1. Introduction

Apart from the United States market for air transport, the European air transport market is potentially the most lucrative in the world.\(^1\) Significant changes must occur, however, if this potential is to be reached. The majority of European airlines have historically been viewed as public utility types of enterprises.\(^2\) National governments play a dominant role in the European air transport industry, participating in varying degrees of ownership, subsidization, and regulation. At present, high fares, poor scheduling, and restrictive practices characterize European commercial air services.\(^3\) The result is an anti-competitive environment and pervasive inefficiency.\(^4\)

However, the times are changing. Powerful pressures from outside as well as within the international air transport industry are causing the nations of the European Economic Community (EEC)\(^5\) to reevalu-

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1 Hammarskjöld, Deregulation — Idealism, Ideology or Power Politics? Focus — Europe, 12 ANNALS AIR & SPACE L. 65, 67 (1987). As of 1987, there were more than 350 million citizens in the European Economic Community, almost one third more than the United States population. Id.


4 See Comment, Competition and Deregulation: Nouvelles Frontières for the EEC Air Transport Industry?, 10 FORDHAM INT'L L.J. 808, 808 (1987) (authored by Jacqueline O. LiCalzi). The combined intra-European traffic constitutes less than one third of the United States domestic market, while operating cost per unit is at least 70 percent higher than the equivalent United States unit cost. Hammarskjöld, supra note 1, at 67. Such a significant difference in unit operating costs is due in part to shorter routes, the primarily international nature of operations, the different social atmosphere and constraints, and much weaker competitive pressure. Id. at 67-68.

5 The EEC was established in 1957. Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 3 [hereinafter Treaty of Rome]. The original signatory nations were Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. Denmark, Ireland, and the United Kingdom became members in 1973,
ate their antiquated policies and practices. Most significantly, the Single European Act is "forcing a redefinition of the legal framework for aviation among the members of the EEC, as well as that between the EEC and third countries." Of additional importance is the "invasion of a mature, deregulated and consolidated U.S. airline industry into international air transport." These two factors have made it incumbent upon the EEC and its individual member states to undertake serious liberalization efforts if the European airlines are to become major players in the international air transport arena in the 1990's and beyond.

This Comment focuses on liberalization of air transport within the EEC. Part 2 highlights the current state of affairs of Europe's air transport industry, noting the general trend toward liberalization and the barriers which presently inhibit liberalization efforts in Europe. Part 3 explains the legal framework that governs EEC liberalization efforts, with significant emphasis on the recent liberalization package and the Single European Act. Part 4 of this Comment offers an outlook for the future, citing to the United States deregulation experience as a basis for contrast and comparison. Included in this section is an analysis of industry consolidation, privatization, and the future of bilateralism. Two proposed approaches for liberalization are explored in Part 5. The first is a global approach based on the possibility of treating services such as air transport within the GATT framework, while the second aims for the gradual development of a common EEC air transport policy. Three specific measures are discussed as being particularly helpful in achieving liberalization under this second approach. Part 6 of this Comment briefly evaluates the impact of EEC liberalization efforts on the United States air transport industry. Finally, Part 7 concludes that the competitive pressures in the international air transport industry are too strong for Europe to ignore. Only by working with one another under a common policy can the EEC member states achieve unified competitive strength.

Greece in 1981, and Portugal and Spain in 1986. The goals of the Treaty include harmonious development and expansion of economic activities, increased economic stability, an improved standard of living, and closer relations between member states. See Treaty of Rome, supra, art. 3.


8 Id.
2. **The Current State of Affairs in Europe**

2.1. **The General Trend Toward Liberalization**

"Liberalisation means the reduction of constraints imposed upon the existing actors in the marketplace . . . whereas deregulation refers to the abolition of all restrictions dominating the air traffic marketplace, thus providing free access to international air transport." Although both are liberal aviation policies, liberalization addresses existing companies and attempts to lift gradually the restrictions imposed upon them. Deregulation goes a step further and aims for unrestrained entry into both national and international markets, and free competition under free enterprise conditions. Europe has chosen the liberalization approach. The deregulation approach, initiated by the United States with the Airline Deregulation Act of 1978, has had mixed results. In spite of its flaws, the American deregulation experiment has prompted worldwide change. One commentator has noted that "[a]t the international level, spreading the deregulation gospel became an instrument for national policy with the purpose of breaking through the long-established negotiated and agreed system of mutual advantages and of common government-sanctioned rules."

The major structural changes in the United States airline industry over the past decade have unleashed powerful economic tailwinds, which have forced Europe’s airlines and governments to confront and accept the need for some form of liberalization. Hampered by limited
domestic markets, restrictive international agreements, and often inefficient airlines, the nations of Europe are realizing that increased liberalization is essential if their airlines are to remain viable in the increasingly competitive global airline industry.\textsuperscript{16} Europe's liberalization efforts must include a relaxation of the requirements for national ownership and control of airlines, and a broadening of the extent to which cooperative arrangements and transnational mergers between airlines are allowed.\textsuperscript{17} Ideally, government subsidization, protectionism, and other free market distorting practices will be eliminated.\textsuperscript{18}

Although there is clearly a trend toward liberalization of air transport in Europe, there is no consensus as to the optimal degree of liberalization or the appropriate means of achieving it. Some European countries, namely France, Italy, and Germany, support a more cautious and gradual liberalization approach, and "[are] strain[ing] to protect their flag carriers from price cutting and painful competition."\textsuperscript{19} Their view is that "'freedom' must be . . . strictly regulated (allocated) to ensure fair competition and equal chances."\textsuperscript{20} This protectionist viewpoint is a serious obstacle to the development of a liberalized air transport environment within the EEC. Other European nations, especially the United Kingdom and the Netherlands, are pushing for complete deregulation.\textsuperscript{21} Since deregulation will require both privatization and denationalization,\textsuperscript{22} which have been slow to occur, the United Kingdom and the Netherlands are pressing for stronger and faster reforms.\textsuperscript{23}

