THE CIVIL AVIATION CARTEL: A STUDY IN THE
POLITICS OF INTERNATIONAL COLLABORATION

By

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The thesis examines the formation and development of post-World War II international collaboration in the economic regulation of the commercial aspects (i.e., market entry; market shares and prices) of civil aviation. Specifically, it studies the formation and operation of one type of international regime: a cartel. The thesis seeks to answer two questions: why do states cooperate to support an international cartel? And why do states cease to support a cartel?

The study proposes three reasons why states will support a cartel: (1) to promote consumer welfare and the growth of the industry; (2) to ensure the development and protection of their national carriers; and (3) in response to hegemonic activity.

It then considers why states cease to participate in the cartel arrangements. This occurs: if states no longer believe that the cartel is promoting consumer welfare and industrial growth; if they conclude that their industry no longer benefits from cartel protection; or if the hegemon is unable or unwilling, or both, to support the regime.

All three give valuable insights. Nevertheless, the author proposes that it is possible to establish a hierarchy of usefulness according to the depth and scope of understanding offered by each explanation. It is argued that hegemonic stability theory provides the most useful insights.
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INTRODUCTION

The development of international civil aviation is not one of the more popular subjects of study in political science. And yet politics, specifically international politics has played a very important role in the development of the industry. In the words of Anthony Sampson, author of *Empires in the Sky*:

> Airlines and politics have collided with each other from the beginning. The airlines, as they changed the shape of the world, were also locked into the ambitions of nations. They provided a kind of visual projection of changes on earth—the shifting political balances of power and wealth, the swings of economic beliefs, the technological developments coming up against political deadlocks and reactions (Sampson 1985:24).

To a large extent it is the nature of the industry which makes it an issue area susceptible to the interplay of political forces. First, international civil aviation belongs to a group of industries which are "international" in character. These include all transportation and communication services whose task is precisely to transcend national borders in order to build links between states. Second, as a corollary, it forms an integral part of the global infrastructure which is essential for the development of the world economy. If states are to benefit from their respective comparative advantages and from global economies of scale, it is crucial that the transport of goods and services (i.e., people) across national boundaries be facilitated. Third, the industry has high public visibility. Consequently, air carriers
are ideally suited to become symbols of national pride and to manifest visually a state's global presence. Finally, the actual operation of the industry requires the derogation of the principle of state sovereignty. States must come to an agreement permitting foreign air carriers to enter their air space and/or land on their territory.

It is this latter point which serves as a focus for this thesis. Traditionally, the study of international relations has been primarily concerned with the existence of conflict and the occurrence of war; however, in recent years a growing number of scholars have shifted their attention to the examination of the dynamics behind international collaboration or the formation and operation of regimes. In the post-World War II era, a multitude of collaboratory arrangements are found operating in all areas of international life. Within the issue area of international civil aviation, alone, a number of different regimes exist. This thesis focuses on international collaboration in the economic regulation of the commercial aspects (i.e., market entry, market shares and prices) of civil aviation. Specifically, it is concerned with the study of the formation and operation of one type of international regime: a cartel. The thesis seeks to answer two questions: why do states cooperate to support an international cartel? And why do states cease to support a cartel?

The cartel regulating the commercial aspects of international civil aviation is the International Air Transport Association. It has been described as "one of the most powerful and authoritarian private international cartels that the world has ever seen" (Pillai 1969:xii). Founded by a group of airline executives from 60 airlines who met in Havana in 1945, IATA became the trade association of the world's scheduled international air carriers.
The organization was preceded by what is referred to as old IATA. This organization, founded by six airline companies at the Hague on August 25, 1919, was a free association of primarily European air companies. Its purpose was to facilitate international aerial traffic through the standardization and coordination of schedules, timetables, conditions of carriage, procedures and documents for the settlement of accounts between companies, airline liability, etc. (Chuang 1972:20). Although it provided a forum for airlines to discuss fares and rates on routes, it possessed no formal rate-making power. The new IATA continued to provide the services of a trade association; but as compared with its predecessor, its membership and function had expanded. With the exception of the USSR and the People's Republic of China, the airlines of all major states joined the association. Thus it became a truly international organization. Unlike the membership of the old IATA which was predominantly composed of airlines owned by private companies, most of the new IATA airlines were partially or completely state owned. The major exceptions are U.S. carriers that are completely privately owned.

Through international agreement, IATA is authorized to organize tariff coordinating conferences which fix international air fares and rates.

Although the thesis focuses on the IATA cartel, two other "institutions" will also receive some attention. They are important since their activities are linked to those of IATA in the regulation of the commercial aspects of civil aviation. These institutions are bilateral agreements and the International Civil Aviation Organization.

Bilateral agreements are signed between states and dictate the terms of market entry, capacity regulation, and tariff-setting. It is important to note that there is an intimate relationship between the regulation of market
entry, capacity and price-setting. Price-setting may be undermined if market forces are allowed to control market entry and capacity. Consequently, any institution regulating the latter needs to be examined. Moreover, bilateral agreements provide the mechanism by which states give their implicit or explicit approval of IATA tariff-fixing functions. Without such approval, the organization's operations can be impeded at a national level. Currently, a network of over 1,200 intergovernmental air transport agreements exists.

The International Civil Aviation Organization (ICAO) is an intergovernmental specialized agency of the United Nations Organization. Established by representatives of 54 states, who met in Chicago November 1944 to discuss "matters of routes, land rights, and the general principle of air navigation and international air organization,"³ (pre-conference letter of Chairman Adolf A. Berle, then United States Secretary of State qtd. in Salacuse 1980: 849), ICAO was originally to play an important role in economic regulation. Article 44 of the Chicago Convention listed two of the objectives of the Organization: 1) to "meet the needs of the peoples of the world for safe, regular, efficient and economical air transport," and 2) to "prevent economic waste caused by unreasonable competition" (Mateesco 1981:614). However, for over thirty years, ICAO's role in economic regulation was minimal.⁴ Instead, ICAO primarily occupied itself with the regulation of technical standards and promotion of aviation safety, regularity and efficiency (Salacuse 1980:831). In the period beginning in the mid-'70s, ICAO's involvement in economic regulation increased.

There are three basic reasons why states may support the operation of a cartel. First, states may believe that this form of industrial organization is optimal for the promotion of consumer welfare and global industrial
growth. Second, a state may believe that the survival and success of its own international carrier requires cartel regulation. There may be a variety of economic, political and security interests associated with flag carrier ownership that explain why possession of an international airline provides such a great incentive for state cooperation. Third, a state may support the operation of a cartel due to the activity of a hegemon which, for reasons other than those already stated, promotes this type of collaborative arrangement.

The view that consumer welfare and industrial growth are best promoted by cartel regulation rests on the characterization of the aviation industry as a public utility. As a public utility, it is a natural monopoly. According to Harold Demsetz and Richard Posner, a natural monopoly exists where economies of scale, usually arising from high fixed costs, are found. In such a situation efficiency gains are to be made, not in an environment of perfect competition, but in an environment where a few large firms are allowed to benefit from the economies of scale. The objective of regulation is two-fold. First, regulation is required to protect the firms from competitive forces. It is argued that in such an industry there is an incentive for firms to try and enter the market and initially capture a large share of the market through predatory pricing. (Their objective is to secure a position in the market and then, with the help of economies of scale, become monopolists themselves.) These practices result in market chaos and undermine efficient monopolistic operations. Second, although regulators desire to create an environment in which economies of scale may be exploited, they want to ensure that monopolists do not abuse their power. Cartel regulation is thus needed to guarantee that the benefits of this form of industrial
organization are passed down to the consumer. In addition to being a natural monopoly, a public utility has another characteristic: it is a public service that regulators feel obligated to provide. It is argued that in a competitive environment, or in a situation where an unregulated monopoly exists, unprofitable routes would be abandoned. A price-fixing cartel is needed to ensure that these uneconomical, yet vital services continue to operate.

A second motive for supporting cartel action is not concern for correcting market imperfections or failures, but the desire to ensure the preservation of a state's market share in the industry. A cartel that fixes prices will protect inefficient industries from competition. In this case, states are interested in enjoying a variety of economic and political benefits derived from possession of an international flag carrier.

Perhaps one of the most important economic benefits is the effect airlines have on the balance of payments. An air carrier earns balance of payments receipts by collecting fares from foreign travelers, and can save potential foreign exchange losses by carrying its own nationals. Thus support of the cartel may provide gains, or at least prevent losses of foreign exchange.

Many airlines are partially or completely state owned. Any revenue gained from the operation of an international airline will be a credit in the government budget. This logic may also take a more extreme form in the case where states use the cartel to preserve artificially high prices in order to ensure large profits to the industry. In this case regulation is seen, in effect, as an indirect means by which government can tax international travelers. Government officials may also be interested in ensuring that
their travelling expenses do not appear as losses in the government budget. This may easily be arranged in situations where a national carrier exists.

The possession of an international carrier may also have industrial spin-offs. It may stimulate the development of local industries, e.g., food preparation, fuel management, advertising, and airplane manufacturing. Similarly, it may develop the state's industrial base by requiring skills and facilities to be developed in order to ensure aircraft maintenance. An international carrier may also facilitate international communication which in turn may promote trade, investment, and tourism. This will promote a state's economic development.

The final economic reason prompting a state to support a cartel is interest in creating market demand for certain services or products which it provides or manufactures. By creating an environment in which foreign airlines can develop, the cartel will indirectly stimulate demand for a state's products. For example, a state that possesses a major aircraft manufacturing industry will adopt an international policy that will promote the formation and expansion of foreign carrier companies which will in turn purchase aircraft from it.

However, economic motivations may not be the only, nor even the most important factor underlying a state's support of an international cartel in civil aviation. This form of industrial regulation may also provide states with a number of political benefits. First, states may be interested in ensuring the survival of their international flag carrier for reasons of status. They associate the possession of an international carrier with technological and economical development; and they view it as an effective way
of investing their state with a global presence. Governments may be interested not only in enhancing their state's international prestige, they may also be concerned with promoting domestic support.

Straszheim writes:

In the last decade dozens of new national carriers have appeared, all of which are anxious to show the flag. One motivation for this behaviour lies in the intense desire of these nations for rapid growth and a highly urbanized and technologically advanced society. Also, the unstable political environment which often prevails may have led the government in power in some less developed countries to undertake projects with a short time horizon. New jet airports and aircraft are flashy symbols of progress.

(Straszheim 1969:16)

Next, an international flag carrier has the potential to become a useful instrument of foreign policy. The inauguration or termination of a flag carrier's operation to a country can be used as an indication of good will or antagonism towards other states. It can also be used to facilitate the forging of political links amongst allies. For example, it allows a state to acquire access to or operation through politically sensitive areas. This function may be particularly important to a state's security interests.

Another reason for wanting to possess a national carrier, linked to security interests, is a desire to reduce a state's vulnerability to foreign pressures. Without an international airline a country is dependent on foreign carriers. Consequently, foreign operators have a potential political bargaining tool since they can threaten to terminate services. A flag
carrier may also be important in a national emergency when it can be used to provide airlift capacity. Similarly, it can be chartered and used to augment military air force fleets.

The various advantages of owning a national carrier, which have just been discussed, provide sufficient explanation as to why states owning inefficient carriers would wish to protect their industry from competitive forces. In an unregulated environment they would be forced to meet competitive prices through heavy subsidization of their industry, and eventually would probably find themselves driven out of the market. The question then arises, why should states with efficient carriers support a cartel? Of course, if they believe consumer welfare and global industrial development is best promoted by such an arrangement further justification of their behaviour is not necessary. However, if this is not the case, is there any other reason why a state would support the operation of a cartel?

A third explanation of why a state may support a cartel is rooted in the theory of hegemonic stability. The phrase "hegemonic stability theory" was originally coined by Robert Keohane to refer to the work of a diverse group of writers who suggest that there is a direct relationship between the existence of a dominant power in the international system and a strong economic regime (Gilpin 1987:87). The theory originated in the writings of Charles Kindleberger who specifically linked the existence of a hegemon to the formation of liberal economic arrangements. However, authors such as Robert Gilpin and Robert Keohane gave the theory broader significance by suggesting that the existence of a hegemon was a necessary although not sufficient condition for the formation of collaboratory arrangements in general. (Since a cartel can hardly be categorized as "liberal arrangement," this thesis is
concerned with the latter conceptualization of the theory.) Hegemonic stability theory begins with the premise that in an anarchical world where states are egotistical, rational actors they will not find it in their immediate best interest to cooperate. They face a prisoner's dilemma. Each state would prefer the outcome of cooperation as opposed to a situation where no regime is formed. However, a state could make even greater gains by not adhering to the terms of the agreement while the other party or parties continue to abide by the rules. Consequently, there is an incentive to defect. Since no superior authority exists to ensure that states do not defect, states do not cooperate for fear of being the "sucker" (i.e., losing from an arrangement by cooperating while the other state[s] involved defect[s]). They find themselves in their least favoured situation. A hegemon or dominant power is needed to facilitate cooperation by becoming the superior authority that enforces the rules of the agreement.

Not only may there be an actual problem with coordinating state cooperation, but often there are also costs to be paid associated with the operation of the regime. A dominant power may be needed to actually pay the costs of the regime itself, or to allocate costs among states and enforce payment. It is important to underline that the hegemon will only agree to take on the duties associated with establishing a particular form of international order if it finds that the arrangement promotes its own specific economic and political interests. (The hegemon after all is also a rational actor.) Thus, according to the theory, regime formation not only requires the existence of a dominant power, but it also requires that a state be both willing and able (i.e., has the power to enforce the terms of the agreement and, in some cases, pay associated costs) to play the role of hegemon.
The theory then branches into two versions. The first, which predomi-
nates in the writings of Robert Gilpin and Stephen Krasner, suggests a
coercive model of hegemony: the dominant actor uses force to ensure that
weaker states adhere to a particular global ordering. In other words,
certain states may not find it in their ultimate interest to support the
regime. In this version the hegemon may pay the costs associated with the
regime or it may force the other states to pay the costs. The second, or
benevolent version, informing the writings of Charles Kindleberger and Robert
Keohane, suggests that the hegemon pays for the cost of establishing an order
which is viewed by all states as being in their common interest. In other
words, acquiescence is not secured through coercive means.

Hegemonic stability theory has been used to primarily describe the role
of Britain in establishing free trade in the period from the end of the
Napoleonic wars to the outbreak of the First World War; and the role of the
United States following World War II as manifested, for example, in the
establishment of liberal norms embodied in the General Agreement on Tariffs
and Trade (GATT), and the International Monetary Fund (IMF). It may also be
used to understand why a dominant state with efficient air carriers would
support and bear the costs (i.e., losses made by its carriers by not operat-
ing in a freely competitive system) of cartel operation. For example, a
hegemon will support the operation of a cartel if it is concerned with ensur-
ing the viability of its allies' airlines. This behaviour is not altru-
istic. Rather, the state sees its security interests as being promoted by
bolstering the economies of other states. One way in which a state can
enhance the development and power of its allies is by allowing them to reap
the economic benefits of owning and operating an airline. With strong
allies, a state's security is increased. A second explanation for hegemonic support of a cartel is also connected to the hegemon's security interests, although in this respect the dominant power's behaviour is explained by its desire to secure the friendship of its allies. If the hegemon's allies are particularly committed to the operation of a cartel, they are likely to be alienated by a power whose activity undermines their favoured form of industrial organization. In order to prevent this estrangement, the hegemon may feel compelled to support the system. A final reason explaining the dominant power's behaviour has already been touched on in a previous context. If the hegemon possesses a large aerospace industry it may find it lucrative to support a system which encourages the development of other states' industries. In this way a demand for its manufactured products is assured.

Various variables which may explain state cooperation in the formation and establishment of an international cartel have been discussed. It is not clear which explanations are the most pertinent for understanding the dynamics behind the cartel operating in civil aviation. This study seeks to determine whether one of the three explanations for state support of a cartel can account for all developments within the regime.

The second question which the thesis addresses is why does support for a cartel weaken? The explanation lies in the converse of why states cooperate to support a cartel. First, states may cease to support a cartel if new economic studies make them believe that cartel action is not optimal for consumer welfare and industrial growth. For example, economists may discover that the industry is not a natural monopoly, or that market chaos and predatory pricing will not ensue in a deregulated atmosphere, or that low-profit services will not be abandoned by profit-maximizing firms. Secondly, states
may weaken their support if they lose interest in gaining from the various benefits derived from the development of their own national industry. An alternative explanation may be that previously inefficient states suddenly grow efficient and find that their national industry will be best promoted by deregulation. A final explanation of cartel weakening lies in the theory of hegemonic stability. According to the theory, a regime will weaken (or according to more extreme versions actually disintegrate) when a hegemon ceases to support it. There are two possible explanations for this change. First, the reason why the state paid the costs of regulation may cease to exist. For example, the security interests of a hegemon may no longer require that the state take measures to bolster the economies of its allies. The second reason is associated with hegemonic decline. The theorists propose that as the hegemon loses power it is no longer willing nor able to pay the costs associated with maintaining its preferred international order. Consequently, the cartel weakens (as argues Keohane) or breaks down (as Gilpin and Krasner argue).

The thesis is divided into six parts. The first part provides a brief history of the evolution of international civil aviation and describes regulatory institutions existing prior to World War II. The second part describes the formation of the post-World War II regulatory regime in the period from 1944 to 1946. This is followed by an analysis of the various positions taken by states and the actual outcome of negotiations. The third part examines the period from 1947 until the mid-1960s, the heyday of cartel operation, and explores the reasons why states supported the IATA cartel. The fourth period discussed, from the mid-1960s to the mid-1970s, sees the
weakening of the cartel. There follows some analysis of why weakening occurred. The fifth part describes the breakdown and restructuring of the IATA cartel over the period from 1977 to 1981 and analyzes the developments. The final section of the thesis examines developments in the post-1981 period.
NOTES

1 Regimes are defined as:

Sets of implicit or explicit principles, norms, rules and
decision-making procedures around which actors' expecta-
tions converge in a given area of international rela-
tions (Krasner 1982:185-186).

2 Of the 85 IATA members in 1982, 69 (81%) were government owned. Of these, 42 (61%) were 100% government owned; 21 (30%) were more than 50% government owned; and 6 (9%) were less than 50% government owned. Sixteen (19%) were privately owned. Of these, 7 were U.S. carriers and 2 were cargo carriers. With the exception of U.S. carriers, practically all major car-
rriers were to some degree government owned (Rosenfield 1982:483). For a good description of the different types of airline ownership see Gidwitz 1980: 6-13.

3 The preamble to the Chicago Convention on International Civil Aviation states:

Whereas the future development of international civil aviation can greatly help to create and preserve friend-
ship and understanding among the nations and peoples of the world yet its abuse can become a threat to the gen-
eral security; and whereas it is desirable to avoid fric-
tion and to promote that cooperation between nations and peoples upon which the peace of the world depends; there-
fore, the undersigned governments having agreed on certain principles and arrangements in order that
international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically, have accordingly concluded this Convention to that end. (Mateesco 1981:605).

4 Pillai writes that in the period from the formation of the organization to the 1970s there were three instances where ICAO made any serious effort to study tariffs. In 1957 the ICAO Council suggested the undertaking of an objective study of international air transport and rates and methods used in establishing them. The project was not carried out. In 1963, the "desirability and possibility of action by ICAO in the field of airline tariffs" was debated in closed session (subject No. 15 on the Agenda of the 51st session of the council before the Air Transport Committee, 1963 qtd. in Pillai 1969:125). It was decided that there was "no justification for ICAO to undertake specific studies or other economic work on the subject of airline tariffs" at that time (qtd. in Pillai 1969:127). Proposals in 1965 for ICAO involvement in tariff issues ended in a resolution directing the Council to undertake studies "with the objective of exploring and analyzing measures to further the development of international air passenger travel" (qtd. in Pillai 1969:128).


1. THE DEVELOPMENT OF INTERNATIONAL CIVIL AVIATION PRIOR TO WORLD WAR II

The pre-World War II development of civil aviation passed through two distinct phases: the period before 1919 and the period from the 1919 Paris Convention on Aerial Navigation to the end of World War II.

BEFORE 1919

The first heavier-than-air flight was made in France on October 9, 1880 by Clement Ader who skimmed the ground in a motorized machine in the form of a bat (Mateesco 1981:24). This was followed by two flights of longer duration, reaching higher altitudes in 1903 by Wilbur Wright in the United States and Captain Ferber in France. From 1903-1919 the airplane was primarily seen as an instrument of sport and then of warfare; however, already in February 1918 the first airmail service was initiated (Mateesco 1981:24-26).

It was clear from the beginning that the development of this new form of transport had important international ramifications for it posed a new challenge to the principle of state sovereignty. During the first two decades of the 20th century, legal writers, especially from Europe and France debated the issue of whether states had ownership of air space over their territory. They drew on the principles of property and maritime law. Opinions ranged between two extremes. The first compared air space to the high seas and advocated complete freedom of flight. The other, influenced by the logic of property rights, argued that freedom of flight should be restricted to the air space over the high seas and no man's land. A state had complete sovereignty of air space at all levels of altitude above its territory (Salacuse 1980:810).
This period saw the beginnings of attempts to establish some form of international regulation of aviation. In 1910 eighteen European states met in Paris to draft an international treaty. The conference was unsuccessful for delegates were unable to agree on the issue of sovereignty. The major protagonists were Great Britain and France. The former argued for absolute sovereignty over air space, while France supported a regime of limited freedom (i.e., the French government maintained that a state should be allowed to protect air space above its territory through legislation, but that it should not be allowed to completely restrict overflight, nor apply any restrictions in a discriminatory fashion) (Salacuse 1980:812).

AFTER 1919

During World War I, the production of aircraft rapidly increased as airplanes became recognized as instruments of war. The experience gained during the war years brought about technical improvements in airplane design and construction (Chuang 1972:16). American Secretary of War, Baker, made the observation:

Ten times as many years would not have produced the same advance if the years had been devoted to peaceful pursuits and commercial use of airplanes had been the only incentive to investors and producers (qtd. in Jönsson 1987:6).

After the war, the conditions for the development of commercial aviation services were ripe: a large number of bombers were available for conversion into passenger aircraft, pilots were trained, the war had disrupted other
forms of transport, and the post-war conferences generated an initial need for air transport services (Gidwitz 1980:37).

The first international and domestic air services began to operate on a regular basis in 1919. Many of the early airlines were organized by aircraft manufacturers who were eager to exploit their manufacturing capabilities and by maritime shipping companies which wanted to extend their transport options (Gidwitz 1980:37).

