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The EU's External Aviation Policy - Addressing Future Challenges

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The EU's External Aviation Policy - Addressing Future Challenges

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The EU's External Aviation Policy - Addressing Future Challenges

1. INTRODUCTION

1. Aviation plays a fundamental role in the European economy both for EU citizens and industry. By supporting 5.1 million jobs and contributing €365 billion or 2.4% to European GDP¹, it makes a vital contribution to economic growth, employment, tourism, people-to-people contacts as well as the regional and social cohesion of the Union. As set out in the Commission's 2011 Transport White Paper², aviation is and will remain essential for connecting Europe with the rest of the world. Over the last two decades, by removing historic barriers, the EU has transformed and integrated fragmented national aviation markets into the single largest and most open regional aviation market in the world.
2. But Europe has been harder hit by the global recession than other regions, and the competitive position of its international airlines in particular is under threat from a number of different challenges. This Communication argues that the EU's external aviation policy needs a major and rapid transformation to meet these challenges: Europe must maintain a strong and competitive aviation industry at the centre of the global network that connects the EU with the rest of the world. We must properly reflect aviation's strategic role in general, the particular role which is played by EU carriers, airports, manufacturers and service providers in terms of growth, jobs and the major contribution that aviation can make to the EU's growth strategy "Europe 2020" and to the recovery of the European economy. Europe's airlines are on the front line of this competitive challenge and are fighting to survive in a tough international market³ that is characterised by diverse regulatory frameworks and cultures, by bilateral air services agreements which restrict market access, and by competition that is often distorted in third countries by unfair subsidies or practices such as over-flight restrictions.
3. This Communication evaluates the progress achieved since the Commission's 2005 Communication in developing an EU external aviation policy⁴. It is focused on

¹ "Aviation: Benefits Beyond Borders", Report prepared by Oxford Economics for ATAG, March 2012. It should be noted that these figures include considerable indirect and induced effects which multiply the impact of aviation on the economy.

² Roadmap to a Single European Transport Area – Towards a competitive and resource efficient transport system", COM (2011) 144 final, 28.3.2011.

³ While forecasting a total net profit of \$3 billion for 2012 for the world's commercial airlines, in its June 2012 financial forecast, IATA forecasts a net loss of \$1.1 billion for European commercial airlines.

⁴ In 2005, the Commission presented a Communication entitled "Developing the agenda for the Community's external aviation policy" (COM(2005) 79 final, 11.03.2005) on the basis of which the Council adopted Council Conclusions in June 2005 and the European Parliament adopted a Resolution in December 2005.

"classical" aspects of international aviation relations and agreements, but also discusses several other important aspects with a strong international dimension which play an increasingly important role in market growth and our overall competitiveness, such as: the development of the Single European Sky and its related technology pillar SESAR (Single European Sky ATM Research); European safety policy, with a growing international role for the European Aviation Safety Agency (EASA), bilateral aviation safety agreements (BASAs) as well as technical cooperation; European aviation security policy, aimed at preventing unlawful interference in civil aviation and European airport and infrastructure policy which must deliver viable and cost-efficient infrastructure. Any revision and strengthening of the EU's external policy on aviation must take these important elements fully into account.

4. While the Communication concludes that the policy established in 2005 goes in the right direction, we need to recognise that, seven years later, the world of aviation is a very different place. European aviation urgently needs a stronger framework where fair and open competition can thrive, and this can be ensured by a much more coordinated European approach to external aviation relations. It is in the interests of the European consumer and of the sector's competitiveness for there to be a shared political readiness to push ahead with EU-level negotiations where the added value and economic benefits have been demonstrated.
5. The EU needs to use the full range of tools available, including Council authorisations of EU-level negotiations with major partners as well as European neighbourhood countries, and, where necessary, to defend ourselves more effectively against unfair practices. The EU needs to show leadership in driving change to international ownership and control regimes that will ensure that EU-based global carriers stay prominent in the global network for years to come. In doing so, we must always remember that we are not only looking to strengthen the competitiveness of the entire value chain of European aviation, and all elements within that, but doing so in the interest of the end-consumer.

1.1. Building on progress since 2005 – time for a review

6. The achievements of the EU's external aviation policy over the past seven years, based on three key pillars - restoring legal certainty; the creation of a common aviation area with neighbouring countries; and comprehensive agreements with key partners - are set out in the Annex. In short, they have been considerable. As a result of coordinated efforts between the European Commission and EU Member States, legal certainty has been restored to nearly 1000 bilateral air services agreements with 117 non-EU countries. Solid progress has been made in developing a wider Common Aviation Area with neighbouring countries, with agreements already signed with the Western Balkans, Morocco, Jordan, Georgia and Moldova. More agreements are being negotiated. The economic benefits resulting from the first of these agreements (Western Balkans and Morocco) have been estimated at a total of €6 billion between 2006 and 2011⁵. Since 2005, the EU has also negotiated comprehensive air transport

⁵ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012.

agreements with a number of key trading partners: the United States, Canada and Brazil.

