



**COUNCIL OF  
THE EUROPEAN UNION**

**Brussels, 16 March 2005**

**7214/05  
ADD 1**

**AVIATION 19  
RELEX 119**

**ADDENDUM TO THE COVER NOTE**

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from: Secretary-General of the European Commission,  
signed by Ms Patricia BUGNOT, Director

date of receipt: 11 March 2005

to: Mr Javier SOLANA, Secretary-General/High Representative

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Subject: Commission Staff Working Document: Annex to the Communication from the  
Commission  
- Developing the agenda for the Community's external aviation policy

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Delegations will find attached Commission document SEC(2005) 336

Encl.: SEC(2005) 336



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.3.2005  
SEC(2005) 336

**COMMISSION STAFF WORKING DOCUMENT**

**Annex to the :**

**Communication from the Commission**

**”Developing the agenda for the Community’s external aviation policy”**

**{COM(2005)79 final}**

## ECONOMIC CHALLENGES

### 1. A SUCCESSFUL AVIATION INTERNAL MARKET

The civil aviation sector (infrastructures, operators and other industrial actors, direct or indirect workers) is a significant component of the European economy. The core of this industry represents more than 130 airlines, a network of more than 450 airports and about sixty service suppliers<sup>1</sup>. Air carriers account for about 1.5% of the European GDP. In terms of direct and indirect employment, the sector employs about 3 million, while the 30 major airlines alone employ more than 350,000 people<sup>2</sup>.

The Community has contributed to making this such a dynamic sector. More than ten years after the internal market was created in this sector, it is estimated that in the enlarged Union, almost 400 million air passengers were transported within this single market in 2003<sup>3</sup>. Between 1992 and 2003, the number of intra-Community routes increased by more than 40%. The increased choice of services and falling air fares resulting from competition, have meant that passengers are the big winners. Industry has responded to the potential offered by the internal market for aviation. The number of airlines increased by 25%. The main Community carriers experienced a productivity rise of 87% between 1990 and 2002<sup>4</sup>.

One has to note however that the success of the aviation internal market has been accompanied by an aggravation of the environmental impact of air transport activities, notably as far as greenhouse gas emissions due to international transport are concerned (in 2002, for EU 15, these emissions amounted to 168% of emissions in 1990).

### 2. THE COMMUNITY AIRLINE INDUSTRY'S POSITION IN THE WORLD

In spite of the integration of 25 national markets supporting the development of a dynamic industry, the aviation sector remains fundamentally international. The European airline industry already plays a considerable role at the world level. It generates more than 30% of the total worldwide air transport revenues, i.e. more than 120 billion €<sup>5</sup>. In 2003, four European<sup>6</sup> passenger and five cargo carriers were respectively among the first fifteen passenger and cargo carriers in the world.. If domestic traffic were taken into account in this classification, the European companies lead on the international markets, in front of the American air carriers for

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<sup>1</sup> "Fast facts" (feb. 2003), Collaborative Forum of Air Transport Stakeholders

<sup>2</sup> AEA (Association of European Airlines)

<sup>3</sup> Eurostat

<sup>4</sup> AEA; productivity in revenue passenger kilometer (RPK) by employee.

<sup>5</sup> Analysis of the European Air Transport Industry 2003, report published by the Commission

<sup>6</sup> Analysis of the European Air Transport Industry 2003, report published by the Commission

which a substantial part of the traffic is domestic. The European companies would have double the international operations of their American rivals<sup>7</sup>.

### 3. PROSPECTS FOR GROWTH IN INTERNATIONAL AIR TRAFFIC

The international vocation of air transport is all the more marked at a time when the international aviation markets are benefiting from the impact of an evermore-open world trade, in which the EU holds the first rank. For 2004, the growth rates of international air traffic are particularly high (+ 16% for the transport of passengers, + 13.4% for freight)<sup>8</sup>. This steady upward trend comes in the aftermath of a sustained period of crisis, and now means that the sector can hopefully look forward to the kind of growth experienced before the difficult period which followed the attacks of 11 September 2001.

For passenger air traffic, the EU is the second world market, after North America and is closely followed by Asia. Out of 600 million passengers departing from a European airport in 2003, one third traveled to a destination outside the EU<sup>9</sup>. Among the 25 main destinations, i.e. three quarters of the international traffic beyond the EU, traffic to North America represents more than 22% of the international traffic, followed by destinations in the EU's neighbouring countries<sup>10</sup> (19 %), followed by two countries with whom the EU has already very integrated air transport agreements (Switzerland and Norway, 12%). Traffic to the Asian region<sup>11</sup> comes next with more than 8 %<sup>12</sup>.