Government involvement began at an early stage. In Europe a number of smaller airlines were consolidated into large state-subsidized carriers. For example, in Britain, Imperial Airways was incorporated in 1924 as a state airline, while in Germany, the government provided 36% of the initial capital required to form Deutsche Luft Hansa; and the French government owned 25% of the Air France which was formed by the merging of five airlines in 1933 (Gidwitz 1980:39). In the United States, although airlines were privately owned, they received very strong government support in the form of mail contracts (Gidwitz 1980:39).

In the early development of civil aviation, the expansion of international services was seen as performing three vital functions. First, the operation of state airlines guaranteed markets for aircraft and engine industries. Second, colonial powers saw airlines as useful tools for strengthening communications with their colonies. For example, by 1929 Imperial Airways had developed a route to British colonies in India which was then extended through Burma to Singapore; by 1935 the Belgians had linked Belgium to the Congo; and by 1931 France was flying to Africa and to Saigon. In addition, colonial powers also established and managed local/regional airlines within their colonies (Thornton 1970:10). And third, the airplane was
seen as a useful instrument for gaining influence in an area through "peaceful penetration." This was perhaps most evident in South America where the French, Germans and Americans struggled for commercial air influence. The rivalry heightened as the tensions preceding World War II increased.

The United States alarmed by German aviation operations on the Pacific Coast and by the German presence near the Panama Canal, put significant pressure on South American governments to revoke German operating permits and to nationalize previously German-owned airlines. With the destruction of the German network, Pan American, supported by U.S. government funding was encouraged to expand and consolidate its own influence in Brazil, Mexico, Cuba, Columbia, and Guatemala (Thornton 1970:16).

The experience of World War I was also important in that it increased awareness amongst states of the need to resolve the sovereignty debate. In March 1919, France convened an international conference in Paris. The outcome was the first multilateral treaty regulating aviation: the Convention Relating to the Regulation of Aerial Navigation or the Paris Convention. The convention was important for it settled the sovereignty issue by recognizing a state's complete and exclusive sovereignty over the air space above its territory. However, it granted states the freedom of transit by incorporating an article in which states, subject to certain conditions, were granted the right of innocent passage during peacetime (Salacuse 1980:814-815). The ramifications of the treaty for the twenty-six signatories were enormous for they had agreed that the development of international aviation was to be dependent on agreements between states.

The Paris Convention also contributed to the standardization of technical rules of flight by establishing rules regarding nationality and
aircraft registration; by requiring the aircraft to be issued certificates of airworthiness and the crew certificates of competency; and by developing uniform regulations on customs procedures, takeoff and landing. It established the International Commission for Air Navigation (ICAN), a permanent interstate organization connected to the League of Nations. ICAN oversaw the development of aviation in the inter-war period fulfilling a very similar role to the post-1944 ICAO. It collected data, implemented and amended technical rules, and provided a forum for international discussion of aviation issues (Salacuse 1980:816-817).

The United States did not ratify the Paris Convention owing to its association with the Versailles Treaty and the League of Nations (Taneja 1980:1); however, it affirmed its acceptance of the principle of complete and exclusive sovereignty of the air space of every state over its territory and territorial waters by signing the 1928 Pan American Convention on Commercial Aviation.

A number of subsequent conferences and treaties established the principles concerning issues of liability, insurance, bills of lading, etc., during this period.

Although a global aviation network developed between 1919 and 1939, it was not until after World War II that measures were taken to regulate on an international basis the commercial aspects of international aviation, (i.e., the exchange of routes, frequencies, capacity and fares). An attempt was made to revise the Paris Convention in 1929 in order to permit greater freedom of operations. The United States, the British Empire, the Netherlands, and Sweden favoured the change, but twenty-seven states were in opposition, including Brazil, Cuba, Chile, Haiti, Uruguay, and Venezuela (Warner 1943:
The conference was unsuccessful in establishing general principles for international operations.

Lack of international consensus led to the basing of the operation of flights between states on one of two arrangements. The first prevailed in Europe and consisted of bilateral agreements between states. The agreements took a variety of forms. For example, major states usually agreed to complete equality of privileges with respect to air routes (i.e., they would both operate on the agreed route). Agreements between a minor and a major power had different provisions. The major power would usually operate a route between the principal centres of the two countries while the minor power would have a monopoly over international services linking provincial cities. These early bilaterals sometimes fixed frequencies. This was the case in the United States-United Kingdom (1935) and United States-French (1939) agreements on transatlantic services. Often secret inter-company agreements were made to avoid rate and service wars. The most extreme form of this nature of collusion, favoured by the Germans, French and Swedes, but not the British, was the revenue pool (Warner 1943:13).

The second type of arrangement, dominant in the Western Hemisphere south of the Canadian border, was based on a unilateral concession which either an airplane company or state was able to gain from another company. U.S. flights to Latin America, and the European Caribbean colonies, were regulated by unilateral concessions negotiated by Pan American (Warner 1943:13).

The pre-World War II development of civil aviation was hindered by the state of technology (i.e., it was not possible to operate a highly developed intercontinental service) and by the high costs involved. However, this situation changed dramatically after World War II, primarily on account of
technological advances made in military aviation. These included significant improvements in the speed, range, capacity, and navigational accuracy of aircraft. As a result, the potential now existed for developing an economically viable international aviation network which could play an important role in reestablishing communications and promoting economic welfare.

The operation of air transport in the first forty odd years of its existence established five precedents: the principle of state sovereignty over air space, the heavy subsidizing of airlines by governments, the use of the airplane as a tool of government policy, the establishment of bilateral agreements governing commercial aspects of international flights, and a fair amount of sharing among states of routes and revenue.
2 THE FORMATION OF THE REGIME: 1944-1946

DESCRIPTION

Even before World War II had come to an end, policy-makers were discussing the future of civil aviation. At the August 1943 Quebec Conference President Roosevelt and Prime Minister Churchill expressed interest in holding a post-war international conference on civil aviation (Sampson 1985:80). Several months later, at the request of the British Government, the Americans agreed to hold such a conference in November 1944 in Chicago.

The Chicago Conference

Delegations from fifty-four nations attended the Chicago Conference held from November 1 until December 7, 1944 (Jones 1960:227). The Axis powers and the Argentine Republic were not invited. Saudi Arabia did not accept the invitation and the Soviet Union withdrew on the eve of the conference. The latter explained that the presence of Switzerland, Spain and Portugal made it diplomatically impossible for the Soviet Union to attend (Wagner 1945:410; Stannard 1945:505).

The objective of the conference was to arrive at an agreement on the regulation of market entry, market shares and rates in international civil aviation. However, it soon became evident that a consensus would be difficult to attain for there was a fundamental division in the positions adopted by the key actors: the United States, British, Canada, Australia, and New Zealand. The United States found itself on one side advocating "freedom of the air," while Britain, Canada, Australia, and New Zealand joined on the
other side advocating varying degrees of international air traffic regulation.

On the issue of market entry, the United States suggested that routes be granted in bilateral negotiations. In contrast, the British and the Canadians initially suggested that an International Authority should be formed which would grant airlines entry to routes by issuing licenses. They then shifted their position arguing that states should be granted the right to establish routes unilaterally to any other country and beyond. The Australian/New Zealand joint proposal provided a more extreme version of the initial British and Canadian position. It, too, suggested that contracting states surrender power over entry and route allocation to an International Authority; however, rather than issue licenses, this international body would actually own and manage all international aircraft and operate international routes.¹ In addition to this arrangement, Australia and New Zealand agreed that states should be allowed to operate their own air services on a regional basis, pending a bilateral agreement on terms of entry.

The regulation of market shares refers to restrictions placed on capacity, frequency and gauge (or aircraft size). In the discussion that follows, a fourth element, which is often referred to as a term of market entry, will be considered under the category of market share restrictions: the granting of traffic rights. Traffic rights in civil aviation represent the different stages of liberalizing the right to fly. They have been categorized as eight freedoms. (Attention usually centres around the first five freedoms.) The eight freedoms are:
Freedom 1: The privilege of flying over a state.

Freedom 2: The privilege to land in a state for technical reasons, e.g., refuelling. Passengers, cargo or mail can not be picked up or set down.

Freedom 3: The privilege to carry passengers, cargo, or mail from the home state to a foreign state.

Freedom 4: The privilege to carry passengers, cargo or mail from a foreign state to the home state.

Freedom 5: The privilege to pick up or set down passengers, cargo or mail between two foreign points. In other words, the carrier of State A can carry traffic picked up in State B to State C on its route from State A to State C.

In recent years, certain writers have added three more freedoms to the list:

Freedom 6: The privilege to pick up traffic in one state and carry it to another via the country of the nationality of the air carrier. It can also be characterized as a special type of fifth freedom or a combination of third and fourth freedoms.

Freedom 7: Sixth freedom traffic which does not stop at the transit point in the air carrier's state. This categorization is only used by some writers; the more conventional definition would argue that this is in essence the fifth freedom.

Freedom 8: Cabotage traffic, i.e., carriage by a foreign air carrier of the domestic traffic of another state.

(Sampson 1984:84; Haanappel 1984:10-12).²
The Americans initially proposed a multilateral grant of the five freedoms; however, as mentioned earlier, they also insisted on bilateral negotiations for route entry. It is not clear whether they intended to surrender the right to require bilateral route agreements or whether these freedoms were to be practiced only on routes negotiated bilaterally. O'Connor argues that the latter was probably the intended position (O'Connor 1971:42-43). The Americans also favoured unrestricted capacity, frequency and gauge with respect to all the freedoms granted. In essence, the United States proposed that market shares be determined by free competition. The British and Canadians adamantly opposed this view. They argued that a multilateral grant of the four freedoms be given according to their initial proposal through the issue of license by the International Authority, or according to their later proposal, by allowing states to unilaterally establish direct routes to any other country and beyond. In the latter proposal, states would be entitled to establish capacity and frequency equal to 50% of their generating potential to various countries along the route (a minimum of one round trip per week on each route was to be guaranteed). On the issue of fifth freedom both the Canadians and the British argued that this right should be granted on a bilateral basis. When exercising fifth freedom rights, the British further argued that airlines should be forced to shrink their capacity and frequency from point to point in accordance with third freedom traffic volumes. Fifth freedom was in no way to be included in the calculation of capacity and frequency allowances on routes. The British conceded that airlines should be allowed to pick up fifth freedom passengers as "fill-up" traffic; however, they argued that these passengers should be charged higher rates than on regional flights operating the same segment of the route. The Canadians
offered a slightly more liberal plan for fifth freedom capacity regulation. They suggested that fifth freedom traffic be considered in the initial allocation of capacity by the International Authority according to some predetermined formula. At the root of the British and Canadian proposals was the intention to guarantee each state a market share roughly equivalent to 50% of its generating capacity. In the Australian/New Zealand proposal market shares were irrelevant for all routes would be operated by a single international company.

On the issue of rate regulation division also existed. The United States was opposed to rate-fixing in principle, although O'Connor writes that the U.S. was prepared to discuss "ways and means" of regulating minimum rates (O'Connor 1971:20). In contrast, the British, Canadian and Australian/New Zealand proposals all supported rate-fixing by an International Authority. In addition, both the Canadians and the British stressed the need to regulate subsidies and prevent rate-cutting (O'Connor 1971:20-30; Haanappel 1984:1-14; Jones 1960:227-229; Wagner 1945).

Adolph Berle described the outcome of the Chicago conference in enthusiastic terms. He said:

> We met in an era of diplomatic intrigue and private and monopolistic privilege. We close in an era of open covenants and equal opportunity and status. . . . We met in the seventeenth century in the air. We close in the twentieth century in the air (qtd. in Morgan 1945:16).

Yet, his assessment of the conference's achievements was overenthusiastic. Although participants agreed to take measures which would facilitate international air travel and ultimately aid the development of the industry, the
lack of consensus on how market entry, shares and rates should be regulated prevented any substantial agreement on commercial regulation.

The Chicago Agreement consisted of six parts: the Convention on Civil Aviation, the Interim Agreement on International Civil Aviation, The International Air Services Transit Agreement, the International Air Transport Agreement, the Draft Technical Annexes to the Convention, and the Standard Form of Agreement for Provisional Air Routes.

Like the Paris Convention, the Convention on International Civil Aviation in Article I affirmed that every state has complete and exclusive sovereignty over the air space above its territory. Consequently, market entry could only be granted on the basis of a bilateral or multilateral agreement. Article V gave non-scheduled flights automatic overflight privileges; however, this right was not extended to scheduled services (Salacuse 1980: 823-825).³

The Interim Agreement on International Civil Aviation established a provisional organization known as the Provisional International Civil Aviation Organization (PICAO), which operated from June 5, 1945 to April 4, 1947. The agreement, which was open to signature, provided the legal framework for the development of international civil aviation and laid the foundation for the International Civil Aviation Organization (ICAO). (See Appendix I.)

The International Air Services Transit Agreement like the Interim Agreement on International Civil Aviation was open to separate ratification. Contracting states agreed to grant all states the first two freedoms subject to certain conditions stipulated in the Chicago Convention. The two key conditions were: first, that a state could designate routes and airports to be
used by all foreign carriers entering its air space, and second, a state could charge airlines which stopped for non-traffic purposes on its territory a service fee. It was signed by thirty-three nations.  

Signatories to the International Air Transport Agreement (also open for separate ratification) granted all contracting parties the five freedoms of the air. (The five freedoms were not to be subject to any capacity or frequency restrictions.) It was not clear whether states signing this agreement were abandoning their intention to bilaterally negotiate route grants or whether these freedoms were only to be granted on negotiated routes. This agreement was signed by nineteen states by February 20, 1945 including the United States (which withdrew its support in 1946), China, Sweden, Afghanistan, Lebanon, Mexico and ten Latin American countries. Turkey and the Netherlands signed with reservations. The agreement was not widely adopted and became "virtually a dead letter" probably in part due to its inherent ambiguity (O'Connor 1971:42; Warner 1945:410).

The division of the five freedoms into two parts, the technical and the commercial privileges open for separate signature, was a consequence of the major disagreement between the key actors. The main contentious issue towards the end of the conference concerned market sharing. Specifically, consensus could not be reached on the principle by which capacity with regard to fifth freedom traffic should be calculated. The British, supported by the Australians, New Zealand and the French, held that the primary purpose of an airline was to carry its own traffic and, hence, argued that fifth freedom traffic be subject to strict regulation, while the Americans, Latin Americans, Dutch and Swedes would not agree to these stipulations (Warner 1945: 418; Sampson 1985:86). In effect, all the Chicago Conference achieved on
this issue was summed up by a reporter in The Economist: "The weeks of discussions achieved only agreement to disagree" (The Economist December 30, 1944:860).

The Draft Technical Annexes provided a set of recommended practices and standards pertaining to communications systems, navigational aids, characteristics of airports and landing areas, rules of the air and of air traffic control practices, airworthiness of aircraft, registration and identification of aircraft, log book requirements, aeronautical maps and charts, customs procedures, search, rescue and investigation of accidents. These recommendations were not mandatory, although states were urged to accept practices "as far and as rapidly as may prove practicable" (qtd. in Salacuse 1980:829).

Finally, the Chicago Convention provided a Standard Form for Bilateral Agreements. This was, in effect, an acknowledgement of the failure to reach a multilateral agreement on commercial rights. According to the model, contracting states would grant each other specific rights (transit, non-traffic stops, or commercial entry over prescribed routes). They would designate airports at which commercial rights would be offered and would set down basic principles of non-discrimination and mutuality of treatment (i.e., market shares).

In addition to producing the Chicago Convention, the Chicago Conference also laid the groundwork for the formation of IATA. Airline operators present at the Conference, supported by their governments, appointed a committee to draft a convention for an international association of scheduled airlines. The first meeting was held in October 1945 (Hammarskjold 1979b: 27-28). (See Appendix II.)
With respect to international commercial regulation of civil aviation, the Chicago Conference had made minimal advances. Market entry was made subject to bilateral or multilateral negotiation. Through the broadly signed transit agreement states were granted the privilege of overflight and non-commercial stops multilaterally. However, no agreement was reached on the issue of market sharing and rate regulation.

The Interim Period

Following the Chicago Conference, two systems of regulating commercial rights evolved. The first characterized bilaterals signed between Britain and its Dominions, most of the Middle East and Eire, which closely regulated frequency, capacity, and rates (The Economist August 3, 1946:145). The second system, based on an unrestricted exchange of the five freedoms characterized U.S. bilaterals signed with Iceland, Ireland, Norway, Portugal, Spain, Switzerland, and Sweden (Sampson 1984:90; Haanappel 1984:17). An agreement between Britain and the United States, however, was not forthcoming.

In October 1945, a conflict over transatlantic rates flared up. The U.S. Civil Aviation Board (CAB), an independent regulatory agency in charge of economic regulation of aviation, had licenced three airlines to operate in the United Kingdom: Pan American, American Overseas, and Transcontinental World Airways. Pan American had been granted two services weekly by a 1937 agreement with the British government. It had then been granted temporary permission to make five flights a week. American Overseas was given temporary permission for seven flights a week to Britain. Then, in October, Pan American announced that it would lower its New York-London fare from $375 to
The British withdrew Pan American's temporary flight grants, and thereby reduced its right to fly to two times a week claiming that the airline was engaging in illegitimate undercutting. Its U.S. competitors were allowed to keep their temporarily granted frequencies. Although Pan-American dropped its proposal, the incident served to remind the United Kingdom and the United States that some form of agreement on commercial rights and particularly rates was needed (The Economist October 21, 1945:826; Taneja 1980: 11-12).

**The Bermuda Conference**

Then, in January 1946, Britain suddenly abandoned its reluctance to negotiate with the United States. It issued an invitation to the U.S. to meet in Bermuda for the purpose of reaching an air transport bilateral agreement (Taneja 1980:13). The positions adopted by the United States and the United Kingdom at the conference were very similar to the policy stances at Chicago. Disagreement centered on the issue of market-sharing and rate regulation. (By agreeing to enter into a bilateral arrangement both states had implicitly accepted the principle established at the Chicago Conference: entry would be subject to a bilateral agreement.) The Americans wanted to secure a bilateral in which the five freedoms would be granted without restrictions, on each route specified in the agreement (i.e., market shares on these routes would be determined competitively). The British wanted market shares to be strictly regulated so that each state would be given a roughly equal share of the traffic on routes between the two countries. The British wanted to ensure even stricter regulation if not complete prohibition of the granting of fifth freedom rights. On the issue of rate regulation,
the United States was opposed to any restrictions, while the British favoured
tariff-fixing.

The bilateral signed provided an elaborate route chart specifying defin-
itive routes and airports where technical and commercial privileges were to be
granted. (See Appendix III.) It resolved the issue of market-sharing and
rate regulation through what was later called the Bermuda Compromise.
Carriers were to be granted the two technical freedoms, without restrictions;
however, the three commercial freedoms could be exercised subject to a
variety of restrictions. These restrictions were ambiguously defined in the
Bermuda principles. The Bermuda principles stipulated that: air transport
facilities available bear a close relationship to public demand; that car-
riers be granted fair and equal opportunity to operate on designated routes;
and that carriers of one contracting party take into consideration the inter-
est of the other contracting party so as not to affect unduly the services
the other provides. In essence, an airline's capacity allocation was to be
related to the traffic demands between the country of origin and the country
of destination (primary traffic). Pick-up traffic or fifth freedom traffic
was not to play a major role in determining initial capacity allocations.
(The Bermuda Agreement did not specify the quantity of fifth freedom traffic
a carrier could pick up in relation to the quantity of third and fourth free-
dom carried) (Haanappel 1984:31-32; Hammarskjold 1979b:29). Using these
guidelines, airlines were to specify the amount of capacity they would offer
on each route. This would then be subject to \textit{ex post facto} government
review. A government that felt that a foreign carrier was abusing its com-
mmercial rights could call for a renegotiation. Each government would then
assemble facts and figures and try to reach an agreement. If this failed,
the government lodging the complaint could denounce the agreement. It was
required to give a 12-month's notice of its intention to revoke commercial
rights. New negotiations were expected to start and an agreement was to be
formulated in order to prevent a termination of service at the end of the
year (Diamond 1975:453). Since the Bermuda capacity principles did not actu­
ally provide a specific market-sharing scheme, they were initially seen as
being a concession made by the British to the United States in favour of the
competitive determination of market shares. Although, as Adriani points out,
the vagueness of the principles allowed a certain flexibility of interpreta­
tion; in fact, they embodied a fairly rigid market allocation scheme (Diamond
1975:41). Wheatcroft describes the parameters within which even the more
liberal interpretations of the clauses operated:

The "liberal" nations have been willing to accept that
commercial competition should be the arbiter of market
shares, but only within certain limits. . . . [T]he evi­
dence suggests that the most which "liberal" countries
have been willing to accept is that their share of traf­
cic on major routes might be permitted to fall as low as
40% of the total before they turned towards measures for
restricting foreign competitors. The difference between
"liberal" and "protectionist" policies may therefore be
thought of as a willingness on the one hand to compete
for 20 per cent of the total market, compared with an
insistence upon a 50/50 division of traffic on the other
(qtd. in Diamond 1975:437-438).
The other dimension of the Bermuda compromise was the concession that the United States made to the British in agreeing to approve the fixing of rates on international routes by an association of international scheduled traffic carriers: IATA.

Appendix II of Bermuda I reads:

The Civil Aeronautics Board of the United States, having announced its intention to approve the rate conference machinery of the International Air Transport Association, as submitted, for a period of one year beginning in February, 1946, any rate agreements concluded through this machinery during this period and involving United States air carriers will be subject to approval by the Board (qtd. in Haanappel 1984:28).