7. Since 2005, the EU's external aviation policy has achieved significant results, enabling the EU to become an important player in global aviation and leading to tangible economic benefits and other advantages. But it is also clear that progress has not been as rapid and extensive as it should have been. The transition from having only bilateral relations between EU Member States and partner countries to a mix of bilateral and EU-level relations has led to occasional confusion among partner countries, and EU interests have not always been best defined and defended. This calls for further efforts to coordinate at EU level between the European Commission and Member States as well as cooperation with industry stakeholders.
8. The changes and challenges facing the global aviation community have enabled the EU to show leadership in pursuing an ambitious and coherent international aviation policy (see below). However, national fragmentation still prevails, with a general lack of unity and sense of solidarity at EU level. We have not yet completed a comprehensive common EU external aviation policy; we are still too much subject to national interests and rely too much on *ad hoc* initiatives based on individual authorisations to negotiate.
9. Recently, a further factor has been the reaction of a large number of international partners to aviation's inclusion in the EU Emission's Trading System. However, given the overall importance of decarbonising the economy, the EU sees sustainable development of aviation as an important subject for our external relations policy, both bilaterally and globally through ICAO. The reactions to the EU ETS demonstrate the need for further collaboration on the climate change issues so as to overcome barriers and increase the scope for mutually beneficial cooperation. The EU strongly supports and reiterates its continued willingness to agree a global approach in ICAO on the issue of aviation emissions so as to enable sustainable development of the aviation industry.
10. What has been achieved over the past seven years represents good progress but is clearly not enough. New challenges are constantly emerging due to the very dynamic and rapidly changing global aviation environment. In addition, these challenges are increasingly of a global scale, which demonstrates the need for joint EU responses, given that solutions are very difficult to achieve at EU Member State level.
11. It is now time to take the EU external aviation policy and vision a significant step forward. Reviewing and upgrading the policy is urgent. The pace of un-coordinated market liberalisation, at EU Member State level with certain non-EU countries is such that if we do not act now to establish a more ambitious and effective EU external policy, then in a few years' time it may be too late. And in this, Member States' apparent intent to continue to grant bilateral air traffic rights to third countries without commensurate return, or account taken of the EU-level implications, could be a contributing factor. In addition, we have not made sufficient headway in tackling ownership and control restrictions. These threaten to ossify the development of a global industry and deny EU carriers important new sources of capital. It is urgent to extend the scope of EU-level negotiations to a number of key and increasingly important aviation partners.

2. KEY CHALLENGES IN A RAPIDLY CHANGING GLOBAL AVIATION ENVIRONMENT

2.1. The medium and longer-term market trends

12. Air transport has almost become an acquired right which is taken for granted in the EU and across the world. Curbing mobility is not an option: connectivity is key to competitiveness. Emerging economies have understandably high aspirations to access to increased travel by air and the gradual appearance of a more affluent population in these markets will contribute considerably to a growing demand for air transport. The global middle class is expected to nearly triple in size by 2030 (from 1.8 billion in 2010 to 4.9 billion by 2030) and rise by more than a factor of six in the Asia-Pacific region⁶.
13. Despite the current economic crisis, global air transport over the long-term is expected to grow by around 5% annually until 2030⁷, a compound increase of more than 150%. Demand for air transport is primarily driven by economic growth and prosperity. With an expected average annual GDP growth rate for Europe of 1.9%⁸ between 2011 and 2030 compared, for example, with growth rates for India and China of 7.5% and 7.2% respectively, aviation growth will see a relative shift to areas outside the EU with Asia and the Middle East in particular expected to become the focus of international air traffic flows. Half of the world's new traffic added during the next 20 years will be to, from, or within the Asia-Pacific region, which will thereby overtake the US as leader in world traffic by 2030 reaching a market share of 38%. Due to below-average growth rates, EU carriers will be losing market shares to non-EU airlines in most regions. In 2003, EU carriers had a market share of 29% of all inter-regional capacity in the world. By 2025, this share is expected to have fallen to 20%.⁹ This trend means that, if nothing is done, European airlines will be less able to generate benefits and growth for the European economy.
14. At the same time, non-EU carriers have reinforced their global position. For example, the fastest regional traffic growth in the world is expected to be in the Middle East, where by 2030 the region's airlines will represent 11% of world traffic, up from 7% in 2010. The global competitive pattern has changed significantly with the rise of the Gulf carriers providing so-called 6th freedom services (connecting markets through inter-continental routes via their hubs), increasing their market shares, positioning themselves aggressively for the future with massive new investments in aircraft and airports and taking advantage of a worldwide network of highly liberal bilateral air services agreements. Governments in the Gulf region have invested heavily in aviation infrastructure, *de facto* turning aviation into a strategic instrument to promote the global role of the region. Similarly, South American markets have grown, albeit from a smaller base; Asian carriers have consistently promoted growth; and US airlines have further consolidated and improved competitiveness, although this has been facilitated by creditor protection legislation.

⁶ Airbus: "Delivering the Future: Global Market Forecast 2011-2030"

⁷ Airbus: "Delivering the Future: Global Market Forecast 2011-2030"

⁸ Bombardier/Global Insight

⁹ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012, based on OAG and AEA Research.

