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**ASSEMBLY — 39TH SESSION**

**ECONOMIC COMMISSION**

**Agenda Item 39: Economic Regulation of International Air Transport — Policy**

**OPENING OF CABOTAGE IN CHILE**

(Presented by Chile)

**REVISION NO. 1**

**EXECUTIVE SUMMARY**

The paper summarizes Chile 's positive experience of unilateral opening of cabotage, proposing that ICAO boost flexibility in the regulation of cabotage in the context of global multilateral open skies agreement.

The Assembly's decision: The Assembly is invited to:

Take note of Chile's experience and to consider the inclusion of an annex in the Multilateral Air Services Agreement as a course of action in offering States the option of opening cabotage to foreign operators.

<i>Strategic Objectives:</i>	This working paper relates to Strategic Objective D — <i>Economic Development of Air Transport</i> .
<i>Financial implications:</i>	Not applicable.
<i>References:</i>	Not applicable.

## 1. INTRODUCTION

1.1 Cabotage is generally understood as the air transport service which is offered between two or more points situated in the territory of the same State, even though during its development overflight over foreign territory is done. ICAOS's Manual on the Regulation of International Air Transport (Doc 9626), points out that air cabotage is the authorized right or privilege granted to a foreign carrier to transport cabotage traffic, which is otherwise prohibited.

1.2 Article 7 of the International Civil Aviation Convention (Chicago, 1944) states that any contracting State has the right to refuse permission of the aircraft of the other contracting States to have passengers, mail or cargo embark on its territory for transportation by means of remuneration or hire, destined for another point within its own territory. From this provision, it is understood that States may reserve the right to operate cabotage services for their own carriers exclusively. The same article adds that, if a State grants cabotage rights to another State, it must do so on the basis of non-discrimination, i.e. It may not withhold it as an exclusive privilege.

1.3 Historically, many reasons have been raised to support the necessity of not opening cabotage to foreign air carriers, such as: Concerns of national security; avoiding that the negotiated traffic rights with one State be taken advantage of by another State; protecting national carriers from excessive competition; safeguarding salaries and other working conditions; avoiding the problem of the "flags of convenience" which operate with lower safety standards, labour conditions or environmental protection, etc . In consideration of these factors, the majority of States continue reserving cabotage for their national carriers.

## 2. REGULATION OF CABOTAGE IN CHILE

2.1 Originally, Chilean law established the legal reserve of cabotage; consequently, domestic air transport could only be performed by Chilean airlines. However, in 1979 the Commercial Aviation Act was enacted, which applied an open skies commercial aviation policy in Chile. By that law, the legal reserve of cabotage was eradicated. In addition, the following principles were established for development of commercial aviation in the country: a) free market access; b) freedom to set prices; c) minimum intervention from authorities in commercial matters, and d) liberalization of ownership and control of companies, all with the aim of providing air services of the highest quality and efficiency, and at lower cost.

2.2 In accordance with these principles, the Commercial Aviation Act legally enshrined the unilateral opening of cabotage, allowing that all companies, of any given State, can enter unrestrictedly into the domestic market of Chile, adjusting only the technical requirements established according to flight safety and complying with the required compulsory insurance.

2.3 This open unilateral cabotage policy was reaffirmed in 2012 through a resolution issued by the Civil Aviation Board in which free access of foreign companies to the domestic market was declared, without demanding reciprocal concession for Chilean operators.

2.4 The desired objective of this initiative is to generate actual or potential conditions of greater competitiveness in the domestic air transport market, facilitating the entry and participation of foreign passenger and cargo operators, thereby promoting improved air services for the benefit of people.

2.5 According to that stated above, and applying the principle of equal treatment between nationals and foreigners, the conditions to operate in the Chilean domestic air market are the same for both foreign and local companies.

2.6 Without prejudice to the fact that air cabotage is unilaterally open, as a result of commercial air negotiations, Chile has also signed and endorsed bilateral and multilateral agreements where cabotage enshrines the principle of reciprocity. For example, in the multilateral arena, Chile is a party of MALIAT and the protocol that opens cabotage, and has signed, without reservation, the Multilateral Agreement on Open Skies of LACAC (Latin American Civil Aviation Commission), which includes cabotage. At the bilateral level, Chile has signed open skies agreements that include cabotage with Paraguay, Uruguay, El Salvador, Qatar, Bahrain, Kuwait, United Arab Emirates, United Kingdom, Iceland, Macedonia, Macao, among others.