2.2. Barriers Inhibiting Liberalization Efforts

There has been some liberalization in Europe since United States deregulation in 1978, but entrenched barriers continue to inhibit its

\textsuperscript{16} Id. at 1-2.
\textsuperscript{18} See id. at 271.
\textsuperscript{19} Greenhouse, supra note 11, at D1.
\textsuperscript{20} Wassenbergh, supra note 10, at 21. Opposition to liberalization comes from those who fear freedom because of their lack of confidence, their limited competitive strength, or their complacency. Id.
\textsuperscript{21} Reports of Conferences, supra note 9, at 306. Nations such as Britain and the Netherlands believe that in spite of the massive shakeout which has occurred as a result of the decade-old deregulation experiment in the United States, "both consumers and airlines will ultimately benefit from the forces of the marketplace." Dempsey, Aerial Dogfights Over Europe, supra note 2, at 685.
\textsuperscript{22} Reports of Conferences, supra note 9, at 306. Normally deregulation only works within one jurisdiction, e.g., within one EEC market. Wassenbergh, supra note 10, at 20. Notions of state ownership and national sovereignty clash head on with efforts to establish a single, borderless EEC air transport market.
\textsuperscript{23} See Dempsey, Aerial Dogfights Over Europe, supra note 2, at 631.
progress. The principle of state sovereignty pervades the entire European air transport industry, and perhaps "is the most formidable obstacle to a free market and free competition."24 One commentator has suggested that air transport is the most "border sensitive" industry in all of Europe.25 The individual European countries are preoccupied with preserving their own national share of the international air traffic market.26 This overriding nationalistic bias27 has a profound effect on the industry environment, most significantly reflected in the prevailing practices of bilateralism and state ownership or subsidization.

Nations customarily deal with air transport relations on a bilateral, country by country basis.28 With regard to the EEC in particular, more than 1500 bilateral agreements involving member states are in force world-wide.29 This system is a natural consequence of the pattern set by the Convention on International Civil Aviation ("Chicago Convention") of 1944.30 There, it was recognized that "each State has exclusive and complete sovereignty in the airspace over its territory and has the full right to determine the conditions on which airlines of other States may use that airspace."31 In fashioning bilateral agreements, two sovereign nations typically collaborate and negotiate arrangements regarding fares, capacity and revenue sharing, and frequency of service.32 These agreements limit market entry and directly restrict the competitiveness of foreign airlines.33 Accordingly, they are inherently discrimi-

24 Dempsey, Aerial Dogfights Over Europe, supra note 2, at 635.
25 See Hammarskjöld, supra note 1, at 69.
26 Wassenbergh, supra note 10, at 31.
28 See, e.g., Haanappel, The External Aviation Relations of the European Economic Community and of EEC Member States into the Twenty-First Century, 14 AIR L. 69, 70 (1989).
29 Hammarskjöld, supra note 1, at 69.
31 Tegelberg-Aberson, Freedom in European Air Transport: The Best of Both Worlds? 12 AIR L. 282, 282 (1987). Although reaffirming the notion that the airspace above each nation is sovereign, the Chicago Convention established "five freedoms of the air," whereby each signatory granted five limited privileges pertaining to the air transport of passengers, mail, and cargo between signatory nations. See Comment, Cutting Drag and Increasing Lift: How Well Will a More Competitive EEC Air Transport Industry Fly?, 24 Int'l Law. 179, 180 (1990) (authored by David Banowsky). Protectionism ultimately limited the scope of the Chicago Convention, and the purposes of the multilateral "Five Freedoms Agreement" have proven achievable only through separate bilateral negotiations. Id.
32 Tegelberg-Aberson, supra note 31, at 283; see R. de Muriás, supra note 27, at 5.
33 D. Kasper, supra note 10, at 3. It is this system of bilateral agreements that lies at the heart of deregulation issues. Wood, supra note 17, at 269.
natory and thus hostile toward notions of integration and multilateralism. 34 Within the EEC, bilateral practices are particularly problematic in light of the Single European Act and its goal of a unified European market. 35

In addition to bilateralism, state ownership or subsidization of airlines is a common feature of the European air transport market. In the European countries where a policy of state support prevails, operating profits are clearly less critical to an airline's survival. As a result, inefficiency runs rampant, and the consumer rather than the airline bears the burden in the form of high fares and poor service. This situation is especially troublesome because, in addition to the governments of state-owned or subsidized airlines having little incentive to accept increased industry liberalization, 36 "management and labor unions of state-owned airlines may also be less than enthusiastic about giving up the shelter of the state for the uncertainties of a more competitive marketplace." 37 If liberalization efforts are to gain momentum, support from each of these significant players — government, management, and labor — is essential. 38 Many European airlines are "operated for purposes of enhancing prestige, national security, tourism, or earning foreign exchange, rather than for reasons which inspire capitalist efficiency." 39 For a variety of reasons, European governments regard air routes as valuable assets, and although the movement toward privatization is growing in Europe, the political realities of governmental sovereignty cannot be lightly brushed aside. 40