2.2. Competing aviation business models

15. The viability of the various business models being pursued in the EU such as the point-to-point and network service models and their related route systems is important in relation to EU carriers sustaining a competitive presence in external markets.
16. The European airline industry is undergoing significant changes. The network carriers now face strong competition from low-cost carriers. These now represent 40% of the intra-EU capacity on offer and a significant further increase is expected¹⁰.
17. This obviously has a major impact on the operations, performance and profitability of EU network carriers. Low-cost carriers have been far more successful than network carriers in exploiting the new market freedoms created by liberalisation by stimulating new demand through lower fares and offering point-to-point services without any constraints of connecting flights. But they have largely limited themselves to short- and medium-haul operations. In recent years, the large European network carriers have experienced significant losses in their short- and medium-haul intra-European businesses due to increased competition from low-cost carriers and high-speed rail. These losses have in part been off-set by long-haul routes, which are the main revenue sources of these carriers. A vigorous external EU aviation policy targeted at key long-haul growth markets would create new commercial business opportunities for EU carriers.
18. Network carriers are expected to continue to play a key role in international air traffic, delivering 74% of total worldwide traffic by 2030¹¹. Network carriers will therefore remain vital for connecting Europe with the rest of the world and it cannot be assumed that low-cost carriers will contribute much to this other than by feeding into the airports from where inter-continental traffic departs. In that sense, the two business models could potentially develop synergies and convergence between each other.

2.3. The importance of hubs

19. The economic benefits of hubs are well known, enabling "thinner" routes to be operated profitably with the support of connecting traffic. In order to be viable a hub requires a significant level of local demand as well as an extensive network of feeder services, which is why the most successful hubs are usually situated at major city airports.
20. With a few caveats, there is no reason to assume that European airlines are not able to operate viable hubs, whether cargo or passenger, now or in the foreseeable future. However, the under-investment in airport infrastructure and the increasing capacity

¹⁰ Low-cost carriers are expected to grow 1.4% per annum faster than the global network airlines and are expected to operate 19% of world traffic by 2030 (Airbus: "Delivering the Future: Global Market Forecast 2011-2030"). The association of European low fares airlines (ELFAA) has published a study ("Market Share of Low Fares Airlines in Europe – Final Report – February 2011", by York Aviation for ELFAA) which indicates that the market share of low fares airlines in Europe could reach between 45% and 53% by 2020.

¹¹ Airbus: "Delivering the Future: Global Market Forecast 2011-2030"

crunch, which at some European airport hubs are already limiting the number of feeder routes that can be operated, must be effectively addressed if European competitiveness is to be maintained. Investments in airport infrastructure and development of hubs, where justified by a strong and sustainable demand, are crucial for allowing European hubs to compete with those developing in other parts of the world. It is therefore important to identify bottlenecks to growth at an early stage and to remove them or at least limit their negative impact by using all means available to use scarce airport capacity more efficiently.

3. MAIN OBJECTIVES FOR THE EU'S FUTURE EXTERNAL AVIATION POLICY

3.1. Creating fair and open competition

21. Another important caveat is that EU carriers are able to compete on open, fair and undistorted basis.
22. The EU considers open markets as the best basis for developing international aviation relations and therefore embraces competition. This has been a fundamental lesson from the success story of the EU internal aviation market. While it is vital to ensure a business climate that enables EU carriers to compete internationally, the EU's external aviation policy must also stress the importance of fair and open competition. When, for example, subsidies, unfair practices, inconsistent application of regulatory frameworks and lack of transparency in financial reporting of companies are used to distort the market, it is legitimate to defend the industry against unfair competition.
23. Aviation competes as a service industry in a global market, so sustainable competitiveness depends upon fair conditions of competition. Europe-based airlines are at a competitive disadvantage internationally if their production costs are higher than those of other airlines. The competitiveness of EU carriers, many of which are struggling financially, is hampered when the economic burdens that lead to higher unit costs of production are higher than those of carriers from other regions of the world. The application of different national taxes on the aviation sector could have a detrimental effect on the internal market and on the competitiveness of EU-based aviation companies and hence would require further analysis. EU carriers are also handicapped by higher costs resulting from congested airports and airspace in Europe, as well as higher ATM and airport charges. Labour costs related to high labour standards and well developed social protection systems are also higher in Europe than in most other world regions as are costs related to compensation for passengers' rights and the cost of carbon emissions. Some of these additional economic burdens and costs for flights to and from Europe compared to the situation in other regions may prevail, at least for some time, while others may, to some extent, be offset by innovation, earlier deployment of new technology in Europe or productivity gains or may be addressed in negotiations with partner countries aiming to create a level playing field, e.g. by respect for international labour and environmental standards.
24. It is therefore important that the entire aviation value chain (airports, air navigation service providers, manufactures, computer reservation systems, groundhandlers etc.) is considered and that the cost structures, the level of exposure to competition in

other parts of the value chain and infrastructure financing mechanisms in other key markets are taken into consideration when assessing the competitiveness of the EU aviation sector and in particular EU airlines internationally. But EU airlines are ultimately responsible themselves for their competitiveness and for offering the right combination of prices and service quality levels that appeal to customers.

