



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION

Strengthening aviation relations with Chile

1. INTRODUCTION

Traditionally, international air transport is governed by bilateral agreements between individual states. However, the so-called “open skies” judgements of 5 November 2002 of the European Court of Justice marked the start of an external aviation policy on Community level.

As outlined in the Communication “Developing the agenda for the Community’s external aviation policy”¹, agreements between the European Community and certain third countries will have the substantial added value of **creating new economic opportunities by opening up markets and promoting investment opportunities** as much as possible. Furthermore, such agreements will be the best way to ensure fair competition by **promoting regulatory convergence**.

Therefore, the European Commission has proposed to launch targeted negotiations seeking to achieve global aviation agreements in the major regions of the world, with the aim of strengthening the prospects for promoting European industry and ensuring fair competition, while at the same time helping to reform international civil aviation. In its Conclusions on external aviation relations, the Council has explicitly taken note of Chile as a potential candidate for a future request for comprehensive negotiating mandates.²

Chile, a country which has already concluded an Association Agreement with the European Community that will establish a free trade area until 2013, has requested to open negotiations of a comprehensive air transport agreement with the European Community. With its **market-oriented economic and transport policy and high regulatory standards**, Chile is a promising candidate for a new-generation air transport agreement with the European Community.

Furthermore, Chile has demonstrated its willingness to reform the framework for international air transport jointly with the European Community by being the first country worldwide to sign a ‘Horizontal Agreement’ with the European Community in the field of air transport.³

A more comprehensive air transport agreement with Chile would further strengthen the commercial and political ties between the EU and Chile. It will bring economic benefits to air carriers, airports, passengers, shippers, the tourism industry and the wider economy in both the European Union and Chile. Furthermore, it will be an excellent starting point for strengthening the aviation relations with other Latin American countries in the future.

With this Communication, the Commission therefore recommends that the Council authorises the Commission to negotiate, on behalf of the European Community, a

¹ COM (2005) 79.

² Council Conclusions of 27 June 2005 on developing the agenda for the Community’s external aviation policy.

³ The ‘Horizontal Agreement’ replaces provisions in the bilateral air services agreements between EU Member States and Chile, which have been found incompatible with EC law, with a Community agreement.

comprehensive air transport agreement with Chile aiming at market opening and regulatory co-operation and/or convergence, notably in priority areas such as aviation safety, security, environmental protection and application of competition rules ensuring a competitive level playing field.

Positive relations between the Chilean aviation authorities and the services of the European Commission have been developed over the negotiations of the ‘Horizontal Agreement’ and in exploratory discussions, providing an **excellent basis for entering into negotiations of an ambitious air transport agreement with Chile**.

2. THE EXISTING FRAMEWORK FOR AIR SERVICES BETWEEN THE EUROPEAN COMMUNITY AND CHILE

2.1. Bilateral air services agreements between EU Member States and Chile

Currently, air services between the EU and Chile are governed by the bilateral air services agreements between Chile and 11 EU Member States.⁴ There is no legal basis for air services between the other 14 Member States and Chile.

The existing bilateral air services agreements establish an incoherent framework for air services between the EU and Chile. While some agreements are very liberal and do not impose any restrictions on flight frequencies or route schedules, other agreements provide for a tight regulation of key economic aspects, such as the weekly frequencies, the route schedules and the fares. These differences in the development of Member States’ bilateral air services agreements with Chile lead to **inequalities in the opportunities available to Community air carriers**.

In September 2004, an Agreement between the European Community and the Republic of Chile on certain aspects of air services (‘Horizontal Agreement’) was initialled.⁵ The ‘Horizontal Agreement’ corrects the provisions which have been found incompatible with EC law in the existing bilateral air services agreements between Chile and EU Member States. In particular, it replaces provisions that require air carriers to be owned and controlled by nationals of a given EU Member State with a ‘Community air carrier’ clause. Chile was the **first country worldwide that agreed with the European Community on a ‘Horizontal Agreement’** that establishes a non-discriminatory legal basis for air services. Upon signature of this agreement, Community air carriers will be entitled to benefit from traffic rights between Chile and any EU Member State where they are established. Chilean air carriers will be subject to certain provisions of Community law when operating routes within the European Community. Due to the different bilateral arrangements, however, it was necessary to include a ‘no-circumvention’ clause in the ‘Horizontal Agreement’ in order to avoid a possible circumvention of the existing bilateral restrictions on traffic rights.

⁴ Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom.

⁵ COM (2004) 829, Proposal for a Council Decision on the signature and the provisional application of the Agreement between the European Community and the Republic of Chile on certain aspects of air services. The proposal was adopted by the Council on 27 June 2005.

2.2. Air transport policy in Chile – Pioneering the Liberalisation of Air Transport

Chile is one of the most advanced countries with regard to the liberalisation of air transport. The Chilean air transport policy is based on the principles of free market entry, freedom of pricing, open skies and minimum government intervention.

