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A POTENTIAL OPEN SKY AGREEMENT BETWEEN THE EU AND MERCOSUR BASED ON THE EU-US AGREEMENT

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Thesis
presented by
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For the
Degree of Master in Industrial Engineering and Management

Academic Year 2007-2008

Acknowledgements

Special thanks to my family, in particular to my mother, without whose support I would have not supported the intense work of drafting this master thesis while working and preparing competitions.

Logically, a particular thanks to my girlfriend, who has always been able to show me the other side of life.

I am also very grateful to Mrs Emmanuelle MAIRE from the European Commission and other people at DGTREN – Aviation agreements, who kindly answered to my questions and provide me with useful materials. Mr Giancarlo CRIVELLARO former Deputy Secretary General for AEA was also very kind providing the European industry's point of view, which undoubtedly enriched my work.

Abstract

Following four years of intense negotiations, the first Open Sky agreement between the European Union (EU) and a third country, the USA in this case, was reached. It entered into force on 30th March this year. In addition, the second stage of negotiations has been launched during the Slovenian Presidency on 15 May¹. This Master thesis aims to evaluate how a similar agreement between the European Union and MERCOSUR (Mercado Comum del Sur) would be perceived.

With regards to the literature, articles from specialized magazines constitute the main source. A meticulous attention was given to the articles of law in air transport, in particular bilateral agreements, national law, European Court of Justice Rulings. Moreover, all the documents concerning air transport supplied by the European Commission on air transport policy were particularly interesting to evaluate its development and to define its relations with third countries. Interviews with Commission officials as well as industry representatives played also an important role.

The structure of this thesis is divided in three chapters. The first chapter aims to assess the relationship between the European Union and MERCOSUR in general and the MERCOSUR itself in particular. Needless to say that MERCOSUR is a group of countries, where the level of integration in air transport is limited. Consequently, the second part seeks to analyze the regional forces in the domain and how the EU can supply some expertise and foster this integration. The Horizontal Agreement between the EU and Chile indicates the framework in which the EU develops its air policy towards South American countries. From the EU perspective, several improvements would be needed to succeed in future negotiations as the USA experience showed. The last and the

¹ Press Release: 'EU-US "Open Skies" the EU and the US start talks on air services agreements to reshape global aviation' available http://ec.europa.eu/transport/air_portal/international/pillars/global_partners/doc/us/press_release_15052008.pdf on 14/06/2008

main part discusses in detail the main questions raised by the USA delegation in the negotiation phase, namely foreign airline ownership, freedoms & hubs, in the case of MERCOSUR.

As far as the results are concerned, it can be claimed that the concept of an European carrier as well as a MERCOSUR carrier will not be an obstacle in the negotiation process. Furthermore, the extension of the fifth freedom - 5th freedom – to carry freight and passengers between two countries by an airline of a third country on route with origin/destination in its home country - to all the countries involved is rather reasonable. On the other hand, cabotage remains a sensitive subject to the MERCOSUR authorities. Considering the foreign participation in MERCOSUR carriers, governments would seriously take into account this option, knowing that their national carriers face financial difficulties. Moreover, airports are prepared to receive the increased number of passengers thanks to the potential agreement. From a technical point of view, the potential agreement is not a revolution. However, in reality, it is politically a huge step for MERCOSUR since this requires not only more integration at the regional level but also a new attitude towards liberalization of the services sector.

TABLE OF ABBREVIATIONS

AEA – Association of European Airlines

CLAC – Comision Latinoamericana de Aviacion Civil – Latin American Civil Aviation Commission

DG TREN – Directorate of Transports and Energy (European Commission)

EC – European Community

ECJ – European Court of Justice

EU – European Union

GATS - General Agreement on Trade in Services

GDP – Gross Domestic Product

FAO - Food and Agriculture Organization

ICAO – International Civil Aviation Organisation

IMF – International Monetary Fund

MERCOSUR – Mercado Comun del Sur (Southern Common Market)

OAA – Open Aviation Area

USA – United States of America ...

WTO – World Trade Organisation

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I. Introduction

The traffic generated by the international air transport industry has been increasing steadily during the last 40 years, with the exception of 1991 and 2001. In contrast, the real yields have been declining. It is important to notice that international travel as a share of total travel has been rising from 24% of all passengers carried in 1991 to 34% in 2002². It is a vital sector in two aspects. Firstly, the plane is an important mean of transport to provide passengers to the tourism sector. Secondly, it also allows the transport of freight affecting directly the international trade. It is estimated that 40% of the value of world merchandise trade and 2% of its volume is carried by air (OECD 1999). Therefore, the air transport can account approximately 10% of world trade in services.

Once the importance of the sector is acknowledged, it is relevant to analyze how it is regulated within a globalized economy.

At the international level, the relationship between two individual countries in the air transport sector is ruled by the 1944 Chicago Convention³. This means that individual countries signed bilateral agreements providing rights of access for the airlines of both countries. The idea behind is that each country is sovereign to regulate air traffic within its borders. Therefore, national governments have the right to decide which carriers have access to the different freedoms⁴. Such

² 'International Trade in air transport: recent developments and policy issues', World Trade Report 2005 Publication, p. 214 available at http://www.wto.org/english/res_e/booksp_e/anrep_e/wtr05-3b_e.pdf

³ Chicago Convention available at <http://www.luftrecht-online.de/regelwerke/pdf/ICAO-E.pdf>

⁴ The eight freedoms in air services agreements are defined as follows:

1st freedom - to overfly one country en-route to another

2nd freedom - to make a technical stop in another country

3rd freedom - to carry freight and passengers from the home country to another country

4th freedom – to carry freight and passengers to the home country from another country

approach led to little liberalization because the States entering into negotiation intended to gain access to the main markets of the partner States while protecting its own markets⁵. This system was very rigid and specially designed to protect the State-owned airlines which were part of the national proud and interests⁶.

Consequently, throughout the time an intense network of bilateral agreements were agreed. At the World Trade Organization (WTO), within the General Agreement on Trade in Service (GATS) there were small steps to change such situation. Only three services related to air transport should be submitted to the GATS rules, namely: aircraft repair and maintenance services, the selling and marketing of air transport services and computer reservation system (CRS)⁷. As it can be seen that the traffic rights and the services directly related to the exercise of these rights are excluded from the negotiations. It is a paradox that a vital sector for the liberalized and globalized trade is still working in a protective system of bilateral agreements.

At the European level, the Community air transport policy has been developed since 1987 with the adoption of the first package. In 1992, the third package was adopted and it comprises three important regulations, namely Regulation in

5th freedom – to carry freight and passengers between two countries by an airline of a third country on route with origin/destination in its home country

6th freedom - to carry freight and passengers between two countries by an airline of a third country on two routes connecting in its home country

7th freedom – to carry freight and passengers between two countries by an airline of a third country with no connection with its home country

8th freedom or Cabotage – to carry freight and passengers within a country by an airline of another country on a route with origin/destination in its home country

True domestic – to carry freight and passengers within a foreign country with no connection with the home country

⁵ International Trade in air transport, op.cit., note 1, p. 230

⁶ RUTGER Jan toe Laer, 'The ECJ decisions: "Blessing in Disguise"?', in Air &Space Law, Vol.XXXI/1, February 2006, p.21

⁷ International Trade in air transport, op.cit., note 1, p. 249

licensing of air carrier (2407/92), Regulation on access for Community air carriers to intra-Community air routes and finally (2408/92) the Regulation on fares and rates for air services (2409/92). In other words, 'from 1997 every EU carrier can operate between two any two points in the EU without any limitation as to frequency, capacity, routing and pricing and without any restriction regarding commercial co-operation, in the form of code-sharing or otherwise'⁸. That is to say that air transport in the EU is liberalized, at least within its borders.

While the EU was still concentrated on its internal market in the air transport sector, the USA was developing an aggressive policy with third countries by establishing Open Sky agreements. Therefore, the USA, even within this legal framework and extending it to its limits, signed Open Sky agreements with several countries, including 11 of the 15 old Members States. These agreements allowed full access to the US carriers to the European Market by means of the provisions of seventh and eighth freedoms. Several alliances were established between European carriers and their US partners to enjoy fully the opportunities provided by these new agreements. At this point, the Commission feared a threat for its young internal market. Thus, it requested the Member States a full mandate to negotiate an Open Sky agreement with the USA. In 1996, the Council decided to grant a mandate in competition rules, ownership and control of air carriers, computerized reservation systems, code-sharing, dispute resolution, leasing, environmental clauses and transitional measures. As it can be seen, this is a limited mandate since the 'core rights', the traffic rights, were excluded from the agreements⁹. As expected, the American negotiators refused to negotiate such agreement since the traffic rights were not on the table. The Commission returned back home and began the infringement procedure

⁸ RUTGER, *op.cit.*, note 5, p. 21

⁹ *Ibid*, p. 22-23

provided by Art 226 EC¹⁰. Afterwards, the Commission brought the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany cases in front of the European Court of Justice (ECJ)¹¹.

After four years of hearings, on November 5th 2002, the European Court of Justice ruled on the bilateral air agreements between eight Member States and the United States by annulling them and requesting their conformity with the EC law, in particular with the new concept of the Community carrier. The Commission welcomed this ruling and the Mrs De PALACIO, former Commissioner of Transports and Energy, declared at that occasion the following: 'Today's judgment is a major step towards developing a new coherent and dynamic European policy for international aviation. In most sectors of the economy, Europe speaks with one voice in international negotiations and takes a leading role in shaping events. Until now, aviation has been excluded from this approach as Member States have pursued their own individual agendas. From now on, it is clear from the Court's ruling that we will all have to work together in Europe to identify and pursue our objectives jointly'¹². It is undoubtedly a victory to the European Commission but only half way. It is true that henceforth the Community has exclusive competence to negotiate with third countries in areas, namely (1) resulting from the European Community Treaty itself or (2) flowing from the measures adopted, within the framework of those provisions, by the Community institutions. Taking into consideration the fact that so far the EC law regulates internally almost all the issues regarding air transport, one could state that the Community has an exclusive competence in external relations for this sector. Nonetheless, the Court did not go further as the Commission expected. In fact, the Court confirmed that Member States remain sovereign in terms of traffic

¹⁰ Art 226 EC: 'If the Commission considers that a Member State has failed to fulfil an obligation under this Treaty, it shall deliver a reasoned opinion on matter after giving the State concerned the opportunity to submit its observations

¹¹ Cases C-466/98, C-467/98, C-468/98, C-471/98, C-472/98, C-475/98 and C-476/98

¹² Press release, 'Open sky agreements: Commission welcomes European Court of Justice ruling', IP/02/1609, Brussels on 5/11/2002

rights, which were the key point responsible for the failure of the previous EU-US agreement. However, the nuance offered by the Court was that the negotiation of traffic rights with third countries, Member States must comply with the European Community law. That is why the Commissioner expressed her will to pursue their objectives jointly since there are shared competences in the external dimension of air transport.

Another important decision made by the Court was the fact that national clauses in the existing Open Sky agreement were not in conformity with the EC law. In other words, the airline “nationality” (the State where the airline is registered) is henceforth irrelevant regarding the relations between an EU country and a third one. The former fragmented national systems hindered the resources optimization within a globalized economy. It is true that national governments, and even citizens, show some concern when de-nationalizing their carrier and even more when opening their markets to other non-national carriers. Thus, it is a political, even emotional rather than a legal process¹³. It is important to recall what Thomas Jefferson declared that ‘merchants have no country; the mere spot they stand on does not constitute so strong attachment as that from which they draw their gain’.

As a result of the ECJ ruling, the Commission developed its action in two vectors. The first one is the so called the Horizontal Mandate. Its main objective is to provide the correct legal provisions to the existing bilateral agreements by replacing the nationality restrictions into the Community designation clause. As it is suggested by Mr van Hasselt, former Head of Unit of Air Transport Agreements at the European Commission, ‘the common designation clause will conduct, in practice, to a Community competence for the negotiation of access to third countries’¹⁴. To this date, there are 43 countries in conformity with EC law¹⁵.

¹³ ERNST C. de GROOT Jan (SVP General Counsel & Company Secretary KLM Royal Dutch Air lines), ‘The aftermath of the CJ judgments: the irrelevance of Airline Nationality’, *Journal on Air Transport Law*, 2004, pp 67-69.