For air cargo, 60 million tonnes left the airports of the EU towards third countries in 2003. Among the 25 main destinations, i.e. almost 85% of the international traffic beyond the EU, the North American market leads (almost half the international traffic), followed by the EU's neighbouring countries<sup>13</sup> (13,5%) and the Asian region<sup>14</sup> (slightly more than 8%)<sup>15</sup>.

Growth in international traffic is expected to continue to grow (+ 6% a year on average both for passengers and freight between 2004 and 2008). For markets connecting Europe to the rest of the world, the highest growth rates (+ 7%

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<sup>7</sup> Roughly 550 billion RPK (AEA yearbook) against 250 billion (ATA yearbook)  
<sup>8</sup> in RPK and freight per ton-kilometer (FTK), by comparing the results of the 11 first months of 2003 and of 2004 (IATA International Traffic Statistics, Nov. 2004)

<sup>9</sup> Eurostat

<sup>10</sup> Romania, Bulgaria, Turkey, Russia and partners of the Barcelona process: Morocco, Algeria, Tunisia, Egypt and Israel.

<sup>11</sup> Japan, Thailand, India, Singapore, China, Hong Kong

<sup>12</sup> A few destinations in Central America or South America<sup>12</sup> (Brazil, Dominican Republic, Mexico, Cuba; slightly less than 5% all together) to the Middle East (United Arab Emirates, 1,6%) or in Africa (South Africa, 1,3%) supplement the first 25 ranks.

<sup>13</sup> Romania, Bulgaria, Turkey, Albania, Russia and partners of the Barcelona process: Algeria, Lebanon, Jordan (+ Gaza/Jericho), Egypt, Israel

<sup>14</sup> Singapore, Thailand, Pakistan, Hong Kong, Japan, China, Republic of Korea

<sup>15</sup> The Middle East (United Arab Emirates, Kuwait, Iran: in total slightly less than 6 %) precedes then Switzerland (slightly less than 5%), South Africa (2%) and Senegal (less than 1%) to supplement the first 25 ranks.

approximately a year) should be experienced in developing markets, and above-all the Asia-Pacific area, passengers and freight combined<sup>16</sup>.

#### 4. A PROMISING EXTERNAL AVIATION POLICY

With an appropriate policy, the economic impact of such a development could be considerable for the European aviation industry. It is not only true for the carriers but also for the other actors who have a stake in the expansion of the air traffic, and more generally, in air transport activities at world level, including the industrial and technology- related sectors.

It is estimated that the creation of an open aviation area between the Community and the United States alone could bring about a rise from 1 to 3% of the total employment of this sector (direct and indirect). In addition to the benefits felt by consumers (more than 5 billion € profits a year), this transatlantic market could bring about 3.5 and 8 billion € a year of direct and indirect profits for the sectors directly connected with air transport<sup>17</sup>. One can legitimately expect as much, or even more, of the establishment of similar arrangements with other regions of the world in full expansion, but where there is a greater need for regulatory convergence and for cooperation.

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<sup>16</sup> IATA International Cargo and Passenger Forecasts 2004-2008

<sup>17</sup> "The economic impact of an EU-US Open Aviation Area" (dec.2002), study by the Brattle Group for the Commission

**NON-PAPER****EU EXTERNAL AVIATION POLICY:****ISSUES ADDRESSED IN THE EU MODEL HORIZONTAL AGREEMENT**

**This text, in question and answer format, is intended to answer questions arising from examination of the text of the proposed Model Horizontal Agreement (MHA) between the EU and partner States.**

*1. At the ICAO Assembly in mid-2004, the EU presented a working paper on ownership and control and designation of air carriers.<sup>18</sup> What is the EU objective? If a partner State agrees to this kind of agreement, does it need to conduct additional bilateral negotiations with individual EU Member States? Is a partner State obliged to negotiate a "horizontal" agreement with the European Commission, rather than pursuing the familiar method of bilateral discussions with individual EU Member States?*

**REPLY:**

**The main purpose of the EU proposal is to bring all existing bilateral Air Service Agreements (ASAs) into line with European Community law, as defined by the European Court of Justice (ECJ).<sup>19</sup> The intention is to ensure legal certainty and the continued application of those Agreements.**

**In its ruling, the ECJ – equivalent to a supreme court in the EU context – found that if an ASA permits designation only of companies owned and controlled by**

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<sup>18</sup> 35th Session of the ICAO Assembly; Economic Commission, Agenda Item 27; document reference A35-WP/96; EC/17; 13/8/04

<sup>19</sup> ECJ Ruling of 5 November 2002 in cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98, and C-476/98 against the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany.