- There are no limits to the foreign ownership of air carriers in Chile. In November 2004, a new air carrier which is ultimately owned by Spanish capital received the necessary authorisations and permissions by the Chilean authorities to start domestic and international operations.
- There are no barriers to market entry for air carriers. Air carriers are authorised to operate if they have a valid Air Operators Certificate, affirming the ability to secure safe aviation activities, and if they comply with the necessary insurance requirements.
- Contrary to worldwide practices, Chile allows foreign air carriers to operate domestic flights, based on reciprocity.
- In the bilateral relations with more than 30 countries, Chile has granted unlimited third and fourth freedom traffic rights.⁶
- International traffic rights are allocated in a public auction in case there is more than one applicant. Traffic rights are freely transferable between air carriers.
- Chile is a signatory of the Multilateral Agreement on the Liberalisation of International Air Transportation (MALIAT) and an additional Protocol.⁷ By virtue of the MALIAT and MALIAT Protocol, Chile grants its partner countries not only unlimited third and fourth freedom traffic rights, but also unlimited fifth and seventh freedom traffic rights.⁸
- Chile is the key driver of the ongoing integration process of Latin American aviation markets. Chile is a signatory of the Fortaleza Agreement establishing open market access on sub-regional routes in South America.⁹
- If the application of competition law does not require it, Chile does not intervene in the pricing of air carriers. The pricing on non-competitive, i.e. monopolistic or quasi-monopolistic routes, is supervised by the aviation authorities.

⁶ Third freedom is the right to carry passengers and/or freight from the home country to another country. Fourth freedom is the right to carry passengers and/or freight from another country to the home country.

⁷ Other signatories of the MALIAT Protocol are New Zealand, Singapore and Brunei. The MALIAT Agreement includes furthermore the US, Samoa and Tonga.

⁸ Fifth freedom is the right to carry passengers and/or freight from a country to a third country on services starting in its home country, e.g. a Chilean air carrier carrying passengers between Spain and Germany on a Santiago-Madrid-Frankfurt flight. Seventh freedom is the right to carry revenue traffic between two countries outside its home country, e.g. a Chilean air carrier carrying passengers between New Zealand and Brunei.

⁹ Other signatories of the Fortaleza Agreement are Argentina, Brazil, Paraguay, Uruguay, Bolivia and Peru.

- The economic liberalisation of the air transport sector has been accompanied by strict enforcement of safety and security standards, user rights and competition rules.
- The airport sector is open to private investment. European investors have a 30% share in the airport consortium operating Santiago International Airport.

3. FURTHER STRENGTHENING THE RELATIONS WITH A PRIVILEGED AND RELIABLE PARTNER IN SOUTH AMERICA

Chile is the most important partner of the European Union in South America. In November 2002, Chile and the European Union signed an Association Agreement.¹⁰ The Agreement establishes a **political and economic association between Chile and the EU**, based on reciprocity, common interest and on the deepening of the relationship in all areas of application.

The EU-Chile Association Agreement will establish a **free trade area** in goods until 2013. Customs duties on industrial products will be completely eliminated until 2010. The Agreement also establishes a free trade area in services and provides for the liberalisation of investment.¹¹ However, air transport services are not included in the scope of the EU-Chile Association Agreement.¹²

The EU is the most important trade partner for Chile. In 2003, Chilean exports to the EU totalled € 7 billion. EU exports to Chile account for € 3 billion. **Between 2001 and 2003 alone, merchandise trade between the EU and Chile has grown by 27%**. The EU is the main investor in Chile with a total foreign direct investment stock of € 12.7 billion equalling 36% of total foreign direct investment.¹³

In March 2004, Chile has formally requested the opening of negotiations on a liberal aviation agreement with the European Union. Chile has reiterated its interest in an agreement that would encompass both liberalisation of market access and regulatory convergence in the 2nd EU-Chile Association Council in May 2005.¹⁴ Opening negotiations in the field of air transport **will further strengthen the economic and political links between the EU and Chile**. As Chile has been the first country in the Southern Hemisphere to enter into an Association Agreement and to establish a free trade area with the EU, it is a logical consequence that Chile should also be among the first countries to enter into a comprehensive air transport agreement with the EU.

¹⁰ Agreement establishing an association between the European Community and its Member States, of the one part, and the Republic of Chile, of the other part - Final act, *Official Journal L 352*, 30/12/2002 P. 0003 – 1450. The Agreement entered into force on 1 March 2005.

¹¹ Art. 94 of the Association Agreement.

¹² Art. 95 (2d) of the Association Agreement.

¹³ Source: Eurostat (2004).

¹⁴ Joint Declaration of the 2nd EU-Chile Association Council, 26 May 2005.