¹⁴ VAN HASSELT Ludolf, ‘The aftermath of the ECJ Open Skies judgments – impact on the regulatory environment’, *Journal on Airport Transport Law*, 2004, p.73

The second vector was the request of global mandates from the Council to negotiate open aviation agreements with like-minded countries. The first mandate agreed in June 2003 was to initiate talks with the Community's biggest air partner: the United States. Taking into account the turbulent history of the Open Sky agreements at the EU level, the EU-US agreement is undoubtedly vital to the success of the European Air policy. At the same time, the Commission wants to enjoy this unique opportunity to show to the Member States this new competence, which was painfully taken from them. It is important to the Commission that this agreement provides the best results. It will be naturally the model for future agreements with other major players. In the light of this last point, the aim of this Master thesis is to study the application of a similar agreement with MERCOSUR (Mercado Comun del Sur). In other words, the EU-MERCOSUR relation in air transport will be considered on the basis of the EU-US framework. It should be stated that at the moment of this analysis (August 2008) no mandate was requested by the Commission to the Council for this region of the globe. For information, up to now the Community has signed the horizontal agreement with Paraguay and Uruguay and the discussions are ongoing with Argentina and Brazil. However, no reference is made to Venezuela, the most recent member to Mercosur¹⁶.

However, before analyzing the two hot issues raised by the EU-US negotiation (1-foreign ownership, 2-freedoms and hubs) and its impact in a possible negotiation with MERCOSUR, one should bear in mind that MERCOSUR is a group of 4 countries. The specificity and complexity of MERCOSUR compared with the unity of the US requires a particular attention. Therefore, it demands a study of the regional process in general and of the air transport in particular. The EU supports this integration and its experience can be fruitful for MERCOSUR.

¹⁵ Bilateral ASA brought into legal conformity since ECJ judgments on 5 November 2002
available at

http://ec.europa.eu/transport/air_portal/international/pillars/doc/table_asa_080508.pdf

¹⁶ Idem

With regards to a future relation between the EU and MERCOSUR in air transport, one should also take into consideration the EU and Chile recent agreement which was defined as model to the region.

Moreover, the experience of the US negotiation can be a source of inspiration for future agreements. The first OPEN SKY agreement raised some technical and political problems within the EU, in particular with one of the main stakeholders, the airlines. Therefore, improvements in the relationship between the Commission and the airlines could facilitate a potential negotiation with MERCOSUR.

II. The two main actors

1. Mercosur

a. Definition

The Common Market of the southern cone - MERCOSUR - was established by the Asuncion Treaty on March 26th 1991. As its name indicates, it aims to build a common market in this region. It was operational on 1st of January 1995 among the signatory countries, namely Brazil, Argentina, Paraguay and Uruguay.¹⁷ Venezuela is under a ratification process in Brazil and Paraguay to join this regional group. Following Chavez's intervention at the Brazilian Congress in May 2007, stating that 'institution is a parrot that only repeats the orders of Washington'¹⁸, Brazilian authorities do not seem very keen on this ratification process until the Venezuela's president change its policy towards the USA¹⁹. Furthermore, the Paraguayan counterparts also seem to reconsider their

¹⁷ History of Mercosur available at <http://www.mercosur.int/msweb/principal/contenido.asp>

¹⁸ 'Lula manda convocar embaixador da Venezuela' in BBC news on 01/06/2007 available at http://www.bbc.co.uk/portuguese/reporterbbc/story/2007/06/070601_venezuelachavezdb.shtml

¹⁹ Bragon, Ranier (2007-09-22), "[Folha de São Paulo](#)", *Congresso brasileiro reage a fala de Chávez*, São Paulo, São Paulo: Folha da Manhã S.A., p. A10

ratification. As a consequence, for the purposes of this study, Venezuela will not be part of the analysis since one should not take for granted its integration in the regional bloc with the current Venezuelan government. For the Five neighbouring countries, namely Bolivia, Chile, Colombia, Ecuador and Peru have the status of associated members whereas Mexico is an observer member.

Institutionally speaking, there is a council of the common market, where the decisions are made, several commissions preparing the legislative work, a court and a secretariat. The MERCOSUR parliament was decided and in principle will be operational at the end of the year 2010 with 18 representatives from each country²⁰. There also several consultative committees, groups ad hoc and subgroups (sub-group 5 for transport matters) providing advice.



Image 1 - MERCOSUR's map

²⁰ 'Mercosur parliament starts on sour note ' Reuters alertnet on 14/12/2006 available at <http://www.alertnet.org/thenews/newsdesk/N14171666.htm>

b. Main Achievements

It is important to remember some figures concerning this regional group. It is a considerable area of 12 millions km² (four times bigger than the EU) with a population of more than 225 millions inhabitants, with Brazil representing 79% of the population. With regards to GDP, it is estimated as the fourth biggest economy after NAFTA, EU and Japan. It is undoubtedly one of the biggest centres attracting investment thanks to its natural resources²¹. From a macroeconomic point of view, here are some important indicators.

Table 1- Mercosur Economic indicators provided by IMF

Indicator	Year	Brazil	Argentina	Paraguay	Uruguay
Growth (%)	2004	4.9	9	4	12.3
	2005	3.3	7.5	3	6
	2006 ⁽¹⁾	3.5	4.2	3.5	4
Inflation (%)	2004	6.6	4.4	4.3	9.2
	2005	6.8	9.5	4.8	5.2
	2006 ⁽¹⁾	4.6	10.4	4.7	6.5

⁽¹⁾ estimated

As it can be observed from the table above, the growth rates in Mercosur are relevant compared with the economic stagnation in the Eurozone. Furthermore, the past investors' nightmare, the inflation, is no longer a problem. The main problem is still the social gap despite all the governmental and international commitments and programs.

²¹ Data provided by the Brazilian Ministry of Foreign Affairs available at http://www.mre.gov.br/portugues/destaques_home/pro_tempore/index.asp under the topic Statistical data

To conclude, nothing would be better than an optimistic vision about Latin America. Mr Rodrigo de Rato, the Managing Director of International Monetary Fund, showed his optimism about Latin America for the coming years in a conference in 2005. He stated that ‘the ongoing expansion offers a timely window for Latin American countries to deepen the reforms of the past few years and to build upon its recent gains. Indeed, if growth can be maintained at its present level for the next 10 years, real per capita income in 2015 will be 40 percent higher than it is today in the region. That will be a significant change from the relative stagnation of the last 25 years’²².

c. Air transport policy

In its Art 1 of the Asuncion Treaty is stated that co-ordination of macroeconomic and sectoral policies is one of the goals. Transport is one of the domains in which Members States should harmonize legislation²³. It is unconceivable to develop a common market without an efficient mobility of goods. Even though all the Member States recognise the importance of the transport sector for the global economic performance, there is no definition of a Common Transport Policy. It would be vital to show the path for the future integration. Logically, its implementation would require several years or decades as it occurred in Europe. In the Treaty of Rome, a Common Transport Policy was declared but its implementation has just started in the 90’s. A possible way to overcome the discussions of a global transport policy, it could be suggested to concentrate on one sector. Taking into account the lack of infrastructure in roads and in trains associated with the large surface of MERCOSUR, air transport would be the

²² De RATO Rodrigo Speech , Managing Director of International Monetary Fund, ‘Latin America in the Global Economy—Challenges and Opportunities’, February 4, 2005 available at <http://www.imf.org/external/np/speeches/2005/020405.htm>

²³ Treaty establishing a Common Market between Argentina, Brazil, Paraguay and Uruguay available at www.sice.oas.org/trade/MRCSR/TreatyAsun_e.ASP#CHAPTER_I

simplest means of transport to put into practice. Afterwards, a spill over effect could be expected in the other domains. Once again, there is a lack of political will in this matter. It can easily be demonstrated by the fact that there is no Working Group on air transport created within the MERCOSUR structure. The only regional agreement in this area was established outside the Mercosur framework and it is a partial one. It will be described in the next chapter.

2. EU - Mercosur dialogue

a. Historic context

The relationship between the EU and MERCOSUR started immediately after the Mercosur's constitution in 1991. The EU looked for an interregional group approach with Mercosur. This was the perfect occasion for 'the EU to export its regional governance model and to increase its reputation as an international actor'²⁴. Furthermore, this dialogue was intensified as a reaction to the US project of Free Trade Area of the Americas (FTAA) initiated in 1994²⁵. The idea behind was a clear expansion of the NAFTA (North American Free Trade Agreement) to Central and South America. The EU leaders feared that FTAA had the same repercussions of Mexico's membership to NAFTA regarding the trade with the EU. 'The European companies lost about half of the Mexican market'²⁶ when it join NAFTA and as a consequence 'the EU's participation in Mexico's trade reached its lowest point in 1996 to an amount of only 6.1%'²⁷. This

²⁴ Santander Sebastian, ' La legitimacion de l'Union Européenne par l'exportation de son modele d'integration et de gouvernance. Le cas du Marche commun du sud', *Etudes Internationales* XXXIII(1), 2001, pp.51-67

²⁵ Antecedents of FTAA process available at http://www.ftaa-alca.org/View_e.asp

²⁶ SANTANDER Sebastian, ' The European Partnership with MERCOSUR: a relationship based on strategic and neo-liberal principles', *European Integration Journal*, Vol. 27 N° 3, September 2005. p. 298

²⁷ Brief report of Mexico trade relations with the EU available at http://europa.eu.int/comm/trade/issues/bilateral/countries/mexico/index_en.htm

rapprochement between the EU and MERCOSUR aims two goals. First, there is a need to maintain the European exports and presence in the Mercosur market. The Europeans are the main investors in the region 'European enterprises are actively conquering the South American market, benefiting from the regional integration efforts and the privatization and macro-economic stability policies that result from the Argentine convertibility plan (1991) and the plan Real in Brazil (1994)'²⁸. Secondly, by providing institutional help the EU helps the MERCOSUR to become a political and commercial block in the region, reducing the American influence. When in 2001, the US attempted to establish a trade agreement with Argentina; the EU was quite lucid of the potential consequences bearing in mind the US-Mexico agreement.

During the fifth meeting of the bi-regional negotiations committee in the same year, the EU state clearly that the trade proposal on the table was for the Mercosur countries as a group. Moreover, the EU threatened that if the Mercosur had broken down, the EU would have not signed a trade agreement with the individual countries²⁹. The MERCOSUR remains an example of regional integration, where the main achievements are discussed in the next point.

b. European Model in Crisis

Although the French and Dutch negative answer to referendum on the European Constitutional in May 2005 was considered as a defeat to Europe and certified by the NO in the Irish referendum in June this year, this effect went beyond its borders, in particular to MERCOSUR. Whereas this region was seeking to move forward in integration, its European reference gave a step back. It is true that the economic dimension is under construction in MERCOSUR but it is also generally agreed that a political dimension in a globalized world is requested. Logically, it requires a certain level of maturity of the Member States and their citizens, which

²⁸ SANTANDER Sebastian, op.cit note 15, p. 294

²⁹ SANTANDER Sebastian, op. cit 15, p. 298

was not even reached in Europe where the integration process started 50 years ago. Therefore, from the other side of the Atlantic, despite the fact that leaders acknowledge the need of a political entity, they also fear developments in this domain³⁰.

c. Future Association Agreement

Nevertheless, the dialogue between the two regions continues and it is usually divided in a classical way: politics, trade and cooperation. As far as the political dialogue is concerned, the former Commissioner, Chris Patten, stated that it [...] is practically finished. This includes: a democracy and human rights clause; the reaffirmation of political principles such as the rule of law and good governance; the improvement of our political dialogue mechanism; the creation of an institutionalized inter-parliamentary dialogue; and the promotion of meetings with representatives of the civil society of both regions³¹. With regards to trade issues, the negotiation results are not so fruitful. Currently, 20% of MERCOSUR exportations have as destination the EU whereas 24% of the importations in MERCOSUR come from the EU³². MERCOSUR is currently the world biggest food producer³³. As a result, the main products exported to the EU are agricultural goods and the EU sells mainly industrial goods. This is a typical trade relation between the north and the south countries. This is the reason why Brazil puts forward the agricultural agenda, requesting the EU to open its markets. On the other hand, the EU insists on the opening of the markets for services,

³⁰ Interview with Mr Dominique MOISI, Director of the Institut Francais des Relations Internationales and Professor in Brussels on 15/05/2008

³¹ Speech by Commissioner Chris Patten at III Conference EU – Mercosur Business Forum on 16/05/02 available at http://ec.europa.eu/comm/external_relations/news/patten/mebf.htm

³² Data provided by the Brazilian Ministry of Foreign Affairs available at http://www.mre.gov.br/portugues/destaques_home/pro_tempore/index.asp under the topic Statistical data

³³ MERCOSUR: basic data available at <http://www.wikipedia.org/wiki/Mercosur>

investments and government procurement³⁴. Besides the bilateral trade relations, the main trade issues are essentially defined at the world level under the auspices of the World Trade Organisation and its Doha round where intense negotiation takes place between developed and emerging economies. Recently, after seven years of negotiations, 153 countries fail to reach an agreement on the framework for commercial relations³⁵. To this date, no further developments in this field are foreseen in the near future and some analysts advocate that an agreement will not be possible sooner than 2020³⁶.