25. It is equally important that competition, both within the EU and externally, is not distorted by unfair practices. Within the EU, the European Commission has recently opened a series of in-depth investigations into cases of potential state aid to airlines from regional airports in several EU Member States. The concern is that airlines receiving such aid obtain an undue economic advantage that competitors do not enjoy, thereby distorting competition within the EU single aviation market. The Commission has also announced in 2012 that it will revise its Community guidelines on financing of airports and start-up aid to airlines departing from regional airports. The recent adoption of EU rules¹² regarding social security for mobile workers in the EU such as aircrew will also improve the functioning of the single market as the practice adopted by some airlines of using the least onerous social security systems irrespective of the crew member's home base can no longer be continued. Adopting or amending EU legislation can therefore contribute to enhancing a business environment that enables EU carriers to compete internationally.
26. On the external side, Regulation 868/2004¹³ was intended to protect against subsidisation and unfair pricing practices causing injury to EU carriers in the supply of air services from non-EU countries. However, strong calls have been made for developing more effective EU instruments in the aviation sector to protect European interests against unfair practices. Regulation 868/2004 has never been used and the industry argues that the Regulation is not practicable as it has been modelled on tools used in anti-dumping and anti-subsidy for goods and is not properly adapted to the specificities of the aviation services sector. The possible remedies and the Regulation's procedural aspects are also considered inappropriate for a services sector. A more appropriate and effective instrument would need to be developed to safeguard fair and open competition in the EU's external aviation relations.
27. The aviation systems against which EU airlines and hubs compete in the Gulf are the result of clear decisions taken to develop aviation as a strategic economic sector generating benefits for the overall economy. Gulf carriers insist that they do not enjoy unfair competitive advantages from these systems. Given this, it would appear that one immediate way forward should be to develop – most appropriately at EU-level – standard "fair competition clauses" to be agreed and included in the respective bilateral air services agreements with EU Member States.

¹² The European Parliament and the Council reached a first reading co-decision agreement on a proposal from the Commission to amend Regulation (EC) No 883/2004 on the coordination of social security systems and Regulation (EC) No 987/2009 laying down the procedure for implementing Regulation (EC) No 883/2004.

¹³ Regulation (EC) N° 868/2004 of the European Parliament and of the Council of 21 April 2004 – Official Journal 30.4.2004 (L 162/1).

28. In this new commercial context, it is both important and legitimate that the EU is able to act effectively internationally to safeguard the competitiveness of EU airlines against unfair competition and/or practices wherever they may come from.

3.2. A growth strategy based on "More Europe"

29. The EU aviation sector, notably Europe's international network carriers, has gone through a difficult period and is still facing very serious challenges ahead. Meeting these challenges requires concerted and rapid efforts at EU level, with more coordinated action that must be more effective than the current system of bilateral negotiations and relationships. The EU, where united, has shown that it is capable of delivering added value. This applies both to negotiations and when it comes to ensuring the proper functioning of agreements through, for example, common positions in the Joint Committee under the various agreements.

30. The independent study carried out for the Commission¹⁴ has estimated that there would be very significant economic benefits, more than €12 billion per year, from further EU-level comprehensive air transport agreements with neighbouring countries and key partners particularly in fast-growing and/or restricted markets. These include, notably, Turkey, China, Russia, Gulf States¹⁵, Japan, Egypt and India.

31. It is of strategic importance for the EU to maintain a strong and competitive European-based aviation industry connecting the EU with the world. The fastest-growing aviation markets are now outside Europe, so it is vital that European industry has the opportunity to grow in these markets as well. The challenge will be to position European industry to take advantage of the opportunities offered by the rapidly changing environment and of access to new fast-growing markets. Meeting this challenge will require a coherent EU vision as well as a clear signalling of stronger unity in the EU's external aviation relations.

32. The EU's external aviation policy should be driven by three parallel objectives which can be reconciled to the benefit of the overall economy, growth and jobs: (i) creating consumer benefits (which suggests a strong continued focus on market opening); (ii) safeguarding competitiveness, which suggests stronger EU-level measures to insist on ownership and control reform, reductions of the regulatory burden and an international level playing field (all difficult to secure at Member State level); and (iii) wider public policy objectives going beyond traffic rights (the EU approach will therefore seek to ensure overriding public safety, security and environmental goals).

33. The EU's external aviation policy and initiatives should promote and defend European interests more vigorously and continue to promote and share European values, standards and best practices on a collaborative basis. It should aim at the highest possible standards to be applied in the industry, through regulatory cooperation and convergence. These goals will not be achieved without coordinated EU-level negotiations with key partners.

¹⁴ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012

¹⁵ Notably United Arab Emirates and Qatar.