4. ECONOMIC BENEFITS OF AN EU-CHILE AIR TRANSPORT AGREEMENT

The total air traffic volume between the European Union and Chile is about 600.000 annual passengers. Due to the geographic distance, a substantial share of passengers is carried on indirect flights via other Latin American countries.

While the bilateral air services agreements between several EU Member States and Chile do not impose any restrictions on the number of flights, the most important bilateral markets in economic terms¹⁵ are governed by agreements that restrict the ability of air carriers to offer air services according to the demand of passengers. **The existing restrictions constrain the potential growth of air services between the EU and Chile.** Forecasts predict an average annual growth rate in air services between the EU and Chile of 5.9% between 2004 and 2008¹⁶.

In recent months, air carriers from both the EU and Chile have indicated their interest in entering the EU-Chile market. However, the existing restrictions in the bilateral agreements would not allow them to operate flights on a scheduled basis. **Tourism flows between the EU and Chile have increased 50% between 1998 and 2004**¹⁷ but further growth of the tourism market could be hampered by the existing restrictions in the air services agreements if no action is taken.

Trade flows between the EU and Chile have increased by 27% between 2001 and 2003 alone. Eliminating the existing restrictions on air services would **facilitate an unconstrained growth of trade between the EU and Chile**, particularly given the long distance and the substantial share of perishable goods in the trade relations with Chile.

The lifting of restrictions could **enhance market opportunities for Community air carriers**. Released from the existing restrictions on the number of weekly flights and the routes, air traffic between the EU and Chile is likely to increase. The number of direct flights between the EU and Chile is expected to increase, allowing Community air carriers to increase their market share of the total volume of the EU-Chile market. A further liberalisation and the resulting increase in direct flights will **increase choice for European passengers and shippers for flights to Chile**, an important trading partner of the European Union. An increase in air services, particularly an increase in direct air services, will facilitate a further **increase in trade and tourism flows between the EU and Chile**.

Since Community air carriers currently account for nearly two thirds of the passenger market and 70% of the freight market,¹⁸ and since more than 65% of passengers between the EU and Chile are European residents,¹⁹ it is expected that the **major**

¹⁵ Spain, Germany and France account for more than 90% of the passenger traffic between the EU and Chile.

¹⁶ Source: IATA Passenger Forecasts 2004-2008.

¹⁷ Source: Sernatur, Estadísticas de Turismo.

¹⁸ Passenger market shares in 2004: Lan Chile 32%, Iberia 31%, Lufthansa 20%, Air France 12%. Freight market shares in 2004: Lan Chile 30%, Iberia 22%, Martinair 18%, Air France 13%, Cargolux 10%, Lufthansa 7%. Source: Junta de Aeronautica Civil.

¹⁹ Source: Sernatur (2005).

share of these economic benefits would be reaped by the European airline industry, European consumers and the wider European economy.

With its modern regulatory framework, Chile is an excellent candidate for deepening the aviation relations with the Community in an Open Aviation Area – both in terms of market access and in terms of regulatory cooperation. An enhanced **regulatory cooperation between the EU and Chile would facilitate further the air services between the EU and Chile.**

Maybe even more important than the direct economic impact on the EU-Chile market is the medium-term impact on other air transport markets. The **economic benefits of open international aviation markets** have been clearly identified in a study conducted on behalf of the European Commission on the economic impact of an EU-US Open Aviation Area.²⁰ Released from the existing restrictions on the number of weekly flights and flight routes, air traffic is likely to increase. With open market access, airlines will be able to take advantage of new market opportunities and offer air services on the routes where their customers demand it. Cross-border investment flows will bring further efficiency gains.

In the longer term, an EU-Chile Air Transport Agreement could have **wider economic implications for the air transport between the EU and other Latin American markets.** Chile is the main driver of air transport liberalisation within Latin America, both in political and commercial terms. 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. As a consequence, Chile has relatively modern and liberal agreements with all Mercosur countries. Furthermore, Chile is the key player in the industry-driven integration process in Latin America. The main Chilean airline, LAN, has established affiliates in Peru, Ecuador and Argentina. In the longer term, an Air Transport Agreement with Chile could be expanded towards neighbouring countries in Latin America, increasing further the economic benefits of a comprehensive Air Transport Agreement with Chile.

The **clear potential benefits of an Open Aviation Area Agreement with Chile have been confirmed** in an impact assessment study by independent consultants. While the short-term economic benefits might be limited due to the low number of non-stop flights between the Community and Chile and the already existing degree of market access, there are nevertheless commercial benefits for the EU airline industry even in the short term. It was confirmed that the regulatory and policy framework for air transport in Chile should allow the Community to reach without great obstacles a model agreement with Chile achieving greater levels of regulatory convergence and new opportunities for EU industry and users. Furthermore, the study underlined the substantial economic benefits in the longer term for the European airline industry, air transport users and other economic actors, taking into account the implications for relations with other Latin American countries.