The last vector is cooperation in the fields of Education, Culture, Technology and Research.

As the political and cooperation areas find a consensus and an important work has already been done, trade is the critical point. There is some urgency in the signature of the establishment for a Free trade Area with Mercosur, as it was underlined by the Commission in its communication to the Council and to the European Parliament last December³⁷. There are strong expectations upon the conclusion of an agreement after several years of negotiation. Furthermore under the Financial Perspective 2007-2013, the European Union decided to allocate 50 billions euros to foster the bi-regional cooperation in three priority areas:

- Mercosur institutional strengthening
- Supporting Mercosur in preparing for the implementation of the Association

³⁴ 'EU-Mercosur resume trade talks in Lisbon', 20/10/2004 available at http://www.bilaterals.org/article.php3?id_article=854

³⁵ 'EU 'heart-broken' over trade talks collapse' on 30/07/2008 available at <http://euobserver.com/19/26564>

³⁶ ENTRETIEN AVEC PATRICK MESSERLIN, DIRECTEUR DU GROUPE D'ÉCONOMIE MONDIALE DE SCIENCES PO « Les pays les plus pauvres souffriraient d'un échec » published on 29/07/2008 available at http://www.lemonde.fr/cgi-bin/ACHATS/acheter.cgi?offre=ARCHIVES&type_item=ART_ARCH_30J&objet_id=1045461

³⁷ COM(2005) 636 final – 'Communication from the Commission to the Council and the European Parliament – 'A stronger partnership between the European Union and Latin America', 08/12/2005 available at http://europa.eu.int/comm/external_relations/la/doc/com05_636_en.pdf

Agreement

- Fostering the participation of civil society to Mercosur integration process³⁸.

It is in this framework that a potential Open Sky agreement between the EU and Mercosur must be seen. Air transport being a service, especially Brazil might not be so keen on the opening of its market. On the other hand, the EU is being criticized for its agricultural subsidies and tariffs on primary goods not only by Brazil and Argentina but also by other nations. Therefore, some EU concessions can be foreseen, especially thanks to the potential growth in services in MERCOSUR which is highly profitable. As a result, it might lead the governments, the Brazilian in particular, to show some flexibility regarding the transports. Without a competitive air transport market, the final price of Mercosur products will include high transport costs. Furthermore, the MERCOSUR governments seek to foster the tourism sector by taking full advantage of their natural competitive advantages.

³⁸ European Commission – Mercosur Regional Strategy Paper 2007-2013 on 02.08.2007 available at http://ec.europa.eu/external_relations/mercosur/rsp/07_13_en.pdf

III. Before the EU-MERCOSUR Negotiation

1. Regional Integration in Air transport

a. Fortaleza agreement

Before analyzing the relation between MERCOSUR and the EU in the light of a future OPEN SKY agreement, it is worthy understanding how the regional forces are related in the air transport field. As it was already mentioned in the previous chapter, there is no working group within the MERCOSUR structure dealing with this topic.

Considering the commercial liberalization in MERCOSUR, it was decided in December 1996 a subregional agreement on air transport named Fortaleza Agreement. The participants are the four Mercosur full members as well as two associated countries Bolivia and Chile. In 2000, Peru also joined this agreement. It aims to develop new air services in the region, in addition to those operated under the bilateral agreements. It is important to notice the fact that under the bilateral agreements there are only ten points of departure and arrival in this huge area. Consequently, it is expected that this agreement will foster the development of new markets in an effective response to the needs of passengers³⁹.

The Fortaleza agreement is a multiple OPEN SKY agreement, although very restricted since only the first, second, third and fourth freedoms (except those routes defined by bilateral agreements) are satisfied. Nevertheless, according to Art.1 paragraph 2 the fifth and the sixth freedom are not excluded but require an authorization from the Member States involved⁴⁰. It is a partial integration when

³⁹ Peru membership to the Fortaleza Agreement available at <http://www.rree.gob.pe/Mlti.nsf/9060f36257c43df1052569bc006fc00a/0f8ddd7488220c205256e52002ada8e?OpenDocument>

⁴⁰ Fortaleza agreement – full text available at <http://www.cpcmercosur.gov.ar/leyes/ley250806.htm>

compared to the European Union or even the Andean Community of Nations⁴¹ where the cabotage is possible.

This is a first step towards integration in air transport. There is an engagement to the legal *rapprochement* between the National Air Transport Authorities in the authorizations of routes, frequencies, and schedules for regular flights as well as the commercial and operational activities (Art.8). It is important to highlight that Art.6 of the Annex C clarifies that the resolutions are adopted by simple majority at the Council, which shows the path of integration by avoiding the Intergovernmentalist approach with the unanimity vote. However, it is written in the same article that such resolutions must be seen as recommendations to the Member States, inviting them to cooperate. At the first sight and considering the European jargon, one can perceive that they are not binding but they constitute the base on which the Arbitral Commission decides. The Commission is in charge of the conflicts resolution and its decisions are binding (annex D). Moreover, the door is opened for further integration by the Art 18, which provides a periodical revision of the agreement in order to gradually eliminate the restrictions. As a result, the Council of the National Air Transport Authorities has been meeting every year, establishing goals for a further integration at the regional level. Nonetheless, since the decisions are not supranational as the Europeans are, the last meetings have been characterized by an impasse between the liberal Chilean position and the conservator Brazilian one. Brazil has not defined a clear policy on the subject whereas Chile with its well-defined regulatory framework has chosen the Open sky policy⁴². A new impetus was given in 2003 when eventually Argentina ratified the agreement. It is unbelievable how an important country for integration process was able to postpone this decision for seven years. At the end, it was ratified and it is a sign of commitment to the all group. It is also the acknowledgement of its importance for the future in this field of activity.

⁴¹ Regional group formed by Peru, Bolivia, Ecuador and Colombia

⁴² SILVA, F.C., "Air Transport in MERCOSUR", State University of Londrina, Parana, 2004

To conclude, one should bear in mind that this agreement presents some differences with the MERCOSUR normative source, specifically 'the elaboration process, the territorial scope of application and the dispute settlement mechanism'⁴³. However, knowing the importance of air transport in 'commercial integration and economical, social and political development, it is expected that air transport policy will be liberalized in the medium term'⁴⁴. Therefore, it is the only agreement available at the moment in this region regulating only the routes which were not defined by the bilateral agreements. Further institutional development can be foreseen in the future if the advantages are demonstrated by the coming results.

***b.* CLAC influence**

Besides the Fortaleza Agreement, one can not forget the decisions taken at the CLAC (Commission Latino Americano de Aviacion Civil) level. This is the regional branch of ICAO for Latin America countries. Logically, the MERCOSUR countries participate in the decision making process and accept the recommendations and or decisions. All 21 member are aware of the fact that regional integration in order to succeed in a globalized world. Its Executive Committee seeks for interregional cooperation in the air transport sector with the aim of reaching a future agreement of regional flexibility. Furthermore, the delegations agreed upon to apply all the means in order to the increase the regional traffic of 10%⁴⁵.

⁴³ Ibidem

⁴⁴ 'Background of liberalization and experiences in the Latin American region', in ICAO case studies, March 2003 available at http://www.icao.int/icao/en/atb/ecp/CaseStudies/ClacBackground_En.pdf

⁴⁵ Minutes of the XVI Ordinary Assembly of the Latin American Civil Aviation Commission, Rio de Janeiro, Brazil, 8-10 November 2004

c. Regional designation

Similar to the communitarian designation issued of the ECJ ruling, the members of the CLAC (Comision Latinoamerica de Aviacion Civil) showed some interest for this concept. In other words, it was suggested to apply the same concept to Latin American countries when they will negotiate with the EU and / or US. For this region, this would mean that a country member of CLAC can attribute to another member airline the possibility of exploiting the traffic rights from and to Europe. A draft model on airline designation was already proposed to the CLAC member states⁴⁶. Naturally, this question will be arisen when the Commission will negotiate the horizontal agreements with these countries. It seems that the Commission does not see any inconvenience in the application of its concept in other parts of the world for two reasons. First, it is its own concept and it is imposed to the other states by the horizontal agreement regarding the European carriers. Second, it would be a sign of closer integration, which is highly supported by the European Union. Mercosur is a case in point as it was already shown in the previous chapter.

d. Other issues

In addition to the regional designation, several members support the idea that other issues besides traffic rights should be seen within the regional framework. It is important to have a global perspective on infrastructure, environment, maintenance, security topics⁴⁷.

⁴⁶ [Rec A16-10](#) Draft model clause on airline designation and authorization to be adopted by LACAC member states in their negotiations with member states of the European community. (Nov-2004) available at <http://clacsec.lima.icao.int/>

⁴⁷ Minutes of the 8th of the Specific Group of Air Policy from CLAC, 8/03/2004, p. 7 available at <http://clacsec.lima.icao.int/Reuniones/2004/CE66/NE/66NE04.pdf>

2. EU and Chile agreement

The relationship between the EU and Chile can be a vital source of information to understand the relation between the EU and Mercosur in air transport in three ways.

First, Chile is an associated MERCOSUR member, participating in the regional integration process. Second, for the air transport purposes, Chile signed the Fortaleza agreement with the other MERCOSUR members in addition to Bolivia. Third, Chile was the first country to sign a horizontal mandate with the European Union. Moreover, the negotiations for an open aviation area between the EU and Chile have already begun. It should be highlighted that the horizontal agreement signed in 2004 removes the discriminatory provisions for European airlines. 'This agreement is also an important first step for the aviation relations between the EU and Chile. It will contribute to the integration of aviation markets in Latin America as it will also allow non-Chilean airlines to fly from Chile to the EU'⁴⁸.

Regarding the Open Aviation Area, the Commission aimed at opening the air market and simultaneously and enhancing the regulatory cooperation. Chile was invited to the table of the discussions because it shares the same EU values, namely market driven and consumer approach to aviation policy⁴⁹. Furthermore, the Commission recognizes Chile as 'a promising candidate for a new-generation air transport agreement with the European Community'⁵⁰. This means that Chile

⁴⁸ Press Release , 'European Commission proposes aviation agreement with Chile '23/12/2004 <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/1541&format=HTML&aged=1&language=EN&guiLanguage=en>

⁴⁹ Press Release, 'Commission proposes to open aviation negotiations with Australia, Chile and India' 05/09/2005 available at <http://www.europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/1090&format=HTML&aged=1&language=EN&guiLanguage=en>

⁵⁰ Communication from the Commission - Strengthening aviation relations with Chile (COM/2005/0406 final) available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&type_doc=COMfinal&an_doc=2005&nu_doc=406&lg=en

is a next candidate for an Open Sky agreement. The Commission has pointed out the area where an intense cooperation could be implemented, 'such as aviation safety, security, environmental protection and application of competition rules ensuring a competitive level playing field'⁵¹. It should be borne in mind that Chile is a liberalized country in terms of air transport. 'Chile allows foreign air carriers to operate domestic flights and grants its partner countries not only unlimited third and fourth freedom traffic rights, but also unlimited fifth and seventh freedom traffic rights'⁵². Moreover, it signed the Multilateral Agreement on the Liberalization of International Air Transportation (MALAIT), which includes cabotage and seventh freedom to all the signatory parts⁵³.

The analysis of the previous chapters leads to observe that Chile has a far more developed policy in air transport compared to its MERCOSUR neighbours. Nonetheless, the European Union seems to support this policy and even states that 'if the EU-Chile agreement is successful, it could be the model for an extended air transport partnership with other countries in South America'⁵⁴. In other words, the Community will expect MERCOSUR countries to have the same policy with the EU. Furthermore, 'Chile has already concluded the most liberal bilateral air services agreement in the world with Uruguay, which even includes access to domestic flights. Chile has recently strengthened its cooperation with both Argentina and Brazil in the field of air transport and signed a new 'open skies' agreement with Paraguay. Its relation with Uruguay is one of the most liberal in the sector, where even domestic flights are possible for a Chilean airline under the Uruguayan territory. As a consequence, Chile has relatively modern

⁵¹ Ibidem Point 1 – Introduction

⁵² Ibidem Point 2.2 - Air transport policy in Chile – Pioneering the Liberalisation of Air Transport

⁵³ Multilateral Agreement on the Liberalization of International Air Transportation. available at <http://www.maliat.govt.nz/>

⁵⁴ Communication from the Commission - Strengthening aviation relations with Chile (COM/2005/0406 final) - Point 5. CONCLUSIONS: SUBSTANTIAL ADDED VALUE OF A FUTURE EU-CHILE AIR TRANSPORT AGREEMENT available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&type_doc=COMfi nal&an_doc=2005&nu_doc=406&lg=en

and liberal agreements with all Mercosur countries⁵⁵. Therefore, Mercosur countries, in particular Brazil, are under some pressure to open their air transport market. This comes not only from Chile side but also from the US, where the bilateral open sky agreement with Argentina is the proof. The Community will be in the same direction as Chile and US concerning Mercosur countries.

