

**Presentation by the Director General of Hermes - Air Transport Organisation at
Session 4 Liberalization of Airline Ownership and Control: Addressing Social and
Labour Concerns - ICAO Virtual ATRP informal meeting on Air Carrier Ownership
and Control
(Zoom - 18 November 2020)**

Air transport promotes freedom of movement and brings people closer together. Yet the providers of this freedom, the airlines, operate in a cage of regulatory complexities second to no other international industry. One of these complexities is the “ownership and control clause” found in international air services agreements and most national (or regional – EU) legislations alike. Ownership and Control (O&C) restrictions, by the way applicable only to airlines and no other part of the aviation value chain (airports, manufacturers etc), have caused airlines some headaches:

First, the restrictions prevent cross-border mergers which are an important component to expansion, consolidation of operations and growth in any other industry. Airlines have had to make do with (awkward) structures of joint ventures and airline groups (even within the EU where O&C has been fully liberalised). These were the only ways to achieve economies of scale and expand networks to better accommodate consumer demands but do not replace or fully realise the potential and benefits of full mergers.

Second, the airline industry is highly cost intensive, characterised by cyclical demands, vulnerability to external shocks, and very low profit margins compared to other industries. These difficulties are aggravated by airlines’ limited access to financing. For some airlines securing capital from foreign investors is vital to their survival. Limiting foreign investment also negatively impacts transfer of know-how to the airline business and may deprive passengers from stronger competition.

Considering all this, why stick to the O&C restrictions? What purpose do they still serve today? And what impact would their removal or liberalisation have on the industry, workers and consumers?

Some of the arguments put forward in favour of maintaining O&C restrictions are: the maintenance of traffic rights under bilateral air service agreements, providing a clear identity and link to a regime of national labour law and safety and security oversight, preventing “abuse” of traffic rights by nationals of States that do not have rights under the governing air services agreement.

Hermes - Air Transport Organisation in 2018 launched a call for position papers on ownership and control in airlines with the participation of IATA, ACI, CANSO, ECAC, AACO, AASA, AFRAA, ERA and the WB

The 2018 Hermes Report Committee under the lead of the ex-Secretary General of ICAO and Honorary Member of Hermes, Raymond Benjamin came up with the summary on the topic of ownership and control in airlines.

The members of the committee are:
Chairman

Raymond Benjamin, Honorary Member, Hermes – Air Transport Organisation & ex Secretary General, ICAO

Securing airline financing is faced by severe difficulties. As in every industry including other parts of the air transport supply chain, investors are expected to carefully balance expected returns against undertaken risks. Small markets and inability to reap economies of scale and scope may significantly discourage investors who also prefer to avoid funneling money into fragmented sectors characterized by hyper-competition. Moreover, complexities in the regulatory environment and legal uncertainties create further disincentives for investment. These regulatory barriers may limit market size; allow inefficient carriers to remain afloat; and raise investment risks from a legal perspective. In fact, these barriers may significantly inhibit financial/portfolio investors, while the inability to effectively control an airline may discourage strategic investors and deny any potential synergies emerging at a systemic airline level. Securing financing from governmental sources is also a difficult issue. In some regions, like in Europe, subsidizing airlines is forbidden for competition reasons. In several cases, governments have other priority sectors to finance rather than aviation.

Current attempts to circumvent the regulatory restrictions, whilst producing benefits, are not allowing the industry to realize its full potential. In particular, there seems to be empirical support that effectively dealing with ownership and control clauses either through circumvention or through non-application by governments may have a positive impact for the airline sector. The European Union has created new industry dynamics by substituting national with community ownership and control clauses thus encouraging inter alia the development of low fare airlines and allowing consolidation through mergers and acquisitions among network carriers.

In Latin America, LAN has successfully engaged in transnational acquisitions, creating among others LATAM, while Australia and New Zealand have also adopted a liberal stance vis-à-vis international ownership and control of their carriers. It is of interest also to note that even in parts of the world where national clauses in ownership and control are powerful, alternative market responses are also possible. In fact, the establishment of the three strategic alliances (i.e. Star, SkyTeam and oneworld) among network carriers about twenty years ago is certainly a success story in terms of creating a seamless global network experience. Similarly, low fare airlines such as Air Asia/JetStar and Air Arabia have managed to establish a solid presence in Australasia and Middle East/North Africa respectively by establishing local subsidiaries. Yet, all these circumvention efforts, irrespective of how successful they may prove in the short- and possibly in the medium term, add costs; raise complexity; and create legal uncertainties. Thus, they fall short of achieving the benefits of full integration offered by a relaxation of ownership and control clauses. Even the community clause introduced in the European Union may face legal challenges on international routes and markets when third (i.e. non-EU) countries are reluctant to accept it in the renegotiation of their bilateral agreements.

In any case, financing will flow to the airlines that investors believe are most likely to be successful. Successful airlines will be the carriers that have the lowest operating costs and/or the greatest ability to generate revenues. For example, airlines that can best use customer data to develop ancillary revenues may be able to gain market share, since the ancillary revenues will allow the carriers to lower base fares.

We see the future industry as one dominated by carriers pursuing cost leadership and/or revenue generation models that extend beyond national boundaries. These carriers will have the access to private financing necessary for fleet acquisition and will be able to gain market share over carriers that are more reliant on government financing. Clearly, the industry will require a shift from a nationally-based industry to a market that better allows for international growth. As an example, the European Union community carrier approach has allowed for the development of carriers with successful business models that offer consumers increased choices in air travel. This approach requires individual states to recognize community-wide ownership and control of carriers domiciled in the community of states. Other regional blocs could adopt similar approaches to facilitate the creation of successful carriers.

The successful airline industry that will emerge will be well-managed, attract investments, benefit travelers and drive GDP growth. Regulatory barriers, such as ownership and control, are obstacles to the movement towards this emerging industry, but are not insurmountable obstacles. The barriers can be lifted by governments or circumvented by airlines. However, the barriers may remain in certain regions of the world due to the political will and priorities of the countries in those regions. Ultimately a new multilateral approach to airline regulation will only emerge under the auspices of ICAO.

In conclusion

Decision makers should consider the benefits of being proactive in creating the environment that will allow airlines access to the capital necessary to effectively compete in the industry. This may include relaxing ownership and control restrictions within a regional context. States should consider acting in concert with like-minded states to seek regional solutions to develop the environment needed to support aviation growth. Moreover, regional blocks should develop a dialogue with other regional blocs to facilitate aviation growth for the benefit of their populations and economies.

Although ownership and control may not be seen as a major problem to some governments and airlines given the advent of alliances and the other workarounds employed to facilitate air transport, it may be the case that the states that are proactive in developing policies that facilitate aviation growth will produce the winning airlines in the long run.

Thank you.