**nationals of the signatory EU Member State, such discrimination between EU economic operators is in breach of EC law.**

**Since the issue of non-discrimination between economic operators is one of the basic principles on which the EU Single Market is based, a solution needs to be found as a matter of urgency. Until this is done, any EU carrier may make a legal challenge to the continued application of such agreements; and such a challenge is very likely to succeed. In such a case, the European Commission would find itself obliged to request the denunciation of the bilateral ASA in question.**

**There are two possible methods for amending existing ASAs.**

**The Model Horizontal Agreement, as provided to partner State authorities, represents one method, and the European Commission has already reached agreement on these lines with a number of partner States, with more to follow. This approach has the advantage of relative simplicity and speed. The MHA directly amends bilateral ASAs, and removes any need for additional negotiations with individual EU Member States.**

**Alternatively, a partner State can conduct individual bilateral negotiations with each EU Member State concerned, to amend each ASA separately.**

**It is important that the problem is solved as soon as possible, and the risk of legal challenge to existing Agreements removed.**

2. *The introductory section of the Model Horizontal Agreement (Recital 6) indicates that there is no intention to affect the balance of rights and obligations between EU air carriers and air carriers of the partner State. If the "Community designation" provision in the MHA replaces existing 'substantial ownership and effective control' clauses in existing ASAs, might air traffic rights for EU air carriers not be increased? Under the MHA, how would the overall balance of air traffic rights between EU Member States and partner States be maintained?*

**REPLY:**

**Air traffic rights between a partner State and an EU Member State are covered by existing bilateral Air Services Agreements, which will remain in force after amendment through the conclusion of a Model Horizontal Agreement. Unless EU Member States decide otherwise, future amendments to bilateral ASAs concerning air traffic rights will be negotiated by each EU Member State, and not by the European Commission.**

**The provisions of existing ASAs relating to the number of airlines that may be designated and any frequency, capacity or other traffic right restrictions, would remain unaffected by the proposed amendment. While the number of airlines which an EU Member State may consider for designation will increase, the number of airlines which can be designated will remain subject to the provisions of existing agreements. There will be no effect on the balance of air traffic rights, previously agreed between a partner State and an individual EU Member State.**



3. In the Model Horizontal Agreement, Article 2.2.i uses the expression 'established'. Does this expression give European air carriers more flexibility than the 'principal place of business' (PPB) definition?

**REPLY:**

**As a consequence of the ECJ ruling, any EU carrier<sup>20</sup> which can show that it is established in the territory of an EU Member State, must be able to exercise traffic rights from that State to a partner State, in the same manner and on the same terms as carriers which are "nationals" of the EU Member State in question.**

**The EU has defined establishment in the following terms:**

**"Establishment on the territory of a Member State implies the effective and real exercise of air transport activity through stable arrangements; the legal form of such an establishment, whether a branch or a subsidiary with a legal personality, should not be the determining factor in this respect. When an undertaking is established on the territory of several Member States, as defined by the Treaty, it should ensure, in order to avoid any circumvention of national law, that each of the establishments fulfils the obligations which may, in accordance with Community law, be imposed by the national law applicable to its activities."<sup>21</sup>**

**The intention is to allow an EU carrier, whose principal place of business is in EU Member State "A", to fly from the territory of EU Member State "B" within the limits of the bilateral ASA between EU Member State "B" and a partner State.**

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<sup>20</sup> Cf. Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers *Official Journal L 240* , 24/08/1992 P. 0001 - 0007

<sup>21</sup> Corrigendum to Regulation (EC) No 847/2004 of the European Parliament and of the Council of 29 April 2004 on the negotiation and implementation of air service agreements between Member States and third countries (OJ L 157, 30.4.2004) *Official Journal L 195* , 02/06/2004 P. 0003 - 0006

4. *The Model Horizontal Agreement (Article 2.3) states that the partner State "shall not discriminate between Community air carriers on the grounds of nationality." Might this provision give an EU air carrier additional traffic rights through multiple designation in another EU Member State, whereas the partner State would be limited to existing rights?*

**REPLY:**

**The overall balance of traffic rights between an EU Member State and the partner State would remain unchanged. EU air carriers could exercise traffic rights from EU Member States other than their own, only in so far as such rights are at that time available and unused (i.e. in terms of frequency, capacity and designation).**

**Unused frequencies, where they exist, have been agreed in the context of agreements which, in principle, assume a balance of rights and obligations on each side. If one party to the agreement chooses not to exercise such rights, it does not abandon the possibility of doing so in future. Typically, such decisions are taken on commercial grounds, and a change in market conditions – such as a major increase in bilateral trade flows – may lead to greater interest on the part of carriers. Similarly, a decrease in economic activity may induce operators to reduce services.**