It might be interesting to reflect on the reasons for this liberalization attitude from Chile, on the one hand, and more recalcitrant positions from Brazil or, in a less extent, from Argentina, on the other hand. Two main reasons explain these approaches, namely location and financial health of airlines. First, landing in Chile means the end of a journey, e.g. Santiago del Chile Airport is not a strategic hub for flights coming from Europe or even from US; whereas Sao Paulo airport means an important HUB for South America. Secondly, the former national carrier LAN Chile, now LAN Airlines owing to the acquisitions in various countries is in good financial health⁵⁶. It was elected the best South American airline in 2004 and 2005⁵⁷. LAN Argentina is also entitled to operate within this country. Unfortunately, the Brazilian and the Argentinean carriers can not show the same results and future perspectives. The Brazilian government might be protecting its airlines from a hard competition in order to form international champions in the air transport. While this could be considered as a strategy, the mismanagement will not be solved in a closed market. Besides, improvements at the management level usually take place in a competitive market.

From the European industry sector point of view, given the major difference in the respective size of the EU and Chilean markets, using the Open Aviation Area model for an air transport agreement between the EU and Chile would not be appropriate. Contrary to the US case, an OAA with Chile would bring no

⁵⁵ Ibidem, Point 4. ECONOMIC BENEFITS OF AN EU-CHILE AIR TRANSPORT AGREEMENT

⁵⁶ Press Release: LAN Results in the last trimester of 2005 available at http://www.lan.com/about_us/info_inversionistas/pressrelease/2006_03_03.html

⁵⁷ Press Release: LAN the best South American airline in 2005 available at http://www.lan.com/about_us/noticias/2005_06_24.html

demonstrable added value for the European industry. Therefore, an OAA between the EU and Chile is not a priority to the European industry owing to the imbalance of the traffic between Chile and the EU. At the same time, it is pointed out the fact neighbouring countries might not adapt the same liberal approach since they have a stronger domestic/international market⁵⁸.

To conclude, the Commission seems to have once again a liberal approach towards the air transport policy. Establishing Open Aviation Areas with different regions / countries all over the globe is its strategy. The European industry favours this concept. However, it underlines the fact that these agreements with certain countries, for instance Chile, would grant unbalanced rights to the detriment of EU carriers. Negotiating similar agreements with US, India and China where there is a mature or a potential market shall be fostered because they represent huge volumes of traffic for tourism and business reasons. Considering the power of the European market, conceding fifth and seventh freedoms to foreign airlines, it will damage the European industry without the opening for European airlines in the counterpart countries. Despite this opposition, the Commission continues with the same vision and it indicates that the Chile example must be followed by the South Latin countries, showing the way for a future agreement with Mercosur.

⁵⁸ Interview with Mr Giancarlo Crivellaro, former Deputy Secretary General from Association of European Airlines, Brussels, on 04/04/2008

3. SINGLE SKY

This topic is relevant in this study for political and economic reasons. First, the decision to create a single sky among the members of a regional group is a political step. Knowing that the air space is part of the territory of a nation and therefore linked to the sovereignty, an agreement on the matter represents a will to intensify the relations between the Member States. Secondly, there is an economic advantage of this integration. For instance, at the EU level, the non air traffic management optimization is representing between €1.3 to 1.9 billion a year because of delays⁵⁹. This is the reason why the International Air Transport Association highly supports this initiative⁶⁰.

As a result a glance of the European concept is provided in the next point. Passing by its implementation in ASEAN countries, the Single Sky topic will be concluded with a brief overview of its application in the MERCOSUR region. This topic could be an example of the EU cooperation with MERCOSUR as it happens in areas such as technical norms, tariffs and agriculture.

a. EU experience

The idea of a Single Sky in Europe appeared in 1999 when the Commission issued a communication under Mrs De Palacio Loyola, Transport Commissioner. The aim of this program is 'to improve and reinforce safety, to restructure European airspace as a function of air traffic flow, rather than according to national borders, to create additional capacity and to increase the overall

⁵⁹ Press Release: European Commission, 'One Single sky for the whole EU', 10/12/2003 available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/1702&format=HTML&aged=0&language=EN&guiLanguage=en>

⁶⁰ IATA Technical and Economic Resolution, 13/04/2003 http://www.iata.org/NR/ContentConnector/CS2000/Siteinterface/sites/soi/file/B130403_Single_Sky.pdf

efficiency of the air traffic management system (ATM)⁶¹. With an ever increasing traffic, the question of capacity is at the stake and the Single Sky tackles this issue. Furthermore, the concept of Functional Air Blocks replacing the current national borders represents another innovation. The current fragmentation cost is evaluated between €35 millions and €100 millions /year⁶². Although this is a very technical matter, a social dimension was not forgotten. Logically, the air controllers are directly affected by the new system and they showed some concern. In particular, the French trade unions feared the liberalization/ privatization of the air traffic management, which was immediately denied by the Commissioner.⁶³ Although the Single Sky legislation was adopted in 2004, the results have not been achieved. As a consequence, the European Commission adopted in June this year the II Single Sky package, comprising a communication and two regulations, where a momentum was created to stimulate its implementation⁶⁴.

***b.* ASEAN experience**

The model of regional integration in air transport is already being implemented in other parts of the world. ASEAN (Association of Southeast Asian Nations) has defined the Single Sky among its members for 2015⁶⁵. The EU Single is a case

⁶¹ The Single European Sky legislation available at http://www.europa.eu.int/comm/transport/air/single_sky/framework/legislation_en.htm

⁶² Report commissioned by the Performance Review Commission , 'The impact of the fragmentation in European ATM/CNS', April 2006 available at <http://www.eurocontrol.int/prc/gallery/content/public/Docs/fragmentation.pdf>

⁶³ Press Release: 'Single European Sky: Loyola de Palacio denies accusations of privatization and sell-off of air traffic management', 05/12/2001 available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1749&format=HTML&aged=0&language=EN&guiLanguage=en>

⁶⁴ All the documents available at http://ec.europa.eu/transport/air_portal/traffic_management/ses2/index_en.htm

⁶⁵ 'Preparing ASEAN for Open sky', AADCP Regional Economic Policy Support Facility, February 2004 available at http://www.usaid.gov.au/publications/pdf/asean_open_skies.pdf

study for this region of the world, where the level of liberalization is quite reduced. In a less extent, the experience of the Pacific Islands Air Services Agreement (PIASA) in 2003 was mentioned. Once again, the complexity of the bilateral agreements in multi-national framework is considered as an obstacle to the development of air transport.

c. **MERCOSUR**

This idea was already prescribed by the InterAmerican Development Bank in a large extent and it was named the Single Latin American Sky⁶⁶. Despite, the high level of integration, the EU faced several resistances to implement the project. That is why applying this model to such a large area with a considerable number of countries as it is the case in Latin America will require a considerable amount of political will. As a consequence, this part will only concentrate on the application of the Single Sky concept to the Mercosur in a process of a signature of an Open Sky Agreement with the EU. The former can put in the table of negotiations this model, by proposing its technical and financial help. At the same time, all the European expertise and research developed throughout the recent years could be transferred to Mercosur taken the necessary proportions.

In the case of Mercosur, the fragmentation problem is not so relevant. There only four countries involved. Furthermore, Brazil counts for 70% of the surface. On the other hand, the extension of the territory is a key point, considering the fact that Mercosur is almost four times bigger than the EU. Moreover, the traffic projections in the region are quite impressive. For instance, Brazil presents 8% growth per year on the sector, the double compared to the world level⁶⁷. Similar

⁶⁶ BOSCH Antonio & GARCIA-MONTALVO José, 'Free and Nondiscriminatory access to airports: a proposal for Latin America', IADB publication, May 2003

⁶⁷ MELLO José Carlos , 'Transporte aéreo en Brasil sigue la evolución del crecimiento del País', <http://www.mre.gov.br/cdbrasil/itamaraty/web/espanhol/economia/transp/aereo/apresent.htm>

to Brazil, Argentina foresees 10% growth for the coming years⁶⁸. This is why 'Argentina plans to invest USD 85 million over the next five years in constructing and upgrading the country's ATM systems'⁶⁹. Another argument supporting the idea of Single Sky is that by sharing the same technology and information, these States can fight better against the illegal transnational traffic by planes in the Mercosur countries. An agreement was already established to foster the cooperation in this domain but unfortunately no provisions were made in the technological field⁷⁰. Moreover, the social dialogue in Europe was a success and this dimension shall not be forgotten in the Mercosur case. In addition, the intense partnership with the air forces was vital to the EU achievement. In countries like in MERCOSUR where the Air forces still have a strong political influence, their participation in the entire process shall be required.

Briefly, the expected increase in the traffic, a considerable traffic flow flying through Brazil towards Europe and US, financial resources availability make the best moment to choose this system. Naturally, the analysis of costs and benefits weighs more for the latter, showing surely the way to be chosen. Afterwards, this economic analysis must be translated into political will in order to implement these projects. This is certainly what the Mercosur is missing. It has been for more than 15 years since the great adventure in the Mercosur countries started. It is now time to foster this integration in air transport. This sector will without any doubt continue the spill over effect into other areas.

⁶⁸ 'The Argentine Market for Navigation Aids and Air Traffic Control Equipment', USA Market Research Reports available at <http://strategis.ic.gc.ca/epic/internet/inimr-ri.nsf/en/gr132877e.html>

⁶⁹ Ibidem

⁷⁰ Agreement N0 15/02 about the Cooperation to fight against the transnational illicit activities due to the illegal traffic of planes between the MERCOSUR countries available http://www.mj.gov.br/mercosul/RMI/Documenta%C3%A7%C3%A3o/RMI_Acordo15-02.pdf

4. Airlines participation

The Open Sky agreement with the US is the first agreement where the Commission is negotiating on behalf of the Member States. Therefore, it is important to analyze the process in order to improve it for further negotiations, for instance MERCOSUR as it is suggested in this thesis. This part of the study aims to shed some light on the future European performance vis-à-vis third countries. As previously stated in the introduction, after the ECJ ruling, the Community - under a specific mandate from the Council – is in charge of the negotiation with the third countries on air transport issues. It is a long learning process for both entities: the Commission and the airlines. According to a Commission official⁷¹, the Commission needs to prove mainly to Member States that it brings added value in this field as demonstrated in the international negotiations for instance the Commercial Policy. Furthermore, it needs to develop an environment of confidence with the airlines. During the negotiation with the US, the European airlines have participated only partially. This attitude was contrary to the national traditions and shows a lack of trust in the European airlines. In the recent past, airlines participated fully in the negotiations between the National Aviation Authorities establishing the agreement. In the US, the Air Transport Association, which represents the sector⁷², takes full part in the game. It is true that it was an agreement between two States but the commercial interests were always on the table. Mr CAMUS, Air France European Affairs Department, states that even if there is a formal representation via AEA, they would prefer to participate directly. This attitude is based on the fact that their goodwill ('fonds de commerce') is decided by the Commission in these agreements. In other words, during these negotiations, the strategic interests of the companies are at stake and their presence is vital. Moreover, he claims that all the companies concerned by a future agreement should be present. Furthermore, he criticizes the Commission's

⁷¹ Interview with Emmanuel VIVET, European Commission DG TREN, Brussels, on 04/04/2008

⁷² Air Transport Association available at <http://www.airlines.org/home/>

approach, i.e., the ideological approach instead of a pragmatic view. That is to say that, according to this airline representative, the Commission must have a case by case approach while dealing with a third country in the air transport matters⁷³.

In the same line of thought, the AEA representative⁷⁴ declared that the Commission needs to formalize the system of representation. Furthermore, the Commission should include in its agenda the EU industry interests which are not always linked to aspects of traffic rights. In other words, the starting point of the Commission should be the EU airline industry's commercial interests, thus providing added value to the existing bilateral agreements. This is why AEA showed its concern about the EU-Chile agreement as it was mentioned before.

It is interesting to notice that the industry seeks to use the European and National levels to attain its goals. On the one hand, it supports the idea of having a European approach towards the international negotiations in order to defend the European interests. The first reason is the recognition of the weak position of European countries acting separately in front of major players namely US, China and India. The second reason, and intrinsically associated to the first, is related to the high level of standards required at the European level which are not respected by all the international companies. On the other hand, airlines can use the argument of sovereignty, to which Member States are attached, while negotiating the traffic rights. They can exert huge pressure on National Authorities rather than the European ones, which defend the common interest and not one company in particular.