4. LESSONS LEARNED AND THE WAY FORWARD

4.1. What remains to be done from the 2005 roadmap?

34. Over the past seven years, there have been substantial achievements - both quantitative and qualitative in the EU's external aviation policy (see details in the annex). But there have also been shortcomings and real disappointments, from which lessons should be learned.
35. Under the first pillar (restoring legal certainty), much has now been achieved. However, continued engagement with certain partners and a coordinated and determined EU approach to these few countries should be pursued with a view to resolving outstanding issues.
36. Under the second pillar (neighbourhood agreements), a number of important agreements have been negotiated which will generate increasing benefits both for the EU and the neighbouring countries. Contacts and negotiations with the remaining neighbouring countries should be intensified and accelerated with a view to reaching agreements by 2015 with Ukraine, Turkey, Tunisia, Azerbaijan, Lebanon, Algeria, Armenia, Egypt, Libya and Syria (obviously subject to national and regional political conditions). It is important to ensure that, over time, a truly integrated common aviation area evolves from this process where relations between the neighbouring countries themselves also become open and integrated. In view of the similar objectives that the EU pursues with neighbouring countries, it no longer makes sense for the Council to have to consider granting authorisations to negotiate agreements on a country-by-country basis. It would be far more efficient to grant the Commission a single authorisation to negotiate with the remaining neighbouring countries albeit still on a country-by-country basis. This would also allow more flexibility in terms of the timing of when negotiations are launched.
37. Under the third pillar (comprehensive agreements with key partners) a number of important agreements have been negotiated. However, it is also an area where some key objectives still need to be achieved, notably under the EU-US and EU-Canada agreements regarding the liberalisation of ownership and control of airlines.
38. Despite the progress made worldwide towards a more liberal regulatory regime for international air transport, governments have still not reformed the archaic ownership and control rules for airlines. Most countries still maintain rules stipulating that airlines must be majority owned and controlled by their own nationals thereby denying air carriers access to a wider range of investors and capital markets. The effect has been to impose an artificial industry structure on the airline sector that does not exist in other industries. Despite aviation's global reach, there is not a single truly global airline in the way that other industries have global companies. Cross-border consolidation, seen by many as a pre-requisite for a more economically sustainable airline industry, is severely restricted. In the US, for example, foreign ownership of voting shares of airlines may not exceed 25%. These national restrictions on ownership and control have given rise to three global airline alliances (Star Alliance, SkyTeam and oneworld), and more specifically the joint ventures created between some of their members on some routes. These have come to play a role as the nearest proxy to global airlines.

39. Under existing EU legislation, however, EU carriers are not subject to national ownership and control restrictions but can be owned by any EU interest. In recent years, the European airline industry has undergone a process of cross-border consolidation around three main European air carrier groups: the Air France-KLM Group; the Lufthansa Group with SWISS, Austrian Airlines and a significant share in Brussels Airlines; and most recently the International Airlines Group (IAG) created as the parent company of British Airways, Iberia and now also bmi. Moreover, the EU majority ownership requirement can be waived through EU comprehensive agreements with partner countries which would allow foreign majority ownership and control.
40. The consolidation trend in Europe is unique, in that cross-border mergers and acquisitions are only permitted within the EU while ownership and control regimes remain fundamentally stuck where they were negotiated in 1944 in the Chicago Convention. The difficulties encountered as a result of current ownership and control provisions are significant and require negotiations with partner countries and highly complex governance structures. Inevitably this means that the full benefits of consolidation cannot be achieved. Alliance members cooperate more and more closely to offer customers a seamless integrated global multi-hub network service.
41. Part of the problem in removing ownership and control restrictions is the need, for reform to have any real meaning, to secure the agreement of a critical mass of the global market or a large proportion of countries. For global reform of ownership and control to advance, the logical starting point is the trans-Atlantic market. Since between them, the EU and US account for nearly half of global aviation, they represent a powerful bloc and the emergence of genuinely trans-Atlantic carriers would create important momentum. The time is now ripe to take the additional steps envisaged in the EU-US air transport agreement to liberalise airline ownership and control in order to enable airlines to attract investment irrespective of the nationality of the investor. However, this important policy objective of allowing foreign investment in airlines should also be pursued more widely - both bilaterally between the EU and other key partners, and at a global multilateral level notably through ICAO. The EU should take a stronger lead in assessing how the concerns related to the current ownership and control clauses can be catered for, particularly with like-minded countries, whilst also addressing the need for airlines to access capital funding and enhancing the attractiveness of airlines in the financial markets. Negotiations of free trade agreements may play a useful complementary role in removing restrictions.
42. It is also important now to finalise negotiations with Australia and to allow the benefits to start flowing from the EU-Brazil agreement, the signature of which has unfortunately been delayed.
43. The third pillar also represents a huge potential for further benefits. For example, in 2005, the Commission already demonstrated significant economic benefits from future comprehensive agreements with Russia, China and India and therefore requested authorisations to negotiate comprehensive air transport agreements with each of these countries, which have so far not been granted. These potential benefits have been confirmed by the independent study carried out for the Commission and the objective of comprehensive agreements with these key partners should therefore

be maintained and pursued. The study has also shown potential major economic benefits from comprehensive agreements with a number of other important partners.