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35 See infra notes 67-76 and accompanying text.
36 D. Kasper, supra note 10, at 4.
37 Id.
38 Marshall, Opening the Skies: The Prospects for European Airline Deregulation, J. EUR. BUS., Sept.-Oct. 1989, at 43, 44. Sir Colin Marshall, CEO of British Airways, states that "competition cannot be truly fair when some carriers are actively supported and protected by their governments while others have to fend for themselves against overseas competition . . . ." Id. at 44.
39 Dempsey, Turbulence in the Open Skies, supra note 2, at 362-63. For a more extensive discussion of the numerous rationales behind government intervention in airlines, see id. at 363-64 nn.209-12.
40 Haanappel, supra note 28, at 69. For open commercial competition to thrive, the principle of complete and exclusive sovereignty over territorial airspace will have to be weakened, the system of bilateral agreements will have to be dismantled, and individual states will have to relinquish control over routes, rights, fares, and rates. Comment, supra note 31, at 185.
3. **THE LEGAL FRAMEWORK GOVERNING EEC LIBERALIZATION EFFORTS**

3.1. *The Liberalization Package*

In July of 1979, the European Commission issued its first official Memorandum\(^1\) dealing with air transport services. Memorandum 1 recognized the need for stimulating an evolutionary process of development in Europe’s highly regulated air transport sector.\(^2\) The Commission’s goal was to increase competition gradually in order to improve flexibility and innovation in the industry.\(^3\) Civil Aviation Memorandum 2 was issued by the Commission in March of 1984.\(^4\) The proposals in Memorandum 2 focused on maintaining the existing bilateral structure of intergovernmental agreements and collaboration, while imposing modest and gradual reductions in capacity and tariff controls to make the system more flexible.\(^5\) Unfortunately, the European Council adopted neither Memorandum. Then, on April 30, 1986, the European Court of Justice issued a judgment in the *Nouvelles Frontières*\(^6\) case. Most significantly, the Court concluded that the competition rules of Articles 85-90 of the Treaty of Rome\(^7\) were applicable to air transport. Hence, although a common air transport policy had failed to emerge, the substantive provisions of the EEC Competition law were now in place to police anticompetitive practices within the EEC air transport industry.\(^8\)

Finally, on December 14, 1987, the EEC took its first major step toward a common air transport policy. On that date the European Council approved the first phase of a liberalization “Package,” consist-
ing of two Council Regulations, one Council Directive, and one Council Decision, each of which became effective on January 1, 1988. This set of liberalization measures constitutes the most likely formula by which liberalization of intra-EEC air transport services will be achieved under the Treaty of Rome. Council Regulations 3975/87 and 3976/89 lay down the procedure for applying the rules on competition to the air transport industry and deal with group exemptions to the competition rules.

Turning to the more substantive measures, Council Directive 87/601 addresses fares for scheduled air services between member states. Member states are now obligated to give approval to any fares which are "reasonably related to the long-term fully allocated costs of the applicant air carrier, while taking into account other relevant factors." That a proposed air fare is less than the fare offered by another air carrier operating on the same route is no longer sufficient reason for denying approval. In addition, two zones of flexibility for discount and deep-discount fares are now available within which airlines can freely set fares subject to certain conditions.

Council Decision 87/602 focuses on capacity sharing between air carriers on scheduled routes and on market access for air carriers to scheduled routes between member states. Member states can no longer insist that capacity on individual routes be shared equally by all carriers operating on those routes. The traditional rule of 50-50% sharing capacity between flag carriers on intra-European routes has been re-


50 Mifsud, supra note 7, at 157.
52 Id.
53 See id., art. 5.
54 Sorensen, supra note 34, at 36-37. In the bilateral arrangements within the EEC, it was generally accepted that passenger-capacity offered on a route basis or country-pair basis should be divided 50-50% between the two airlines in question. Kalshoven-van Tijen, Recent Developments in EEC Aviation Law: 'The Second Phase', 15 AIR L. 122, 129 (1990).

https://scholarship.law.upenn.edu/jil/vol12/iss3/4
placed with a graduated 45-55% and then 40-60% rule.55

Articles 5 through 8 of Council Decision 87/602 concern market access and allow for the designation of more than one carrier of a member state to operate on certain high-density routes, the creation of third- and fourth-freedom traffic rights for scheduled carriers on routes between main and regional airports, the combination of scheduled air services by a carrier that operates a scheduled air service to or from two or more points in another member state or states, and the potential for the creation of certain fifth-freedom routes.56

Phase one of the Package took only modest steps toward relaxing fare restrictions and capacity restraints. However, those steps, along with the acceptance of the principle of limited fifth-freedom rights and the establishment of procedures for applying the EEC's competition rules to the air transport industry, constituted the first significant indication that the member states were willing to undertake comprehensive and meaningful change.57

On June 18-19, 1990, the European Council adopted further measures as part of the second phase of EEC air transport liberalization.58


56 See Council Decision 87/602, supra note 49, art. 5-8; Sorensen, supra note 34, at 37.

[A] third-freedom air carrier means an air carrier having the right to put down, in the territory of another State, passengers, freight and mail taken up in the State in which it is registered;

[A] fourth-freedom air carrier means an air carrier having the right to take on, in another State, passengers, freight and mail, for off-loading in its State of registration;

[A] fifth-freedom air carrier means an air carrier having the right to undertake the commercial air transport of passengers, freight and mail between two States other than its State of registration[.]

Council Decision 87/602, supra note 49, art. 2(d). The measures in the first phase of the Package pertaining to market access have, in practice, resulted in the creation of over 100 new air connections in the EEC. Kalshoven-van Tijen, supra note 54, at 127.