⁷³ Interview with Mr CAMUS, Air France European Affairs Department, by phone on 05/05/2008

⁷⁴ Interview with Mr Giancarlo Crivellaro, Brussels, Former Deputy Secretary General from Association of European Airlines, Brussels, on 04/04/2008

From the consumers' point of view, 'liberalization of services between Europe and third countries is a logical-and desirable next step'⁷⁵ states the Air Transport Users Council, the UK's consumer watchdog for the aviation industry. To summarize, there is a new process taking place which requires understanding and trust amongst all stakeholders: the Commission, the Member States, the airlines and the consumers. In particular, the first three actors shall henceforth integrate this new dimension and establish long-term relationships. Therefore, the Commission shall enhance its dialogue with air carriers. With regards to the issue of liberalization, whereas the Commission's approach is naturally approved by consumers but it frightens the airlines. Once again the creation of a positive atmosphere could solve the problem in a large extent. Similarly to other matters, the external agreements will integrate the EU sphere, where the issue linkage is part of the game. By common sense, all the players might consider that the outcome is a win-win situation from its global perspective and that air transport is not an exception. On the other hand, the airlines themselves should integrate the European dimension and they can no longer enjoy the privileges that they have in the past while communicating directly with the National Authorities. Therefore, they must reach an agreement amongst themselves and then be represented by a single entity, the AEA for instance, as it happens with many sectors in the relation between the Commission and the private sector.

5. *Towards membership in ICAO*

It is true that the EU aviation market is one of the leading markets. The Community has been developing its competences on the matter and the ECJ ruling in June 2002 gave a new impetus. However, this activity is highly regulated at the international level by ICAO (International Civil Aviation Organization) and

⁷⁵ 'Inquiry into future of European aviation relations with the United States of America and other States', The Air Transport Users Council Memorandum 25/09/2003 available at <http://www.caa.co.uk/docs/306/Lords%20Inquiry%20-%20EU-US%20Air%20Services%20Agreements.pdf>

to a less extent by EUROCONTROL. Nonetheless, the EU is not participating fully, since it does not speak with a single voice regarding the decision-making process, despite the fact that it is recognized as a regulatory body in air transport. As a result, the Community required membership to those institutions. Regarding the second, on October 8th 2002, a protocol on the accession of Member States and the Community was signed and is currently in the process of ratification⁷⁶. As far as the ICAO is concerned, the process is in a preliminary stage. In other words, the same year of signing of the EUROCONTROL protocol, the Commission recommended that the Council authorize the Commission to open and conduct negotiations with ICAO in compliance with the conditions and arrangements for accession stipulated by the European Community⁷⁷. So far, the Community is merely an observer at the ICAO negotiations. As stated by the former Director of Air Transport at the European Commission ' the Commission should be able to present common positions in all the phases of the ICAO process in order to guarantee consistency with the EU rules and enforcement in the fields where the Community has competence'⁷⁸. This membership is vital within an international context. At the present, the Community is negotiating with US, India, China and MERCOSUR as it is proposed by this document, will certainly be the next partners sitting at the negotiations table. Moreover, the creation by 2010 of a Common Aviation area with the neighboring area is certainly another argument supporting a Community global attitude by belonging to the ICAO. In addition, the AEA representative stresses the fact that the adhesion to the ICAO is a pre-condition for the Community to become a worldwide player. Nevertheless, neither the Council nor the European Parliament

⁷⁶Eurocontrol members available at http://www.eurocontrol.int/corporate/public/standard_page/org_membership.html

⁷⁷ SEC/2002/0381 final (Recommendation from the Commission to the Council in order to authorize the Commission to open and conduct negotiations with the International Civil Aviation Organization (ICAO) on the conditions and arrangements for accession by the European Community) available at [http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:52002SC0381\(01\):EN:NOT](http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:52002SC0381(01):EN:NOT)

⁷⁸ AYRAL Michel, 'The role of the Community in air transport', Journal on Air Transport Law, 2004. p.38

expressed their opinion on the subject. Three years later in June 2005, the Council declared that it takes note of this request⁷⁹. One should bear in mind that it is not the first time that the Community is a full member of an international organization. The Food and Agriculture Organization (FAO) is a case in point. Furthermore, it is on this membership basis that the Community proposes to join the ICAO.

Being a WTO member, the Community can also play an important role in the air transport field in this forum. The main advantage of having a communitarian approach is the opportunity to deal with subjects that are attractive to companies but that are rarely treated at the bilateral agreements. Aeronautical construction, technical advice, State aids, harmonization of the competition rules (which implies a control of big alliances) and harmonization of the security rules are examples of the topics that the Community could incorporate in the agenda at the international arena. These common standards should be discussed in a multilateral rather than in a bilateral basis as it happens with the US. The Commission can and should be a pioneer, by proposing a regulatory framework in air transport at the world level. Within a liberalized system, it is important to provide common ground rules showing that principles are observed. Furthermore, the coming bilateral and / or regional agreements would be just focused on commercial issues.

⁷⁹ Press Release of the Council Meeting on Transport, Telecommunications and Energy on June 2005 available at http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/trans/85602.pdf

IV. Current agreement

After the intense negotiations since 2003, the European Commissioner Jacques Barrot is glad to announce the first-ever agreement on Open Sky between the two side of the Atlantic in March 2007. Besides the most difficult topics during the negotiation period, which will analyse in point V of this thesis it is important to outline its main successes:

- a) The recognition of all European airlines as "Community air carriers" by the United States, allowing for the consolidation of the EU aviation sector and the compliance with the November 2002 Court cases in the so-called 'Open skies judgments';
- b) The possibility for any "Community air carrier" to fly between any point in the EU to any point in the US, without any restrictions on pricing or capacity.
- c) The possibility to operate flights beyond the European Union and the United States towards third countries ('5th Freedom');
- d) The possibility for the EU airlines to operate all-cargo flights beyond the United States to a third country, without a requirement that the service starts in the EU (7th Freedom - All Cargo), US airlines will preserve their existing rights only;
- e) Provisions on commercial arrangements between airlines (code-sharing, wet-leasing...).
- f) Unprecedented Regulatory convergence mechanisms notably in competition, state aid and security. The provisions on security are of key importance in work towards a 'one-stop security' approach.
- g) Institutional mechanisms including a Joint Committee to handle any issue covered by the agreement, a dispute settlement procedure with arbitration provisions.
- h) A unilateral granting by the United States to the EU of so-called '7th Freedom rights for Passengers' to a number of non-EU European countries, i.e. the right for Community airlines to operate flights between a city in the United States and a city in these European countries.

- i) A number of access rights for Community airlines to the US 'Fly America' programme for the transport of passengers and cargo financed by the US Federal government. Such rights have never previously been granted by the United States to a third country.
- j) Rights in the area of franchising and branding of air services, defined for the first time in such an agreement, to enhance legal certainty in the commercial relations between airlines;
- k) Provisions on antitrust immunity in order to facilitate the development of airline alliances;
- l) Provisions on the development of joint EU-US approaches in international organisations and in relations with third countries;
- m) Provisions on EU-US technical cooperation in relation to climate change.⁸⁰

This agreement entered into force on 30 March 2008 and many new routes were established, offering a better choice for travellers⁸¹.

⁸⁰ European Commission Press Release 'Open sky: Jacques Barrot welcomes the draft aviation agreement reached by the EU-US negotiators' on 05/03/2007 available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/277>

⁸¹ Intervention by John R. Byerly, Deputy Assistant Secretary for Transportation Affairs about U.S.-EU Air Transport Agreement in Dublin on 08/05/2008 available at <http://www.state.gov/e/eeb/rls/rm/2008/104512.htm>

V. Negotiation topics

1. *Miscellaneous*

Before analysing two major issues in the negotiations with the US and with the potential MERCOSUR, foreign ownership and freedoms & hubs, there are several beforehand conditions that must be fulfilled.

The European industry argues that one can not conceive the opening of the markets when the same rules are not applicable. According to the air carriers and AEA representatives, competition law and state aids are good examples where a rapprochement between the EU and the third countries is desirable. In particular, after the 11th September, it is difficult to accept for a European airline that its American counterparts are strongly subsidized. The protection against bankruptcy under the chapter 11 and the aids provided due to the new security measures are cases in point. This distortion in competition was denounced to the European authorities, which did not approve any form of help to the European carriers. These questions are crucial when all the industry was facing the same dilemma.

All the stakeholders, who were interviewed during this research, underlined the fact that the negotiations with MERCOSUR can not begin if the lawful system in this region is not fully respected. Besides the State aids and competition law, there are other issues namely safety, maintenance, environment and infrastructures. It is not surprising that they are exactly the same topics that the CLAC members desire to cooperate. In other words, a potential negotiation between the EU and MERCOSUR will certainly reinforce this momentum, providing a common ground for negotiations.

2. Foreign ownership

The issue of Foreign Ownership is directly linked with the EU-US Open Sky agreement negotiation since this clause is raising some questions in the US. Some turbulence might affect the outcome of the agreement with the US. Daniel Calleja, Air Transport Director for the European Commission, recently stated that American investors in the European Union and European investors in the US are not subjected to the same rules. He insisted that if the US refuses to modify the rules on airlines ownership, the EU ministers will have to analyze the new scenario and the agreement might not be signed⁸². This is an important topic that should be taken into account for the purpose of this analysis, mainly regarding its applicability to MERCOSUR.

Although in a less extent, together with traffic rights, foreign airline ownership is considered a matter of sovereignty. It is, therefore, carefully regulated by national governments or the Community at the European level. It is interesting to point out that besides the fact that air transport is a vital sector national and international economies; it is still coupled with the memories of the World Wars. Furthermore, its importance during a possible war period is always recalled. Likely in the future this vision might change in the process of liberalization and globalization as it happened with the de-nationalization of the national carriers as expressed above.

a. European rules

At the European level, there was an effort in this sense. In 1992, the Regulation 2407 was adopted, establishing that investors from non-EU Members States can hold up to 49% of an airline's capital. This is the maximum possible conceived by European politicians and maybe European citizens. More than 50% would make

⁸² ADAMS Marilyn, 'Protectionism door threatens to slam on Open Skies', in USA Today on 29/03/2006 available at http://www.usatoday.com/money/biztravel/2006-03-29-open-skies-threatened_x.htm

a revolution in the actual mindset. However, this limitation is not respected when investments come from other EU Member States, as recently shown by the acquisition of KLM by Air France. The notion of EU carrier is quite clear in this regulation ten years before the Court's ruling in 2002. Once again the nationality is irrelevant within the EU territory, the EU is perceived as one entity.

The EU case is an exception of the Chicago Convention of 1944. It established that the country where the aircraft is registered must have the effective control of the company. The European airline designation allows that an airline under the regulatory control of the country X can be detained by the country Y. Logically, it is the country where the aircraft is registered, that will be questioned if there is an accident. There are two examples: DHL Air which is under German control but is authorised by the UK; and Air Botnia which is under Danish/Swedish control and is authorised by Finland. However, there is no case of a major company requesting designation from a country other than its origin country⁸³.

***b.* US rules**

On the other side of the Atlantic, the situation is considerably different, in spite of the motto of the country is liberalization. Foreign interests control in an American airline can not exceed 25% or one third of its board of directors. This restriction was created in 1920s when the memories of the World War I were still very present⁸⁴. There is, however, a nuance in the Civil Aeronautics Act 1938 stating that an American air carrier should be owned or controlled by American citizens in the opposite proportions expressed above. By using this distinction between ownership and control, the Department of Transportation (DOT) has already allowed KLM, through its subsidiary, Wings Holdings, to increase its non-voting

⁸³ Minutes of the 8th of the Specific Group of Air Policy from CLAC, 8/03/2004, Annex 2 p.12 available at <http://clacsec.lima.icao.int/Reuniones/2004/CE66/NE/66NE04.pdf>

⁸⁴ ADAMS Marilyn, op.cit note 69

equity in Northwest Airlines to 49%⁸⁵. According to this Department, this decision was justified 'to reflect more accurately today's complex, global corporate and financial environment, consistent with the requirement for US citizen control'⁸⁶. It is interesting to point out that at that time of the first Open Sky agreement between US and a third country was being discussed. The third country was exactly the Netherlands, KLM's mother land. The agreement entered into force in 1992. This arrangement was possible in order to succeed the first agreement. In other words, regarding the foreign ownership, the DOT revises its position, even though without changing the law, because it not only took into consideration the new complex world and but it also answered positively to the political pressure.

c. EU – US negotiations

In the course of the negotiations with the EU, the Department of Transport decided to put forward a proposal in a mid-way position combining the existence of 25% and the distinction of security/safety and commercial decisions. In other words, the first decisions would remain under the control of US citizens while the second can be made by foreign investors as it was the case with KLM. To be clear, 'The rule that DOT proposed in November 2005 would leave foreign ownership caps untouched but would enable foreign companies to better protect their investments in US airlines. DOT argues that it is merely clarifying existing statutes'⁸⁷.