²⁰ The Brattle Group, The Economic Impact of an EU-US Open Aviation Area, Study prepared for the European Commission, December 2002.

5. CONCLUSIONS: SUBSTANTIAL ADDED VALUE OF A FUTURE EU-CHILE AIR TRANSPORT AGREEMENT

A modernised framework for air transport between the EU and Chile offers significant new opportunities for strengthening air transport in a competitive level playing field. Further to that, it will strengthen further the excellent commercial and political relations between the EU and Chile.

The model of an air transport partnership between the European Union and Chile is inspired by the ambitions to take forward an agenda for reform on an international level. The resulting agreement on the liberalisation of air transport between the European Community and Chile would establish a modern framework for air services between the EU and Chile, with market access as open as possible and regulatory co-operation and convergence. If successful, it could be the **model for an extended air transport partnership with other countries in South America**.

The negotiations will aim, on the one hand, at a **reciprocal opening of market access**. Air services between the EU and Chile are often operated on a one-stop basis via intermediate points which are significant markets in their own right, e.g. Brazil or Argentina. Therefore, fifth-freedom rights via such intermediate points are important to increase further the benefits of an agreement with Chile. Chile shares the objective of air transport liberalisation and has already indicated in exploratory talks its willingness to grant cabotage rights, i.e. the right to operate domestic flights in Chile. Such cabotage rights would be a welcome precedent for ongoing Community negotiations with other third countries.

The reciprocal opening of market access with Chile has already been implemented by some Member States. Very recently, Finland reached an agreement with Chile providing for full market liberalisation. However, other Member States have not yet reached an advanced degree of market access in their relations with Chile. Fourteen Member States currently do not have any access at all to the Chilean market. This incoherent and fragmented framework has led to inequalities in the opportunities of Community air carriers which are not consistent with the equal opportunities for all Community air carriers in the Single Market.

A comprehensive air transport agreement on a Community level would make the Community's aviation relations with Chile coherent and would grant **equal opportunities for all Community air carriers for air services to Chile**. Furthermore, it would create **substantial new market opportunities for air carriers** in the 14 Member States that currently do not have any rights concerning air transport from and to Chile. An air transport agreement on Community level would give smaller carriers the possibility to extend their network to Chile. While traffic demand between several Member States and Chile might be too thin to make direct flights commercially sustainable, air carriers would have substantial benefits by being allowed to code-share on their alliance partners' flights to and from Chile.

Open aviation markets need a framework that ensures fair competition and high standards of safety, security and environmental protection. Market opening and regulatory co-operation towards convergence go hand in hand. The bilateral air services agreements between some Member States and Chile have granted Chilean air carriers fully open market access while not adequately ensuring regulatory

convergence. A comprehensive air transport agreement with Chile on a Community level will equally reinforce **high standards of safety, security, environmental protection, passenger protection and other regulatory issues**.

With regard to environmental issues, the agreement must be consistent with the Community's commitment to **sustainable development**. Apart from the economic benefits highlighted above, the expected growth in air traffic also has unwanted side-effects, notably on the air quality and noise levels around airports and through the contribution to global climate change. It is important that the agreement does not restrict the EU's ability to apply regulatory or economic instruments to mitigate these adverse effects.

Safeguarding fair competition is a key issue in open aviation markets. By achieving greater levels of regulatory convergence, a comprehensive air transport agreement between the Community and Chile will **ensure a competitive level playing field** to avoid distortions of competition. Chile has strong competition authorities enforcing competition rules. There is no government support to the airline industry, not even after the industry crisis of 9/11. In aviation safety, Chile has an outstanding record in South America and can be compared to European standards. As a consequence, based on the current level of enforcement of safety and security standards, of competition rules and air transport users' rights in Chile, **prospects for a high level of regulatory co-operation and/or convergence between the Community and Chile** are excellent.

In informal exploratory talks, Chile has confirmed its **willingness to achieve a high degree of regulatory convergence with the Community** in order to facilitate air services between the EU and Chile. Such a regulatory convergence can only be achieved on Community level; the bilateral agreements fall short of ensuring an adequate regulatory cooperation. An agreement will establish cooperation mechanisms to ensure that the rules of the agreement are respected and further developed.

The substantial added value of an air transport agreement with Chile could be further increased by similar agreements with other countries in South America. Hence, the new partnership between the European Union and Chile should be a **model for the region** and open for other countries that might wish to join.

In light of the above, the European Commission recommends that the Council authorises the Commission to open negotiations with Chile with a view to concluding a comprehensive air transport agreement.

The Commission will work closely together with Member States and all relevant stakeholders in further developing and achieving the objectives set out in the negotiating directives.