57 See Haanappel, supra note 28, at 70; Editorial by Peter Sutherland, former EEC Commissioner for Competition, 15 AIR L. 233, 235 (1990) [hereinafter Editorial]. For an in-depth analysis of the phase one liberalization measures, see generally Comment, supra note 31, at 187-98.

Those measures, effective as of November 1, 1990, are designed to pave the way for phase three and the goal of full integration of civil aviation in a unified internal market after January 1, 1993.69

Phase two consists of three Council Regulations. Council Regulation 2342/90 replaces Council Directive 87/601 of phase one dealing with fares for scheduled air services. Apart from the existing discount and deep discount zones of flexibility, a third normal economy fare zone has been introduced.60 Council Regulation 2343/90 replaces Council Decision 87/602 of phase one, relaxing the provisions pertaining to market access and capacity sharing. Community air carriers can now freely operate third- and fourth-freedom services on any route between any airport in the EEC, whether it is hub or regional.61 Furthermore, the use of fifth-freedom service is expanded from thirty to fifty percent of a carrier's annual seasonal seat capacity.62 With regard to capacity sharing, Article 11 permits member states to increase their capacity share for any season by seven and one half percentage points above the previous corresponding season, and no capacity limitations apply to services between regional airports.63 The Council has agreed to adopt provisions by January 1, 1993, to abolish all bilateral capacity restrictions.64 Council Regulation 2344/90 merely amends some of the dates of Council Regulation 3976/87 concerning application of the EEC's competition rules to the air transport industry.65

The liberalization measures of phase two of the Package, while falling short of all that the European Commission sought,66 have undoubtedly brought the process of liberalization much further along the path toward phase three and a unified market for air transport.

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60 See Council Regulation 2342/90, supra note 58, art. 4(3)(b); Kalshoven-van Tijen, supra note 54, at 139.
61 See Council Regulation 2343/90, supra note 58, art. 4.
62 See Council Regulation 2343/90, supra note 58, art. 8(1)(b); Kalshoven-van Tijen, supra note 54, at 139.
63 See Council Regulation 2343/90, supra note 58, at 11.
64 See id.
65 See Council Regulation 2344/90, supra note 58, at 1.
66 See generally Kalshoven-van Tijen, supra note 54, at 127-36 (discussing the proposals submitted by the European Commission).
3.2. The Single European Act

The Single European Act, entered into force on July 1, 1987, calls for a unified internal market by the end of 1992. Although in reality the commitment to establishing an internal market by December 31, 1992 is only a statement of political intent, it is presently a major motivating force within the EEC. The Single European Act clearly dictates that the EEC member states coordinate their policies in order to bring about a single EEC market without frontiers. In this internal market there is to be a free movement of goods, persons, services and capital.

In light of the goal of full economic integration, the EEC's twelve member states must seriously consider the restructuring of their present air transport policies. The current legal structure of Europe's air transport industry is premised on notions of individual sovereignty, nationality, and bilateralism. However, the Treaty of Rome deemphasizes individual sovereign rights, expressly prohibits distinctions between member states that involve nationality issues, and obliquely regulates bilateral dealings with third countries. The EEC governments must transform their air transport policies to conform with their Treaty obligations if the goal of the Single European Act is to be attained.

One commentator has written that, "[i]n air transport, the advent of 1992 generates expectations of open competition in pricing and product, and more services to more cities than ever before, in much the same way that the passing of the 1978 Airline Deregulation Bill opened up competition among airlines in the U.S." Although it is tempting to envision a unified EEC market with one sovereign air space, one aviation authority and comprehensive regulatory framework, and one new "EEC nationality," many commentators feel that this is not a realistic picture of the immediate future. The internal EEC air transport mar-

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67 See Single European Act, supra note 6. Article 8A of the Single European Act makes specific reference to Article 84 of the Treaty of Rome, supra note 5, the article dealing with air transport. The majority of the Single European Act's provisions are amendments to the Treaty of Rome or new provisions to be added to the Treaty. Single European Act a Milestone on the Road Toward a European Union, 4 COMMON MKT. REP. (CCH) 10, 812 (1986) (CCH Comment).
68 Dempsey, Aerial Dogfights Over Europe, supra note 2, at 675-76.
70 Mifsud, supra note 7, at 155. For a more detailed discussion of these concepts as obstacles to liberalization, see supra notes 24-40 and accompanying text.
71 Mifsud, supra note 7, at 155.
72 Marshall, supra note 38, at 43.
73 This is often referred to as a "cabotage area," a common air space within which participating states and their registered aircraft have exclusive traffic rights. See Wassenbergh, supra note 69, at 283-84.
74 See id. at 282-83; see also Haanappel, The External Aviation Relations of the
ket which emerges by the end of 1992 will not likely be a completely unified legal "cabotage area," since the policies of national air sovereignty and bilateralism are too entrenched to be uprooted in such a short time. In any event, harmonizing and coordinating existing air policies rather than establishing a completely unified and integrated system is the current liberalization approach. While this approach might not lead to wide-scale deregulation and a single EEC air transport policy by the close of 1992, it is an attempt to loosen many of the constraints which currently inhibit European airlines and thus promote increased competition in the European air transport market.

4. AN OUTLOOK FOR THE FUTURE

4.1. Overview

Although some form of change is inevitable, it is doubtful that European air transport liberalization will parallel the United States' deregulation experience. First, the pace in Europe is likely to be much slower than in the United States as policymakers address the many complex issues arising from the different social, economic, and regulatory frameworks in each member state. Second, United States deregulation was premised on a free market economic model, which might not be appropriate in an environment such as the EEC where many airlines do not need to make a profit in order to survive, and where there has never been a truly "free" market. Although looking to the United States domestic experience can provide some useful insight, fundamental differences in Europe's market structure must not be ignored.