The process was following the normal legislative path when alarms suddenly rang owing to the attempt by Dubai Ports World, a company based in the United Arab Emirates, to purchase the concession of five majors US ports. Some congressmen showed concern about the homeland security and national

⁸⁵ 'In the Matter of the Acquisition of Northwest Airlines, Inc', Wings Holding, Inc, DOT Order N0. 91-1-41 (1991)

⁸⁶ Idibem

⁸⁷ 'DOT Contemplating Further Review Of Ownership Rule', in Aviation Daily 25 April 2006

defence. It is known that during war periods, US airlines can be requested to transport troops. The new proposal of foreign ownership will never prevent the US from transferring soldiers, as it is the case in Europe. Naturally, US labour joined the movement, fearing the loss of jobs for US citizens.

According to David Grossman, a veteran business traveller and former airline industry executive, taking into account the number of open sky agreements between the US and third countries⁸⁸, the only reason why DOT is insisting in changing the current law is to inject capital from foreign investors in order to alleviate the economic crisis, which the US airline industry is facing⁸⁹. Delta Air Lines declared in favour of the change of the law. Even if at the first sight its major European partner, Air France-KLM, could seem interested in participating in its capital and rescuing from bankruptcy, this is not the case according to the Air France representative⁹⁰.

In contrast from the European industry point of view in general, foreign participation in airlines' capital is an element which can facilitate market access and can be quite interesting and according to the AEA representative⁹¹ is an integral element of the OAA concept promoted by his organisation in relation to the US. After intense negotiations, the final agreement foresees that, in a nutshell, EU investors can detain up to 49.9% of a US carrier while having a maximum of 25% of voting rights⁹². It is certainly an unbalanced result for the European Union and its carriers. Nevertheless, it allowed securing a first agreement and a promise that this issue will be a priority of the second stage of

⁸⁸ Open Sky US partners available at <http://www.state.gov/e/eb/rls/othr/2006/22281.htm>

⁸⁹ GROSSMAN David, 'The Open Skies: a foreign-ownership quagmire', in USA Today on 03/04/2006 available at http://www.usatoday.com/travel/columnist/grossman/2006-04-03-grossman_x.htm

⁹⁰ Interview with Mr CAMUS, Air France European Affairs Department, by phone on 05/05/2008

⁹¹ Interview with Mr Giancarlo Crivellaro, Brussels, Former Deputy Secretary General from Association of European Airlines, Brussels, on 04/04/2008

⁹² Official Air Transport Agreement –annex 4 (page 25) available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:134:0004:0041:EN:PDF>

negotiations initiated 60 days after its entering into force, i.e. June 2008. Furthermore, the EU carriers can limit the US investment to 25%⁹³.

In the case of MERCOSUR, one can believe that the Commission will apply the same rules. In this scenario, MERCOSUR will have to make some concessions.

d. MERCOSUR – current situation

i) Brazil

Before analyzing the foreign participation in Brazilian airlines, it is rather important to have an overview of the foreign direct investment in Brazil.

As it was shown in the chapter concerning the MERCOSUR as a global actor, the inflation rates have been decreasing significantly during the last decade. Consequently, the Foreign Direct Investment has been following the inverse path, i.e., it has been increasing considerably. In 2000 Brazil became the second largest emerging economy destination for FDI inflows (just after China) and the Latin America's largest FDI recipient, accumulating 34% of all inflows to the region (against 8.6% in 1990)⁹⁴. There is no doubt that the European companies are leading this process. However, as it was highlighted in the Brazil Country Report published by the Commission, several sectors are still ruled under certain restrictions on the topic of in foreign capital. Airlines are a case in point.

According to the Aeronautic Brazilian Code, foreign investment in national carriers is currently limited to 20%⁹⁵. It should be noticed, however, that in a

⁹³ Presentation made by DG Transport and Energy about the agreement available at http://ec.europa.eu/transport/air_portal/international/pillars/global_partners/doc/us/2007_03_27_background_briefing_slides.pdf

⁹⁴ Brazil Strategy paper from 2001-2006, European Commission publication available at http://europa.eu.int/comm/external_relations/brazil/csp/02_06en.pdf

⁹⁵ Brazilian Law Number 7565 of 19/12/1986 article 186 available at <http://www.planalto.gov.br/CCIVIL/LEIS/L7565.htm>

recent report issued by the World Trade Organisation the limit established is 49.5%⁹⁶. This difference in figures might be a sign that the WTO report is probably foreseeing future evolutions. This even justifies why in the above mentioned European Commission Report, the Brazilian government is willing to accept to increase the limitation up to 30% in one of the sectors where the restrictions remain, the media. A spill over effect can be expected in other sectors, mainly in the air transport sector. Similarly to the US airline industry, Brazilian airlines are undergoing a financial crisis, which can lead the government to review the legal framework.

It is worthy noticing that in November 2005, when VARIG, the flag Brazilian carrier, was looking for an investor, TAP, a Portuguese carrier, showed a great interest but it never became effective. Although VARIG was the largest Brazilian and South American airline and one of the most ancient companies of the world, the company declared bankruptcy in June 2006⁹⁷. After several months of auctioning, GOL (another Brazilian carrier) purchased VARIG for US\$320 million while keeping the brand VARIG. Despite the announcement that the new VARIG would have several EU destinations, one can see in their corporate website that Paris is the only European capital served by VARIG⁹⁸. It is important to note that its current mother company GOL only operates in Brazil and South America and it is owned by the Fundo de Investimentos em Participações Asas, an American Investment fund ⁹⁹. To conclude, the ownership issue is certainly not relevant for Brazilian authorities while potentially negotiating with EU representatives.

⁹⁶ 'International Trade, op.cit note 1, p. 228

⁹⁷ History of Varig available at <http://en.wikipedia.org/wiki/Varig>

⁹⁸ VARIG corporate website available at <http://portal.varig.com.br/br/varig/index.html>

⁹⁹ Relatório Anual 2007 da GOL available at http://www.mz-ir.com/gol/2006/web/arquivos/GOL_RA07port.pdf

ii) Argentina

Regarding Argentina, the situation is different from the Brazilian one. The current limit is 49%¹⁰⁰ but one exception was accepted to Aerolíneas Argentinas, which is the main carrier in the country. It is interesting to see the evolution of the ownership of this company to understand the reason of this exception.

Aerolíneas Argentinas are the carrier flag for Argentina. Argentines were proud of its success when in 1980 it operated the first transatlantic route between Argentina and New Zealand. Unfortunately, it accumulated a long debt, which was absorbed by the government led by Carlos Menem in 1989. At this moment the privatization started and the only tender was the Spanish consortium Iberia-Cielos. Meanwhile there were several conflicts with the Argentinean government and in 1994 Iberia detained 85% of the capital. In 1996, SEPI (Sociedad Estatal de Participaciones Industriales), the Spanish public group in charge of the public participation, held the leadership. It is only in 2001, when the SEPI decided to implement the financial recovery plan that the politicians and trade unions revolted¹⁰¹. They accused the SEPI's mismanagement of sacrificing the most profitable routes. SEPI declared that between 1996 and 2001 more than US\$600 millions were transferred to Aerolíneas and that it was important to pursue the plan¹⁰². In the middle of the Argentinean crisis in 2001 SEPI made the decision of selling its participation in Aerolíneas to Air Comet S.A for the symbolic amount of one dollar¹⁰³. At present, Aerolíneas seems to have recovered from its financial

¹⁰⁰ 'International Trade in air transport: recent developments and policy issues', World Trade Report 2005 Publication, p. 228 available at http://www.wto.org/english/res_e/booksp_e/anrep_e/wtr05-3b_e.pdf

¹⁰¹ 'Fifty years of Aerolíneas Argentinas history' available at http://news.bbc.co.uk/1/hi/spanish/latin_america/newsid_1390000/1390421.stm

¹⁰² RISSI Marcelo 'SEPI: "Aerolíneas Arg. es un saco sin fondo"', in 14/06/2001 available at http://news.bbc.co.uk/1/hi/spanish/latin_america/newsid_1388000/1388433.stm

¹⁰³ "AEROLÍNEAS ARGENTINAS S.A. otra vez un tema de la agenda política", 23/09/2005 available at http://blogs.periodistadigital.com/aviaciondigital.php/2005/09/23/aerolineas_argentinas_s_a_otra_vez_un_te

turbulence by the fact that it has paid in 2005 the last final payment to creditors of US\$245.7 million¹⁰⁴.

In a nutshell, it shows to what extent financial problems, in the case of US and Argentina, can guide the governments to re-examine their laws by changing them or by admitting an exception. This might also occur in Brazil. On the other hand, this task can be strongly contested by politicians and/or citizens. In the case of US, it is a matter of sovereignty related to the defence. On the South, it is true that in Argentina that there was no contestation in the first foreign intervention and that exception was accepted. However, if there is a proposal to go beyond the 49% limit of foreign participation, it might raise some concern. One of causes appointed for the 2001 Argentinean crisis was the foreign intervention in the economy. Therefore, the grant of more freedom to foreign investors in Argentinean airlines shall harm some wounds that are still to be healed.

It is true that Brazil and Argentina are two main players, as well in air transport. Nevertheless, a little overview of the Uruguayan and Paraguayan air transport will be provided.

iii) Uruguay

Starting with Uruguay, the Lineas Aereas Uruguayas Pluna S.A is the national carrier flag, even after its privatization in 1995 imposed by its poor financial health. Currently, its capital is shared between the private (51%) and the public funds (49%)¹⁰⁵. VARIG holds 49% of the capital and runs the company. It is a small company but it caught the attention of the region's big boys. Aerolineas Argentinas thought to take it over and if that would have happened the Uruguay's

¹⁰⁴ 'Aerolineas Argentinas.(Latin America/Caribbean Report)', published in February 2005 available at http://www.findarticles.com/p/articles/mi_hb3078/is_200502/ai_n13122616

¹⁰⁵ Brief description of PLUNA LINEAS AEREAS URUGUAYAS S.A. <http://www.pluna.aero/uruguay/historia.asp>

airlines could have been monopolised. Moreover, the first operating profit (US\$ 546.000) in a long time occurred at the end of 2003¹⁰⁶. It became, therefore, even more interesting for regional investors. For international investors it can also be an opportunity since Uruguay is well strategically located between Brazil and Argentina and could become a regional hub. It is a relatively small market with its 3.5 millions inhabitants¹⁰⁷ but with a fast growing rate. The growth of passengers in the main airports in Latin America accounts for 11.5% on average in 2005 whereas the number of passengers in the Montevideo Airport increased approximately by 21%, reaching one million passengers in 2005¹⁰⁸.

iv) Paraguay

Considering Paraguay, although its demographic size (6.5 millions of inhabitants)¹⁰⁹ almost doubles that of Uruguay, its traffic is rather reduced. In the Asuncion airport there are only 380.000 passengers per year¹¹⁰. The main reason for this traffic figures is that 60% of its GDP comes from trade activities with Brazil and the rest with Argentina, where the trucks are the means of transport. Furthermore, a large percentage of the population is working in agriculture and the market economy is based on exporting imported consumer goods to neighbouring countries¹¹¹.

¹⁰⁶ STEWART Diego, 'Southern skies: a profitable Uruguayan airline becomes the latest takeover target', June 2005 available at http://www.findarticles.com/p/articles/mi_m0BEK/is_6_12/ai_n6108883

¹⁰⁷ Basic data about Uruguay available at <http://en.wikipedia.org/wiki/Uruguay#Economy>

¹⁰⁸ Press Release from Internacional Airport of Carrasco (Montevideo) on 23 March 2005 available at http://www.aic.com.uy/lis_prensa.php?id=3

¹⁰⁹ Basic data about Paraguay available at <http://en.wikipedia.org/wiki/Paraguay>

¹¹⁰ Brief description of the Asuncion Airport available at <http://www.dinac.gov.py/aeropuertos/asuncion.asp>

¹¹¹ Basic data about Paraguay available at <http://en.wikipedia.org/wiki/Paraguay>

Altogether, Uruguay and Paraguay represent small markets at the regional level. Thus, the interest on the part of European investors to participate in the airlines capital is rather limited. If the passenger's growth rate keeps the same path in Uruguay, a foreign participation in an Uruguayan airline could be analyzed in order to form a regional hub.

e. European Industry's point of view

According to the Air France representative, the French carrier does not seem very interested to invest in foreign companies in general. He states that it is only a question of coherence between the European and American rules; it is not a key point for the industry in the negotiation with the US of a first step agreement. He argues that the current system of alliances is functioning well and closer tights in this area can be expected. Although Air France -KLM has 20% of the market share in the traffic between Europe and Latin America, it represents a small part of its turnover. It is important to remember that Air France is a global player in all the regions: North America, Asia and Africa.

f. Conclusion

Although the MERCOSUR rules of foreign participation are similar to the US, MERCOSUR governments will not be opposed to change them. In reality, a negotiation with the EU can be the right moment to modify them without a considerable contestation since it is part of the package deal. Moreover, the financial crisis that the sector is facing will certainly support this decision, since more importance will be given to the jobs than to questions of sovereignty. For instance, in Argentina an exception was already admitted because of the same reason. Moreover, MERCOSUR countries do not feel threaten in their security as US does. Consequently, the airline issues are strictly related to commercial matters and not defence ones. In addition, Europeans, in particular Portuguese and Spanish investors, seem prepared to invest in MERCOSUR carriers. The latest example is TAP.