4.2. Key principles guiding the EU's future external aviation policy

44. Given the deepening of the single market, the emergence of truly European carriers which are increasingly multi-national in their ownership structure and the EU's expanding powers in practically all areas of aviation, it is high time for the EU to pursue a much more coordinated and assertive approach in its external aviation relations. In some cases, it may be enough to strengthen the existing level of coordination between the European Commission, Member States and industry while continuing to pursue relations with partner countries on a bilateral basis. This would require stronger formalised EU coordination and transparency arrangements. However, experience shows that even when coordinated, bilateral relations entail a serious risk of sub-optimal results. EU-level negotiations which are based on EU unity and authorised by the Council generally represent a more appropriate and effective way in pursuing the European interest. This approach should therefore be developed as the general practice with all major partners, rather than as an exception to the rule - as at present.
45. The EU should continue to be bold in promoting further openness and liberalisation in aviation, while ensuring that a satisfactory level of regulatory convergence is achieved. Wherever necessary, it should also stand up for the EU's industry, economy and jobs and ensure that the appropriate instruments are deployed to defend its interests. In negotiations with partner countries, due attention should also be paid to labour and environmental standards and respect for international conventions and agreements in both areas to avoid market distortion and prevent a race to the bottom.
46. Changes are also needed within the global context of aviation. This is where ICAO can play a leading role in modernising the existing framework governing the global aviation market, as it does in other key areas such as safety and security. ICAO can help to further develop the economic regulatory framework for the global aviation sector, including in liberalising ownership and control of airlines, ensuring a worldwide framework for fair competition and ensuring environmentally sustainable development of the sector.

4.3. Enhancing relations with key partners

47. This Communication has stressed the strategic importance for the EU of a competitive European aviation industry which includes EU network carriers with global reach. As a first condition, this requires safeguarding the industry's competitiveness and secondly, securing market access opportunities for it to compete and operate in key markets. Given its particular characteristics, the European cargo and express industry in particular is suffering worldwide from restrictive bilateral air services agreements and should be given a high priority when obstacles are removed to market access. The EU needs to tailor its response to the challenges related to some of the strategic markets and partners, as follows.
48. Turkey, as a key regional player, represents a strategic and one of the fastest-growing aviation markets for the EU. After the US, Turkey is the largest destination for passenger traffic to and from the EU with 30 million passengers carried in 2010.

Since 1999, EU-Turkey passenger traffic has grown on average by more than 9% a year. It represents three times more than EU-Morocco passenger traffic and is more than double the size of the EU-Russia market for passenger services. Turkey and the EU have common interests in many areas of aviation and the scope for cooperation is very considerable. There are also some difficult aviation issues in the region which need to be resolved since they harm both sides. A positive and pragmatic agenda for cooperation should be developed with Turkey that would allow mutually beneficial progress to be made in resolving concrete issues in the region. In particular, a bilateral safety agreement should be advanced. Providing that progress is made in resolving these obstacles, then a comprehensive agreement should be envisaged.

49. With Russia, it is high time to agree on a more coherent, stable and ambitious relationship that can offer planning predictability for both sides' carriers. Russia must urgently demonstrate its commitment to the 2011 agreement to implement the "Agreed Principles on the modernisation of the Siberian overflight system". Beyond that, the scope for cooperation is vast and the potential benefits for Russia and the EU of a genuine strategic partnership, or even a normalised relationship, are equally significant - as are the potential costs if the relationship is not taken forward. As soon as the current obstacles are resolved, the EU should therefore propose a road-map whose ultimate objective should be a comprehensive EU-Russia aviation agreement.
50. Relations with the Gulf States have in recent years been a largely one-way process of opening EU markets for Gulf carriers, which has created significant imbalances in opportunities. At the same time, doubts remain about whether the transparency in the financial performance reporting of some Gulf carriers meets international standards. In addition, some Gulf States have remained reluctant to accept or even discuss "fair competition" clauses with EU Member States individually. This trend must be reversed, firstly towards ensuring transparency and fair and open competition and then, on that basis, towards continued market development. It would be appropriate to coordinate this process at EU level through comprehensive EU aviation agreements with the key countries.
51. Asia is growing fast in importance in global aviation and is therefore obviously a market where EU carriers cannot afford not to be actively present. Many Asian countries now pursue more liberal aviation policies; several have expressed interest in concluding comprehensive agreements with the EU. The EU should pursue such opportunities, provided that these countries fully recognise EU law in aviation including the principle of EU designation, and provided that these markets offer equal opportunities and fair competition for the two sides. Significant potential economic benefits have been demonstrated from comprehensive EU air transport agreements with China, India and Japan which should be pursued. The EU is also, with much interest, following developments in ASEAN towards a fully liberalised ASEAN Single Aviation Market by 2015, which has many similarities to the creation of the open regional aviation market in Europe. This will offer new interesting opportunities for cooperation between the EU and ASEAN and should at some stage lead to a comprehensive EU-ASEAN aviation agreement. Singapore has taken a lead in this respect and has presented itself as a "pathfinder" for the EU to deepen its presence in ASEAN, and beyond.
52. Similar regional developments are underway in other regions of the world, including in Latin America where the continued consolidation of airlines should be welcomed

since it offers possibilities for developing closer bloc-to-bloc relations that merit further market opening.

53. Africa's aviation market has a long-term potential for growth. In EU-Africa aviation relations at present, priority is given to improving aviation safety in Africa by supporting the creation and operations of Regional Safety Oversight Organisations and providing assistance to the countries included in the EU list of airlines subject to an operating ban within the EU.