4.2. Industry Consolidation

In the United States, policy makers have allowed substantial consolidation of the air transport industry. Between 1983 and 1988, the United States experienced a broad assortment of airline mergers, take-
overs, and bankruptcies as a result of this laissez-faire attitude of the Department of Transportation. As of October, 1989, the eight largest airlines, often referred to as mega-carriers, controlled more than 93% of the domestic United States market. Many see this strong trend toward oligopoly ("a marketplace controlled by the large and the few") as an alarming signal that the climate for domestic competition is frigid. In the international arena, however, due to the combined effect of industry consolidation in the United States, liberal bilateral air transport agreements, and the generally more competitive climate in many international air transport markets, United States mega-carriers now maintain a much stronger presence.

Feeling vulnerable to the growing international strength of American mega-carriers, many European airlines have begun consolidating by making alliances with European partners, as well as with the United States and other countries. These alliances range from limited cooperative agreements to far-reaching and comprehensive cross-border mergers. Inter-airline cooperative arrangements between European carriers of different nationalities are positive liberalization measures that will enhance Europe's competitive position in the international air transport market. The shared Computerized Reservation Systems of Amadeus and Galileo are significant "examples of new inter-airline cooperation.” Other opportunities for cooperation include coordinated scheduling, marketing, and training agreements, investment in foreign airlines, and inter-airline alliances for the joint operation of international air routes.

Merger discussions between European carriers have become increasingly popular as well. Although the merging of carriers results in a partial "loss of individual identity by national airlines," the resulting economies of scale and enhanced competitive strength are desirable features. Nevertheless, there have been very few full-scale cross-border mergers within the EEC. This is a significant contrast to what occurred in the United States after deregulation, but it is not surprising. In the

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80 Id.
81 "Competition ... must be there to offer the choices, the varying fares and the variety of services the public wants and expects." Scocozza, supra note 13, at 3.
82 Haanappel, supra note 55, at 85.
83 Greenhouse, supra note 11, at D1; see Balfour, supra note 46, at 237.
84 Haanappel, supra note 55, at 102.
85 Greenhouse, supra note 11, at D1.
86 Haanappel, supra note 55, at 102.
EEC, twelve sovereign states exist side by side, each desiring that their national airlines retain separate identities. The possibility of cross-border mergers and acquisitions within the EEC presents a distinctive set of problems which did not exist in the United States, arising primarily from the "geographical and political make-up of the region." First, under national law, many European countries require that their airlines be largely owned and controlled by their own citizens rather than by foreign entities. Second, a standard clause in many bilateral air transport agreements requires that a national carrier be "substantially owned" and "effectively controlled" by nationals of the designated nation. Third, where multinational airlines are created within the EEC, it is unclear who will negotiate bilateral air transport agreements with non-EEC states on their behalf. These are just a few of the potential legal problems that multinational carriers within the EEC would have to confront. In addition to the multitude of legal complications, linguistic, socio-cultural and labor problems may be an unavoidable result of full-scale international mergers and take-overs in Europe. Until the EEC develops an effective approach for dealing with this multitude of problems, it is doubtful that extensive merger and acquisition activity will occur.

4.3. Privatization and the Future of Bilateralism

In spite of the numerous obstacles to liberalization, it is very unlikely that the status quo in European air transport will remain intact into the 1990s. The crucial question is whether the presently entrenched system of state ownership or subsidization of airlines and "bilateral air transport agreements between EEC member States will be maintained, or whether it will be totally replaced by an intra-EEC multilateral regulatory regime." Despite a growing movement toward privatization, many European airlines are still state-owned or subsidized. This situation complicates the ability of liberalization measures premised on free market principles to work effectively. A few years ago,
the British Government, a leader in the fight for EEC air transport liberalization, denationalized British Airways.95 Believing that the goal of free and fair competition in Europe as promised by 1992 cannot exist unless all airlines are free of state control, British Airways is now calling on the European Commission to require that other EEC member governments privatize their airlines as well.96 The Commission's response has been to encourage member states to remove the standard national ownership clause from their bilateral agreements and national laws, and instead require only that the carrier be owned within the EEC.97 Although such a measure would eliminate some of the problems presently inhibiting inter-airline investment and merger activity within the EEC,98 it would be only a small step in the slow-moving process of privatization.

The movement away from bilateralism is proceeding with similar lethargy. The first and second phases of the EEC liberalization Package99 contain a series of measures designed to relax some of the more restrictive bilateral rules and to encourage competition. While it is improbable that the bilateral system will be abolished altogether, the present approach of the Package seems to favor the development of an intra-EEC agreement setting forth how member States will operate among themselves within the newly relaxed bilateral structure.100 As one commentator notes, "[t]he shift away from bilateral agreements that serve to protect state sovereignty toward a community policy of free competition is emerging only gradually."101 The United Kingdom and the Netherlands have paved the way for liberalized bilaterals and have thus created an environment conducive to reform.102 By loosening constraints on route access, capacity control, and tariff approval in its bilaterals with the Benelux countries103 and others, the United Kingdom is hoping to encourage liberalization throughout the EEC and enable "both consumers and airlines [to] benefit from the pressures of the marketplace."104