U.S. anti-trust laws required such explicit approval by the CAB; otherwise, the IATA cartel could be charged with anti-competitive, conspiratorial activity. The CAB granted IATA anti-trust immunity on February 19, 1946, and renewed it in 1947, 1948, 1950, 1951, 1952, and 1954. In 1955, permanent approval was given. As will be discussed, this policy changed in the late 1970s (Haanappel 1984:29). Rates charged were to be subject to government approval. Appendix II of Bermuda I reads:

Rates to be charged by the air carriers of either Contracting Party between points in the territory of the U.S. and points in the territory of the U.K. . . . shall be subject to the approval of the Contracting Parties within their respective constitutional powers and obligations . . . (qtd. in Haanappel 1984:28).
Thus, all IATA rates and fares had to be submitted to the aeronautical authorities of both contracting parties at least 30 days before their proposed introduction. If, during this period, a rate agreement was disapproved by a contracting party, or if the IATA traffic conference was unable to reach an agreement or if IATA machinery was inapplicable or if a contracting party withdrew or failed to renew its approval of the IATA rate conference machinery, one of two measures would be taken. In the event that the CAB was granted the authority to fix international rates and suspend international rates, and if a disagreement arose over rates and fares to be charged by designated carriers on bilaterally agreed routes, the disputed tariffs would go into effect provisionally pending settlement of the disagreement by arbitration. However, in the event that the CAB was not granted such authority, the government objecting to the tariffs could take action to prevent the inauguration or continuation of the service it complained about (Haanappel 1984:29-33). The former provision did not come into operation since Congress never gave the CAB more than the power to suspend and reject international air tariffs. And this did not occur until 1972. Bermuda I gave vague guidelines as to the level at which tariffs should be set: they were to take into account the cost of operation, a reasonable profit, and the rates charged by other air carriers. The intention of both contracting parties was described as encouraging cheap rates consistent with sound economic principles (qtd. in Haanappel 1984:32). The Bermuda Agreement made no reference to charters.
Summary

The Chicago Convention and the Bermuda Agreement established the framework for the regulation of the commercial aspects of civil aviation. Three basic principles were embodied in the operation of the regime or cartel. First, market entry would be subject to bilateral agreement. Second, states would be guaranteed a market share neither falling below 40% nor exceeding 60% of the total traffic available on major routes. Finally, tariffs would be set on all international routes by IATA. All operators agreed to charge a uniform fare for the same category of service on the same route.
ANALYSIS

Analysis of the Chicago Conference

Although the regime was not formed at the Chicago Conference, analysis of the positions adopted by the various states is useful for it reveals their attitudes towards the regulation of market shares and rates, or specifically, the adoption of a cartel system.

The first questions to be addressed are: Were the positions adopted by states a consequence of concern for general consumer welfare or industrial development? Were states influenced by economic studies suggesting that in a deregulated atmosphere predatory pricing would ensue, or a monopoly would take control? It should be first pointed out that comprehensive economic studies of the industry had not been made by this time. Thus, any opinions about the nature of the industry were based on observations of the pre-World War II period. Such observations were unsatisfactory since they lacked an empirical foundation. Clearly, in the case of the United States and its supporters, economic arguments in support of regulations did not influence their position. On the contrary, they opposed excessive regulation on the grounds that it would promote the unhealthy activity of the pre-World War II European cartels (Biddle 1945). Rather, they argued that industrial development would be enhanced by the free operation of market forces. The British, Canadians, and the various states supporting their positions may have been influenced by economic arguments supportive of cartels. Sir George Cribbet, commenting on the post-war negotiations, writes:

It was against a pre-war background of excessive competition in Europe, with its corollary of burdensome
subsidies, rate warfare and other unfair competitive devices, and the revival of intense national rivalries, that the various problems were considered (qtd. in Harbison 1982:9).

However, one can infer from these states' public declarations that a determination to ensure that their own air carrier would be guaranteed an equitable share of the market was on a par with, if not considered to be more important than, consumer welfare and the general development of the industry. The only proposal that seemed to reflect a prime concern for consumer welfare was that of the Australians and New Zealanders. They were prepared to abandon the idea of owning a "flag carrier" in favour of an internationally owned and controlled airline. Their position was dominated by the view of international aviation as a public utility. They wanted to ensure that their countries would receive a high level of international service. At the same time, they realized that they did not possess the economic resources to operate flights at their desired level of frequency. An international corporation, committed to providing adequate service to all parts of the globe, would provide these countries with the transport they required at a limited cost, since operations could be cross-subsidized with higher profit routes. In addition, they argued that in a system where an international body controlled aviation, international conflict would be avoided. In the words of the New Zealand delegate:

... Any other system we suggest leads to national competition, to an attempt to serve national interests as against world interests, to achieve individual needs at the expense of others. It must lead to the creation and
expansion of large commercial organizations whose activities must in the long run be based primarily on the profit motive. It may well be felt that in commercial hands there might be some small degree of extra efficiency; I would ask you to balance this possibility with what seems to us the certainty of a commercial and national rivalry in this field which must lead in the long run to commercial and national competition and ill-will, and which cannot in the long run hope to achieve that proper balance between the rights and necessities of all nations, which would to a much greater degree be within the competence of an international body (qtd. in O'Connor 1971:23-24).

The Australian/New Zealand proposal did not gain much support. A Brazilian delegate expressed the general attitude towards it when he said: "Our times are not ripe for the internationalization of aviation and perhaps the time will never be ripe for it" (qtd. in Jönsson 1987:99). The plan was rapidly discarded as being too radical, and the Australians and New Zealanders gave their support to the British plan instead.

As was suggested earlier, the positions adopted by other states reflected an interest in promoting the development of their respective aviation industries. This would suggest that the second set of explanations for state support of a cartel should be examined. Haanappel provides insights into the motivations behind the two key protagonists' behaviour at the Conference: Britain and the United States. He writes:
The British and American proposals reflected very well the economic situation of the airline industry in the U.K. and in the U.S.A. at the end of the war. The British airline industry, like the one in most other European countries, had been almost completely destroyed during the war, whereas the American airline industry could at the end of the war dispose of large numbers of readily available aircraft, in particular military transport planes, which could be easily converted into civil aircraft. A system of free competition would definitely favor the U.S. airlines, and it was exactly this competition which the British feared. They intended to protect their own weakened airline industry through an international regulatory machinery which would give each country a "fair share" of international air traffic (Haanappel 1984:13)

British interest in protecting their own airline was motivated by security, prestige, political and economic considerations. Warner, in describing the attitude of British policy-makers, writes: "In their thoughts the problem of civil aviation mingles constantly with questions of security" (Warner 1945:419-420). Influenced by the experience of the war, which had brought out the vital importance of air power to a state's national security, the British believed that the development of their civil aviation industry would provide the needed support and training for the Royal Air Force (The Economist December 30, 1944:862).
In addition to security concerns, the role of a national air carrier as a status symbol was of great importance to Britain. Stannard writes that in order to understand the approach of British policy-makers at Chicago, it is necessary to see their attitude in relation to pre-war developments. Since the men shaping Britain's policy in the '40s were the same as those who shaped its policy in the '30s. He observes that pre-World War II British international aviation was not considered to be a viable commercial enterprise in its own right. Rather, the British government, through extensive subsidies, maintained it for prestige reasons (Stannard 1945:500).

A third consideration was the vital role an international carrier could play in preserving Britain's colonial links. The Economist reported on December 30, 1944 that the development of British civil aviation was needed "to knit together a Commonwealth that will become ramshackle if all its parts can move more readily to foreign countries than they can to each other" (The Economist December 30, 1944:822). A more immediate political motivation was the British desire to possess an airlift capability in order to aid in the liberation of the colonies after the war (Thornton 1970:23).

Both a short run and a long run economic motivation seem to have been decisive factors in Britain's insistence on developing her own international carrier. In order to satisfy the high demand for imports arising from post-war reconstruction needs without adding to her balance of payments problems, Britain needed to export goods and perform international services for others. An international carrier was crucial to these activities (Warner 1945:419). The second consideration hinged on two beliefs about the economic future of civil aviation. First, British policy-makers were convinced that in the long run, one or two nations would establish aircraft industries which
would then dominate all world air routes. The British wanted to ensure that they would not be ousted from the race at an early stage, so that in the future they could secure for themselves a monopoly position in the airline industry (Warner 1945:419-420). Second, they were influenced by the early experiences of the shipping industry which suggested that the demand for new transportation is very elastic. They reasoned that the provision of services would create its own demand and bring large economic returns to the British industry paralleling the fortunes made by early shipping magnates (The Economist December 30, 1944:862).

Given the weak state of the British aviation industry vis-à-vis the American industry with its surplus of transport planes which could be easily converted into civil aircraft, there was a growing belief in Britain that "competition with well-stocked American airlines, already in full operation will be well-nigh impossible" (The Economist December 30, 1944:861). The only system which would ensure the protection of Britain's industry was an extensive international regulatory regime which restricted market entry, guaranteed market shares, and fixed rates.

In view of this, it is not surprising that the fifth freedom issue proved to be the major stumbling block in the Chicago negotiations. The right to pick up or leave passengers along international trunk routes was vital for these operations to be economically viable. At the Chicago Conference, only the United States was in a position to operate such services. The British feared that by agreeing to an unrestricted exchange of the five freedoms, they would in fact jeopardize the future development of their own international services. The Americans, with their competitive advantage, would have gained such a strong foothold in the operation of long trunk
routes that the British would be unable to gain any share of fifth freedom traffic at a future date. A more immediate concern was that the exercise of American fifth freedom rights would diminish the volume of third and fourth freedom traffic carried by British carriers since they would be competing within the same market.

There was another reason for British support of international regulation. They were convinced that unrestricted competition would result in unfair competition and would lead to subsidy wars between governments. Not only would this burden a state's operating budget, but it might foment ill-feeling among states and hinder government cooperation in other issue areas (Warner 1945:419-420). This would, in turn, threaten post-war international security.

However, the pre-Chicago as well as the Chicago negotiations indicated that the United States was unwilling to accept the type of international regulatory regime envisioned by the British. Thus, the British decided to stall negotiations in the hope that the passage of time would strengthen their negotiating position. They believed that with the reconstruction of their post-war economy their need for U.S. economic and military aid would diminish, and hence their dependence on the good will of the United States would be reduced. Second, they hoped that, as Europe recovered from the war, it would gain cohesion and support the British in their attempt to resist U.S. pressure to allow competitive market forces to dominate the industry (Thornton 1970:29).

The Canadians and most of the Europeans adopted a similar position to the British at the conference. Like the British, they were interested in developing their own industries for reasons of: prestige; access to the
colonies, in the case of the Europeans (e.g. French interests in Indochina, and Dutch interests in the East Indies); and interest in securing certain economic benefits (e.g. gains to the balance of payments) which would not accrue to them in an open competitive environment. The underlying belief was that in a liberal regime the United States would gain a monopoly over civil aviation.

In the case of countries that opposed cartel regulation, the question must be asked: were they not interested in securing a market share for their own industries? On the contrary, it would appear that the United States and the states supporting its advocacy of free competition saw cartel action as being detrimental to the development of their own air carrier service. They believed that in a deregulated environment, they would have access to a greater market share than in a regulated environment.

In his analysis of the U.S. position at Chicago, Thornton writes:

In general, the Chicago conference can be described with reasonable accuracy as an attempt by the United States to capitalize on its overwhelming strong bargaining position in international direction by securing for itself a near monopoly of long-haul air transport (Thornton 1970:25).

The United States was clearly the most powerful actor in the international system in the immediate post-war period. Its wartime activity (i.e., performing intercontinental and long-haul transport) had established a route network and given its pilots operating experience. It had also stimulated the production of transport aircraft which could easily be converted into civil aircraft (Thornton 1970:19). According to a 1944 report in The Economist, "the U.S. owned nearly one-half of the total productive aircraft
capacity of the world; and it had a virtual monopoly on the production of civil transport" (The Economist December 30, 1944:861). Owing to the highly developed state of its international civil aviation industry, relative to other countries, the development of American industry would be best promoted in an environment of free competition. Thus, it is not surprising that it opposed British attempts to regulate the industry.

It is worth noting that the U.S. espousal of freedom of the air in the post-war period represented a substantial change to its previous policy. Burden wrote in 1945:

The United States, long an ardent protectionist nation, appeared as an eloquent advocate of free trade in the air; and Great Britain, long identified with the gospel of free trade and freedom of the seas, apparently forgot her bold assaults on mercantilism in the nineteenth century and favored restriction and control in the air. The change in position is perhaps symptomatic of the change in the relative industrial strength of the two powers. The United States seems motivated by the same combination of self-interest and idealism that moved Great Britain to assume her historic attitude towards ocean transport (Burden 1945:19).

As in the case of the British, a key motivation behind the U.S. desire to promote the development of its own industry was its concern for its own security as well as the security of the Western World. Jones describes this mixed motive:
The United States had already sensed that it would be called upon to lead the so-called "Free World" in the century to come, and about the only bond between the free world nations was reciprocal trade and commerce, person-to-person contact, mutual assistance and loose military alliances. Since our own survival hinged on this arrangement, it seemed imperative that we establish a foremost place in the air, including civil international air transport (Jones 1960:229).

The negotiations at Chicago showed that U.S. policy-makers were very aware of the political leverage that could be acquired from holding a dominant position in the industry. For example, during the Chicago negotiations, one of their major concerns was to convince the British to grant American airlines fifth freedom rights. As described earlier, the British did not have transport aircraft and resisted freely granting this commercial right fearing that they would lose their chance to compete on international trunk routes. The United States thus offered to provide the British with transport aircraft so that they would not feel as though they were at a complete competitive disadvantage. (The United States was in such a strong position that the offer would not jeopardize its own competitive advantage.) It is interesting to note that the wording of the offer made by Berle implies that the United States would use its position as chief supplier of transport aircraft to favor countries of whose policies it approved. Berle stated explicitly that the U.S. government

is prepared to make available civil air transport planes,

when they can be released from military service to those
countries which recognize as we do the right of each nation to maintain friendly intercourse with others (qtd. in Morgan 1945:13).

It does not seem too far-fetched to suggest that the United States also viewed expansion and development of American international aviation as a useful tool for wielding similar political influence.

The final motivation behind U.S. proposals was clearly economic: due to its competitive advantage, its industry stood to gain most in an unregulated environment.

Several countries in Europe and Latin America supported the American position. In Europe the behaviour of the Scandinavian countries, Switzerland and Portugal, can be explained by the fact that these states were small traffic generators. They realized that they could gain a larger market share in an unregulated environment than would ever be possible under any quota system dividing traffic; consequently, they favoured U.S. proposals (Burden 1945:118; Lim 1981:45). The support given by many small countries, and particularly those in Latin America, seems to have been influenced by two considerations. First, these states' services were not very developed (or in some case nonexistent), and consequently, they did not have the immediate concern of protecting their own industry. Many countries were more interested in seeing U.S. civil aviation develop for it would then be able to provide services to their countries (Burden 1945:20; *The Economist* December 9, 1944:768). More importantly, these countries were very vulnerable to U.S. pressure, and could be coerced into adopting a policy friendly to American interests. Evidence of this use of power is found in a report in
The Economist which noted that the Mexican delegate denounced "the 'dictatorial' methods used by Mr. Berle in seeking their [Latin American] support" (The Economist November 11, 1944:634).

When one considers the relative power distributions in the post-war period, at first glance it seems surprising that the United States was not able to achieve its objectives at the Chicago Conference. In fact, Chicago seems to have been a British victory since the British were able to stall all important decisions on the regulation of commercial rights from being made. This, of course, raises the question: why?

Although the United States had both the military and economic leverage to coerce the British to adopt policies it favoured, it was unwilling to pay the costs of such an action: alienating its ally. This had relevance to both its short run and long run foreign policy objectives. At the time of the conference, World War II was not yet over and although allied victory was expected, the United States wanted to ensure that it would have British support in defeating the Japanese once the Germans had capitulated. The Americans wanted to avoid provoking ill-feeling and creating a relationship based on mistrust (Thornton 1970:23-24). In more general terms, they were probably also looking ahead to their post-war interests in bolstering their own security through building extensive links with friendly nations. But at the same time, however, the United States was not prepared to compromise its own position. Thus it would appear that U.S. policy was directionless—on the one hand, the Americans were unwilling to pay the costs of promoting their preferred policy, while on the other hand, they were not willing to change their own position.
A comment made by Taneja sheds some light on this period. He writes that, in the immediate post-war period, U.S. policy was not coordinated. Following the Chicago Conference, an Air Coordinating Committee was organized to act as a center for government aviation policy and to make sure that there was agreement among various government agencies (Taneja 1980:12). This would suggest that internal conflicts in policy-making weakened U.S. ability to achieve its goals.

Another factor explaining the outcome of the Chicago Conference is also linked to the issue of power fungibility. Although the United States was overwhelmingly powerful in general economic and military terms, and clearly had the most power in the industry in terms of its traffic generating capabilities (80% of transoceanic traffic originated from the U.S. [O'Connor 1971:22]), its possession and manufacture of civil transport aircraft, and even its control over strategically important bases (e.g. the Hawaiian islands); it is also true that the British and Europeans had an important negotiating tool. In order to develop its international network, the United States needed access to a number of valuable refuelling islands controlled by these countries. For example, an Atlantic journey required a stop at Gander, which was situated in the British colony of Newfoundland. Other British bases were located in Egypt, India, Malaya and Australia (Taneja 1980:12). The Portuguese, with their control over the Azores, and the Irish had similar potential instruments of leverage.
Analysis of the Bermuda Conference

The initial positions put forward at Bermuda by the British and Americans were, to a great extent, a repetition of their policies at Chicago. However, certain developments facilitated their reaching a consensus.

The British were experiencing a severe crisis in their balance of payments and began to negotiate a $3.75 billion loan from the Americans (Thornton 1970:35). This request was met with considerable opposition in the United States (a public poll in the United States showed 70% were against the loan [Taneja 1980:13]). In the middle of the loan negotiations, Britain reversed its decision to stall air transport negotiations and requested to meet the Americans at Bermuda to negotiate a bilateral agreement. The ability of the United States to provide a loan, and in this way influence British policy in international aviation, provides a good example of how general economic potential can be translated into obtaining a desired outcome in a specific issue area.

Stanley Morgan, a member of the U.S. delegation to Bermuda, described how the United States used the loan as leverage:

During the few months before the Bermuda Conference, the State Department had been urgently pressing the British for this meeting. It had been subtly pointed out that the effect it would have on the British loan negotiations if a strong effort to reach some agreement was not made before the loan came up for debate in the Senate. It was no secret that the airlines' lobby would work against the British loan if our aviation interests continued to be ignored (qtd. in Jönsson 1987:114).
It also appears that British eagerness to adopt some form of international regulation was influenced by their limited success in securing highly restrictive agreements in the immediate post-Chicago period. They looked at the success of the United States in signing bilaterals, which exchanged the five freedoms without restricting capacity or frequency on any of the offered services, and realized that the United States was able to use its supply of aircraft as a negotiating tool in arriving at agreements with countries "hungry for aircraft." It was clear to the British that they could strengthen their own position in the aviation industry quickly through access to U.S. funds and aircraft. In order to do so, they were willing to make certain compromises.

The urgency of arriving at an agreement was compounded by a shift in the country's view of its own future potential in the aviation industry. Research into jet propelled aircraft and a slight economic recovery, generated a mood of optimism, and the British began to believe that in the long run they had a chance of meeting American competition. Consequently, they also modified their position on the restriction of fifth freedom rights for they realized that these would be crucial to the economic viability of their own future international trunk route services (The Economist February 16, 1946).

Certain new variables also influenced the U.S. policy stance. As mentioned earlier, the United States now possessed a policy-making body which enhanced its ability to prioritize and achieve policy objectives. Second, although British need for a new loan increased U.S. relative power, the U.S. position was slightly weakened by its desire to secure a favourable outcome from Britain and the Commonwealth at a concurrently held telecommunications
conference. The United States was also interested in eliminating imperial preferences which discriminated against it (Thornton 1970:35). And one more factor influenced the U.S. position on fifth freedom rights. The Americans began to appreciate the value of certain fifth freedom restrictions as they came to realize that an unrestricted exchange of fifth freedom rights could work to their disadvantage. *The Economist* reported on August 3, 1946 that the U.S. State Department had declared that in future negotiations the United States would not freely offer fifth freedom rights. Instead, it would obtain for U.S. airlines what it could by hard bargaining (*The Economist* August 3, 1946:165-166).

Although a certain rapprochement had been reached between British and American interests, particularly on the fifth freedom question, it is still not clear why the Americans were willing to make such large concessions. For a country which would not gain, and was in fact likely to make losses in a highly regulated environment, the acceptance of the IATA tariff-fixing mechanism and the market-sharing scheme embodied in the Bermuda capacity principles is puzzling. Thornton explains U.S. support for a cartel system by arguing that U.S. aviation policy was shaped by an "overriding concern for national defence or its stated equivalent, anti-communism" (Thornton 1970:681). Specifically, U.S. behaviour was motivated by the view that a cartel would promote its security interests in two ways. First, it ensured the development of the international aviation industries of other states which in turn bolstered their economies. Thornton writes:

U.S. policy called for the maintenance of non-communist governments in all states not already communist. This
required strong, economically healthy governments throughout the free world. It was also assumed to mean governments friendly to the United States. Thus when a foreign country begged for favorable treatment from the United States government for their airline, the United States, fearful of weakening a friendly government or of restricting the foreign exchange earning power of the seeker, felt obliged to assist (Thornton 1970:682).

And second, the United States wanted to ensure that it retained the friendship of foreign governments whose cooperation it needed in the implementation of its chosen defense strategies. For example, the United States Strategic Air Force needed access to bases in Italy, Spain, Portugal, the U.K., Japan, and the Netherlands. Another consideration prompting the United States to support this restrictive regime may have been the stake that the U.S. aircraft manufacturing industry had in stimulating foreign demand for U.S. aircraft.

The preceding analysis of the formation of the international civil aviation regime would seem to support the view that U.S. behaviour can be explained by the third set of reasons why a state might support a restrictive cartel. The United States, due both to its power and as witnessed by its behaviour, was able and willing to play the role of a hegemon. Its behaviour was self-interested, but at the same time its willingness to make concessions (or pay the cost of reduced profits due to a regulated environment) served the interests of weaker nations which for a variety of economic, political and security motivations wanted to ensure the development of their own industries. U.S. hegemony was in no way benevolent, for the United States
was quite prepared to manipulate the interests of nations or even coerce them into adopting policies that favoured U.S. concerns (e.g., as seen in the fact that the bill granting $3.75 billion to the British was not introduced into Congress until the end of the Bermuda Conference; and as seen in the pressure placed on Latin American countries at Chicago by Berle). A final observation which can be drawn from the behaviour of the United States is that where its security and economic interests clashed, security interests were paramount.
1 The Australian/New Zealand proposal took its cue from a French proposal at the 1932 Disarmament Conference. The French had suggested that a continental, inter-continental or inter-colonial organization operate international aviation services under the aegis of the League of Nations (Wagner 1943:15)

2 Jönsson provides useful diagrams to illustrate the six freedoms.

Freedom 1: \[ A^* \rightarrow A \rightarrow B \rightarrow C \]

Freedom 2: \[ A^* \rightarrow A \rightarrow B \rightarrow C \]

Freedom 3: \[ A^* \rightarrow A \rightarrow B \rightarrow C \]

Freedom 4: \[ A^* \rightarrow A \rightarrow B \rightarrow C \]

Freedom 5: \[ A^* \rightarrow A \rightarrow B \rightarrow C \]

Freedom 6: \[ A^* \rightarrow X \rightarrow A \rightarrow B \rightarrow C \]

A, B, C, X: four states
A*: airline of country A
: direction of route

(A* has right to collect traffic at B and fly the traffic to C.
A* has right to pick up in X traffic that is bound for C and route it through A. This traffic normally belongs to the airlines of X and C.)

