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EU Market Access Developments – 10 years Open Skies – how to proceed from here?

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Ladies and Gentlemen,

At first sight, this issue is a no-brainer.

- On 5th November 2002, practically to the day 10 years ago, the ECJ decided on the EU competence in international aviation relations.
- On 5th June 2003, barely six months later, and in a direct response to the ECJ Judgement, the Council of EU Transport Ministers adopted two Decisions (one related to the USA, the other on Horizontal Agreements), and a Regulation to establish the external dimensions of an EU aviation policy.
- In the years following these truly historic occasions, many international negotiations were held, and legal clarity with respect to many bilateral Air Service Agreements was established.
- On 11th March 2005 the Commission presented its Communication entitled "Developing the agenda for the Community's external relations policy", which essentially drove the EU's External Relations. The EU institutions have since then effectively developed three pillars of activity in this field, differentiating between the pure Horizontal Agreements that restore legal certainty, the Neighbourhood Agreements and the Comprehensive Agreements with like-minded countries. The single most important agreement in the context of the latter was of course the EU-US Open Aviation Area Agreement, signed in two phases.
- The latest anchor point in this thrilling development is the Commission's Communication published recently and entitled "The EU's External Aviation Policy – Addressing Future Challenges". It has yet to be endorsed by the Council, and the Parliament will evidently also be working on a report and resolution.

So what else is there to report? 10 years of dual jurisdiction, as well as a process to manage the stakeholders within the European Union, and to gradually harmonise the over 3600 bilateral agreements. We could perhaps debate whether, particularly in the context of the EU-US Agreement, the EU used its leverage well enough; with respect to other third countries, the EU is frequently challenged to demonstrate the added value it creates vis-à-vis traditional Bilateralism. To which the Commission consistently replies that, in a global context, the Member States systemically fragment European negotiating clout.

But technically, and for the purposes of this Conference, it would appear at first sight that there is not really that much to write home about, if we set aside the main argument that the relationship between the Member States and the Commission, as well as between the industry and the Commission, can always be, and actually has been, improved.

Well, I have news for you.

Dramatic changes are taking place in the market, in fact so dramatic that we must review past experience and if necessary think out-of-the-box. After 10 years of Open Skies, international aviation is anything but business as usual.

What has happened? From a European perspective, we now have two distinct markets, with different factors driving them: the intra-European market and the international market.

The intra-European market is driven by *costs.* With over 140 million passengers flying on low cost carriers, market behaviour and expectation on intra-European flights has changed. Low cost carriers now cover appr. 45% of the European market.

Of course their competitors have adapted to the challenge. Lufthansa, Air France, KLM, Iberia and others have developed, or announced they would develop, varying models of lower cost entities which are to function as an additional product platform within the respective airline group. The bottom line is that traditional carriers which depend on intra-European routes must find – without Chapter 11 – ways of *reducing legacy costs,* because the short haul product has been *commoditised.*

So what is next in the EU internal market? To avoid pure speculation, let me try to describe some vectors which could drive further developments.

One is perception. The perception is that low cost carriers are really low cost and can drive any competitor out of the market, either as absolute low cost system-wide à la Ryanair, or relative low cost on a route-by-route basis à la Easyjet. This perception drives the creation of the Germanwings and Iberia Express of this world. They will probably seek to compete by unbundling, and then re-bundling the product elements to fit the brand. The message is: this may not be the absolute rock bottom price for a flight, but it is the best value for money. The objective is to minimise the effects of commoditisation by maintaining brand loyalty.

A second vector is consolidation to generate economies of scale and scope. Ryanair has certainly morphed from David to Goliath, actually drives the rules of the game, and is clearly seeking to maintain or even strengthen its hold on the market perhaps by not only relying on organic growth but also acquisitions. It is a nigh-on certainty that consolidation will have to occur if other players are going to continue to remain competitive in this market segment.

A third vector is a growing need for an integrated European transport policy. What is European aviation really about? Airlines have the worst of both worlds: on the one hand they are part of a public service utility, offering scheduled services, but with inadequate investments into the infrastructure and rising external costs, and on the other hand, they operate in a market which does not function properly because it has too low market entry barriers, and too high market exit barriers. To complicate matters, Member States pursue different policies with different priorities; there is not yet a single market, because Europe consists of historically grown nations with own social legislation and taxation systems. The Third Package was an important step, but it was liberalisation without harmonisation; now, particularly in light of experience in other regions of the world, European policy makers must develop a policy which recognises the role of aviation by promoting competition as a driver of consolidation and investing into infrastructure as a prerequisite of international competitiveness.

So what is happening structurally on international routes?

Arguably, the bilateral strategic alliance grew into multilateral alliances, but these appear now to be ceding relevance to new structures. These began with the big players of alliances in Europe strengthening their influence by not only co-operating with their alliance partners, but buying them or merging with them. But this development has reached an international, inter-regional dimension with International Business Agreements maturing within all three major alliances.