95 Marshall, supra note 38, at 44.
96 Id.
97 See Mifsud, supra note 7, at 155.
98 See supra notes 88-93 and accompanying text.
99 See supra notes 49-66 and accompanying text.
100 Hammarskjöld, supra note 1, at 69.
101 Dempsey, Aerial Dogfights Over Europe, supra note 20, at 630.
102 Id. at 630-31.
103 The Benelux countries include Belgium, the Netherlands, and Luxembourg.
104 Dempsey, Aerial Dogfights Over Europe, supra note 20, at 630-31. For specific examples of the United Kingdom's liberalized bilateral agreements, see id. at 631-34.
5. TWO PROPOSED APPROACHES FOR LIBERALIZATION

5.1. A New Legal Framework: Global Multilateralism and the GATT Approach to Trade in Services

As the present liberalization efforts in Europe slowly inch forward, many commentators and industry experts are seriously considering a new and hotly debated approach to air transport liberalization — treating services, including air transport, within the multilateral framework of the General Agreement on Tariffs and Trade ("GATT").\textsuperscript{105} This approach goes well beyond the traditional bilateral system of air transport agreements, surpasses the possibility for a regional multilateral framework, (i.e. a common EEC air transport policy),\textsuperscript{106} and establishes instead a worldwide multilateral framework.\textsuperscript{107} According to Professor Wassenbergh, a KLM executive and Dutch scholar:

> An agreed framework of international ‘trade rules’ in the service sector should incorporate the GATT- principles of non-discrimination; transparency; national treatment; conditional MFN [most favored nation]-treatment as applied in the GATT-Code on tariff barriers; right of establishment for providers of services that require local presence; right of access to distribution systems for services produced in one country and delivered in another; GATT-processes with respect to the settlement of disputes.\textsuperscript{108}

This comprehensive and innovative approach aims at liberalizing and thus expanding international trade in services on a global scale. Most significant is the potential elimination of all discriminatory barriers to free trade in services. In the air transport industry, non-discriminatory market access would mean that all route and capacity constraints as


\textsuperscript{106} See infra notes 121-140 and accompanying text.

\textsuperscript{107} Haanappel, \textit{supra} note 28, at 84. The overall objective is “to replace present regulation which is based on the principle of national (and permanent) sovereignty, by a multilateral regulatory system based on the interdependence of all states, their common interests, i.e. on the economic principles of free trade . . . .” Wassenbergh, \textit{supra} note 105, at 92.

\textsuperscript{108} Wassenbergh, \textit{supra} note 105, at 86.
well as fare restrictions would necessarily be abolished. In Europe, ideally, the GATT approach would encourage privatization, "abolish nationality as a basis for economic regulation, and permit the infrastructure of civil aviation" to keep up with the resulting increase in air traffic.

The United States is a strong proponent of the GATT approach to trade in services. Since a larger proportion of United States gross national product now comes from the provision of services rather than from the production of goods, the inclusion of services within the GATT framework would substantially help the United States address its serious balance of payment problems. The issue is so important to the United States that even though the United States is the "principal beneficiary of the present bilateral air transport regime," its negotiators are willing to include air transport in order to obtain a trade in services provision within the GATT. Professor Wassenbergh is also a strong supporter of applying multilateral trade principles, such as the GATT principles, to air transport. He feels that the EEC, which currently negotiates on behalf of its member states within the GATT, could readily expand its role to include negotiation involving air transport and other services.

Although this approach sounds good in theory, it faces substantial obstacles. First, there are significant national vested interests in services, including those of entrenched regulators and nationalized, monopolistic, or oligopolistic businesses, who perceive services as too important to be subjected to the rigors of competition. Second, the GATT principles apply much more readily to tangible goods, rather than to intangibles like services. Determining when a service crosses the border, or even whether a specific service is being imported or exported, can prove to be extremely difficult. Finally, the GATT operates without sufficient institutional support. Applying the intricacies of a trade in services provision within the existing GATT framework

109 Reports of Conferences, supra note 9, at 307.
110 Mifsud, supra note 7, at 169.
111 Id. at 164-65; see id. at 165 for a discussion of the benefits of a GATT service provision.
112 Id. at 165; see infra notes 142-43 and accompanying text.
113 Mifsud, supra note 7, at 165.
114 See id. at 170.
115 Id. at 166.
116 Id. at 166.
117 Id. But cf. Wassenbergh, supra note 105, at 86-88 (offering a definition of trade in air services for the purpose of the economic regulation of the import of air transport services).
118 Mifsud, supra note 7, at 166.
would necessarily require a strong and effective administrative structure. At a minimum, a supervisory body, rule making and voting procedures, and a dispute resolution mechanism would be needed to ensure that the GATT would operate properly in its new role. In light of these obstacles, many industry practitioners and international aviation organizations are reluctant to adopt this new legal framework as a means of governing international airline activities.

5.2. A More Workable Approach: Regional Multilateralism and a Common EEC Air Transport Policy

Adopting an entirely new global multilateral legal framework which encompasses air transport and other services may not be the most desirable or the most efficient means of promoting airline industry liberalization in Europe. Gradual expansion and liberalization of the existing bilateral framework governing European air transport is a more realistic and immediately workable approach. Such liberalization efforts should strive toward the ultimate goal of eliminating bilateral agreements altogether and replacing them with a common EEC air transport policy. The transition from the current bilateral regime to this proposed regional multilateral regime within the EEC has already begun, prompted by, among other things, the Single European Act and its goal of a unified internal market by the close of 1992. The first two phases of the EEC liberalization Package represent significant steps in the direction of a common EEC air transport policy, but subsequent liberalization efforts must go further. Specifically, in the third phase of the Package, the European Commission should strive to implement policies designed to encourage inter-airline cooperation, further extend fifth-freedom rights, and improve Europe's inadequate infrastructure.