(Jönsson 1987:33)
3 The Chicago Convention did not define "scheduled air services."

4 As of 1981 Brazil, China, Indonesia and the USSR had not signed the transit agreement. Thus states had to negotiate bilaterals for the first two freedoms (Guildmann 1981:151).

5 The Hawaiian islands were an important refuelling stop for flights between Australia and Canada. The British, interested in developing links with and between the Commonwealth countries, were eager to gain transit as well as commercial rights to them.

DESCRIPTION

In the two decades that followed, the cartel system operated fundamentally unchallenged. Knut Hammarskjold divides the period into two different phases: the pioneering period from the mid-fourties into the early fifties and the period of consolidation from the fifties to the early to mid-sixties (Hammarskjold 1979a:47).

The Pioneering Period

In the years immediately following Bermuda, a large number of bilateral agreements based on the Bermuda I model were concluded. By the end of 1949, 200 bilaterals had been signed. The United States was particularly active, negotiating 40 bilaterals in the first two years (Jones 1960:231). This, of course, was not surprising for in "a war-ravaged world" it was the only state which had "money, airplanes, and a large number of potential travelers" (Lowenfeld 1975a:40).

The United States was very liberal in its route grants, and in return it was able to obtain extensive concessions from all countries with which it negotiated. As a consequence, it was able to build up a "world-circling east-west air route system" (Jones 1960:233). The Europeans, the British and other Commonwealth nations in their bilateral negotiations with each other were on the whole cautious about granting routes (Straszheim 1969:38). In Latin America two trends developed: a few northern states were eager to grant foreign countries access to a variety of routes while the other states adopted a more protective attitude to route grants (Bogolasky 1978:96). The
African and Asian countries were not significant actors during this period. Most of these states did not negotiate bilaterals in the pioneering period. Indeed, many did not even own their own airline. These countries serviced by U.S. and European flag carriers gave, for the most part, unilateral access to their markets.

Policy towards market-sharing varied among states and this was reflected in the bilaterals signed. However, it should be understood that the variation occurred within the parameters set by the Bermuda principles. In other words, the agreements signed did not violate this aspect of the cartel system. The United States adhered to a liberal interpretation of the Bermuda principles (i.e., a 40-60 division as opposed to a 50-50 market split). The only exception to its more liberal policy was the reluctance to provide "beyond rights" to foreign carriers in return for similar privileges it had acquired in other countries. (Beyond rights enable a carrier to fly to a point in a country granting the right and beyond to points in any other country or countries.) In this way, the United States prevented foreign carriers from gaining a share in the traffic moving from U.S. gateways into the U.S. hinterland or beyond the United States (Stoffel 1969:128). A few European states, such as the Netherlands, Sweden, Norway and Denmark, and certain northern Latin American states followed like the United States a more liberal interpretation of the Bermuda principles. The four European states were particularly keen on negotiating an unrestricted exchange of fifth freedom rights. However, most European states (e.g., France, Italy, Belgium, Ireland, Spain, Portugal, and Greece), most Latin American states, the British and Commonwealth nations favoured a more restrictive interpretation of the Bermuda principles. In their bilateral negotiations they pursued a
50-50 split of the market on major routes. This was guaranteed by a variety of specific capacity control schemes. In the most restrictive bilaterals these might take the form of an agreement on pre-determined capacity and frequency formulas or commercial revenue pooling.

All the bilaterals signed during this period either implicitly or explicitly condoned tariff-fixing by the IATA Traffic Conferences. Although disagreements occurred throughout the process of tariff negotiations, they were not substantial and did not in any way challenge this fundamental principle of the cartel system.

The Consolidation Period

The period from the mid-1950s to the mid-1960s was marked by high traffic growth. Air transport expanded at the annual rate of 15-20% (Hammar-skjold 1979a:46-48). (See Table 1 and Table 3.) The decade was marked by three major developments: European demands for greater access to U.S. markets; the entry of a large number of carriers from newly independent developing countries; and tensions arising from service competition, U.S. attempts to lower fares against the opposition of the European carriers, and overcapacity (owing to the introduction of jets in the early 1960s). For the most part, these developments did not signal any fundamental change in the cartel system.

With the beginning of economic prosperity and the development of new technologies (in particular, that of jet aircraft in the early '60s), European countries found themselves in a position to expand their air transport industries. They felt that they had made too many concessions to the United
States in the pioneering period and began to pressure for renegotiations of bilaterals. Stoffel, writing in 1959, described the situation:

Today many governments feel that they were too generous to the United States when they made those agreements. They now seek to protect their own national airline by stretching the liberal Bermuda principles to suit their purposes or by asking for amendment or renegotiation (Stoffel 1959:119).

The major source of contention was the question of fifth freedom rights. The Europeans felt that they had little to gain from fifth freedom rights if their flights stopped and turned around at the international gateways of New York (for transatlantic flights) and San Francisco or Los Angeles (for transpacific flights). In contrast, it was clear that the United States was making large gains from the same privileges granted in Europe (e.g., an American carrier could land in London or Paris and pick up passengers and then fly on to a variety of Eurasian centres: Rome, Cairo, Bombay, etc.).

With the encouragement of air carriers such as Air France, KLM, BOAC, and Air India, which resented the appropriation of their traffic by U.S. carriers, the European governments began to demand greater concessions to compensate for the uneven distribution of benefits. Initially, this took the form of a threat by a number of states including France, Italy, and India to cancel bilaterals unless the liberal interpretation of the Bermuda capacity clauses was abandoned in favour of predetermined capacity and frequency. The United States made a few concessions. However, this European tactic was soon superseded by a new approach based on demands for "equality of
opportunity." States insisted on reciprocity on a route-for-route basis, in
terms of traffic centres served, and the acquisition of beyond rights.

The European carriers were granted access to Boston, New York, Philadel-
phia, Chicago, and new routes to New York, San Francisco and Los Angeles as
a quid pro quo for fifth freedom rights. Similarly, certain states (e.g.,
France, the Netherlands, and West Germany) won beyond rights to Latin America

U.S. carriers' market share began to decrease as European carriers
expanded their activity and became more competitive. In 1951 American car-
riers carried 37.2% of total international traffic (measured in ton-miles).
This rose in 1955 to 38.9% and began falling subsequently: 33.4% in 1960
and 31.4% in 1961 (Lissitzyn 1964:258). This trend became particularly
evident in the North Atlantic Market. In 1946 the United States had gener-
ated 70% of the transatlantic and transpacific traffic and carried about 80%
of it. During the consolidation period, although it continued to generate
about 70% of transatlantic traffic, its actual carriage fell to 40% (Jones
1960:234). Writing in 1964, Kittrie said:

The competitive position of the American flag carriers
vis-à-vis the foreign airlines has been a subject of
great concern in recent years. Having originally pleaded
for complete laissez-faire on the hope that the forces of
supply and demand would ensure to the benefit of the
United States lines, our domestic carriers have been
finding the competition of the revitalized foreign car-
rriers much too hard to meet (Kittrie 1964:8).
However, regardless of declining market shares, the U.S. government continued to sign bilaterals which granted large concessions to foreign carriers. Concessions further diminished U.S. traffic shares as new carriers began competing in markets previously monopolized by U.S. carriers. Not surprisingly, U.S. carriers and the public protested.

The first wave of criticism followed agreements made with the Scandinavian countries, Germany, The Netherlands, and Australia. From 1952 to 1954 the United States began negotiations with SAS over the polar route to Greenland. The U.S. granted the route and gave SAS fifth freedom rights at Anchorage (Thornton 1970:681). According to the terms of the German bilateral, Lufthansa obtained lucrative operating rights on routes from Germany via intermediate points in the United States (including New York) and beyond to the Caribbean and South America (Lissitzyn 1964:254; Thayer 1965:78-79). The Dutch agreement gave KLM operating rights on two important routes from Amsterdam to New York and Curacao and Amsterdam to Montreal and on to Houston. The Netherlands had little to offer as a quid pro quo in air transport privileges, and the agreement was concluded only after the Dutch government had raised the issue to the highest level. In a speech from the throne to Parliament the Dutch Prime Minister made a special appeal to the U.S. President (Lissitzyn 1964:254). The Australians obtained lucrative operating rights to London via San Francisco and New York, exchanging less valuable rights in return. The State Department argued that failure to grant these routes would set an undesirable precedent (Lissitzyn 1964:254).

Criticism of these agreements came from various quarters. For example,
the agreement with West Germany complaining that Lufthansa was gaining fifth freedom rights to the detriment of U.S. domestic and international carriers (Lissitzyn 1964:252).

In 1956 the Senate Committee on Interstate and Foreign Commerce held a hearing on "International Air Agreements" and produced a report which was highly critical of U.S. policies. The Committee recommended that legislation be passed that would restrict Presidential review of the decisions of the CAB concerning certificates for foreign air transportation and foreign air carriers. The purpose of this measure was to increase the role of economic as opposed to political considerations in the U.S. negotiation of bilaterals. This legislation was not passed (Lissitzyn 1964:253).

In Congress, Senators Smathers, Mundt, and Capehart and Representatives Jarman and Bow criticized uncompensated route awards and stressed that traffic carried by a country's airlines should be related to its traffic generation (Congressional Record April 4:5136 qtd. in Thayer 1965:78). The Eisenhower Administration responded by reminding its critics that during bilateral negotiations, U.S. representatives "are charged with the responsibility for taking into consideration the interests of the traveling public, the interests of the areas served by air transport operations, and the interests of the air transport industry." Furthermore, the State Department stated that "the government makes every effort to balance conscientiously all of these interests so that the welfare of the United States as a whole will be served" (Lissitzyn 1964:253). It added that, in many cases, the United States had no choice "but to be liberal with other members of the free world alliance" (Department of State Bulletin June 24, 1957:1012-13 qtd. in Thayer 1965:79).
Following 1957, the United States became less liberal in its route concessions. For example, KLM, Alitalia, and SAS all failed to obtain routes from Europe to the American West Coast (Lissitzyn 1964:255; Straszheim 1969:40). Similarly, the United States denied the Japanese rights to complete an around-the-world flight. This action led to diplomatic tensions and the issue was not solved until 1965 when, in exchange for access to New York and Atlantic, the United States was given landing rights in Osaka and, in addition, beyond rights from Tokyo (Straszheim 1969:41).

The second wave of criticism focused not on what were perceived as U.S. "route give-aways" but rather on disturbing developments in the policy of other states: particularly as seen in Europe and Latin America. It was found that a number of states were adopting restrictive practices and were violating or abusing Bermuda capacity standards. For example, certain countries were prescribing maximum traffic allowances, trying to make carriers pay a percentage to the national carrier on traffic carried, restricting fifth freedom allowances in an arbitrary fashion, even trying to close sections between two countries and preventing third parties from carrying traffic in the region, limiting frequencies, insisting that foreign carriers use local travel agents (who often were more interested in promoting their national carrier's traffic), and charging foreign carriers exorbitant fees for the use of ground services (in most cases carriers were forced to use the locally available services) (Slotemaker 1966:905). Although these states were more than eager to restrict U.S. fifth freedom rights, they were, in effect, abusing privileges granted to their carriers by the United States by allowing carriage of excessive volumes of fifth freedom traffic. In Europe,
KLM, SAS and Sabena were singled out as the major offenders in such activity (Lissitzyn 1964:236).  

The Kennedy Administration appointed a nonpartisan group to investigate these complaints. The group submitted its conclusions in the 1961 "Project Horizon" Report of the Task Force on National Aviation Goals in a hearing held before the Aviation Subcommittee of the Senate Committee on Commerce. In addition to confirming the occurrence of restrictive practices and abuse of fifth freedom privileges, the report also brought attention to the increasing tendency of foreign carriers to strengthen their bargaining position vis-à-vis the U.S. through the formation of pools (e.g., the Commonwealth pool of British, Australian, Indian, and Canadian airlines). A further observation was also made: certain carriers, particularly Latin American ones, were undercutting IATA rates and thereby diverting traffic from U.S. carriers (Lissitzyn 1964:256).  

The investigation had two consequences. First, the CAB introduced a proposal which would empower the Board to request foreign carriers to provide data on their traffic activities and require them to file their schedules with the Board for approval (Kittrie 1964:6-7). This would allow the United States to enforce its position on fifth freedom rights. If the Board found that abuses were occurring, it would be able to suspend operations. Furthermore, this power would give the CAB a bargaining tool in its campaign against restrictive practices. Not surprisingly, the proposal was met with strong protests from BOAC, SAS, KLM, and Sabena which moved that the CAB lacked the power to amend foreign air carrier permits in the manner proposed (Kittrie 1964:6-7; Lissitzyn 1964:255). After a major debate in the CAB and Congress, the proposal was dropped and "the basic conclusion was that such action was
largely unjustified and would precipitate retaliation abroad" (qtd. in Straszheim 1969:208).

The second consequence was a Presidential Order of 1961 to make a thorough study of U.S. policy. The investigation gave rise to a 1963 policy statement that reiterated support for the bilateral entry system and the Bermuda capacity principles. It encouraged the government to seek adequate access for U.S. carriers to foreign markets, to promote travel to the U.S., and encourage the purchase of U.S. aircraft. Next, it encouraged the CAB to give technical and financial assistance to less developed countries. And finally, it supported the IATA fare machinery but asked Congress to give the CAB authority to set prices and veto tariffs that it considered unreasonable. This proposal was also a response to the Chandler crisis, which will be discussed shortly. The proposal was not adopted (Taneja 1980:18; Straszheim 1969:204; Haanappel 1984:31).

The 1963 policy statement concluded:

A well reasoned policy . . . will carry us far toward the primary objective of U.S. international air transport policy: to develop and maintain an expanding, economically and technologically efficient international air transport system best adapted to the growing needs of the Free World, and to assure air carriers of the United States, a fair and equal opportunity to compete in world aviation markets (qtd. in Straszheim 1969:204)

The consolidation period also saw new competition entering the commercial aviation industry. From 1954 to 1958 more than 75 new international airlines entered the scheduled international field. Of these, 45 actually
survived and continued to operate (Jones 1960:234). This proliferation was primarily due to a structural change in the international community: decolonization. With the gaining of independence, many new nations sought to enter into the international aviation market. Most had neither material nor technical resources to compete effectively. However, the developed states were ready to provide aid in the form of capital investment, technical assistance and aircraft leasing. The United States was particularly active. From 1956 to 1961 it provided almost $300 million in capital assistance. Of this, $136 million was in the form of Export-Import Bank loans for the purchase of U.S. aircraft. However, the availability of these loans was not non-discriminatory. The United States also provided aid through the Agency for International Development and technical assistance through ICAO (Straszheim 1969:28). As mentioned earlier, the 1963 Policy Statement made explicit reference to the need to encourage the development of aviation in less developed countries (LDC). The Europeans, while providing assistance to several LDC countries in the form of financial and technical aid, were fairly cautious in granting their airlines access to European gateways. Many insisted on specific capacity restrictions, or granted access subject to pooling arrangements (Straszheim 1969:38). The United States was more liberal in its route grants. For example, against CAB opposition, the White House supported the granting of access to New York for Air Afrique and Nigerian Airways. In exchange, Pan American Airways received additional route grants in Africa. In explaining this unequal exchange, the State Department stated that these agreements were consistent with the United States' aid program to Africa (qtd. in Straszheim 1969:41). The initial
foreign assistance was not sufficient to make most LDC carriers economically viable, and heavy government subsidization was required to continue operations. In order to protect national carriers from foreign competition, LDC governments frequently adopted highly restrictive policies.

Throughout the consolidation period, government attitudes towards rate-making procedures largely remained the same. The IATA system was not free of crises; however, disagreements as a rule ended in compromise. Unfortunately, due to the secrecy surrounding the IATA conferences, information about negotiations and particularly disagreements is difficult to obtain. Nevertheless, it is possible to identify three types of challenges which the IATA cartel was forced to meet: service competition, U.S. pressure to lower fares, and illegal discounting which resulted from overcapacity in the early 1960s.

The operation of the IATA cartel virtually eliminated price competition, and consequently, airlines resorted to other methods of attracting passengers; namely, service competition. Service competition could take a variety of forms: e.g., in meal and drink service, lounge service, seating density, baggage allowance, and even in the provision of gifts. The Traffic Conferences tried to regulate this by providing rules relating to conditions of service. However, disputes often arose, particularly when new services were being introduced by carriers. Perhaps one of the most publicized controversies during this period was the in-flight entertainment ban. In 1961, TWA made a large investment in providing in-flight entertainment for its passengers. The IATA carriers protested and called for the dismantling of this system, warning that it would lead to costly service competition. IATA argued that traffic would not increase as a consequence of the entertainment,
and instead, airlines would be forced to increase rates to pay for this costly perk. At the 1964 IATA Athens Conference, virtually all carriers, led by Quantas, refused to discuss the issue of rates until the entertainment issue had been settled. In response, the anti-trust division of the Justice Department advised the CAB to re-examine "the entire concept of IATA conference machinery and the CAB immunization of agreements and resolutions" which "are per se violations of the Sherman Act" (qtd. in Pillai 1969:43). The issue was resolved at the conference in Vienna, where it was agreed that carriers would be allowed to offer in-flight entertainment, but a $2.50 charge per headset would be levied. The CAB approved the decision (Pillai 1969:40-42).

From the early '50s on, the United States was the major proponent of lowering rates and was consistently opposed in its initiatives by the Europeans. The mandate of the traffic conferences was to fix rates at "reasonable levels" paying due regard "to all relevant factors such as cost of operation and reasonable profits" (Pillai 1969:57-58). However, there were two problems associated with this task. First, the word "reasonable" was essentially ambiguous. And second, there was a lack of data available to the IATA Cost Committee which would enable it to make accurate cost-based proposals. The United States in its allegations that rates were too high based its calculations on its own efficient operating costs, on the example of below-IATA rates being charged by Loftleider on its North Atlantic services, and on the fact that U.S. non-scheduled airlines were offering non-subsidized transatlantic services at levels below the IATA prices (Keynes 1964:177-178). On the basis of these calculations, the United States felt that the Europeans' attempt to preserve artificially high prices should be
challenged. This sentiment was expressed by the Senate Committee on Commerce in 1963:

The prime need for rate control is not the protection of U.S. flag carriers from the low rates of foreign competitors, but rather the protection of the American public from excessive and unreasonable rates charged by IATA carriers with the active assistance of their governments. . . . As noted earlier in this report, foreign carriers and their governments have pursued a high-rate policy which arises from higher costs and a desire to offset losses on uneconomic routes. This policy, from all indications will continue. The U.S. flag carriers are the most efficient in the world and can afford, and have publicly declared on many occasions that they wish, to charge lower rates than their foreign competitors. It is the committee's firm belief that the additional powers contained in the bill as reported will most effectively enable the Board to pursue its, as well as U.S. flag carriers', announced policy of pressing for lower international air fares (Lissitzyn 1964:263).

The United States had limited success in lowering fares by introducing the Tourist Class in 1952 and economy fares on the North Atlantic in the spring of 1958. In 1949 Pan American had proposed the implementation of a Tourist service on the North Atlantic. The plan was finally endorsed three years later; however, the agreed fare was 20% higher than the price suggested by the American carrier (Keynes 1964:177). Economy fares introduced on the
North Atlantic in 1958, followed a proposal made by Pan Am the year before. The agreed fare was 13% lower than the tourist fare in effect, although Pan Am had pressed for a 25% reduction (Keynes 1964:177). Keynes, analyzing these incidents, writes:

there is no doubt that the higher level of fares (and lower density of seating) provided for in the finally adopted agreement were brought about by the need to accommodate the views of European carriers (Keynes 1964:180).

When tariff disagreements arose in 1956 and 1962-1963, the CAB was even less successful in lowering prices. The 1956 conflict began when the CAB announced its intention to disapprove an IATA agreement providing for a 10% increase in first-class fares on the North Atlantic. The CAB felt this proposal should be accompanied by a reduction in tourist fares, saying, "tourist fares generally [were] higher than can be justified on the basis of a standard of service . . . designed to meet the needs of a mass transportation medium" (qtd. in Keynes 1964:180-181). However, the CAB reversed its stand and approved fare resolutions for the 1956 season due to protests by foreign governments and IATA members. At the 1962 conference in Chandler, Arizona, in response to financial difficulties (following the introduction of jet aircraft that resulted in temporary overcapacity), the IATA membership resolved to increase North Atlantic economy round trip fares by 5%. The CAB, which had been advocating a decrease in fares to reflect lower jet operating costs, announced its disapproval of the IATA resolution. The British government threatened to detain U.S. planes violating the agreement. European carriers and governments joined the British in pressuring the CAB to reverse
its decision. The U.S. Secretary of State wrote to the CAB, implying that the absence of government authority over international rates made it necessary for the CAB to retreat from its position. This, in fact, was not the case, for as Keynes points out:

The available alternative to retreat was, then, the use (or threatened use) of suspension power to most British and other services conducted at rates which were in our opinion too high.

Why was this course not adopted? Briefly because neither the State Department nor the Board had, or at any rate would admit to having, authority to take this action, which was clearly within the prerogative of the United States' government (Keynes 1964:185-186).

At Montreal, the airlines agreed to a minor adjustment in the rate structure, and the CAB gave its approval to the fare increase (Pillai 1969:7-8). The rule of unanimity for fare resolutions made it very difficult for U.S. carriers and the CAB to implement lower fares through the IATA framework. Thus, the United States resorted to a new tactic: the encouragement of non-scheduled low-priced operations working outside the IATA framework. As will be seen shortly, this proved to be a major development which weakened the IATA tariff-fixing cartel.

The final challenge to the IATA cartel during this period, resulted from the introduction of jets in 1960-1961. As previously mentioned, the jets created temporary overcapacity and consequent financial problems for certain carriers. Illegal discounting spread extensively. The problem was debated in IATA, and carriers pledged to discontinue these practices. IATA tried to
curb this activity through its enforcement mechanism; however, its attempts were largely unsuccessful. By 1963 demand for commercial traffic services increased and the problem of discounting largely disappeared except in Latin America and the Middle East (Straszheim 1969:142). The problem reappeared in full force in the mid-'70s with the entry of wide-bodied aircraft.