4.4. The tools to be applied

54. The EU wishes to develop strong, comprehensive and mutually beneficial aviation relations with its key partners. This goes well beyond the simple issue of liberalising traffic rights and should include, for example, regulatory, technological and industrial cooperation. Comprehensive air services agreements with neighbouring countries and major and like-minded partners should address and synchronise the regulatory conditions for fair competition and for a sustainable aviation industry including essential aspects such as safety, security, environment and economic regulation.
55. This Communication has stressed the importance of maintaining a competitive European aviation industry. To make sure that this strategic objective is achieved will require more systematic coordination, stronger solidarity and use of the full range of tools which are available to the EU, the European Commission, EU Member States, EU industry and European aviation institutions and agencies. It will also enhance the potential benefits for the EU's partners. This could take various forms which should be considered jointly.
56. It is important that all affected parties are as fully involved as possible in establishing the policy and then in the negotiations, both in the preparations and in the discussions themselves. For this reason, the Commission is prepared to re-examine the practical arrangements to ensure that negotiations are transparent and inclusive. At the same time, we need to make sure that the processes that govern EU external aviation relations are efficient, effective and not excessively bureaucratic.
57. The Commission believes that a more effective instrument to ensure fair competition is an important part of the tool-box that the EU will need to develop the EU's external aviation policy further. Regulation 868/2004 has proven complex and impracticable for the aviation services industry and, subject to a full assessment of its impact, the Commission will review and as necessary make proposals for more appropriate measures once all the stakeholders concerned have been consulted.

5. CONCLUSION

58. It is now time for EU Member States, the Council and the European Parliament to consider carefully how best to devise the EU's future external aviation policy and to take the decisions that will be needed for a more ambitious policy to match the serious challenges facing the European aviation sector today and to unleash the full potential that aviation can contribute to the European economy.

WHAT HAS BEEN ACHIEVED SO FAR FROM THE EU'S EXTERNAL AVIATION POLICY?**The emergence of an EU external aviation policy**

1. The development of an EU external aviation policy was a logical consequence of the creation of the EU internal market and associated common rules. A key milestone was the "open skies" judgement of the European Court of Justice on 5 November 2002¹⁶ which concluded (i) that the Union acquires an exclusive external competence where international commitments fall within the scope of the common rules; and (ii) that the national ownership and control requirements for designation of airlines under bilateral air services agreements violate the freedom of establishment enshrined in the EU Treaties.
2. In June 2003, the Council granted authorisations to the Commission to negotiate a comprehensive air transport agreement with the United States and to negotiate "Horizontal Agreements" with all other non-EU countries to bring their bilateral agreements with EU Member States into conformity with EU law.
3. In June 2005, the Council agreed on three key "pillars" for an EU external aviation policy aimed at: (i) bringing all bilateral air services agreements that EU Member States have with third countries into conformity with EU law following the "open skies" Court judgement, notably by removing national ownership and control requirements and so recognising the freedom of establishment of EU air carriers; (ii) developing a wider Common Aviation Area by 2010, to incorporate neighbouring countries to the south and east of the EU; and (iii) negotiating EU-level comprehensive agreements with other key partners based on individual authorisations to negotiate where the economic benefits and added value of an EU agreement have been demonstrated.

While significant challenges and much work remain, important progress has been made on all three pillars since 2005.

Achievements made under the three pillars**First pillar – restoring legal certainty**

4. The necessity of restoring a sound legal basis for aviation relations with the EU has been accepted worldwide; with only a few exceptions this is no longer a real issue. Some 117 non-EU countries have recognised the principle of EU designation. Of these, 55 countries have agreed to amend all their bilateral agreements with EU Member States through Horizontal Agreements with the EU while the remaining countries have done so on a bilateral basis with individual EU Member States. In total nearly 1000 bilateral air services agreements have been brought into legal conformity with EU law representing 75% of all extra-EU passenger traffic. There is, however, still work to be done with a few important aviation countries, to complete

¹⁶ Court cases instigated by the European Commission against eight Member States in relation to their bilateral air services agreements with the United States.

the implementation of EU designation. These include India, China and South Korea and also South Africa, Kenya, Nigeria and Kazakhstan. Of these countries, it is only South Africa, Kenya, Nigeria and Kazakhstan which have not yet recognised the principle of EU designation at all. Where regional organisations exist, such as in Africa and South East Asia, a regional approach should preferably be followed by negotiating bloc-to-bloc agreements. Such bloc-to-bloc Horizontal Agreements should contain elements of reciprocity (in particular with regard to ownership and control provisions) which would allow for reciprocal progressive recognition of respective regional aviation markets with benefits for both sides. Restoring legal certainty, preferably on a regional bloc-to-bloc basis with the Regional Economic Communities where they have power to conclude a Horizontal Agreement, continues to be a prerequisite for wider cooperation in key aviation areas such as safety, security, economic regulation, air traffic management and environment.

5. The results achieved are significant. These changes recognise the removal of national ownership and control restrictions on EU carriers as required by EU law. As a result, EU carriers can offer services from any EU Member State to non-EU countries, provided that designation rights and traffic rights are available under the relevant bilateral air services agreements. Furthermore, mergers between EU carriers are recognised. But above all, legal certainty to bilateral agreements has been restored which is important for all operators.