For a true regional multilateral EEC air transport policy to emerge, extensive cooperation between EEC member states is critical. This necessarily requires a willingness on behalf of each member

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119 See id.
120 Reports of Conferences, supra note 9, at 307.
121 Haanappel, supra note 28, at 84.
122 Competitive pressures from Far East airlines, who have high standards and low costs, and from United States airlines who have the benefit of extensive hub and spoke systems and highly developed computerized reservations systems have also been significant factors in prompting recent liberalization efforts in Europe. Wood, supra note 17, at 271.
123 See supra notes 67-69 and accompanying text.
124 See supra notes 49-66 and accompanying text.
125 See supra notes 84-86 and accompanying text.
state to deemphasize its national identity and relinquish the exercise of its sovereign rights. Some degree of industry consolidation is inevitable if cooperation is to be maintained. In the short term, focused cooperative arrangements are preferable to full-scale, comprehensive mergers. Cooperative agreements can be designed and implemented in a relatively short amount of time, and they pose few risks to the operational stability of the individual airlines. Accordingly, future liberalization measures should encourage such inter-airline alliances. Coordinated efforts among European airlines in areas such as training, scheduling, computerized reservation systems, and international operations would foster an environment of unification within the EEC, and improve the efficiency and lower the operating costs of individual airlines.

Although enhanced efficiency and competitiveness can also result from far-reaching mergers and acquisitions, the United States experience has shown that control in the hands of a select group of megacarriers can lead to higher fares and restrictive market entry barriers. Other negative side effects of extensive merger and acquisition activity include deteriorating labor-management relations, declining margins of safety, limited small community access, and a marked decrease in the quality of airline service. Europe can learn a great deal from America's mistakes in this area. Mergers must be carefully screened by the parties involved to make sure that their management philosophies as well as their operational policies can be successfully integrated. In addition, proper application of the EEC competition laws may eliminate some of the problems that result from unrestrained industry consolidation. In sum, through cooperative efforts rather than extensive merger and acquisition activity, the EEC should strive to expand market access and improve operational efficiency. The EEC must also continually monitor the industry to ensure that competition is not distorted by hidden barriers and unfair trade practices.

See Wassenbergh, supra note 34, at 264.

Haanappel, supra note 55, at 84. The concern, according to Sir Leon Brittan, the EEC Commissioner for Competition, is that "the major airlines might build fortresses for themselves by purchasing emerging competitors in their domestic markets, resulting in the elimination of competition." Balfour, supra note 46, at 237-38.

Dempsey, Aerial Dogfights Over Europe, supra note 2, at 684.

Haanappel, supra note 28, at 83. Cf. generally Balfour, supra note 46 (discussing the controls on airline industry concentration provided by the new merger regulation and the competition rules contained in Articles 85 and 86 of the Treaty of Rome, and noting their apparent shortcomings). Efforts to avoid extensive U.S. style airline mergers will not be easy, and the underdeveloped EEC aviation policy leaves those enforcing competition laws without clear guidance. Id.

D. KASPER, supra note 10, at xvii-xviii. The European Commission is currently examining several cases of airline acquisitions, including the acquisition by Brit-
Another important element that must be a part of future liberalization efforts is the unlimited extension of fifth-freedom rights throughout the EEC. As this occurs, the EEC aviation system will become more flexible and thus more competitive. Innovative and enterprising airlines will emerge, and reorganization of the airline route system into an advantageous "hub-and-spoke" framework might occur. The result will be more efficient use of airplanes, higher load factors, and lower costs for airlines, as well as more favorable fares and increased route selection for passengers.

Finally, it is very important that factors relating to the inefficient infrastructure within which the European airline industry now operates not be overlooked during Europe’s liberalization process. Dramatic improvements are vital, since the infrastructure has become the greatest single source of customer dissatisfaction and wasteful extra cost to airlines. First, the current system of separate, national air traffic operation must give way to a coordinated, EEC-wide system of airways management. Second, the airspace over Europe must be redesignated. Commercial airline customers currently travel an average of twelve percent more miles than necessary because much of Europe’s airspace is reserved for military use only. Finally, both runway and terminal capacity must be increased in key areas to handle the increased traffic flow that is likely to result as liberalization proceeds. These fundamental structural deficiencies must be addressed

ish Airways and KLM of a 20% stake in Sabena World Airlines, and the Air France takeover of UTA. Balfour, supra note 46, at 238.

Comment, supra note 4, at 840; see supra note 56 for a definition of fifth-freedom rights.

Sorensen, supra note 34, at 36.

Comment, supra note 4, at 840. In such a system, airlines route all their flights from one region into an intermediate hub, where passengers can then connect with flights to other regions. Id.

Id. at 840-41.

Marshall, supra note 38, at 44. The term “infrastructure” refers to the system of flight paths or airways to which carriers are assigned, and to the system of airports and ground transportation networks. Id. at 44-45.

Marshall, supra note 38, at 44-45.

Id. at 45. The existing air traffic control system is alarmingly close to saturation. Airlines Warn of Crippling Congestion Unless Europe Upgrades ATC Systems, AVIATION WEEK & SPACE TECH., June 6, 1988, at 92, col. 1. Both the number of delayed flights and the length of delays are increasing substantially, while at the same time, the number of passengers carried each year is expected to double by the year 2000. See id.

Marshall, supra note 38, at 45.

Id.

Id.