**Summary**

The three developments during this period: increased European aggressiveness, the entry of new carriers into international markets, and tensions disrupting the smooth operation of IATA price-fixing had varying impacts on the cartel system. The conflicts arising from European and other states' demands for new gateways and beyond rights from the United States and for a greater share of international markets in general did not reflect a breakdown of the cartel system. The various renegotiations of the terms of market-sharing fell within the parameters set by the Bermuda capacity principles. The only dimension of states' aggression which may be seen as a departure from the Bermuda principles was the arbitrarily restrictive regulation of foreign fifth freedom traffic and the carriage of excessive volumes of fifth freedom traffic by certain states' carriers. In the latter case, states were obviously violating the rule that capacity should be allocated according to primary justification traffic. The extent of these abuses is undocumented and, consequently, it is difficult to judge their significance. However, it would seem that for the most part the parameters of a 40-60 market split were not abandoned in states' bilateral negotiations over traffic rights, capacity, and frequency restrictions. The entry of new carriers into international markets increased competition on international routes. This
had an impact on the size of certain states' market shares and was to be one of the factors that influenced a change in U.S. policy in the future; however, this development did not directly challenge the three principles on which the cartel system was based. The appearance of service competition and U.S. pressures to lower IATA fares produced certain tensions at the IATA conferences, but they did not in themselves challenge the basic principle of multilateral tariff-fixing—particularly since the disputes were resolved. However, illegal discounting did constitute a violation of this basic cartel system principle. As in the case of fifth freedom violations, the extent to which illegal discounting was practiced is undocumented, and thus, once again, it is impossible to determine the significance of this development. Straszheim argues that illegal discounting was short-lived (Straszheim 1969:142). Consequently, one can only suggest that the cartel system may have weakened for a short period during which these practices were adopted. However, one can also conclude that in general the principles of the cartel system continued to be embodied in states' regulation of the aviation industry from the late 1940s to the mid-1960s.
ANALYSIS

During the "heyday" of the cartel, states supported the regime. To a certain extent, their behaviour may have been influenced by economic arguments that posited that in a deregulated environment predatory pricing, market chaos and loss of services would ensue. However, this consideration does not seem to have been the main motivating force behind their conduct.

With the exception of the United States, countries supported the cartel because they felt that this nature of regulation would ensure the development of their own industries. States were interested in establishing their own air carrier services for a variety of economic, political and security related motivations. Their operations were inefficient and it was clear that in an unregulated environment their carriers would not be able to compete with efficient U.S. carriers. As has been described, within this category of states, a distinction in approach to the granting of market access and market-sharing existed. The adoption of a more liberal or a more restrictive interpretation of the Bermuda capacity clauses by states reflected varying concerns over the degree to which they believed their industry should be protected. In many cases, this expressed either, in the case of the former, a weaker commitment, or in the case of the latter, a stronger commitment to the cartel system. But in both cases, at a fundamental level, the states supported the principles of the cartel. European and Latin American states which were reluctant to grant foreign carriers market access and which tended to interpret the Bermuda capacity principles restrictively were clearly very concerned about their market shares. These states either had inefficient industries and/or were primarily third and fourth freedom traffic carriers. States belonging to the latter category were adamant about controlling fifth
freedom rights which allowed foreign carriers to compete in their third and fourth freedom markets. The newly emergent African states also favoured more restrictive policies, although in the immediate post-war period, these states had given foreign carriers (especially the United States) fairly liberal access to their markets. This anomaly may be easily explained. In the immediate post-war period colonial states did not possess the resources to establish aircraft industries. Consequently, they were quite happy to receive any form of service which other states were willing to provide. As these states gained independence, they became interested in establishing their own industries. The chief motivation seems to have been prestige considerations. This view is supported by the comments of the Ghanian Minister of Transport who stated in 1960 that his government would support uneconomic operations in order "to expand and develop Ghanian influence to the greatest extent possible in Africa and elsewhere" (qtd. in Pillai 1969:16). The operations of the undeveloped states were highly inefficient and required both financial and technical aid from developed countries and heavy subsidization from national governments. Consequently, it is not surprising that these states were in favour of the more restrictive version of the cartel system. The states that opted for a more liberal cartel system based on liberal route access and a less restrictive interpretation of Bermuda capacity clauses tended, for the most part, to be small traffic generators. The Netherlands, Sweden, Norway and Denmark, four states belonging to this group, in particular favoured fewer restrictions on fifth freedom traffic. These states were more likely to gain access to a larger market share in a less restricted environment than in a system in which fifth freedom carriage was rigidly related to traffic generating capabilities. In the
case of certain Latin American states, Bogolasky suggests, a different motivation for granting foreign carriers liberal route access and a larger market share existed. These states were interested in encouraging tourism and felt that by granting foreign carriers a greater share of their market, they would be guaranteed a larger volume of tourists (Bogolasky 1978:95-97).

The United States, like other states, wanted to develop and expand its own industry. The prospect of economic benefits and the desire to establish an international communications network seems to have been its primary motivation. Commenting on the latter, Jones explains:

The free world nations are held together only by their common national interests, mutual assistance and cooperation, and military alliances. It seems obvious that communications by means of rapid and efficient transportation of person, property, and information is of absolute necessity to the existence of such communities of nations; and since the leadership of these hegemonies has been entrusted to the United States, it follows that the United States must establish and maintain a foremost place in this most flexible, rapid and efficient means of transportation—civil air transport (Jones 1960:220).

However, these objectives would be best pursued in a deregulated environment. The United States, which possessed the most efficient industry, generated the bulk of travelers across the Atlantic, Pacific, to Asia and Central and South America, and owned a large fleet of air carriers, could easily monopolize the industry if competitive forces were allowed to operate. And yet, on many occasions, the United States took action which was detrimental to
the development of its own industry. First, it supported a cartel system which allocated market shares and fixed high prices. Second, even when it challenged the high IATA prices, it was prepared to retreat. (This was particularly clear in the Chandler Crisis.) And third, it gave huge route concessions allowing foreign airlines to compete in its lucrative markets. The question must be asked, why did the United States behave in a way that hindered the development and expansion of its industry?

One explanation would be that the United States was pressured into taking these actions. However, this suggestion may be discarded since, clearly, throughout the pioneering and consolidation periods, the United States dominated the aviation industry and enjoyed overwhelming economic and military superiority. The other explanation lies in the theory of hegemonic stability. The United States, for reasons other than concern for the development of its own aviation industry, was willing to support the cartel system. Two reasons for cartel support seem to have motivated U.S. behaviour. The first was connected to U.S. security interests; the second to its economic interests.

The United States saw its security interests as being furthered by ensuring that the economies of its allies were strong. By supporting a cartel system, the United States would allow an environment to be created in which states could develop their own aviation industries. This, in turn, would stimulate the growth of their economies. U.S. liberal route concessions may also be explained, in part, by this motivation, for they helped foreign industries develop by introducing them into highly profitable markets. Straszheim writes:
... the United States made liberal concessions as part of its aid program of rebuilding the Western World—economically as part of the dollar shortage ... and politically as part of its efforts to unite the West (Straszheim 1069:39-40).

The security needs of the United States also required that it establish military bases in various parts of the world. Thornton writes that from 1949 to 1962 the U.S. Air Force needed bases in Italy, Spain, Portugal, the United Kingdom, Japan and the Netherlands in order to be able to reach potential targets in the Soviet Union (Thornton 1970:681). This U.S. need gave countries a certain amount of political leverage. In return for cooperating with the United States, they asked for route concessions and pressured the United States not to take action that would be damaging to the development of their aviation industries. Thornton writes:

Airline traffic rights were among the things sought by foreigners in exchange for military bases, and were commonly obtained without equivalent United States airline routes (Thornton 1970:681).

With this in mind, the concessions made by the United States to various states become more understandable. For example, behind U.S. concessions to SAS was the former's interest in securing strategic bases in Greenland (Thornton 1970:681). Similarly, the bilateral agreement concluded with the Germans on the occasion of Chancellor Adenauer's visit to Washington which gave Lufthansa important privileges, also appears to have involved a security trade-off. In the case of the Netherlands agreement, President Eisenhower even admitted the importance of the "Netherlands
pulling its weight as a sound member of the Western Alliance (qtd. in Thornton 1976:254). Thus, Thornton summarizes:

The reasons for the apparently poor showing of the United States in traffic bargaining is not hard to estimate. As might be expected, it is clear that ever since World War II, the United States has been using her bargaining power in the airline sphere as a means of securing foreign agreement to things which have little to do with the airline industry. Obviously, these objectives have a higher priority in the minds of policy makers than does the success of the United States airline industry, or even of better airline service for United States citizens. The overriding objective has been national defence, or its stated equivalent, anti-communism. The United States considers the Soviet Union and its tool, international communism to be the major threat to her safety (Thornton 1970:681).

A third motivation for supporting a cartel system and aiding the development of its allies' industries was also linked to U.S. security interests: it wanted to ensure the friendship of its allies. This motivation was highlighted by several incidents. The granting of extensive air route privileges to less developed countries, in conjunction with the generous provision of financial and technical aid, was in Straszheim's opinion partially motivated by a desire to counter Soviet aid and secure allies (Straszheim 1969:28). U.S. behaviour in response to its declining market shares and foreign restrictive practices may also be explained in terms of its reluctance to
alienate its friends. Towards the end of the consolidation period the United States became concerned with the fact that it was losing its market share and that countries were indulging in restrictive practices which discriminated against its carriers. Jones, writing in 1960, commented:

The "sacred Bermuda" principles were beginning to cost the U.S. a lot of money. They were fine in 1946 when we generated about 70% of the transatlantic and transpacific traffic, and carried about 80% of it. Now, these same "principles,"--"fifth freedom," plus "reciprocity of rates," "reciprocity of traffic centers" and "dog leg routes" exposed the great U.S. traffic market to dozens of international airlines of other nations, many of which generated little traffic, operating chiefly for reasons of politics and pride, and dependent on the American tourist dollar. Our own airlines were carrying about 40% of the transatlantic traffic, although the U.S. generated about 71% of it. Were we trading transatlantic dollars for Paris and Rome "fifth freedom" nickels? (Jones 1960:234)

Yet, the government was unwilling to take measures to protect its aircraft (i.e., requiring filing of schedules with the CAB by foreign carriers and requesting data on traffic activities) by giving the CAB suspension power. The motivation seems to have been political: it was unwilling to alienate its allies who protested strongly against such measures, and was prepared to make economic sacrifices to this end.
Similarly, U.S. behaviour vis-à-vis IATA also suggests that, when U.S. attempts to lower prices were met with foreign government protests, the United States was willing to back down in order not to jeopardize its relationship with its allies. This was particularly evident in the Chandler incident. The event also offers interesting insight into U.S. aviation policy-making: within the U.S. government there was a division between policies supported by the CAB and those supported by the State Department. The CAB was concerned with U.S. air carriers' economic interests, while the State Department was often responsible for subverting CAB proposals in the interest of foreign policy. Indeed, it was the Secretary of State who wrote to the CAB recommending that it withdraw its disapproval of increased North Atlantic fares. The excuse the former gave for this policy was obviously weak; for as Keynes points out, the U.S. had the authority to suspend British services.

Finally, an economic concern may have also motivated the United States to support the cartel system. In the interest of fostering a demand for the products of its aircraft manufacturing industry, the United States was willing to support a system which would encourage the development of foreign industries. Thayer argues that U.S. liberal route concessions were linked to this motivation. He writes:

The vested interest [sale of U.S. transport plane] thus acquired makes it inevitable that the U.S. permit entry into markets which enable those airlines to pay on their loans. In a sense, the Ex-Im Bank has acted for some years as a promoter of freer entry of foreign airlines.
into the U.S. market, a factor often officially stated when new routes are awarded (qtd. in Diamond 1975:436)

Lissitzyn, more specifically, when commenting on U.S. concessions made in the signing of the Dutch-American bilateral brings attention to the comments of a State Department official who claimed that U.S. policy was influenced by the lobbying of U.S. aircraft manufacturers who stressed that KLM was the largest foreign purchaser of U.S. civil aeronautical equipment (Lissitzyn 1964:254).

Thus, throughout the twenty years of the "heyday" of the cartel, the United States supported the cartel for reasons associated with its role as hegemon, while other states supported the system in order to promote the development of their own international air carriers.
NOTES

1 Predetermination requires prior government determination or approval of capacity before air services commence. It usually stipulates capacity, frequency of flights, scheduling of flights and/or types of aircraft used. According to this system, an airline may either reach an agreement on capacity and related matters which will be then subject to government approval, or the airline may first be required to seek government approval of capacity and frequency (Haanappel 1984:35).

2 The U.S. pointed out that most of the European traffic across the North Atlantic was not based on 'primary justification'; i.e., third and fourth freedom traffic between the U.S. and the nation of the carrier. Rather, in most cases, European carriers carried traffic between the U.S. and third countries via their homeland. The U.S. argued that this was in fact fifth freedom traffic and subject to regulation according to the Bermuda capacity principles. The Europeans refused to accept this view, stating that this traffic was merely a combination of third and fourth freedoms, and therefore not subject to the restrictive Bermuda standards (Lissitzyn 1964: 256).

3 During the debate, it was pointed out that the major aviation powers did not require U.S. carriers to file schedules and submit data. This type of activity was primarily found in Latin American countries. In 1962, 32 countries exercised control over U.S. carriers by either requiring traffic data, requiring schedules to be approved, or controlling capacity. Nine of the 32 had no bilaterals with the U.S. and operated under temporary permits. Twenty-two had bilaterals and these restrictions were imposed illegally. The
22 countries were: Argentina, Austria, Brazil, Chile, Costa Rica, El Salvador, Finland, Ghana, Guatemala, Honduras, Greece, India, Indonesia, Iran, Iraq, Japan, Korea, Lebanon, Mexico, New Zealand, Nicaragua, Nigeria, Pakistan, Paraguay, Philippines, Portugal, Spain, Switzerland, Thailand, Turkey, Uruguay, and Venezuela.

4 The Civil Aeronautics Act, 1938, had given the CAB power to disallow discriminatory charges. In addition, all agreements to which U.S. carriers were party were to be submitted for CAB approval. Without approval, they could be subject to anti-trust prosecution. It was according to this condition that the CAB had indirect control over fare agreements for it was not granted any direct authority over rates charged by American carriers in foreign air transportation (Bebchick 1958:11). The 1958 Federal Aviation Act gave the CAB the power to remove international discriminatory tariffs. With Part 213 of the CAB Economic Regulations enacted in 1970, the CAB was given the power to limit the operation of foreign air carriers, when the government under whose authority carriers operate has taken action which impairs, limits, terminates or denies operating rights of U.S. carriers. It was not until 1972 that legislation was enacted which granted the CAB power to suspend and reject international tariffs. It was not given the right to fix them (Haanappel 1984:31, 45).

5 Illegal discounting may take the form of a grant of excess mileage, additional stopovers, and excess baggage. In addition, airlines may offer travel agents rebates on tickets sold which are then passed on to the consumer as price discounts.

DESCRIPTION

It is not easy to describe developments in the period from the mid-'60s to the mid-'70s. Hammarskjold has described these years as a time of change and fragmentation. In his words:

It was not until the early and mid-sixties that substantial changes—the beginnings of fragmentation began to occur in the regulatory structure (Hammarskjold 1979a: 48).

The difficulty in understanding the various forces that affected the weakening of the cartel system is that many had their origin in previous periods while others interacted and fed on each other. As a consequence, not only is it impossible to restrict description of certain trends to the specific time period under discussion, but it is also very difficult to consider these forces in isolation. An attempt will be made to deal with the former problem; but, due to the latter difficulty, a certain amount of back-tracking will be necessary.

The description is divided into two parts. The first part identifies five major developments that had adverse affects on the operation of the cartel. The first three developments: the increase of international scheduled operations due to decolonization; the increase in available capacity due to technological advances, and the oil crisis followed by a recession are important because they changed the environment in which the cartel system operated. The other two developments: the growing importance of non-IATA
international carriers and the proliferation of charter operations are significant both because they changed the environment in which the cartel operated, and because they signalled that the cartel system no longer operated in certain important sectors of the international market.

The second part examines how airlines and governments responded unilaterally to the challenges of the new environment. (Some responses violated the principles of the cartel system while others did not.) It then describes the effect that these unilateral actions had on the multilateral tariff-fixing operations of the IATA cartel.

The Increase in International Scheduled Airlines

In the late '60s and throughout the '70s, the number of international airlines increased dramatically. As was mentioned in the previous section, many of the new airlines were established by newly independent less developed countries. The increase in scheduled airlines, of course, led to more competition in the industry and translated into shrinking market shares for many states.

Technological Change

The introduction of jets in the 1960s had provided an almost 100% increase in passenger seat miles available for international service (Jones 1960:240). This led to overcapacity and, as described earlier, airlines resorted to illegal discounting tactics. The problem had been resolved by increased demand. However, it soon reemerged. Based on excessively optimistic growth projections (14-15%), airlines had in total ordered 1,000 jets to
arrive by 1970 (Slotemaker 1966:916). These added to the overcapacity problem which was aggravated by a new technological innovation: the long-range wide-bodied jet. This type of aircraft increased available capacity even further. In addition, it required higher revenues to break even because its operating costs were higher than those of other aircraft. (This was due to higher human and capital resource inputs.) (Salacuse 1980:832) The Economist of August 6, 1966 reported that, in the following five years (1966-1970), airlines would have to spend nearly as much on new aircraft as they had done on the existing fleet which was bought over a period of 15 years (qtd. in Slotemaker 1973:917).

**The fuel crisis**

The fuel crisis had a tremendous impact on the airline industry. International aviation fuel prices increased from US$0.125 per gallon in early 1973 to US$0.406 per gallon in July 1974 (IATA, 1975:3). Fuel constituted 12% of total operating costs in 1973, while by 1974 this figure had risen to 22% (IATA 1974:41). Each increase of 1¢ in aviation fuel raised airline costs by $100 million (Diamond 1975:485). Escalating operating costs reduced carrier profit margins. In 1972 IATA airlines' operating profit was 1.6% of revenue. In 1973 this rose to 4.2%, but following the oil shock, profits fell to -0.3% of revenue. They recovered in 1975 with profits rising to 2.5% of revenue (The Economist October 4, 1975:75). The effect of economic recession caused by the oil crisis was also reflected in traffic growth trends in the '70s. Traffic increases were lowest in 1974 and 1975—the immediate post-recessionary years. (See Table 1.)
On the lucrative North Atlantic market, which represented 1/3 of total international traffic, the results of economic recession were very evident. Taneja writes that total traffic growth increased at an annual rate of 9.7% between 1968 and 1978 (as compared with the 15-20% rate of increase in the 1950s and early 1960s. Between 1968 and 1973 the total (scheduled and charter) rate of growth was 16%. Following the oil crisis, the rate of growth dropped to -6.0% from 1973 to 1975 (Taneja 1980:107). (See Table 4).

Increased Non-IATA Scheduled Carriers

During this period a growing number of non-IATA airlines entered the international market—many engaging in price-cutting activities. These airlines determined their tariffs individually or after discussion with other airlines flying similar routes. As a rule pricing decisions were subject to government approval.

Haanappel writes that airlines stayed out of IATA for two reasons: political and economic. The first category includes airlines such as Aeroflot, Balkan Bulgarian Transport of Bulgaria, Interflug of the German Democratic Republic, Malev of Hungary, and Tarom of Romania. These airlines do not compete with IATA rates. They explain their behaviour by a reluctance to join a "capitalistic trade association of profit-minded international airlines" (Haanappel 1984:118). The second category, however, is of great concern to the IATA cartel. Airlines such as Loftleider (Iceland), Air Bahama (a Loftleider subsidiary), and Luxavia (Luxemburg) engage in extensive tariff competition. Perhaps the most significant threat came from airlines originating in the Far East. These included: Cathay Pacific Airways (Hong Kong), China Airways (Taiwan and formerly an IATA member), Korean Airlines,
Malaysian Airlines System, Singapore Airlines, and Thai International. They formed the Orient Airlines Association (OAA) which organized regional meetings. Some carriers participating in this organization kept dual membership in the OAA and IATA.

The Development of Charter Services

Charters or "irregular services" were in operation in the pre-World War II period; however, it was not until the mid-'60s that these services began to undermine seriously the activity of the cartel. In order to understand the development it is necessary to trace the history of charter regulation.

In the immediate post-war period, the volume of charter traffic was negligible. Charters were considered to be so insignificant, that states did not even bother to develop a comprehensive international regulatory framework that would standardize the terms of charter entry, capacity and pricing. The Chicago Convention explicitly gave states the freedom to limit the commercial activities of non-scheduled international services as they saw fit.¹ Thus, charter growth was not only a function of demand, but was also contingent on the degree to which states made their national legislation on charter certification and entry restrictive.

Charter services first established themselves in the United States and Europe, and their popularity continued to be localized in these areas, particularly on the North Atlantic market. Data collected on charter growth indicates that in 1959 charters held 12.2% of the international market, while by 1971 they held 32.2% (ICAO 1971:27,34). On the North Atlantic, in 1961 204,000 passengers travelled to and from the U.S. while by 1971 the number had risen to 2.5 million and to 3.7 million in 1973 (Lindberg 324). The
increase in total traffic on the North Atlantic between 1968 and 1973 was only 13.8% for scheduled carriers while for the same period charters enjoyed a 24.1% growth rate (Taneja 1980:107). (See Table 4 and Table 5.) The huge growth in charter traffic was primarily the consequence of an increase in the number of U.S. charter operators. In 1971, the U.S. share of total international non-scheduled traffic was almost 40% (ICAO Bulletin May 1976:26). In order to understand the sudden increase in world charter operations resulting from the entry of U.S. charter operators in the mid-'60s, it is necessary to describe the changes in U.S. national charter legislation.

U.S. policy towards charters went through several phases. Wassenbergh describes them as follows:

... the U.S. first tried to protect the scheduled airline system against charter competition, then started to protect charter carriers against scheduled competition, and allowed and pushed greater freedom for charter carriers, and now favours price competition between scheduled and charter services (Wassenbergh 1981:253).

Following World War II, a large number of cheap surplus military airplanes appeared on the market. The CAB authorized operators of these carriers to provide "irregular, limited and sporadic service" (Goldklang 1961: 100). After September 10, 1947, the CAB prohibited irregular carriers from engaging in foreign air transportation, although it continued to permit foreign flag carriers and scheduled U.S. carriers to provide charter services. Two years later, the CAB modified its policy and started granting limited exemptions to irregular carriers to conduct transatlantic charter flights. Exemptions were given to "recognized educational, religious and
charitable groups," and the CAB explained that these services would not compete with scheduled operations for at the height of the tourist season demand for transportation exceeded scheduled service supply (Goldklang 1961: 100). More exemptions were given in 1950; however, the CAB began to be concerned with the large increase in charter traffic (e.g., charter passengers across the Atlantic increased from 5,600 in 1950 to 12,000 in 1951). The CAB reviewed policy and found that extensive abuses of the "affinity" requirement were taking place (e.g., names of charitable groups turned out to be travel agencies, etc.) In March 21, 1951 the CAB announced that it would severely curtail the activities of irregular carriers (Goldklang 1961:109). The new policy prohibited irregular carriers from engaging in international operations (with the exception of the carriage of military and refugee groups). Furthermore, the CAB insisted that certificated American carriers (i.e., scheduled carriers) interested in conducting charter services be obliged to prove that scheduled flights did not provide reasonably adequate services on the routes on which they wished to operate. The CAB also limited methods of solicitation by charter groups, and curtailed travel agent activity. Foreign carriers remained the responsibility of IATA, although the CAB did ask the latter to adopt a resolution fixing minimum rates for scheduled carriers' charter flights above the rates charged for scheduled services. IATA, however, did not take this step and charter prices remained uncontrolled (Goldklang 1961:106). Another shift in policy occurred in 1955 when the CAB announced that irregular carriers (or supplementals) could once again obtain exemptions and operate on the transatlantic market. Charter carriage increased, and between 1958 and 1959 IATA charter traffic rose from
90,000 to 172,000 passengers carried (Goldklang 1961:116). This rise coincided with the increased jet surcharge placed on scheduled tariffs.