An additional piece of the puzzle has fallen into place with the increased presence of Gulf carriers in the international alliances, and their involvement in acquisitions. Again, it is noteworthy that Lufthansa, according to the press, appears not to rely solely on its alliance partner Turkish Airlines, but also interested in exploring ways of strengthening that co-operation beyond an alliance partnership as strategic answer to the Gulf carriers.

My point here is that 20 years after the US/Netherlands Agreement, *globalisation* has driven airlines out of the traditional bilateral paradigm. Key for success in such a global market is size and connectivity. If the airline has a relevant home market for its international network, it will seek to combine 3rd and 4th, with 5th and 6th freedom operations. If it has a small home market, it will rely solely on its connectivity at its hub. But in all cases, the players seem to now believe that organic growth will not be sufficient to maintain a sustainably competitive position in the global market. This is a paradigm shift in international aviation in a mere 20 years!

International airlines, or better: airline groups, will, in my view, strengthen their position in the markets they dominate, and strategically compete for growth in new markets through co-operation and acquisition. This will ultimately mean that smaller competitors will exit international routes, unless they operate in clearly defined niche markets with high barriers to entry. That would leave three or four international groups, functioning on the basis of equity swaps, acquisitions, mergers or intense co-operation, sharing a large part of the international market with significant competition in selected key markets, and competition for growth markets.

What does this mean for the EU external relations policy? And where does this leave the EU/US Open Sky as the incarnation of a new way forward in international aviation agreements?

Well, I for one, am frustrated. In view of these fundamental, dramatic market developments, we need political leadership. And the visionary concept of the EU and the US at the time of the negotiations of an EU/US OAA had that leadership aspiration. The Transatlantic Aviation Area or, as it was later called, the Open Aviation Area, was supposed to be exactly that: One open aviation area, not three. There was a vision underlying those negotiations. And as much as I acknowledge the need for political realism in negotiations, I do fear that we are beginning to get used to *managing* the *acquis international,* instead of reminding ourselves of that *vision.*

Surely, time has come to review ownership and control provisions. It is not a dogma, it is a necessity to question whether these restrictions are still fit for purpose in light of all these on-going developments. The EU + North Atlantic + US market is the single biggest global traffic market; the aviation relationship between the European Union and the USA should not be reduced to managing a Treaty; the Joint Committee should be motivated turn a vision into reality. Ultimately we should strive to create one aviation market for the global economy, so let us start with reinforcing norms that set a framework for one North Atlantic market.

And this leads me to turn your attention to another phenomenon.

Airlines are becoming increasingly upset about the competitive distortions created by differing levels of *external costs.* Even if I reduce my internal costs, how am I supposed to compete against airlines that do not have an aviation tax, or are supported by their governments? The conditions of competition have become highly relevant, not only the market access opportunities.

Our industry is one of the few service industries where the relevant market is global and not local. Even I go to the hairdresser from time to time, and I will compare prices of the hairdressers in Brussels where I live, but I do not care how much the hairdresser costs in China. But when I *fly* to China, I do care about the production costs of Chinese airlines. The question is how, in a globalised economic environment, can the market conditions be harmonised to enable fair international competition.

The EU-US Open Aviation Area Agreement provided the tools to address that question with its Joint Committee. Does this historical Agreement not mark the beginning of a new approach to co-operation on regulatory issues? Hopefully, we will shortly see encouraging developments on the ETS front. But not only environmental issues, also the Bilateral Air Safety Agreement signed just over one year ago between the EU and the USA has, in its core, an element of international co-operation on standards of competition.

10 years after the first bilateral Open Skies Agreements we should, in my view, look at whether broader conditions of competition – on safety, environment, competition policy, state aids, consumer rights, security, etc – should be harmonised – with the ultimate vision in mind that if they are not harmonised, airlines will not be able to

compete under fair market conditions, for the simple reason that there is not one market.

This would not happen overnight, and many incremental steps would be necessary.

Would it not be a superb moment if the EU and/or the US would raise the need for a review of conditions of competition at the forthcoming Air Transport Conference in March 2013? This event, as you know, takes place every 10 years. Time has come to see the enormous momentum we now have in international aviation, and to take stock of the changes now required to provide for a suitable framework for global aviation. The EU/US would then gain profile as the region which could, in due course, develop a tool kit for other regions to adopt. ICAO would become a platform to promote the EU/US leadership as a standard setter for the other regions.

In summary, therefore, I leave you with three messages:

Firstly, the ECJ and Council of EU Transport Ministers did actually set the stage in 2002 for a new approach to international aviation by determining how the Member States would co-ordinate their international aviation negotiations.

Secondly, the liberalization of the intra-European market, and the regulatory tools for the international negotiations, acted as catalysts in enabling market dynamics.

Thirdly, the markets have matured even further, so that legal and political answers must be found to guide these developments, ideally with the Air Transport Conference providing a good platform to address these issues, and the EU/US Joint Committee as a good institution to find solutions. If not at the Air Transport Conference, then at the next EALA Conference!

Thank you.