Twenty-seven of Europe’s largest airports forecast a growth in traffic from 353 million passengers in 1989 to over 657 million in the year 2005. Everitt, The Pros and
6. **The Impact of EEC Liberalization Efforts on the United States Air Transport Industry**

The degree and pace of EEC liberalization will inevitably affect the airlines of other countries, especially the United States, who hope to retain a competitive edge in the international air transport market. Broadly speaking, United States airlines oppose liberalized market access of foreign airlines because it results in increased competition on routes currently served exclusively or primarily by United States carriers. Dealing on a bilateral, country by country basis, American negotiators have historically extracted significant advantages for United States carriers. Consequently, most United States airlines, by virtue of their nationality, have the right to serve over forty European destinations, while no European carriers have remotely similar rights with regard to serving destinations within the United States. When and if the EEC begins functioning as a single domestic market and negotiating as such, questions will certainly arise as to the right of access by EEC carriers to the extensive American domestic market. Such rights are presently denied in the United States due to cabotage restrictions. Even if a unified EEC air transport system does not quickly materialize, increased liberalization efforts in Europe still pose a serious threat to the competitive advantage of American carriers in the transatlantic market. As European carriers begin engaging in consolidation efforts, improved operating efficiency and lower operating costs of airport privatisation in the EEC after 1992, 15 AIR L. 327, 328 (1990). To meet this substantial increase in volume airports plan to invest 27.5 billion U.S. dollars in new airport capacity. Id. 144 Eser, supra note 87, at 34.

145 D. KASPER, supra note 10, at 5. Currently, the U.S. share of the transatlantic air transport market inures to the benefit of only a handful of mega-carriers, while the European share must be divided among more than twenty-two carriers competing without the economies of scale or traffic rights of their American counterparts. Mifsud, supra note 7, at 161. Liberalization of the EEC air transport industry will result in greater cooperation and consolidation among European carriers, thus cutting into the United States' present competitive advantage.

146 Id. at 160. This is referred to as a divide and conquer strategy. See id. at 161.

147 Id. at 35; see supra note 73 for a definition of cabotage.

148 Such consolidation measures include inter-airline cooperative agreements, mergers, and acquisitions. For a further discussion, see supra notes 83-93 and accompanying text.
costs will enable them to compete much more effectively with United States mega-carriers.

7. Conclusion

In light of United States deregulation in both the domestic and the international arenas, the Single European Act, and the liberalization Package, the nations of the EEC cannot avoid the pressure to create a more liberal, competitive environment for the air transport industry. However, significant barriers entrenched in notions of national sovereignty continue to impede Europe's liberalization efforts. Although the American deregulation experience remains too controversial to convince protectionist member states that deregulation and competition are entirely desirable, a 1987 survey shows that European air travellers favor air transport deregulation by a margin of five to one. Most European policy makers, however, reject the applicability of American-style deregulation to Europe. Instead, they have embarked upon a more gradual approach that reflects a reluctance to uproot the traditional bilateral system.

Changes within the EEC are occurring slowly. Although the first phase of the Package involved only modest liberalization measures, it was important because of its implicit recognition that the time framework of January 1, 1993 was as relevant to the air transport industry as to any other industry. The first phase was merely a first step in a newly established, long-awaited progression. The liberalization measures of phase two will propel the nations of the EEC further toward phase three and the creation of a unified market for air transport after 1992.

The ultimate long-term goal should be the development of a common EEC air transport policy. If this goal is to be attained, the European Commission must implement more extensive, forward-looking liberalization proposals. Encouraging inter-airline cooperation, extending fifth-freedom rights, and overhauling Europe's inadequate infrastructure are three significant liberalization measures that realistically can be accomplished in the foreseeable future. The key for the short term is harmonization and coordination of the air transport policies of individual member states.

149 Wassenbergh, supra note 34, at 273.
150 Haanappel, supra note 55, at 99. In contrast, North Americans, who have lived with deregulation for several years, only favor it by a 1.8 to 1 margin. Id.
151 Comment, supra note 4, at 835.
152 Editorial, supra note 57, at 234-35.
For the longer term, as the present bilateral system based on national sovereignty is gradually chipped away, more comprehensive changes can and will occur, and a common EEC air transport policy will eventually emerge. Ultimately, negotiations with non-EEC countries regarding air transport could be conducted by the European Commission on an EEC-wide basis rather than individually by each member state. Although such a negotiating stance would significantly enhance the competitive position of the EEC in the global air transport arena, it appears to be a long way off. The transformation of Europe's fragmented and antiquated air transport industry into a single, unified, competitive market is not likely to occur by the 1992 deadline. What will occur, however, is the "acceptance that a European aviation policy for the 1990s will mean European airlines accepting risks vis-à-vis each other. They cannot fight more powerful outside forces by each retreating to [their] own individual bunker[s]."

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138 Hammarskjöld, supra note 1, at 72. See generally Kalshoven-van Tijen, supra note 92 (discussing whether the European Commission is "fit, willing, and able" to become a European version of the United States Civil Aeronautics Board and engage in air transport negotiations on a Community-wide basis).

154 Virtually all of the measures dealing with external aviation relations submitted by the Commission were not adopted by the Council in phase two of the Package. Weber, supra note 59. One commentator has suggested three reasons for the non-inclusion of these proposals.

Firstly, it is evident... that several of the 'external' proposals were considered as clearly premature and reaching out too far. Secondly, a number of aspects of these proposals could have had detrimental effects on relations with a number of third countries. Thirdly, the process of liberalization within the EEC has not yet gained a critical stage which would render the extension of the liberalization process beyond the EEC area a requirement.

Id. at 278 (footnotes omitted).

155 Hammarskjöld, supra note 1, at 73.