3. FREEDOMS & HUBS

a. EU-US experience

The leitmotiv of the EU negotiations with the US is without any doubts the question of freedoms. The EU aims to rebalance the situation while the US is not willing to make further concessions on the subject since the current situation is benefiting them.

Currently thanks to the Open Sky bilateral agreements between the US and Member States, the US have the possibility to link commercially two member states. They possess the majority of the traffic rights of fifth freedom in Europe and even in some cases the seventh freedom for freight. In other words, boarding new passengers from Paris to Frankfurt in a plane coming from Washington is possible (fifth freedom). Furthermore, if an American carrier sees that there is a niche to build a direct flight, for example, from an EU airport to Beijing for the freight, there is absolutely no restriction in both countries (seventh freedom). As it was shown by the previous examples, the American carriers enjoy fully the existence of fragmented European market.

Contrary to the US carriers in Europe, the European carriers in the US can not exploit a line between two American cities. For instance, let us suppose that a British Airways plane takes off in the UK, lands in New York and continues its journey to Los Angeles. In the segment New York – Los Angeles no new passenger can be admitted on board, only the passengers coming from UK. This is definitely a loss of potential resources for European airlines since they fly with free seats. Naturally, by forbidding the cabotage in the American territory, the government had two intentions. First, it aimed to limit the competition within its borders to the American companies. Second, it obliged the European carriers to establish alliances and a code-share system with their American partners because, they knew that it is impossible for a European airline, even if it is a major one, to provide direct flights to all American destinations. With reference to

the seventh and eighth freedoms, it will take a long time to persuade the Americans in this direction.

Briefly, market access to the European and American carrier is rather different. Consequently, the European Commission, on behalf of the European Union, is putting some pressure on the American side on this subject. This is one of the points where once again one can perceive a difference with the past negotiations. It is a completely different weight negotiating when the delegation represents the entire community instead of one particular country. One can believe that Americans can feel threaten and some negative reactions can be expected. On the other hand they also recognised the profits that they can receive from this agreement in general. Having a clear Open Sky agreement in this regard to the entire EU would economically interesting for the American airlines, in particular FEDEX and UPS for the freight sector¹¹²

Besides the cabotage in the US, there is another important point for the European carriers namely the “Community designation clause”. The irrelevance of the nationality as it was called by de GROOT, KLM SVP, will foster the competition between the European airlines. ‘The Open sky agreement would also lift restrictions on European airlines, allowing them to fly between the USA and European cities outside their home countries for the first time’¹¹³. For instance, Air France can fly directly from Milan to the US. Thus, Alitalia would no longer be the only European carrier on the departure from Italy to the US. This issue is normally part of the horizontal mandate but since the US agreement is a global one, it integrates this dimension. The concept of communitarian designation has been applied to countries where the horizontal mandate is being discussed such as Lebanon, Jordan and Morocco. According to a Commission official, the airlines are not enjoying this possibility in small markets like the ones mentioned

¹¹² Interview with Emmanuel VIVET, European Commission DG TREN, Brussels, on 04/04/2008

¹¹³ ADAMS Marilyn, op.cit note 69

before. Nevertheless, the carriers can see it differently in the case of the US since it is a large market with high revenue passengers¹¹⁴.

In a nutshell, the possibility of cabotage associated with the communitarian designation open unlimited routes between Europe and the US. Henceforth, the commercial relation in air transport will be no longer regulated by the State. Instead it is the market which decides the best routes based on economic criteria. Michael Whitaker, vice-president of United, receives warmly this agreement by declaring that 'it will get government out of the decisions'¹¹⁵. However, it is important to state that the European airlines, the first beneficiaries of the cabotage in American territory, do not show a particular interest at this stage. According to the AEA representative, this option is not immediately commercially appealing thanks to the existence of alliances. The actual system has been working for a long time and it has proven its benefits for the consumers. Clearly, in order to operate cabotage rights within the American market, it will require investments and replanning crews and maintenance. However, the issue of cabotage and consecutive cabotage are inherent to the OAA concept and the AEA would hope that this matter will be addressed in a second negotiation phase.¹¹⁶

i) Airports' capacity

On the other hand, even if theoretically the array of possibilities is infinite, airport facilities would be the bottleneck. 'With 70% of the 50 largest European airports have already or almost reached saturation point in terms of ground capacity and severe capacity constraints being forecast for the year 2025'¹¹⁷ the possibilities of

¹¹⁴ Interview with Emmanuel VIVET, European Commission DG TREN, Brussels, on 04/04/2008

¹¹⁵ ADAMS Marilyn, op.cit note 69

¹¹⁶ Interview with Mr Giancarlo Crivellaro, Brussels from Association of European Airlines, Brussels, on 04/04/2008

¹¹⁷ Joint ECAC and Eurocontrol Study on Airport Capacity: challenges to growth, 14 December 2004 available at http://www.eurocontrol.int/eam/gallery/coment/public/library/CTG04_report.pdf

flying from Europe are not so encouraging if the European institutions, the Member State governments and the industry do not take planning decisions. Furthermore, the transit traffic through Europe to the US can be severely affected since North America and Asia have been opening new airports or improving the existents¹¹⁸.

The problem of capacity is particularly highlighted in the most important airport for the transatlantic traffic: Heathrow. So far under the Bermuda Agreement II, only four companies have the right to fly from Heathrow to the US. There are two British carriers, British Airways and Virgin, and two American airlines, American Airlines and United. It is not only limited in terms of companies but also in terms of destinations. For instance, if United would think in a flight connecting Heathrow to Denver, the national authorities would not allow. Under a future Open Sky agreement, this rule would no longer exists. Nonetheless, it is not automatically possible to land or take off from Heathrow owing to its capacity limit. It is common sense in the aviation world that slots can be bought and sold but they are costly and getting enough slots might take years. This is the reason why Jeff Smisek, Continental President, does not support the idea of an Open Sky agreement. According to him, the single advantage that the Americans have in signing such an agreement is the access to Heathrow. Once this access is refused, it makes no sense to discuss the agreement. It is central to remind that 40% of the transatlantic flow originates in Britain¹¹⁹. As a result, BAA, the company in charge of Heathrow management, launched a plan in order to absorb

¹¹⁸ In Hong Kong and Shanghai major new airports were opened in the last six years, there are new airports planned for the IT centers of Bangalore and Hyderabad. Meanwhile, in the US, the state of the art new airport of Denver celebrates its 10th anniversary and there are at least 9 projects for new runways at major US airports, namely in Atlanta, Chicago, Houston, Seattle, Boston, Charlotte, Washington, St Louis and Norfolk. Source ACI North America 2004

¹¹⁹ 'EU and Us Resume Talks on Open Sky Aviation Deal ', in The Guardian Newspaper , 17/10/2005 available at <http://www.buzzle.com/editorials/10-17-2005-79131.asp>

the expected 90 millions passengers in 2030 (in 2005 there were 70 millions passengers)¹²⁰.

b. MERCOSUR Single Aviation Market

Prior to the analysis of the EU – MERCOSUR regarding freedoms, one should focus on the relation between the main players in MERCOSUR, namely Brazil and Argentina since the concept of the Single Aviation Market is not developed. They are related in air transport by two different kinds of agreements. The first was already defined and it is the Fortaleza agreement. This agreement concerns the routes which are not established by the bilateral agreements and it is extended to other members namely Chile and Bolivia. The second, and far the most important, is the bilateral agreement, the core stone of their relations. This agreement was signed in 1948, later than the other Brazilian bilateral agreements due to the geographic imbrications of both countries and its implications. Eventually, an agreement was found. Thus, Argentinean airlines enjoy the fifth freedom and can fly from Buenos Aires through Sao Paulo to the US and/or Europe. Instead, the Brazilian carriers, which were not so keen on flying to other secondary points in Latin America, had the right of the sixth freedom. To put it simply, a Brazilian carrier was given the right to fly from Buenos Aires directly to the US and / or Europe through the Brazilian territory even if the American and / or European destinations were not Brazilian routes¹²¹.

In conclusion, the authorities had established the principle of traffic complementarity between the two countries. Each country can participate in

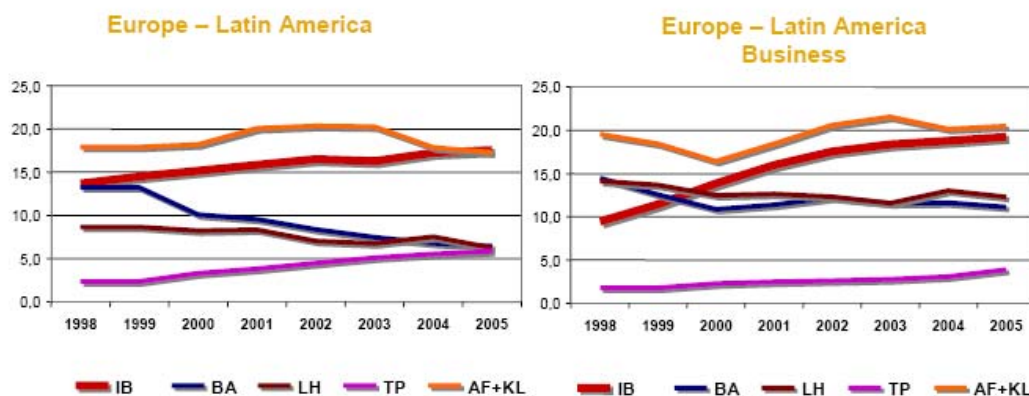
¹²⁰ Heathrow Airport interim master plan , June 2005 available at <http://www.heathrowairport.com/assets/B2CPortal/Static%20Files/LHRInterimMasterPlan.pdf>

¹²¹ SIMOES HENRIQUES José, 'Acordo de ceus abertos – Argentina/Estados Unidos – reflexos no relacionamento Brasil/Argentina, 1999 available at <http://www.sbda.org.br/revista/Anterior/1683.htm>

other's country traffic for the same destinations¹²². The same principle was applied between the other Mercosur countries. In other words, the size and the geographic position of Brazil are strong assets which difficult the construction of a Single Market for Aviation in MERCOSUR without a return to Brazil. Likely, with an external influence providing some side payments such as in agriculture topics or new traffic right in Europe, Brazil could be prepared to eliminate the restrictions.

c. Current EU – MERCOSUR Bilateral Agreements

In order to analyse the current legal framework, i.e., the bilateral agreements, it would be necessary to study the Bilateral Agreements between the all Member States and Brazil and Argentina respectively. Since there are no published data regarding this traffic, the traffic between Europe and Latin America serves as the better approximation. According to an AIR France representative, it seems that the accurate figures for Brazil and Argentina alone are not far from those indicated in the following chart.



Graph 1 - Market share in 2005¹²³

¹²² SIMOES HENRIQUES José, op.cit, note 106

¹²³ Iberia presentation on Market share in the routes between Europe – Latin America in 2005, available at <http://grupo.iberia.es/content/GrupoIberia/Documentos/Year%202005.pdf>

As one can observe, once there is a clear idea of leading companies in the traffic between Europe and these countries, the number of bilateral agreements is promptly reduced. There are two main carriers in this market: AF-KLM (AF+KL) and Iberia (IB). Nevertheless, as it was already mentioned before, this market represents a small part of the Air France turnover. As a result the bilateral agreement between France and these two countries will not be examined. For exactly the opposite reason, TAP is considered. Although TAP (TP) traffic holds only 5% of the market, the Portuguese carrier has unquestionably chosen the Brazilian one as its strategic market. This decision is justified not only by its historical links but also by its touristic potential. It is the European carrier which has the highest number of flights to Brazil¹²⁴. Thus, the bilateral agreements requiring further analysis are Portugal and Spain with the Latin American counterparts. However, owing to the lack of cooperation with the Portuguese Authorities, the details of these agreements were not provided and, therefore, they will not be discussed.