Second pillar – Common Aviation Area with neighbouring countries

6. Solid progress has also been made on developing a wider Common Aviation Area. The EU has negotiated a number of important air services agreements with neighbouring countries which will, over time, constitute a Common Aviation Area based on a parallel process of gradual market opening and regulatory convergence towards EU aviation legislation and regulations, encompassing some 55 countries and 1 billion inhabitants i.e. double the size of the population of the EU. In addition to Switzerland, Norway and Iceland, which are part of the internal aviation market, comprehensive air transport agreements have been signed with the Western Balkans¹⁷, Morocco, Georgia, Jordan and Moldova and an agreement has been initialled with Israel. Negotiations are ongoing with Ukraine and Lebanon, they are expected to start soon with Tunisia and Azerbaijan, and at some stage also with Armenia.
7. The economic impact of those neighbourhood agreements that were negotiated first has been measurable and significant. An independent study carried out for the European Commission¹⁸ has estimated the total economic benefit from the EU-Morocco agreement (2006) to have exceeded € 3.5 billion between 2006-2011, with a massive growth in air traffic between the EU and Morocco and many new routes and carriers, resulting in more competition, choice and lower prices. There has been a real decline in passenger fares of around 40% since 2005. Similarly, the EU-Western Balkan agreement (the ECAA agreement) has generated a total economic

¹⁷ Multilateral agreement signed with the following partners: Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK

¹⁸ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012

benefit of more than € 2.4 billion between 2006 and 2011. Of the total economic benefit, 80-85% is consumer surplus gain resulting from lower fares, while the remainder represents other productivity and efficiency gains.

8. Neighbouring countries have done a great deal to align their regulatory framework with EU legislation in key areas such as aviation safety, security, air traffic management, environment, passenger rights, economic regulation and social aspects. This is in the interest of the consumers and aviation industry both of the EU and the neighbouring countries. The EU gives significant assistance to neighbouring countries in supporting them to align their legislation with EU rules. Both sides have agreed to grant additional traffic rights (5th freedom rights i.e. the right to carry traffic between a partner country and intermediate or beyond points as part of a service starting/ending in the airline's home country) to apply once the process of regulatory harmonisation has been completed. In the case of the Western Balkans, the early implementation of EU aviation rules under the ECAA Agreement will also contribute to their efforts in the context of the EU accession process.
9. Relations with one key neighbouring country - Russia - have been difficult. Russia is a potentially highly important partner for the EU due to its geographic proximity and the mutual dependency that creates significant commercial opportunities. More than 40% of Russian international passenger traffic comes to the EU, for instance. However, the scope for mutual benefits is not exploited to its full potential.
10. 2011 marked a turning point regarding Russia's recognition of EU law. In September 2011, Russia - for the first time - agreed to incorporate the principle of EU designation in its bilateral air services agreements with EU Member States, a process which is now being completed.
11. However, one key issue still remains to be fully resolved: the Russian system of charging EU carriers for using Siberian routes to fly to Asian destinations. It has been estimated that EU airlines have had to pay more than €300 million annually for flying over Siberia, most of which has apparently gone to a direct competitor. At the end of 2011, the European Commission and the Russian Government exchanged letters to the effect that the 2006 negotiated, agreed and signed "Agreed Principles on the modernisation of the Siberian overflight system" should be fully implemented by 1 July 2012. The EU expects Russia to honour this international commitment and reserves its right to take the necessary measures if this should not be the case.

Third pillar – comprehensive agreements with other key partners

12. Under the third pillar, the EU has negotiated a few agreements with major partners. These comprehensive agreements aim at a combination of market opening, creating the conditions for fair and open competition through regulatory convergence, liberalisation of ownership and control of airlines and resolving "doing business" issues.
13. A first stage agreement with the United States was signed in April 2007 and a second stage agreement in June 2010. An agreement was signed with Canada in December 2009 which provides for a staged market opening based on Canada's changes of its foreign investment regulations. A comprehensive air transport agreement was initialled with Brazil in March 2011, although Brazil's signature is still pending. The

Council has also granted the Commission authorisations to negotiate comprehensive agreements with Australia and New Zealand. Negotiations with these countries have not yet been completed.

14. The EU-US agreement has played a pivotal role in shifting international aviation agreements away from mere market access negotiations based upon reciprocity. For the first time, a major international agreement acknowledged that conditions for competition also needed to be addressed and harmonised to ensure fair competition. The EU and the US have developed a new template agreement which facilitates the role of aviation. While the US and Canada agreements have so far only been applied during a period of economic downturn which has had negative impacts on most aviation markets, the benefits are expected to be very significant, reflecting the size of the trans-Atlantic market. A study¹⁹ undertaken on behalf of the Commission concluded that an EU-US Open Aviation Area agreement would, over the first 5 years, generate more than 25 million additional EU-US passengers and more than € 15 billion benefits for consumers as well as create 80,000 new jobs in the EU and the US combined. The benefits and efficiencies resulting from regulatory cooperation and convergence, and the effect of the work of the Joint Committees established by the agreements, are already clear. Under the EU-US agreement, for example, the Joint Committee has addressed a broad range of issues including market access, regulatory cooperation and convergence and conditions for competition. This provides a valuable forum to monitor the implementation of the agreement and address obstacles to doing business. The Joint Committee was, for example, a catalyst for the June 2012 EU-US cargo security agreement that will allow cheaper and faster air cargo operations as a result of mutual recognition of the respective air cargo security regimes.

¹⁹ "The Economic Impacts of an Open Aviation Area between the EU and the US", Final Report, January 2007, Booz Allen, Hamilton,