**While an EU air carrier could obtain designation in other EU Member States, it would not be able to exercise any traffic rights other than those already agreed by a partner State. In this context, the amendment of provisions on designation in bilateral ASAs cannot create additional air traffic rights for Community carriers.**

*5. Article 3.2 of the Model Horizontal Agreement seems to permit a parallel system for designation and for regulatory control (issuance of certificates and exercising safety oversight). Who has final responsibility for safety?*

**REPLY:**

**Safety is guaranteed in the European Union through common rules and intergovernmental cooperation. High standards of safety are ensured by a new body, the European Aviation Safety Agency (EASA), set up in 2002 to become the authority responsible for the issuance of certificates of airworthiness and, soon, certificates of competency of operators (AOCs) and pilot licences. EASA also makes sure that maintenance organisations all over the world which repair European aircraft receive the appropriate certificates. In this way, EASA guarantees a high uniform level of civil aviation safety in Europe by regulating certification and by being responsible for safety oversight for all safety matters. Certificates issued by EU Member States before EASA became operational remain valid, and EASA operates in close collaboration with national aviation authorities.**

**The Model Horizontal Agreement has two effects:**

**a) notwithstanding the obligations of the Chicago Convention, notably those stemming from its articles 32 and 33, both Parties to the Agreement have the right to inspect (carry out "ramp inspections" on) aircraft operated by the air carriers designated by the other Party and registered in that Party;**

**b) both Parties agree to recognise certificates issued by their respective competent authorities, which in the case of the European Union may be EASA or the EU Member State aviation authority responsible for safety. AOCs which have been issued in the past by EU Member State aviation authorities remain valid, and are "grandfathered" by EASA. If the AOC of an air carrier (whether issued by an EU Member State aviation authority or by EASA) does not fulfil requirements, however, it may have to be revoked. For this reason, it is important for the partner State to be aware of the new distribution of responsibilities between EU Member States and EASA, as this falls within the scope of article 83bis of the Chicago Convention.**

6. *Aviation fuel is exempted from taxation in bilateral air service agreements. What is the meaning of Article 4.2 of the Model Horizontal Agreement?*

**REPLY**

**This provision (Article 4.2) is included for the following reasons:**

- (a) Article 6 of the EU Treaty states that environmental protection requirements must be integrated in the implementation of Community policies.**
- (b) Article 14(2) of Regulation 96/2003/EC permits any two EU Member States to waive exemptions from fuel taxation on intra-EU flights between their territories.**

**So far, no EU Member State has decided to exercise this option. It is important to ensure, however, that in the event that two EU Member States choose to apply taxation to aviation fuel on flights between their territories, these measures are applied to all carriers operating on these routes, including any partner State carriers operating on a fifth or seventh freedom basis on such routes.**

**In conclusion: the provision in the Model Horizontal Agreement is designed to deal with a possible future development within the Single Market, and has no specific relevance for partner State carriers. Only if a partner State carrier were to exercise fifth freedom rights between the two EU Member States concerned would the issue of fuel taxation arise, and then only if those EU Member States applied such taxation to EU carriers on the same route.**

7. *In relation to Article 5, what is the European Community law regarding tariffs for carriage wholly within the European Community? Are there implications for partner State air carriers operating services within the European Community?*

**REPLY**

**Relevant EU legislation stipulates that on intra-EU air routes “only Community air carriers shall be entitled to introduce new products or lower fares than the ones existing for identical products.”<sup>22</sup> This means that partner State carriers cannot be price-leaders on air routes between two points wholly within the EU.**

8. *What is the relationship between the European Community and the list of European Free Trade Association (EFTA) States in Annex 3 (i.e. Iceland, Liechtenstein, Norway and Switzerland)? What impact would conclusion of a Model Horizontal Agreement between the EU and a partner State, have on relations between that partner State and EFTA States?*

**REPLY**

**The Community and its Member States are prevented by international agreements concluded with the EFTA States<sup>23</sup> from discriminating against EFTA interests in case the latter acquire majority ownership and effective control of Community carriers. Air carriers licensed by an EFTA State do not, however, have similar rights. Thus, while an EU Member State cannot refuse to designate a carrier licensed by an EU Member State on the grounds that it is owned and controlled by EFTA State capital, it is not obliged to designate a carrier licensed by an EFTA State. Equally, a partner State would not be obliged to accept such designation.**

**Conclusion of a Model Horizontal Agreement has no impact on bilateral agreements between the partner State concerned and the EFTA States.**

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<sup>22</sup> Council Regulation (EEC) No 2409/92 of 23 July 1992 on fares and rates for air services; Article 1.3

<sup>23</sup> For Norway, Iceland and Liechtenstein, the Agreement on the European Economic Area (1994); for Switzerland, the Agreement between the European Community and the Swiss Confederation on Air Transport (2002)