Following the Chandler impasse, the years of wavering over charter liberalization ended. The United States took its first decisive step, in a series of measures culminating in the late '70s, to liberalize the regulation of charter operations. In October 1963 the CAB made two recommendations: that the President certify three non-IATA carriers to specialize in charter operations on the North Atlantic for five years; and that "split charters" be authorized on transatlantic services. As Lowenfeld writes, presidential assent to these policies marked the beginning of heightened competition for tourist travel on the North Atlantic between supplemental and scheduled carriers (Lowenfeld 1979:481).

In 1968 Congress extended charter rules to include Inclusive Tour Charters (ITCs) which no longer required prior affinity. However, ITCs, owing to their highly restrictive nature, proved to be less popular than the affinity charters which were becoming increasingly loose in their requirements (Lowenfeld 1979:481; Marx 1981/1982:136-137). The Nixon Administration issued a policy statement two years later, underlining the importance of chartered services claiming that, according to the CAB, these operations were not a substantial threat to scheduled services. ITCs were followed by further schemes which promoted the expansion of the charter market (i.e., Travel Group Charters (TGC) in 1972, one stop Inclusive Tour Charters (ITC) in 1975, and Advanced Booking Charters (ABC) in 1976.

The following year the requirements for ITCs and ABCs were liberalized. The culmination of U.S. charter liberalization was the revocation of old
charter rules in 1979. ITCs, ABCs, TGCs and affinity charters were replaced with the Public Charter. The latter closely resembles a scheduled service.

Policy changes in Europe throughout this period were minor. In the immediate post-war years with a few exceptions (e.g., Belgium), European states adopted a liberal policy to charters which they did not abandon in subsequent years. Thus, one attributes the increase in European charters less to changes in national legislation than to an increased demand for services. This demand was a reflection of a rising European standard of living in Europe.

Beginning in the late 1940s, initiatives were taken in several international forums to regulate or at least to standardize national practices with regard to international charters. As charter services gained importance, pressure on states to arrive at an international agreement on their regulation and in particular to define their role vis-à-vis scheduled carriers increased.

In the first 10 years following Bermuda, ICAO took measures to standardize national regulations on charter entry, and it also developed a definition for distinguishing between charter and scheduled services. In 1949, ICAO ruled that non-scheduled services could operate in member states without obtaining prior permission. However, three years later, it modified its position by stating that contracting parties could insist on prior permission being required as long as this privilege was not "exercised in such a way as to render the operation of this important form of air transport impossible or non-effective" (qtd. in Driscoll 1976:76). In the same year, ICAO produced a standard definition of scheduled air services. It suggested that a scheduled
air service is a series of flights possessing all of the following characteristics: it passes through the air space of the territory of more than one state; it is performed by aircraft for the transport of passengers, mail or cargo for remuneration in such a manner that each flight is open to use by members of the public; and it is operated so as to serve traffic between the same two or more points either according to a published timetable or with flights so regular or frequent that they constitute a recognizable systematic series (qtd. in Marx 1981:133)

IATA was particularly concerned with the operation of charter services and rightly predicted that if they were not restricted, they would present a substantial competitive threat to scheduled services. IATA members pointed to the fact that charter operators tended to have lower operating costs than scheduled carriers and could often operate at very high loads (since there were no requirements on regularity of service, charters could limit their operations to times when they were able to obtain near or full loads). Consequently, they were more efficient and could easily and profitably undercut scheduled flight services. This view was challenged by certain states, and, of course, the charter operators themselves, who argued that their irregularity of service and the various conditions of their operation prevented them from posing any real competitive threat to scheduled services. Nevertheless, IATA adhered to its position and tried to take measures to protect its member scheduled airlines from charter competition. In June 1947 certain IATA members proposed that charter operators be allowed to become members of IATA. In this way, they argued, IATA would be able to control charter tariffs. However, a majority of members rejected this proposal and advocated more extreme measures: they recommended that governments crack down on non-
scheduled operations and restrict the chartering of planes. They also proposed that scheduled airlines not enter into commercial agreements with charter operators. IATA soon found that it had little power over non-IATA charter services; however, it was able to restrict IATA member charter operations. In 1949, rules regulating the prices of charter operations by scheduled IATA members were proposed. Resolution 045 allowed scheduled airlines to perform international air charter services. However, if the rates were lower than IATA fares charged for similar services, certain restrictions were to be made. The IATA resolution allowed three kinds of charters: own use or single entity charters, study group charters, and affinity group charters. In the last case, the charterer sells space to a group:

> which has principal purposes, aims and objectives other than travel and sufficient affinity prior to the application for charter transportation to distinguish it and set it apart from the general public (qtd. in Haanappel 1978: 147).

Resolution 045 allowed IATA airlines to perform Inclusive Tour Charters and military charters in certain traffic areas subject to restrictions. The Resolution was not adopted until 1953 and dominated the market for the next nineteen years. Although the regulations only applied to IATA members, in the '50s and '60s many states adopted these guidelines for the national regulation of non-IATA airlines (Haanappel 1979:148).

As national charter regulation was liberalized in the mid-'60s, non-IATA charter operators found that the new flexibility gave them a competitive advantage vis-à-vis IATA charter operators (the latter's activities being restricted by Resolution 045). In order to circumvent Resolution 045, IATA
scheduled members began creating non-IATA affiliates. (This practice was especially prevalent among European airlines.) By the early 1970s, Resolution 045 had become unenforceable and in 1972 the United States disapproved of the legislation claiming: "the time has come to recognize new concepts of charter air transportation" (Haanappel 1984:148). Resolution 045 remained valid in a number of other areas in the world (e.g., it was endorsed by the African Civil Aviation Conference in 1975 (Haanappel 1978:149).

A final attempt by IATA to gain control over charter services was made in 1974 when once again membership for charter-only airlines in IATA was proposed. This time IATA members voted in favour of the resolution. They adopted a resolution limiting the participation of charter-only airlines to Traffic meetings dealing with fares and conditions of sale and service for charter flights between North America and Europe. Charter operators would not be allowed to vote on matters concerning scheduled airlines. The CAB did not approve these rules stating that they would have "a severe anti-competitive and undesirable impact upon the existing international tariff structure" (Haanappel 1978:150-151). Not surprisingly, few charter operators found it in their interest to subject their operations to the restrictive cartel price-fixing regulations.

Finally, some attempts were made to standardize national practices in Europe, Asia, and on the North Atlantic through multilateral negotiations. At the 1954 ICAO Conference in Strasbourg, it was recommended that European states adopt:

- a general policy that all intra-European non-scheduled flights that do not affect the interests of the scheduled services could be freely admitted to their territories,
without the imposition of 'regulations, conditions, or limitations' referred to in . . . Article 5 of the (Chicago) Convention (qtd. in Marx 1981:141).

In addition, it was suggested that freedom of operation be granted to: flights for humanitarian needs, taxi-class operations (less than four passengers and no regularity), operations chartered by a single individual or institution, and operations confined to freight carriage. As long as these services did not compete with scheduled flights, no prior approval was required (Marx 1981:141). At Strasbourg, the European Aviation Community (ECAC) was founded and one of its first achievements was the multilateral Paris Agreement of 1956 regulating charter transport. The agreement categorized types of flights. The first included humanitarian, emergency, less than six passenger flights, single entity chartered flights, and isolated flights. The second comprised all freight operations and passenger operations between areas not having regular scheduled services. The third included all types. The first and second types were to have freedom of operation, while the third category could be discontinued if it were seen to be harming scheduled services. The third type, which included ITCs and affinity charters, could be subject to regulations, conditions or limitations (Marx 1981:142). The agreement did not in fact bring in any major liberalizing changes. A similar regional multilateral agreement on non-scheduled services was made between the South East Asian countries in the 1971 ASEAN agreement (Haanappel 1984:126).

The huge increase in charter services on the North Atlantic in the late 1960s and early 1970s was of particular concern to scheduled carriers, who saw their market share gradually shrinking. These carriers pressed their
governments to take new regulatory initiatives. As a consequence, in October 1972 the ECAC, Canada, and the United States met in Ottawa to seek an agreement on general principles for North Atlantic charter operations. They did not agree on pricing concepts and charter policy (Hammarskjold 1979b:34). But they did agree to replace affinity group charters by TGCs and ABCs in Europe. The Canadian and Europeans abolished affinity charters but in the United States this scheme continued until the introduction of European type ABCs in 1976 (Haanappel 1984:130). Further attempts were made to reach agreements between IATA carriers and charter-only airlines to agree on minimum North American rules through 1973 and 1974. A temporary agreement on a price floor was reached at Montreaux for 1974-1975, but four North American charter operators withdrew. The negotiations were broken off and were not resumed. An agreement was almost reached between the ECAC, Canada and the U.S. governments on minimum charter rates, but the CAB withdrew on February 11, 1975.

The huge increase in charter operations led to further competition in the aviation market as scheduled carriers struggled to protect their market shares from the new incumbents. The operators of both services became locked into a fast-paced tariff war which left little room for rigid IATA tariff-fixing mechanisms.

**IATA Member Response to the Changing Environment**

IATA members responded to increased competition, overcapacity, higher operating costs and recession in three main ways. The first two: initiating their own charters and illegal discounting, directly undermined the operation of the cartel system by creating a collection of services which did not adopt
the multilaterally set IATA fares. The third: making scheduled prices meet charter prices was a response which tried to operate within the parameters set by the principles of the cartel system. Therefore, it did not directly contribute to the weakening of the regime.

Many scheduled air carriers adopted the first strategy: operating charter services. For example, Pan American and TWA became the largest international charter carriers. European scheduled carriers also engaged in charter activity, and as mentioned earlier, many established non-IATA subsidiaries which provided charter services (Lowenfeld 1975a:43). The second strategy: illegal discounting was a practice which had been popular in the early 1960s. The Economist described the situation on October 4, 1975 as follows:

The airlines' reaction has been to fight like wild cats for business at any price. The cartel has been coming apart at the seams. Discounting has always been widespread in places like Hong Kong, but New York and London are the new centers for cheap airline tickets (The Economist October 4, 1975:75-76).

Reports of discounting were widespread. At the IATA meeting in Oslo in October 1975 it was reported that carriers were spending $300 million above what was allowed on discounts to agents. TWA was reported to have funded a $300,000 scheme offering cars and colour TVs to travel agents' sales staff (The Economist October 4, 1975:75-76). With such widespread non-compliance, enforcement was not only costly but for the most part ineffective. The third strategy adopted was to match charter schemes with new promotional fares. In
the late '60s and early '70s, there was a shift from a two-class fare structure (first class and economy) to a complicated system of excursion fares: shoulder, peak and directional fares, group inclusive tours, and advanced booking or payment schemes (Lowenfeld 1975a:42-43).

The competitive policies of scheduled airlines during the seventies were very successful. In 1971 non-scheduled carriers carried the highest recorded share of international passenger traffic (32.2%), but by 1975 their share had fallen to 25.9% (ICAO Bulletin May 1976:26). In terms of growth rates, from 1966-1971 the average annual rate of growth for non-scheduled carriers was 34% while between 1971 and 1976 this figure had fallen to 7.1%. Of this, for the first period, charter carriers' annual growth rate was 51% while the growth rate of scheduled carrier traffic was 16.1%. During the second period, these figures had dropped to 6.4% and 9%, respectively.

Nonetheless, many scheduled airlines suffered huge financial losses in the early 1970s. From 1968 to 1974, Pan American experienced financial difficulties, and in 1974 lost over $80 million. That same year, TWA lost $46 million in its international operations. Japan Airlines, Alitalia, and Air France lost between $80 and $100 million; and large losses were also experienced by British Airways, Sabena, KLM and Olympic (Lowenfeld 1975a: 44-45). (See Table 2).

**Government Responses to the Changing Environment**

Governments responded to the changing environment in a variety of ways. As has already been described, they took measures to liberalize national restrictions on charter operations. They also issued government orders enabling their airlines to adopt non-IATA fares. Both these actions directly
undermined the multilateral tariff-fixing principle of the cartel. They also engaged in restrictive practices. Some of these (e.g., discriminatory practices) countervened cartel principles; while others (e.g., reluctance to grant routes, the formation of pools, or more restrictive interpretations of the Bermuda principles in general) were responses operating within the parameters of the regime. In other words, the latter were not signs of weakening support for the cartel. Governments helped their scheduled carriers by issuing government orders enabling them to adopt special competitive fares outside the IATA control (e.g., excursion, group, inclusive tour, journalist and travel agent traffic). Haanappel cites the example of a June 1971 order to Sabena by the Belgian government dictating the adoption of special, very low, non-IATA youth/student fares on the North Atlantic. Other governments, fearing this competition, issued similar orders to their national carriers. As a result, travel in the summer of 1971 for students was extremely cheap. IATA naturally tried to dissuade governments from issuing such orders (Haanappel 1984:122-123).

Governments in Europe continued to increase their restrictive policies by limiting entry to foreign carriers through heavy regulation of market shares and by discriminatory practices against foreign carriers. Measures taken by states to protect their industries from market forces were often hidden from the public. An investigation into bilateral agreements between European states by the Commission of the European Communities reported:

These bilateral agreements do not always state precisely the real content of the decisions. They are often supplemented by confidential letters of understanding exchanged between the aeronautical authorities of the
states concerned. These letters interpret, specify or even modify the provisions of the agreements. These letters may concern the creation of commercial pools or call for the creation of such pools (qtd. in Gardiner 1981:13).

In the late '60s, two important combines or pools which shared routes, equipment, maintenance and revenue were formed. Atlas was composed of Air France, Alitalia, Lufthansa, Sabena, and Union de Transports Ariens (UTA). While K.S.S. was a cooperative effort between KLM, Scandinavian Airline System and Swissair. These cooperative activities were also symptomatic of a trend toward regionalism in Europe as seen by the establishment of the Common Market in 1957 (Jones 1960:236). Pillai explains that these particular pools were the "offshoot" of the Montparnasse Committee. This organization, formed of 11 airlines in 1967, was established to exchange technical information. Its objective was to obtain

a position to compete with the largest international flag carriers for long-haul passengers by having a maintenance base and training facility with the same competence and efficiency as their competitors (qtd. in Pillai 1969:14-15).

In addition to pools, a variety of other restrictive measures were used by governments to protect their carriers from foreign competitors. They limited: the number of foreign airlines entering their territory, route grants, frequencies, numbers of passengers carried on routes or route segments, operation of all cargo services, amount of freight, days and hours that foreign carriers were allowed to operate on the routes used by national
carriers, and operations of foreign charter flights (Wassenbergh, qtd. in
Diamond 1975:460). These measures were often directed against U.S. car-
rriers. The *Times* (London) reported on July 29, 1974:

discriminatory practices by foreign governments are in-
creasingly preventing United States airlines from being
fully competitive abroad (*Times* (London) July 29,
1974:15).

It went on to list the ways in which U.S. carriers were being disadvantaged. U.S. carriers were made to pay higher rates for carriage of international
mail; they were burdened with huge airport and airway charges; they were
given mediocre treatment at airports; and they were forced to use expensive
ground handling services provided by the host state. In addition, foreign
passengers were discouraged from travelling on American carriers by giving
more hard currency to tourists travelling on national carriers. Corporate
travel of nationalized companies was restricted to national carriers.
Finally, in many cases, there were currency conversion and remittance delays

In general, European policy toward the United States became more aggres-
sive. According to a number of reports in *Aviation Week and Space Technology*
from this time, Europeans were seeking to increase their bargaining power by
strengthening their overall route systems. In particular, their attitude to
the North Atlantic market had changed and, in the words of a European offi-
cial, they no longer saw it as:

the backbone of the airline industry. It is now the link
with all major international routes and the stronger you
are on those routes, the stronger you will be on trans-

atlantic routes (qtd. in *Aviation Week and Space Technology* October 27, 1975:33).

The Europeans began to demand revisions in existing bilaterals. They wanted to see tighter control on fifth freedom, a more stringent definition of the capacity principles, and a review of route patterns. Their objective in the latter case was to reduce the number of cities being served by U.S. carriers in Europe and to expand European access to U.S. markets. The Europeans again based their demands on the argument that the United States through its fifth freedom privileges was making far greater gains in Europe than the Europeans were making from their limited fifth freedom rights through the United States. They also pointed to the fact that the United States had sixth freedom rights from Europe through to South America and the Pacific, and they argued that their flag carriers should be allowed to carry passengers from the United States through Europe to Asia and Africa. In response to American claims that they had already been too generous in allowing European carriers access to highly lucrative U.S. markets, the Europeans replied that the United States should consider rights gained, not on an individual basis, but in terms of access to a very valuable unified market. For example, in the past the Americans had argued that U.S. flag carriers were entitled to larger shares of the North Atlantic business because travelers were mostly U.S. customers. Now the Europeans argued that Europe as a whole was a very substantial traffic generator. (The first to refute U.S. claims of this nature were the Japanese who pointed to the fact that the majority of travelers on transpacific routes were Japanese) (*Aviation Week and Space Technology* October 27, 1975:33). Over the period 1965 to 1976, the share of international traffic carried by European airlines fell from 47.9% to 43.0%,
and the average annual growth rate for the period was 11.5% (ICAO Bulletin October 1976:20). (See Table 6.)

Not surprisingly, the Arab Nations benefited from developments during the fragmentation period. They pursued a policy of expansion while at the same time insisting on restricted entry and pooling in their markets (ICAO Bulletin May 1976:47; Aviation Week and Space Technology March 17:146). From 1970 to 1975, the share of international traffic carried by Middle Eastern airlines increased from 3.4% to 4.6% (ICAO Bulletin May 1976:20). (See Table 6.)

The Latin American airlines also prospered. Bogolasky writes:

In recent years the Latin American airlines have experienced significant economic improvements due to aircraft equipment replacement, better airline management, and airline pooling agreement undertaken by Latin American airlines with long-haul services (Bogolasky 1978:79).

Between 1968 and 1976, the traffic carried by international scheduled airlines registered in Latin America and the Caribbean increased at an average annual rate of 14.5% as compared with the world average of 12.6% (Bogolosky 1978:78). Nevertheless, the Latin American states also continued with their restrictive practices, particularly towards the United States. For example, Peru tried to limit Braniff's flight frequency after this airline refused to pay a revenue percentage payment on traffic it was carrying from Peru to other areas in South America. The United States and Peru were able to arrive at an agreement restricting frequencies. Similarly, in the mid-'70s Ecuador refused to approve added frequencies to Braniff's operations. This time the United States warned it would impose frequency restrictions on Ecuadorian
carriers serving the United States; and the conflict was resolved soon afterward (Aviation Week and Space Technology July 7, 1975:26). (See Table 6.)

Airlines originating from the Asian/Pacific region also extended their services during this period. This region experienced the largest growth rate in international scheduled traffic over the period 1966 to 1976—21.5%. Airlines originating from this area made large gains in international traffic shares over the difficult early to mid-'70s. Their operations expanded from holding 11.2% of the international market in 1970 to 18.7% in 1975 (ICAO Bulletin May 1976:20). (See Table 6.) These states were particularly eager to gain access to U.S. markets. A U.S. official complained: "Every country out there [in the Pacific Service area] is trying to get something from the U.S." (qtd. in Aviation Week and Space Technology April 14, 1975:21-22). Pooling and illegal discounting (in the case of IATA members) also characterized the international operations of airlines originating from this region (Aviation Week and Space Technology January 13, 1975:27).

The Africans, like the Asian/Pacific states, continued their restrictive practices throughout the fragmentation period. The protection of their weak, uneconomical carriers was seen as an important way of maintaining international prestige and enhancing national identity. Furthermore, as expressed by E. K. K. Dwemsh, Director of Civil Aviation in Ghana, national carriers were considered to be a public service:

Air transport is a service rather than a producing industry, and profit-making should not be the criterion; service to business, service to the acceleration of social progress, these matters override subsidy cost in many
A number of African airlines, which had previously allowed European and American airlines to operate unilaterally, pressed for bilateral agreement during this period. Even countries having no intention to serve the United States, like Ghana, insisted on making these agreements (Aviation Week and Space Technology September 8, 1975:29). In order to strengthen their bargaining positions, vis-à-vis the rest of the world, and to enhance regional cooperation, thirty-two African nations met for the first time during this period (1969) to establish the African Civil Aviation Association (AFCAC) (Pillai 1969:14). From 1970 to 1975 the share of international scheduled traffic carried by airlines originating in Africa increased from 3.8% to 4.5% (ICAO Bulletin May 1977:27). (See Table 6.)

The move towards increased protectionism had its effect even on U.S. policy. McCarroll, writing as early as 1963 noted:

This tendency is notable even in the U.S. where the concern both in the industry and in the government over a sagging market share may be leading towards a more restrictive American policy toward commercial freedom (McCarroll 1963:117-118).

Already by the mid-'60s the United States began to experience balance of payments problems and became concerned with the increased outflow of gold due to U.S. tourist spending abroad. Its first reaction was to try to regain a balance in gold flow by encouraging foreign travel to the United States. Just before the 1965 Bermuda Traffic Conference, the CAB announced that it
would support the "visit U.S.A." program proposed by TWA, which would provide special westbound excursion fares to the United States. The CAB stressed that this would be a "valuable adjunct to the program for strengthening the U.S. balance of payments." U.S. carriers were unsuccessful in obtaining directional fares on North Atlantic and transpacific routes. The balance of payments problem grew more severe. Pillai reports estimates that in 1967 U.S. tourists were spending $1.015 billion in Europe while Europeans were spending only $260 million in the United States. A similar imbalance was seen in foreign payments made to U.S. flag carriers (Pillai 1969:44). In 1967 U.S. tourists paid $795 million to foreign flag carriers while foreign tourists paid $225 million to U.S. carriers (Pillai 1969:44). The following year, a Presidential Task Force on Travel submitted a report advising that the cost of travel to and within the United States be lowered in order to increase traffic volumes (qtd. in Pillai 1969:45). The President recommended a tax on U.S. tourists outside the western hemisphere which was condemned by both the European Travel Commission and the Pacific Area Travel Association. Congress blocked this action (Pillai 1969:45).