### 3. EXPERIENCE OF OPENING CABOTAGE IN CHILE

3.1 Chile has an airport network comprising of a primary network, secondary network and a network of small aerodromes. The primary network includes 16 major airports, within which there are the 7 international airports in the country. The secondary network is composed of 13 aerodromes that allow for smaller operations, compared to the primary network and, finally, there is the network of small aerodromes, which support small-scale operations and mainly play a role of connectivity, sovereignty and social purposes in remote locations of the country.

3.2 Domestic passenger traffic in Chile depicts an average annual growth rate of 8.8 % over the last 20 years and 12.2% in the last 10 years. In July 2016 already, despite adverse economic conditions, a growth rate of 8.9 % was recorded, hoping to close the year with about 11 million trips inside Chile, which is quite significant when compared with the population, which is close to 18 million.

3.3 In 2012, a Uruguayan airline already conducted cabotage operations in Chile under the bilateral agreement between Chile and Uruguay. Following this and once ratified by our country's unilateral liberalization of cabotage without reciprocity, other foreign airlines have also conducted domestic operations in Chile. Thus a Mexican passenger airline conducted services between 2012 and 2013, a Swedish cargo airline operated during the same period and a US airline conducted passenger services between 2013 and 2014.

3.4 Evidently, the unilateral opening of cabotage favoured the entry of new operators on domestic routes, thus increasing competition on some routes. In addition, the mere fact of lowering entry barriers for domestic aviation market, it is possible to challenge this market at any time, which produces an effect of increasing competitive behaviour of the local airlines, which will directly benefit air transport users.

### 4. ASPECTS OF AVIATION SAFETY AND SECURITY

4.1 Among the reasons justifying the reservation of cabotage only for national carriers, usually wields the greatest risk that could arise for the safety and security of aviation. Indeed, in the case of safety, it is argued that the airlines from other States may have less stringent standards than those of the State in which they will operate. Similarly, the fact of allowing cabotage operations of foreign airlines

could undermine the necessary protection against acts of unlawful interference. These concerns, of course legitimate, lack a strong theoretical support, and expertise in Chile can offer a case study to rebut them.

4.2 In the field of safety, there is no reason to lower operational security control barriers to foreign companies that perform cabotage. On the contrary, there should be equal treatment for foreign and national companies, in strict compliance with the Annexes of the Chicago Convention as well as efficient audit work by examining the aircraft and the revision of respective certificates in accordance with Article 16 of the Chicago Convention. Additionally, thanks to the successful results of the ICAO USOAP program, today there is sufficient information for States to know in detail the quality and support of security control systems applied by other States and, thus, know and avoid the risks that may arise as in the case of certain operators.

4.3 In the field of aviation security, the reasons are similar. It makes no sense to argue that a foreign company performing cabotage operations would have less stringent controls. Preventive controls are and must be the same in both international and domestic aviation, whether it be foreign or national companies.

## 5. ASPECTS OF FREE COMPETITION

5.1 On the other hand, it is still being indicated that the opening of cabotage to foreign companies undermines healthy competition and causes market distortions. Indeed, a *"hot money effect"* that is, an airline could enter the domestic market, remain there merely for a period of high profitability (e.g. high season) and then exit the market, repeating this operation could occur only if conditions of profitability are recognized. This would cause that local companies cannot offer continuity on certain routes, because it would reduce the profitability obtained at peak periods, thus resulting in lower investment and finally a deterioration of the service offered on the route.

5.2 The Chilean experience of unilateral opening of cabotage can point out that there have not been instances of *"hot money"*. Apparently, it is costly to try to offer regular flights only in one season and then interrupt and re-offer them again in the next season. There wouldn't be sufficient profitability to perform an operation as indicated. In general, to encounter demand and passenger loyalty, continuity of service and good reputation is required.

5.3 However, even when this phenomenon occurs, it will always report beneficial for passengers in terms of greater choice, better services and lower tariffs. The important fact is that competition takes place in a free and healthy environment.

## 6. PROPOSAL BY CHILE

6.1 Pursuant to the arguments and experience previously described, Chile considers it appropriate to assess the following courses of action with regard to cabotage:

6.2 The incorporation of an annex to the Multilateral Air Services Agreement under which those countries wishing to join the opening of cabotage, may do so bilaterally.

6.3 The incorporation of an annex to the Multilateral Air Services Agreement under which those countries wishing to join the opening of cabotage under some condition, such as frequency restriction on certain routes for example, may do so bilaterally.

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