In 1947, Spain and Argentina signed the first bilateral agreement based on the classical model proposed by the Chicago convention. Two years later, Spain signed a similar agreement with Brazil. With regards to the freedoms in the first agreement, only the fourth freedom is mentioned and the fifth is not excluded but it requires the agreement of the third country¹²⁵. In some cases this is possible as it is shown in the following example. In March 2003, Aerolineas Argentinas operated the first flight between Buenos Aires and Beijing passing by Madrid. However, cabotage is forbidden¹²⁶. This agreement includes a provision were

¹²⁴ Press Release:TAP – ‘Portugal is the favorite destination for Brazilians’, 02/11/2005 available at <http://www.flytap.com/Portugal/pt/Empresa/Imprensa/PressReleases/4020>

¹²⁵ Convention between the Spanish and Argentinean governments concerning the civil air services, 01/03/1947, art II of the Annex

¹²⁶ Ibidem art I of the Annex

other companies rather than Spanish or Argentinean carriers can also operate the routes between these two countries¹²⁷.

As far as the agreement with Brazil is concerned, only the first four freedoms were agreed¹²⁸. It is interesting to notice that regarding the fifth freedom the rights granted to the Brazilian companies are inferior to the ones offered to Argentinean airlines. In other words, the fifth freedom is possible for Brazilian operators as a complement to the traffic with third countries¹²⁹ whereas the Argentinean airlines enjoy this right without any exception. As well as with Argentina, cabotage is forbidden in Brazil and in Spanish territory by Brazilian operators. As far as the common designation is concerned, other companies designated by the governments can operate the defined routes. Once again the European designation as well as a possible MERCOSUR designation will not create any difficulties.

Before seeing the impact on freedoms on an Open Sky agreement, it is important to check if its added traffic would be limited to the airport infrastructures as it is the case with Heathrow.

d. Airports capacity (MERCOSUR and Iberic peninsula)

As far as airports capacity is concerned, Barajas Airport is leading the way positively. The inauguration of the terminal 4 last February increases its capacity to handle up to 70 millions passengers per year¹³⁰. One should bear in mind that the last year's record was 42 millions passengers¹³¹. This investment was the

¹²⁷ Ibidem art VI of the Annex

¹²⁸ Convention between the Spanish and Brazilian governments concerning the civil air services, 28/11/1949, Section 3 of the Annex

¹²⁹ Ibidem Section 4 e) of the Annex

¹³⁰ AENA aplaza una semana la inauguración de la nueva terminal del aeropuerto de Barajas', El Mundo, 12/01/2006 available at <http://www.elmundo.es/elmundo/2006/01/11/madrid/1136980024.html>

¹³¹ Presentation Madrid Barajas airport available at <http://www.aena.es/csee/Satellite?cid=1049727006329&pagename=Estandar%2FPage%2FAeropuerto&SMO=1&SiteName=MAD&c=Page&MO=5>

answer to the expected growth thanks to the fact that Madrid seeks to become a hub to the South America. As the president of Spain's airline pilots' union, Antonio Nieto, clearly stated 'Barajas will become the best hub for flying from Europe to South America. Geographically, Spain is in the south of the Old Continent and it would be logical for Madrid to take on the same role as American airports in Miami or Atlanta, which concentrate on southbound traffic'¹³². It is worthy remembering that Madrid is not only the Hub for Iberia but also for Aerolineas in Europe¹³³. On the other side of the Iberic Peninsula, the airport capacity is a major issue. After five long years of discussion, the Portuguese government declared the construction of a new airport operational in 2017 which will replace the saturated Portela Airport¹³⁴.

Regarding the airport capacity on the other side of the Atlantic, it seems that it will not constitute a problem. The works have already begun at the Buenos Aires Airport, in order to increase its current capacity (six millions passengers per year) to 11 millions¹³⁵. This decision was taken in 2000 and it aims to answer to the touristic growth expected until 2022¹³⁶. The biggest and busiest airport in Brazil and Latin America, the Guarulhos Airport, is also preparing its future. The National Authorities agreed to build a new passenger terminal and third runway expanding its capacity to 25 million passengers annually (in 2004 the annual

¹³² 'Europe's Front Door', Latin trade website available at http://www.latintrade.com/dynamic/index.php?pg=site_en/pastissues/Jun05/destinations1.html

¹³³ History of Aerolineas Argentinas available at <http://www.aerolinas.com.ar/index.asp?pais=ar&idi=es&secc=1&subs=1&tipo=A>

¹³⁴ Speech made by the Portuguese Prime Minister, 'Apresentação do Novo Aeroporto «Lisboa 2017: Um aeroporto com futuro»', 22/11/2005 available at http://www.portugal.gov.pt/Portal/PT/Primeiro_Ministro/Intervencoes/20051122_PM_Int_Novo_Aeroporto.htm

¹³⁵ LLADOS José Ignacio, 'Renders and info of new ultramodern terminal for Ezeiza Airport (Buenos Aires)', 04/07/2005 available at <http://skyscrapercity.com/showthread.php?t=231421>

¹³⁶ Ibidem

movement was 13 million passengers)¹³⁷. In a nutshell, it seems that the airports capacity is not a barrier to an OPEN SKY agreement.

e. **EU-MERCOSUR agreement**

The industry's point of view would certainly enrich this work. However, only Air France had the kindness to express its opinion on the subject. Despite the fact that TAP and Iberia are two important carriers in the traffic between Europe and MERCOSUR, they always postponed the interviews and therefore their views will be not taken into account.

It seems that in terms of freedoms, a potential agreement between the EU and MERCOSUR would be similar to US agreement.

First, the European and eventual MERCOSUR designation will be easily accepted by both parties. From the MERCOSUR governments, it will be the application of a CLAC resolution and the extension of the current provisions in bilateral agreements. On the other hand, the EU will see this measure positively since it is the application of its own concept in another regional group.

Second, regarding the traffic rights, an agreement up to the fifth freedom will not be a major issue. It will be just the expansion to all the countries. From first ex aequo European carrier in Latin Market's point of view, Air France, perceives the potential agreement as an opportunity to create a direct flight from Amsterdam to Buenos Aires. Flying from another point in Europe, other than Paris and Amsterdam, to MERCOSUR would not be attractive while using the AF-KLM airplanes. Instead by the means of a partner, giving this possibility to Air France passengers could be foreseeable in terms of marketing¹³⁸.

Third, the issue of cabotage is a sensitive topic and likely might remain out of the negotiations. Anyway, the European Industry does not show a particular interest

¹³⁷ 'Airport development news', April 2005, Airports Council International, p.2 available at <http://www.airports.org/aci/aci/file/ADN%20-%20Mombberger/ADN%20-%20ACIApril2005.pdf>

¹³⁸ Interview with Mr CAMUS, Air France European Affairs Department, by phone on 05/05/2008

in it, since it would require huge investments without a huge return at the first sight.

Finally, airports are prepared to receive the expected increase in traffic thanks to the liberalization of the transatlantic flights between Europe and MERCOSUR

VI. Conclusion

The signature of an Open Sky agreement between the EU and MERCOSUR passes through a regional integration process and then to a multi-regional agreement. Nevertheless, there is a common denominator: liberalization. Thanks to liberalization of exchanges among the countries, air transport has been developed. At the same time, it is highly regulated by the States. This is a paradox.

At the European level, governments, lead by the Commission, acknowledged that the high regulation was impeding its natural growth. Therefore, some national barriers were eliminated while implementing the single market in aviation. As a result, the standard of services improved, new and more routes were created, the prices decreased and the companies in the market are stronger and prepared to face the global liberalization. Moreover, the concept of European carrier was replaced by the old national carrier concept, alliances were fostered and even an European holding was created (AF-KLM).

For the other side of the Atlantic, this can be a model of regional integration building a Single market in the Aviation. It can be considered a sign of the dynamism of MERCOSUR, showing the will for further integration despite external action from US. In the aviation field, the Fortaleza Agreement was a shy but confident beginning of integration in the 90's that now must be deepened. Furthermore, the concept of Single SKY recently developed in Europe and with a forecasted implementation in ASEAN countries can certainly be adopted by the MERCOSUR countries. The investment costs will be reduced and a more efficient traffic management will take place, which is vital to the increase in traffic in this region. In a nutshell, building the Single Market, adopting the Single Sky and the MERCOSUR airline designation will technically be feasible and it will only request political willingness. It can be perceived as process of building a new Latin American identity in order to face the challenges of the globalization. By fostering the interdependency amongst its Member States, MERCOSUR is less vulnerable to the political and financial crisis appeared in the recent past.

As far as the international traffic is concerned, the liberalization of air transport should be considered in a larger context at the WTO level. At the moment, Brazil and Argentina are particularly focused on the agriculture issues and blocking the services liberalization. Some EU concessions can be foreseen regarding the tariffs on agriculture goods, which will increase the pressure to open the services market. One should bear in mind that MERCOSUR is fourth biggest market in the world and the Europeans are the main investor in the region. The future Free Trade Area Agreement, expected initially to be signed in May 2006 and postponed since then will certainly constitute a catalyst for future negotiations, on air transport field in particular. Moreover, analysts show confidence in the future of the region with important growth rates. With the intensification of commercial exchanges, it is important to reduce the transport costs. As suggested by this analysis, the liberalisation of air transport is one of the means to reach this goal. In addition, thanks to the historic links and its potential in the tourism sector, the answer proposed is the Open Sky agreement. Similarly with the internal market, it should be the market and not the State who should play the main role. The State should be confined to ensure its efficiency and to promote a friendly environment for business. Naturally, consumers share this opinion, which is also the Commission's opinion.

Obviously, in order to achieve it, one should bear in mind that it is no longer possible to act nationally and as it happens with the single market, a communitarian perspective can provide more fruitful results. The ECJ ruling in 2002 is small step in this direction and the Council's mandate to negotiate with the US was the next one. Being present at WTO and ICAO, the Commission is certainly the best player to influence and to push forward the European interests when defining the rules at the world arena. The definition of global common standards will allow henceforth that the negotiations between the EU and a third country will only be concentrated in commercial matters. Furthermore, a formalized system of communication between the Commission and the airlines

should be implemented. However, at the same time, airlines must assimilate this new European dimension, which means that individually their influence is reduced compared to the national level. They should also take into consideration that there are other interests on the table namely the tourism sector and the consumers' interests.

With regards to the concept of airline ownership, freedoms and traffic rights, one can state that it is still seen by the countries as part of the national sovereignty. In the past, amongst the European nations, the land borders were part of the affirmation of a country and since Schengen agreement, none feel less attached to his/her country because of this fact. In the case of MERCOSUR, these topics will become less and less an affirmation of sovereignty unless there is a crisis like in Argentina which will produced the opposite effect. Considering the foreign participation into the airlines' capital, one can foresee the extension of the limits thanks to the financial crisis that affects the sector. The defence argument put forward by the Americans will not play a role in MERCOSUR, since the governments will prefer saving thousands of jobs rather than watching the disappearance of the sector. As far as freedoms are concerned, the extension of the fifth freedom to all countries involved seems quite reasonable. Besides being a forbidden subject in MERCOSUR, cabotage is not a key point for European industry since it requires huge investments. Naturally, an Open Sky agreement would allow flights from all airports in the EU to MERCOSUR and vice-versa. The European airlines show some interest and it can allow for instance Brazilian carriers to fly directly to some airports in Europe without flying through Buenos Aires as it occurs today. Moreover, the major Hubs in Iberic peninsula, Sao Paulo and Buenos Aires show their capacity to receive increased number of passengers thanks to the liberalization. In a nutshell, the US hot topics do not seem to constitute a major challenge in the case of MERCOSUR.

Eventually, an OPEN SKY agreement between the EU and MERCOSUR will foster the relations between these two regions so intensively connected by a long common past.

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Mr Emmanuel VIVET, European Commission DG TREN, Brussels, 04/04/2008

Mr DE VOS Koen, European Commission DG TREN, Brussels, 04/04/2008

Mr MESTRE Carlos, European Commission DG TREN, Brussels, 04/04/2008

Mr MANET Christophe, European Commission DG RELEX, Brussels, 07/04/2008

Mr CHRENEK, Council of the European Union, Brussels, 04/06/2008

Mr LEMOS VIEIRA Ilidio, Portuguese Representation, Brussels, 06/06/2008

Mr Giancarlo Crivellaro, Brussels, Association of European Airlines, Brussels, 04/04/2008

Mr CAMUS, Air France European Affairs Department, by phone on 05/05/2008

Mr Dominique MOISI, Director of the Institut Francais des Relations Internationales and Professor at the College of Europe, Brussels, 06/05/2008