A shift in U.S. policy became noticeable in the early '70s. The United States became very aware of foreign discriminatory practices. The Nixon policy statement issued in 1969 after an extensive review of U.S. policy by the Department of Transport, stated:

Attempts to restrict United States carrier operations abroad should be rigorously opposed, and where required, the United States should take appropriate measures against the carriers of foreign countries restricting U.S. carrier operations in violation of the terms of
bilateral agreements or of the principle of reciprocity (qtd. in Diamond 1975:482).

Concrete steps were taken to promote this policy. In 1970 Part 213 of the Economic Regulations of the CAB was adopted. According to this legislation, the CAB could limit operations of foreign air carriers when governments under whose authority the carriers operated had "taken action which impairs, limits, terminates or denies operating rights" of U.S. carriers (Haanappel 1984:45). This policy was underscored and strengthened by the adoption of the International Air Transportation Fair Competition Practices Act of 1974 (Haanappel 1984:53-55).

In addition to unilateral action taken to resist discriminatory practices, for the first time in 1975 the CAB condoned the reduction of competition between U.S. carriers by agreeing to a route transfer between Pan American and TWA on the North Atlantic. It explained that this step was "necessary . . . to avoid a clear danger of major cessation [of the carriers' international operations] with greater attendant disruption" (qtd. in Dempsey 1978:419).

Finally, the CAB departed radically from its policy of fostering competition by authorizing capacity reduction agreements in the early '70s between BA and Pan American and TWA on routes from London to New York, Chicago, Boston and Washington. The government initiated negotiations for North Atlantic reductions with Belgium, the Netherlands, Scandinavian countries, Italy, and Switzerland. No agreement was reached on Sabena, Alitalia and KLM reductions; but SAS agreed voluntarily to reduce capacity, and TWA and Swiss-air were able to come to an agreement on schedules (ICAO Bulletin May 1976: 57). Pan American and Quantas were able to reach an agreement regulating
transpacific capacity. The United States also requested reductions by VARIG on the United States-Brazil route; and VIASA on the United States-Venezuela route (*ICAO Bulletin* May 1976:57). Opinions about U.S. policy towards Latin America were mixed. Some White House officials said that the United States was developing "a harder stance" towards Latin American countries. However, in light of the fact that the President stayed a Peruvian schedule reduction proposed by the CAB and did not disapprove an Argentinian schedule as recommended by the CAB, the comments of an official outside the White House: "If the U.S. is developing a harder line, I haven't seen it" seem more insightful (*Aviation Week and Space Technology* July 7, 1975:26). Over the period from 1966 to 1976, the share of the international market carried by North American carriers fell from 30.0% to 21.2%. The average annual growth rate for international scheduled traffic carried by North American airlines was 9.5% (*ICAO Bulletin* October 1976:20). (See Table 6.)

The culmination of the United States' movement towards a more restrictive interpretation of the Bermuda capacity principles was the renegotiation with the British of the Bermuda I agreement. The new bilateral, Bermuda II, signed in 1977 was, in the words of Salacuse:

> a further departure from the limited free enterprise of Bermuda I in the direction of an internationally regulated industry, a position that the British had espoused at Chicago over thirty years before (Salacuse 1980:836).

The British renounced the Bermuda I agreement on June 22, 1976. Taneja lists several factors which drove them to take this step. First, the British felt that U.S. carriers were getting too large a share of the United States-United Kingdom market. For instance, they pointed out that during the
year ending March 31, 1976, the United Kingdom had earned only $127 million from the North Atlantic service between the United States and the United Kingdom, while the United States had earned $183 million (Larsen 1977: 82-83). Second, their concern about their own competitiveness was increased by the fact that British Airways did not have the financial resources to acquire necessary wide-bodied aircraft. Third, they were interested in obtaining entry rights to the North Atlantic for British Caledonian and Laker Airways. Another concern was to limit U.S. behind and beyond gateway traffic rights. After the route swap between Pan American and TWA, France and Germany ended with only one U.S. carrier servicing their territory while the British had to continue competing with multiple U.S. carriers. In the area of fare policies, the British disagreed with the Americans on transatlantic passenger fare levels and structures and were particularly annoyed with the CAB for disapproving at the last minute IATA negotiated rates. Finally, the British were uneasy about rumours that the United States would not allow Concorde to fly over their territory (Taneja 1980:21).

As in 1946, the United Kingdom and the United States held differing views on how the commercial aspects of international aviation should be regulated. On the question of market entry, the British felt that each country should designate a single carrier to operate a major route. They also contended that route grants should be limited to the third and fourth freedoms (i.e., they wanted to see fifth freedom rights eliminated or drastically reduced). The United States on the other hand, opted for multiple carrier designation, although President Ford conceded in his International Air Transportation Policy Statement of September 8, 1976 (which may be seen as a response to the British Bermuda I denunciation), that "too many competitors
on some routes may undercut the economic viability of service without benefiting the public." But he underlined that if the quality of service could be improved by competition, it should be authorized. If the operation was profitable, Ford argued, the United States should not restrict designation to a single carrier per route. In line with previous U.S. policy statements, Ford argued against curtailing fifth freedom rights saying that such a move would have a negative effect on service. The statement appealed to market forces as the criterion for judging whether a carrier should begin or continue to serve specific routes (Larsen 1977:86-89).

On the issue of regulating market shares, there seems to have been more convergence between the two states than at Bermuda I. Britain proposed a system of predetermination in which the two states would agree on a base level of capacity. This could be increased provided that the carriers involved could agree on new levels. If they failed to agree, the British proposed, capacity levels should fall back to the base level. Governments might or might not be involved in these negotiations. Every two years the base level would be readjusted to reflect changing traffic trends. The United States was opposed to regulation of capacity, as in Bermuda I; however, the Ford Policy Statement did accede to certain restrictions. Ford stated that the United States would permit intercarrier agreements to reduce excess capacity under three conditions: first, if excess capacity seriously affected the viability of a carrier's operating a particular route; second, if restrictions were necessary to provide sufficient services by scheduled carriers; and thirdly, if other means of capacity reduction had been unsuccessful or would be detrimental to a carrier's competitive position (Larsen 1977:86).
On the issue of fares, the British wanted to see closer government involvement with IATA in producing rate agreements. They felt that the system of price-fixing needed to be strengthened. The United States favoured more fare experimentation. The Ford Policy Statement suggested that carriers should set tariffs according to market forces. It criticized the IATA framework for being insufficiently sensitive to market forces. In particular, the Americans emphasized the need for lower fares (Larsen 1977:87).

Bermuda II, which was signed on July 23, 1977, established a more restrictive regime governing United States-United Kingdom aviation relations. The agreement favoured the British position. Haanappel writes:

The 1977 compromise, however, seems to be slightly more in favor of the British than was the 1946 compromise. This then perhaps reflects the stronger bargaining position of the U.K. in 1976/1977: although after the decolonization process deprived of most of its overseas territories, its airlines and aviation industry in general are no doubt in a much stronger economic position than immediately after the Second World War (Haanappel 1977: 140-141).

The Bermuda II agreement in principle allowed unrestricted multiple designation of carriers on routes. However, restrictions were to be placed on designation in the North Atlantic market: each party would only be allowed to designate more than one carrier on two North Atlantic routes. On other North Atlantic routes, multiple designation would only be allowed if total traffic exceeded 600,000 passengers per year; or if one carrier,
regardless of the activity of another carrier, transported more than 450,000 per year; or if one carrier did not compete at all (Haanappel 1977:142-143).

The British were granted entry to four new gateway cities in the United States: Atlanta, Dallas/Fort Worth, Houston, and Seattle, and they were permitted to serve San Francisco on a non-stop route from Britain (previously, an en route stop in New York was required). The United States was allowed to serve Britain from five new points in the United States: the four above-mentioned cities and another city to be named later. In addition, U.S. carriers were given unlimited rights behind designated U.S. gateways for through-plane services. On the issue of fifth freedom rights, the United States experienced significant losses. Fifth freedom rights beyond London to Austria, Belgium, the Netherlands, and Scandinavia were to be withdrawn. On Pacific air routes the United States also gave up certain fifth freedom rights but it gained important fifth freedom rights between Hong Kong and Singapore. British carriers were allowed to pick up or discharge traffic en route in Canada on certain North Atlantic passenger air routes. They were also granted fifth freedom rights between Hong Kong and Singapore and from Anchorage to Japan.

On the issue of market sharing, for all routes except the North Atlantic, it was agreed that airlines would initially determine capacity and frequency subject to ex post facto review. No government would be allowed to restrict capacity or frequency unilaterally. In the case of North Atlantic routes, however, a predetermination scheme was agreed on.¹³ The Bermuda II agreement allowed for rate-making through the IATA traffic conference system, and like Bermuda I called for government approval of tariffs (Haanappel 1977:144-146).
Unlike most other bilaterals, Bermuda II contained provisions relating to charter services between the United States and the United Kingdom. It also incorporated the Memorandum of Understanding on Passenger Charter Air Services between the United Kingdom and the United States. This document proposed country of origin rules for charterworthiness and stressed the need for a multilateral arrangement for charter air services on the North Atlantic market (Haanappel 1977:146-147). The Bermuda II agreement was not met by enthusiasm and, unlike the Bermuda I agreement, the renegotiated bilateral did not provide a model for future agreements.

Changes in IATA

While states adopted restrictive measures to regulate market entry and capacity, prices were increasingly reflecting market forces. The proliferation of different fares (e.g., over 25 different types on the North Atlantic) complicated negotiation within IATA. The additional problem of increased competition from charters and extensive illegal discounting practices of the scheduled airlines undercut the price fixing capability of the cartel. Agreement on traffic rates became very difficult to obtain, and open rate situations became the norm for several traffic conferences (particularly the North Atlantic Conference where competition was most pronounced) (Taneja 1980:102). In an attempt to facilitate agreement initiatives were taken at the IATA Annual General Meeting in Oslo (1975) to introduce greater flexibility into voting procedures. IATA members approved the restructuring of large regional conferences into sub-areas. With this modification, a single carrier with a fringe interest could be prevented from breaking the unanimity of the larger regional conference with a veto. In large conferences (i.e.,
Europe, Middle East, and the North Atlantic) a single or small minority veto was to be ignored (Aviation Week and Space October 6, 1975).

Summary

From the mid-'60s to the mid-'70s the cartel system was under attack. The principle of negotiating market entry on the basis of a bilateral agreement was not challenged; however, various forces undermined the two other fundamental principles of the regime: the 40-60 market-sharing scheme and multilateral tariff-fixing. Certain discriminatory practices and the introduction of charter services can be seen as attempts by states to violate the former. Using these two strategies, states tried to secure larger shares of the international market than those allocated to them in their bilateral agreements. Whether in fact these practices resulted in their securing more than a 60% share of the market on major routes is difficult to judge. It may be that such action was an attempt to violate the cartel principles but de facto did not do so. Several forces challenged the multilateral tariff-fixing principle of the cartel system. These were: the operation of charter services, government orders, and illegal discounting. They created, in effect, a sector of traffic services which were not under the authority of IATA price-setting. The operation of non-IATA scheduled carriers, may or may not have belonged to this category since there is evidence that at least some non-IATA carriers followed IATA price guidelines. (This point is discussed further in the analysis.) Other developments described: the increase in scheduled aircraft; overcapacity; and the fuel crisis were important not because they directly contributed to cartel breakdown, but because they created an environment in which airlines and states were tempted to take
actions which weakened the cartel. Finally, states' restrictive practices (e.g., their reluctance to grant routes, their resort to pooling agreements or capacity reduction) unlike many other developments described during this period, did not challenge the cartel system. Rather, they represented shifts in states' interpretation of the Bermuda capacity principles. For example, the renegotiation of the Bermuda II agreement reflected an attempt by the British to secure a 50-50 split in its market with the United States.

The developments of the period generated a great deal of tension in the system which was reflected in the inability of the IATA cartel to close many of its rate conferences. In response, it tried to facilitate consensus by introducing greater flexibility into its tariff-setting process. This modification was not sufficient, as could be seen in the next period. In conclusion, it was clear that during this period, the cartel system had begun to break down. Officially, states supported its principles; unofficially, they took actions which allowed a large volume of traffic to operate outside the system.
ANALYSIS

A number of forces behind the weakening of the IATA cartel have been described: competition from non-IATA carriers, competition from charter operations, technical change and the oil crisis leading to recession. However, they do not in themselves explain the underlying dynamic fuelling the new competitive environment which challenged the cartel. To make sense of this period, certain questions must be answered, such as: why did states allow carriers to operate outside the IATA cartel? Or why did states encourage non-IATA charter operators to enter the market? Or why didn't states cooperate to solve their financial difficulties ensuing from overcapacity, higher fuel costs and recession, instead of engaging their carriers in rate wars? In other words, why did states weaken their support of the cartel?

The first possible explanation for weakening cartel support lies in a change in economic philosophy resulting from new economic studies or a different conceptualization of the industry. Although during this time, new empirical studies on the effect of regulation were being published in U.S. academic journals, they have not been shown to have had a major influence on the direction taken by aviation policy.

The second explanatory variable, proposes that support for the cartel weakens because states no longer view blanket support as promoting the development of their respective industries. This, in fact, appears to provide part of the answer. States allowing carriers to operate outside the IATA cartel believed that these carriers could make competitive gains by undercutting IATA prices. Underlying this development was the necessary corollary that certain carriers could operate profitably at prices below IATA levels. This was clearly the case in the highly efficient charter operations.
A slightly different variable probably played a role in explaining why certain states in the Asian/Pacific region allowed their carriers to operate outside the cartel system. Much of their traffic carriage was regional, and there seems to have been a consensus on the part of these states that they wanted to limit the power which airlines from Europe and America had over their regional rate-setting activities. It is interesting to note that for the most part, non-IATA airlines in this region followed IATA tariff levels established for IATA carriers operating in the area. It would appear that their lack of support of IATA was more a matter of principle than a response to actual tariff levels.

Once charter operations began to erode scheduled carriers' market shares, there was an increased incentive for some scheduled carriers to cut their losses by trying to meet charter pricing. Other carriers resisted the attempt to lower IATA price levels because their scheduled carriers were not efficient enough to operate at the proposed levels without extensive government subsidies. Consequently, agreements in many traffic conference regions could not be reached. The practice of rate-cutting became a vicious downward spiral in which carriers in an attempt to preserve at least some portion of their market share were forced to operate at progressively lower prices. For even the most efficient carriers, this eventually resulted in financial losses. The initiation of this vicious circle could have been prevented, or stopped, if the hegemon had taken action to enforce the rules of the IATA cartel. The question must then be posed: why didn't the United States take preventative action? Did it no longer have the power to shape the aviation regime, or did it no longer find its interests promoted through cartel support? If answers to these questions are positive, the second explanatory
variable is not sufficient. Complete understanding of the dynamic behind developments of this period requires discussion of hegemonic stability theory.

Thornton provides some insight into U.S. behaviour. He writes:

We can suspect that the prosperity of the United States international airlines and the quality of airline service will become high priority U.S. objectives once the previously overriding defense needs have disappeared (Thornton 1970:683).

As the European states became economically stronger, one of the main reasons for the United States to support a system that did not promote the interest of its own airlines and its economic welfare ceased to be operative. Thus, the link between U.S. security interests and the economic welfare of its allies weakened. Developments in nuclear technology (i.e., long-range missiles) and, consequently, the declining importance of certain strategic bases around the world also had an impact on changing U.S. security needs. The United States was no longer in a position in which it felt it needed to secure access to these bases by providing aviation concessions. Finally, it is probably not coincidental that U.S. action challenging the cartel intensified during a period of detente with the Soviet Union. These security interests aside, the United States was interested in creating an environment in which its carriers would prosper (i.e., one in which its carriers could undercut prices set by less efficient airlines). The United States had made some attempt to introduce low prices in the previous period, but had been rather unsuccessful as was demonstrated by the Chandler Rate Controversy. It now adopted a new tactic which it hoped would be more subtle
and would not raise the ire of its allies: the introduction of charter services. Taneja points to the direct connection between the Chandler Rate Controversy and charters:

The CAB having given in to demands of the European government for higher fares decided to shift its strategy to implement lower fares. Beginning in 1963, the CAB decided to have a very liberal attitude towards charters, thus forcing the IATA carriers to reduce their fares (Taneja 1980:90).

This strategy was even acknowledged by the CAB at the Transatlantic Charter Investigation in 1964:

the conduct of charter services by a group of certified specialists should be a substantial benefit in maintaining and/or increasing low cost services in the transatlantic market (qtd. in Keynes 1964:189-190).

Competition from charters naturally provided an incentive for scheduled carriers to decrease rates. However, for many less efficient carriers, decreased rates meant deep cuts in profits. Disagreements on what constituted "a fare rate of return" resulted in states being unable to agree on fare levels during traffic conferences. Consequently, in many regions no fares were set and states were forced to negotiate rates on a bilateral basis. Moreover, increased competition from charters made many scheduled airlines resort to illegal discounting which further undermined IATA rate-fixing authority.
It is not surprising that in addition to lowering prices, charters had an immediate positive effect on U.S. market shares. Lowenfeld points out that although:

the share of international traffic being carried by scheduled U.S. flag carriers kept declining, the overall share of traffic carried by U.S. flag carriers began to rise again, because the supplementals were predominantly American (Lowenfeld 1975a:42)

(In 1971, the North American share of total world international non-scheduled traffic was 40.5% [ICAO Bulletin May 1976:26].)

In addition to the explanation that the change in U.S. behaviour was primarily a consequence of a shift in its security interests, or rather the delinking of security interests from cartel support, it also appears that U.S. concern about the apparent decline in its power also affected its aviation policy. For the first time, the United States experienced a balance of payments problem at the end of the 1960s. Its international and domestic confidence was undermined by the disgrace of Vietnam. U.S. suspension of gold convertibility for the dollar in 1971 furthered doubts about U.S. leadership. These were augmented as the oil crisis followed by economic recession underlined U.S. vulnerability. Finally, the United States found that its economic and political leverage was being challenged by the rising economic strength of Japan and Europe. In the particular sphere of aviation, declining U.S. flag carrier market shares and diminished traffic generation made U.S. policy-makers seek ways to improve their own economic position. This new strategy was reflected in the increased importance of the CAB as
opposed to the State Department in formulating U.S. aviation policy. Analysts writing for *Aviation Week and Space Technology* in 1973 observed:

[The] CAB's influence on negotiations conducted by the State Department with other governments has increased substantially in recent months, principally because of its stand that exchanges of routes or traffic rights should be considered only if they are shown to be economically beneficial to the U.S. [This compares to the] State Department's former view that airline operations are business ventures, subordinate to foreign relations [which] is being rapidly revised as the U.S. economic position abroad continues to weaken (qtd. in Diamond 1975:483).

An important indication that the United States was concerned about its market shares was made particularly apparent in the early '70s when it agreed to capacity reduction schemes—a significant departure from its previous policies. The question then arises, what was more instrumental in effecting a shift in U.S. policy: a change in security interests resulting in a choice made by a dominant actor, or a decision brought about by concern for U.S. economic welfare? Was the U.S. no longer able to continue paying the costs of indirectly subsidizing the development of foreign countries' aviation policies? Although evidence from this period which might provide a definitive answer to this question is difficult to find, it is interesting that in certain cases where economic development continued to be linked to security interests (i.e., in the case of developing countries and certain Latin American states), the United States continued to grant concessions (e.g., in
the stay of the Peruvian schedule reduction proposed by the CAB, and the approval of the Argentinian schedule by the State Department). Although there are some dangers in drawing excessively far reaching conclusions from such instances, they do suggest that in the final analysis security interests rather than economic welfare was the decisive factor in determining U.S. policy. U.S. concessions to Britain in the Bermuda II agreement, would also appear to partially support the view that concern for the economic welfare of U.S. carriers would continue to be ignored if U.S. security interests were at stake. Taneja writes:

There were basically three options for the United States:
1) secure a compromised but satisfactory agreement, 2) stick to its original demands and, if necessary, let the air service between the two countries terminate, and 3) exert pressure on the British outside of the aviation field. Given the desire to continue commerce with a strong ally, maintain air service, and avoid what could have amounted to a major confrontation, the U.S. delegation selected the first option (Taneja 1980:21).

This development prompts a further observation. Now, when the United States made economic concessions to industrialized states, its behaviour was motivated not by a security interest in bolstering its allies' economies, but by a security interest in preserving the good will of its allies.

In retrospect, the developments of this period and the two decades preceding it support, at least in part, the hegemonic stability theory. As long as the hegemon has an interest in maintaining a regime and is willing to
pay costs associated with this action, the arrangement will continue to operate. However, once it loses interest in maintaining the arrangement, the regime begins to fragment unless another state (or states) is able and willing to take over its role and ensure that the previous hegemon abides by the rules of the old regime. The defection of the hegemon, argue the hegemonic stability theorists, is a sign of a weakening hegemon. However, as has been suggested, weakening of the hegemon may be less instrumental than a change in the external environment which decreases the value of the old regime as a means by which the hegemon achieves its objectives.
1 In article 5 of the Chicago Convention, contracting parties granted non-scheduled services transit rights. However, if the carrier was engaged in commercial activity (i.e., carriage of passengers, cargo, or mail for remuneration or hire), states agreed that its activity would be subject to the regulations, conditions or limitations imposed by the state of embarkation and the state of discharge.

2 Split charters allowed two groups of a smaller number of passengers to share in a charter of a plane. These were still affinity groups (Lowenfeld 1979:481).

3 Inclusive Tour Charters (ITCs) included a return flight and ground services; i.e., accommodation and ground transportation. They also required stopovers in at least three cities 50 or more miles apart; a minimum 10-day stay, and fares had to cover at least 110% of the lowest fare charged by a scheduled carrier for a similar route (Lowenfeld 1979:481: Marx 1981:137).

4 The Nixon Statement of Policy read:

Charter services by scheduled and supplemental carriers have been useful in holding fare and rate levels and expanding passenger and cargo markets. They offer opportunities to exploit the inherent efficiency of planeload movement and the elasticity of demand for international air transport. They can provide low-cost transportation of a sort fitter to the needs of a significant portion of the traveling public. Charter services are a most valuable component of the international air transportation
system, and they should be encouraged. If it appears that there is likely to be a substantial impairment of charter services, it would be appropriate, where necessary, to avoid prejudice to the public interest, to take steps to prevent such impairment (qtd. in Marx 1981:137).

