a procedure for Member States to use in consulting one another on third country relations. In 1989, the Council acknowledged, in unanimously agreed Conclusions, that external relations should be considered as an integral part of Community air transport policy. Subsequently, in 1990, the Commission put forward a proposal to promote further common action in external relations, to create an authorisation mechanism for bilateral agreements. The Council has never made any progress with the dossier, although formally it still remains on the Council's table and could be revived.

The Commission's attempts to promote Community-level market access agreements with third countries have been no less difficult (with the obvious exception of the extension of the single market to the European Economic Area).

Unfinished business with the US over open skies

Without doubt, given the size and importance of the transatlantic market and the potential influence of US carriers in the Community, the US is the single most important aviation partner. In 1994, the US offered to negotiate individual open skies agreements with the Member States. At the time, the Commission warned the Member States that "the conclusion of such bilateral agreements would weaken the EU and that without a common position no Member State should enter into any agreement with the US". Despite being advised against such action, seven States - Austria, Belgium, Denmark, Finland, Germany, Luxembourg and Sweden - went on to conclude new bilateral pacts. The agreements give each party unrestricted rights to operate between gateway airports, with no restrictions on flight frequencies, capacity or prices; as well as unlimited "beyond rights", including fifth freedom rights. Because they represented a potential distortion of the market, the Commission opened infringement proceedings, in 1995 and 1996, against all seven States, and against the UK for an older and less comprehensive but still, according to the Commission, illegal agreement.

Infringement proceedings against seven Member States

In response to the legal pressure, the Council agreed, in mid-1996, to give the Commission a limited mandate to carry out preliminary talks with the US aimed at establishing a common aviation area. It suggested that negotiations should first focus on building a stable regulatory framework to guarantee fair competitive conditions for carriers. At a later date and if necessary, the Council said, it could grant a mandate for a second round of talks which would concentrate on issues such as traffic rights. However, following initial discussions, the Commission reported back that, while the US was in favour of negotiating a comprehensive deal, possibly on the basis of the EU's third package, it would not begin serious negotiations until the Commission had a full mandate allowing it to negotiate traffic rights immediately.

Commission granted limited mandate for open skies talks with US

Since then, the Commission has repeatedly gone to the Council requesting an extension to its mandate, supporting its case with detailed arguments and studies. The Council has consistently refused, with the staunchest opponents to an extended mandate including Spain, Portugal and the UK, which felt they might be disadvantaged by not having concluded a prior full bilateral agreement with the US. In the face of this opposition, the Commission, having reactivated its eight infringement proceedings went on, in December 1998, to lodge the cases at the Court of Justice. The accords were illegal, it said, because they would "affect the objectives, scope and operation of the internal market in air transport as established by all of the joint EC rules which made its creation possible". A further case against France, which concluded an agreement with the US in 1998, is also a possibility, as is one against Italy which signed an agreement in late 1999.

Infringement procedures taken to Court of Justice

Progress towards agreements with the CEEC

The Commission has had more success in its efforts to extend the single aviation market within Europe. In October 1996, the Council granted it a mandate to carry out negotiations with a view to extending the common aviation area to the ten applicant countries of Central and Eastern Europe (CEEC). The Council's willingness to allow such negotiations reflected the fact that all ten countries are expected eventually to join the EU, and that an agreement would provide a useful

incentive to encourage them to adopt the Community acquis in the sector as rapidly as possible. A first round of bilateral meetings was held with each of the ten CEEC during the spring of 1997, allowing the Commission to assess to what extent each conformed with the acquis, and where potential problems could lie.

The results of this first phase of visits were laid down in an internal Commission report, in May 1997, which revealed a mixed picture. It suggested that, although most of the candidate countries were in the process of revising their principal aviation laws, bringing certification and licensing criteria in line with Community rules, and cooperating with the Joint Aviation Authority (JAA) to adopt Joint Aviation Requirements (JARs), considerable work would be required. Harmonisation measures were still needed in most cases with regard to CRSs, noise limits, slot allocation and consumer protection. Safety concerns were raised with regard to a number of countries, notably Bulgaria and Lithuania, where the civil aviation authorities were hampered by budgetary restrictions, and the Slovak republic, where a lack of understanding between the civil aviation authority and the transport ministry was causing problems.

From the early talks, the Commission concluded that, although all ten countries were willing to integrate their markets into a common aviation area in the long term, only Latvia, Slovenia, Romania and Estonia wanted to proceed rapidly and adopt the third package rules without any transitional arrangements. The other states, notably the Czech Republic, favoured a more gradual process. This led the Commission to embrace a strategy involving the conclusion of a single multilateral instrument establishing the principle of a common aviation area, with bilateral arrangements for a staged introduction of the Community acquis, including a progressive opening up of markets, negotiated individually and laid down in ten annexes. This approach was greeted enthusiastically by the ten CEEC, and the Commission rapidly began work on a draft text. By mid-1999, following further rounds of multilateral talks and bilateral contacts, the substance of the overall agreement had been largely established, although further elaboration was needed on the individual country annexes. The Commission remained hopeful, however, that the accord could be signed in early 2000. The Commission has also proposed a mandate for negotiations with Cyprus, and also expects to put forward one for Malta, whose stalled application for accession to the EU was reactivated in late 1998.

Multilateral accord with the CEEC nearing conclusion

The terms of the bilateral agreement with Switzerland

As a result of its refusal to join the EEA in 1992, Switzerland has remained outside the common aviation area, despite being close to the geographical centre of Europe. However, an agreement on air transport drawn up as part of a package of seven bilateral treaties with Switzerland initialled in February 1999, and formally signed in July the same year, will bring Switzerland into selected parts of the EU's third package. It also provides for reciprocal freedom of establishment for air carriers and will allow consultation and safeguard measures in relation to agreements with third countries and international organisations. On the key question of traffic rights, it liberalises, on a reciprocal basis, routes between any point in the Community and any point in Switzerland. At the insistence of Switzerland, it also confers fifth and seventh freedoms on Swiss airlines, allowing them to carry passengers between EU Member States.

This latter concession was made during the negotiations because, according to the Commission, the Swiss "felt unable to justify accepting the general jurisdiction of Community institutions unless this was founded on complete integration into the single air transport market", and the inclusion of fifth and seventh freedoms was considered a gesture in that direction. However, presenting the agreement to the Council for formal approval, the Commission said that the move was unlikely to have any major commercial implications; the take-up of such rights within the Community had been minor, it said, with airlines preferring to expand into other Member States by buying or establishing subsidiaries, and it appeared likely that Swiss carriers would do likewise. The Agreement itself, meanwhile, is not expected to enter into force until 2001, subject to the successful ratification by Switzerland of all seven bilateral agreements (Chapter Sixteen).

Collated figures for top ten airlines in each region (1997)

	Passengers (m)	RPK* (m)	Revenue ($m)	Employees	Fleet
US	524.12	900,066	86,249	461,852	3,529
EU	212.68	446,677	63,203	275,580	1,430
Asia/Oceania	199.08	412,130	46,879	195,360	1,051

Source: COM/99/182

* revenue passenger kilometres