5 The Nixon Policy Statement stated that the CAB felt there was "no persuasive reason showing that sound and dependable transatlantic scheduled operations are being jeopardized and that impairment is primarily . . . attributable to charter carriers" (qtd. in Marx 1981:137).

6 TGCs required no prior affinity; a group of at least 40, 10 days minimum trip outside the U.S., a 60-day advance payment, and a pro rata cost-sharing plan (Lowenfeld 1979:482).

7 ITCs required no prior affinity; a ground package, a minimum group of 40, one stopover, a minimum 7-day trip and prepayment 30 days before departure (Lowenfeld 1979:482).

8 ABCs required no prior affinity; no ground package, a minimum group of 40, a minimum stay of 7 days, prepayment at least 45 days before, and the possibility of making substitutions in the passenger list up to a limit of 20% of seats contracted for (Lowenfeld 1979:483).

9 In November/December 1977 the CAB
- eliminated the 30-day purchase requirement for international ITCs
- reduced advance purchase requirement for ABCs from 45 to 15 days
- eliminated 7 day requirement for ABCs and ITCs
- reduced ABC and ITC requirement of group size from 40 to 20
- allowed 15% last minute fill-up sale on ABCs

(Lowenfeld 1979:483-484).
The Public Charter required no minimum group size, no advance purchase, no requirement for group accommodation, no length of stay rules, no minimum charter price, and no round trip requirement. All bases for discount prices on scheduled services were to be allowed (e.g., children, senior citizen, standby) on Public Charters (Lowenfeld 1979:484).

IATA recognizes the right of governments to order their national carriers and sometimes foreign air carriers to provide special tariffs for specific categories of traffic. These included carriage of diplomatic and government officials, emigrants, pilgrims, missionaries, diplomatic cargo, and mail, etc. The ordering of tariffs for commercial services can be seen as an abuse of this right (Haanappel 1984:122).

Both parties agreed to double designation on the New York-London and London-Los Angeles routes. Pan American and TWA were designated U.S. rights. British Airways and Laker were chosen to serve the former and British Airways and British Caledonian Airways the latter (Haanappel 1977: 142-143).

Each carrier was to make traffic forecasts for the following season and file them with the aeronautical authorities. If disagreement on these projections existed, then consultation would occur between the states. In the event that consensus did not occur, states would be allowed to increase their frequencies in accordance with the mean of the two traffic forecasts. An addition of 20 round trip frequencies during summer and 15 round trips during winter would be allowed (Haanappel 1977:144).

Bermuda I did not refer to the regulation of charters; nor did most post-Bermuda bilaterals, with the exception of bilateral regulations developed between the United States and other states. Initially, these agreements
took the form of a Memorandum of Understanding (MoUs). In the early '70s, the United States signed MoUs with Belgium, U.K., West Germany, France and the Netherlands. The agreements stressed country of origin rules for certification of airworthiness and the need to reduce administrative procedures. With the exception of the Belgian agreement, consultation on prices was required in the event that tariffs were seen to be unreasonably high or low (Marx 1981:145-147). If a disagreement on prices could not be resolved, the services could be suspended (Haanappel 1984:132).

The United States also signed bilateral agreements with Canada, Yugoslavia and Jordan in the early 1970s regulating charter services. These agreements designated types of charters allowed to operate, accepted country of origin rules on airworthiness, required that carriers be licensed, specified rights to be granted, and allowed carriers to operate without prior approval of each flight. As in the case of the MoU arrangements, carriers filed prices with contracting parties and consultation was required if prices were found to be unreasonable. If no agreement could be negotiated, services could be suspended (Haanappel 1984:132).

**DESCRIPTION**

Following Bermuda II, the international regulation of civil aviation was revolutionized. Lowenfeld writes:

> Not since the close of World War II has there been a period so marked by institutional changes in international civil aviation as was the time span of 1977 to 1978 (Lowenfeld and Mendelsohn 1979:480).

The main developments of the period were: the U.S. adoption of a highly pro-competitive policy; the renewed involvement of ICAO in the regulation of the commercial aspects of civil aviation, and its emergence as a forum for discussion of the concerns of small aviation powers, particularly the less developed countries; and, thirdly, the breakdown and reconstruction of the IATA cartel.

Although the end of the decade did not herald the advent of an "open skies" regime, it did see the partial demise of the cartel system and significant liberalization. The trend towards greater reliance on market forces lost momentum in the 1980s as the United States, the catalyst of the changes in the late '70s, tempered its challenge to the IATA cartel and returned to more restrictive policies.

**U.S. Procompetitive Policy**

The change in American policy was both reflected in and pursued through the enactment of procompetitive U.S. legislation, the CAB Show Cause Order and the signing of liberal bilaterals. These actions challenged the cartel.
system principles of an implicit agreement on market-sharing within the 40-60 parameters, and multilateral tariff-fixing. The movement toward deregulation first took root in the domestic arena and then spilled over into U.S. international policy. In October 1975, the Ford Administration submitted to Congress the Aviation Act of 1975. The objective of the proposed legislation was: to ensure that the United States had the most efficient airline system in the world providing the American public with the best possible service at the lowest possible cost (MacAvoy and Snow 1977:i). The United States advocated liberalizing market entry and giving airlines greater pricing flexibility. The Congressional Hearings of Senators Kennedy and Cannon from 1975 to 1976 on aviation reform were particularly important in bringing the question of deregulation to the forefront and gave rise to a number of aviation reform proposals introduced by Senator Kennedy, Senator Cannon, Congressman Anderson, and even the CAB. By 1976 five reform bills had been circulated and towards the end of the year President Ford issued a new international aviation policy statement. In it he stressed that U.S. policy should be guided by three key principles: greater reliance on market forces; provision for transportation where substantial need exists; and support for a private, viable and efficient aviation industry (qtd. in Rosenfield 1982:470). President Ford hinted at the extension of the procompetitive domestic policy to the international arena by stating:

The United States seeks an international economic environment and air transportation structure conducive to healthy competition among all our carriers. We shall rely upon competitive market forces to the greatest extent feasible. . . . (qtd. in Rosenfield 1982:470).
The Aviation Act of 1975 was not passed, and President Ford lost the 1976 presidential election; however, President Carter adopted deregulation and gave impetus to the movement.

The first piece of international pro-deregulation legislation was passed in November 1977: The Air Cargo Reform Act of 1977. This was followed by an official statement "Policy for the Conduct of International Air Transportation" in early 1978, in which President Carter stressed the need for the United States to pursue the expansion of air transportation and the reduction of prices through a strategy of trading competitive opportunities rather than restrictions (Shubat and Toh 1985:46). Following the signing of the first two liberal bilaterals with the Netherlands and Israel, Carter issued a policy statement on the Conduct of International Air Transportation Negotiations in August 1978 in which he established seven goals for U.S. policy. These were: 1) meeting the needs of consumers through innovative and competitive pricing by airlines; 2) limiting government regulation seeking to prevent discriminatory or predatory practices; 3) liberalizing charter operations; 4) eliminating restrictions on capacity, frequency, routes and operating rights of scheduled airlines; 5) ensuring fair and equal opportunity for U.S. carriers in international markets through the arrest of discriminatory practices; 6) encouraging multiple designation and increasing U.S. gateways; and 7) providing flexibility to permit the development and facilitation of competitive air cargo services (qtd. in Taneja 1980:56; qtd. in Haanappel 1984:51). The following month the Airline Deregulation Act of 1978 was passed which called for the termination of domestic entry and exit controls on routes, the cessation of domestic tariff controls and the disbanding of the CAB as of January 1, 1985. The Departments of Justice, State and
Transportation were to take over control of CAB functions once it had been "sunsetted" (Haanappel 1984:51).

The 1979 International Air Transportation Competition Act, which was passed in February 1980, entrenched the seven policy goals set by Carter's policy statement of August 1978 and added three further goals: 1) to strengthen the competitive position of U.S. air carriers and increase their profitability; 2) to integrate domestic and international air transportation; and 3) to provide opportunities for foreign airlines to increase their access to U.S. points of exchange for benefits of similar magnitude for U.S. carriers, with permanent linkage between rights granted and rights given away (qtd. in Shubat and Toh 1985:47; Haanappel 1984:52-53). The 1979 Act also gave "teeth" to the 1974 Air Transportation Fair Competitive Practices Act. The latter had recognized that the United States had been subjected to discriminatory and unfair competitive practices and had called on the Departments of State, Treasury, Transport and the CAB to keep these practices under review and take "all appropriate actions within its jurisdiction to eliminate" such activity (qtd. in Rosenfield 1982:488). However, the 1974 Act did not provide enforcement tools for such action. The 1979 Act remedied the situation. It stressed that the CAB could protect U.S. carriers when foreign carriers or the government had "impaired, limited or denied the operating rights of U.S. carriers." The CAB could suspend foreign carrier permits or alter, modify, amend, condition or limit operations under a permit. The CAB was allowed to take such action when through either its own initiative or an outside complaint a government or carrier was found to be engaged in unjustifiable, unreasonably discriminatory, predatory or anti-competitive practices
against U.S. carriers or had imposed unjustifiable or unreasonable restrictions on the access of U.S. carriers to foreign markets (Rosenfield 1982: 488-489).

On June 9, 1978, the CAB announced its intention to withdraw anti-trust immunity from the operation of the IATA cartel unless IATA and interested persons could "show cause" as to why the CAB should not rule that its international tariff agreements were no longer in the public interest and therefore should be disapproved (Shubat and Toh 1985:47).

In January 1979 IATA responded to the U.S. order with an 82 page report defending its activities. The report criticized the CAB for trying to force U.S. anti-trust policy on the rest of the world, and for incorrectly assuming that a policy adapted to domestic air service would be equally appropriate for international air service. Furthermore, it stressed that multilateral coordination and standardization in many areas of commercial air transport was essential for efficient operations. The IATA response warned that U.S. activity was in effect going against the public interest and was rapidly leading the way towards economic and political chaos in the aviation industry (Gidwitz 1980:98-99; Aviation Week and Space Technology January 8, 1979:27).

A few months later in November, IATA restructured its traffic machinery and submitted the New Provisions for the Conduct of the IATA Traffic Conferences to the CAB for approval. The CAB gave interim approval to the IATA changes. It dropped its challenge to the IATA "trade association" activities, and on May 14, 1979 set an order to hear evidence and presentations on whether the U.S. should continue to approve IATA rate-making and related activities. The CAB announced that passenger and cargo agency programs would be subject to separate investigations (Aviation Week and Space Technology May 21, 1979:28).
Meanwhile, U.S. action had generated a great deal of controversy abroad and many governments resented the attempt at extra-territorial imposition of U.S. anti-trust laws. This sentiment was particularly evident at the ICAO Special Traffic Conferences, as will be seen later. The statement of a European embassy official interviewed by Aviation Week and Space Technology epitomized the widely held view of U.S. initiatives:

The U.S. is saying that it is our position take it or leave it. That is totally unacceptable. We will not accept it that our government does not have the final say on fares (qtd. in Aviation Week and Space Technology May 21, 1979:38).

As part of the Show Cause proceedings, intergovernmental consultations were held in Bogota, Brussels, and Nairobi. U.S. officials found during the course of these meetings that almost forty nations voiced their opposition to the Show Cause Order (Aviation Week and Space Technology August 6, 1979:27). In documents filed with the CAB states made three major complaints. They said that the U.S. withdrawal of immunity was an affront to the sovereignty of nations and the international community; it violated bilateral agreements, the Chicago Convention and international law; and it would harm the economic development and self-sufficiency of many countries. In addition, these governments pointed to the inconsistencies in U.S. policy: the United States was allowing liberalizing procedures in aviation because this favoured U.S. commercial interests while it prevented deregulation in the shipping industry where it did not hold a competitive advantage. Foreign governments warned the U.S. State Department that U.S. policy would provoke them into taking retaliatory action which would "inevitably affect the overall tenor of their
relations with the U.S." (qtd. in *Aviation Week and Space Technology* August 27, 1979:23).

IATA officials warned the CAB that government measures could include: 1) refusal of landing rights to U.S. carriers or those carriers not participating in traffic conferences; 2) higher landing fees or costly operating procedures for U.S. carriers; 3) withdrawal of fifth freedom rights; 4) requirements that the United States be forced to use costly national ground services; 5) the linkage of international aviation negotiations to nonaviation commerce with possible retaliation against U.S. shipping and sugar industries; and 6) the purchase of military hardware and important exports from other countries as a statement against U.S. aviation policy (*Aviation Week and Space Technology* October 29, 1979). The State Department pointed out the seriousness of these threats in stating:

There is increasing evidence that foreign governments will not hesitate to take these measures where they believe it suits their interests, and in doing so, they may receive the support of other governments within their regions, so they could achieve an appreciable impact on U.S. interests (qtd. in *Aviation Week and Space Technology* August 27, 1979:24).

Consequently, in a security classified document, the State Department advised the CAB to tone down its challenge to the cartel by suspending Show Cause proceedings pending multilateral discussions of governments after one year of the new IATA rate mechanism (the one year trial period had been suggested by European representatives at the Brussels conference July 26-27, 1979) (*Aviation Week and Space Technology* August 6, 1979:27). The State
Department stressed that U.S. policy "has had and will continue to have a serious affect on the foreign relations of the U.S." (qtd. in Aviation Week and Space Technology August 27, 1979:23).

By the end of August, the CAB issued an order limiting the Show Cause proceedings even further to air transportation to and from the United States (Rosenfield 1983:477). On December 5, 1979 the CAB announced its intention to issue an order granting approval and anti-trust immunity to the IATA rate-making machinery for a period of two years subject to several conditions. The CAB ordered that it be allowed to create a committee which would monitor IATA activities and study tariff agreements. Most importantly, the CAB did not allow U.S. carriers to participate in rate-making agreements on the North Atlantic during this time. This decision preceded a series of U.S. liberal bilateral negotiations with several major nations including two key opponents of its new policies: the United Kingdom and Japan. The timing was not coincidental for as CAB members admitted, "the decision to remove anti-trust immunity for all IATA traffic conferences could have led 'to reactions that might hinder the movement toward a more competitive era in international aviation'" (Aviation Week and Space Technology December 10, 1979:35).

At the ICAO Second Air Transport Conference, Mr. Cohen (CAB chairman), in a speech on February 12, 1980, explained that immunity had been given to the new IATA primarily due to diplomatic considerations. The CAB, in its "desire to work with and not against other nations," felt that a two-year test period of the new IATA would be advisable. Cohen explained that in order to assess the impact of the new IATA it would be useful to let one conference area develop on its own outside the conference system. Consequently, the North Atlantic-Europe area was chosen. Cohen went on that two
factors were decisive in the choice of this market. First, the North Atlantic had experienced an open rate situation for some time and he maintained that the situation was far from "chaotic." And second, general foreign policy concerns (i.e., fear that the existence of a government's aviation industry would be jeopardized by a fully competitive situation and would lead to economic hardship) did not apply in this area since the carriers operating the routes were the strongest and most efficient in the global system (qtd. in Haanappel 1984:160-161).

The tentative CAB order was issued in April 1980, and invited further comments from interested parties. In addition to preventing U.S. air carriers from participating in North Atlantic IATA Traffic Conferences, the CAB insisted that CAB and ICAO representatives be allowed to attend and observe all IATA conference sessions.

A final order was issued May 21, 1981 which was to be subject to review in two years time. The CAB stayed the order until September 1981 on the request of the State Department and Department of Transportation. Both the Assistant Secretary of State and President Reagan wrote letters to CAB chairman, Mr. Cohen, asking for a stay until other forms of tariff coordination had been explored. The former underlined the fact that the ECAC and LACAC had made requests of this nature to the U.S. government, while Reagan wrote that it was "essential that the U.S. take every reasonable step to reassure the international aviation community of our willingness to address matters of common concern in a cooperative manner" (Haanappel 1984:162). Meanwhile, IATA filed a motion for the stay of the May 1981 order pending judicial review which it withdrew after the CAB once again delayed the effectiveness of the order until January 15, 1982 (Haanappel 1984:162-164).
In addition to legislative changes in U.S. national aviation law and the issue of the Show Cause Orders, the third pillar of the U.S. procompetitive policy started to be put in place beginning in late 1977: the negotiation of liberal bilateral agreements. These took the form of formal bilateral agreements, protocols to existing agreements, memoranda of understanding, or exchanges of diplomatic notes. The CAB in 1978 described the philosophy behind its policy initiatives:

While the United States has not always shown unflagging devotion to the principles of competition, it has sought a freer regime more consistently than most. In any event, during the past year the principles of free competition have clearly been reaffirmed in the U.S. negotiating strategy. The policy of our government is to trade liberalizations rather than restrictions, offer access to U.S. markets in return for guarantees of pro-competitive rules with respect to pricing, capacity and other economic decisions by the carriers of all states. The underlying premise is that expansion of competitive opportunities for all carriers—foreign as well as U.S.—benefits everyone, particularly the consumer. This has been the domestic experience, and it is equally applicable internationally, if governments will allow (qtd. in Dempsey 1978:442).

More concretely, CAB Chairman Kahn— the main author of U.S. procompetitive policy—summarized U.S. policy objectives in liberal bilateral negotiations as being (1) the elimination of anticompetitive restrictions on
charters and supplemental carriers; (2) the expansion of opportunities for new low-fare scheduled services; (3) the obtaining of maximum access to markets by expansion of the number of nonstop U.S. gateways; (4) the securing of adequate multiple carrier designations; (5) the avoidance of restrictions on capacity and frequency; and (6) the acquisition of maximum flexibility for U.S. flag carriers to operate to intermediate and beyond points (qtd. in Dempsey 1978:442).

Chairman Kahn in October 1977 stressed that in order for the United States to promote its procompetitive policy it was essential that it actively seek out and engage in negotiations with receptive bilateral partners:

instead of reacting passively to individual requests by foreign governments for discussions [the United States] would canvass the world, select out the potential partners offering them the most promising of opportunities, and actively seek out negotiations with them on a bilateral or multilateral basis (qtd. in Harbison 1982:45).

In the pursuit of liberalization the United States adopted a two-pronged strategy. First, it offered an exchange of routes for rates. Previous negotiators, Kahn explained, had negotiated on the basis of obtaining equal benefits through a route for route exchange. In his words, they took a "niggardly view" asking the question "well what have you got to offer us?" and defining "what have you got" in terms of routes they had to offer. Kahn, however, felt that, instead, in exchange for access to U.S. markets, the United States should ask for charter liberalization, flexible pricing rules and low fare-scheduled services (qtd. in Gray 1978:19). When difficulties
arose in obtaining this kind of exchange, the U.S. adopted a second strategy: divide and conquer. This policy was based on the principle that less compliant states could be pressured into accepting more liberal arrangements through diverting traffic to strategically located neighbouring countries. The latter, of course, would have to be willing to accept procompetitive arrangements. This policy was made public through the leak of Michael E. Levine's memo dated February 26, 1979. (At the time, Levine held the position of Director of the Bureau of Pricing and Domestic Aviation.) In it he noted that pressure could be placed on Italy and France, two resisters to U.S. procompetitive advances, through increased competition fuelled by negotiations with Greece, Spain, Portugal and Yugoslavia. Similarly, the British could be pressured by diverting traffic to other European gateways which allowed liberalized scheduled and charter services, e.g., Belgium, the Netherlands, and Finland. Although not explicitly mentioned in the memo, a similar method was probably envisioned as a way of forcing the Japanese to make concessions. By signing liberal bilaterals with South Korea, Singapore, and Thailand (Shubat and Toh 1985:50-51; Aviation Week and Space Technology May 21, 1979:28).

From 1978 to 1981 over 20 liberal bilaterals were signed. The terms of these agreements differed substantially. In general, however, the U.S. exchanged first time access and/or additional gateways for concessions in allowing market forces to determine market entry, market shares and tariffs. Charter services were also brought under the terms of the agreements, and measures were taken to liberalize their regulation. Finally, certain agreements incorporated provisions that promoted fair competitive practices.
In order to achieve its liberalizing objectives, the United States offered countries first time access to U.S. gateways and additional gateways. For example, the Netherlands received two new points in March 1978; the Belgians, three new points (November 1978); West Germany, six new points (November 1978); Jamaica, ten new points (April 1979); and Singapore, six new points (June 1979) (Taneja 1980:65). Gateways were offered under one of four conditions. First, a country might be granted a specific number of gateways in the United States to be selected at its own discretion. These points could be changed on short notice. Rover-points, as these gateways were called, were very valuable since they allowed air carriers to respond to the often unpredictable changes in traffic demand. Jamaica, in April 1979, was the first country to receive such a privilege and was granted ten unspecified points which could be changed at intervals of not less than six months with 60 days' notice to the U.S. government. A second type of agreement simply specified the new gateways, often including a clause allowing for their "phasing in" over several years. A third agreement might specify certain new gateways and provide unspecified gateways to be selected by the foreign country. While a fourth option would simply provide unspecified gateways to be chosen by the foreign country without the extra privilege of rover-points (Haanappel 1984:140-141).

In order to liberalize market entry and weaken strict market-sharing arrangements the United States was interested in obtaining agreements which allowed multiple designation, permissive route awards, and reduced restrictions on fifth freedom and beyond rights. Although the Bermuda I agreement did not specifically call for single designation, multiple designation in post-Bermuda I bilaterals was rare. The United States felt that increasing
designation would "create a more competitive environment." Many countries had opposed such initiatives for unlike the United States they only possessed a single designated international carrier and feared that the entry of several U.S. carriers into their markets would leave them at a competitive disadvantage. However, the United States was able to acquire multiple designation rights in several agreements (e.g., with South Korea [September 1978], Singapore [June 1979], Finland [March 1980], and Belgium [October 1980]). Permissive route awards gave countries the right to allow carriers to enter or leave the market at will. In other words, airlines designated to serve international routes had no public service obligation to actually perform the services they had acquired. Such a provision was incorporated into liberal bilaterals signed with Belgium (November 1978) and the Netherlands (March 1978). Harbison points out that the United States is the only state actually using this privilege (Harbison 1982:56). Interest in weakening market-sharing arrangements, and in particular increasing U.S. carriers' market shares led the United States to pursue reductions on restrictions placed on fifth freedom and beyond rights. It was able to get such concessions from smaller countries and particularly those carrying themselves a large volume of fifth freedom traffic (e.g., Singapore [June 1979]). In addition, U.S. procompetitive policy, called for no limitations on capacity, frequency or gauge. In contrast to the Bermuda capacity clauses, liberal bilaterals incorporating this condition made no distinctions with respect to capacity on third, fourth and fifth freedoms. This was particularly important since it removed disagreements over capacity principles with regard to sixth freedom operations. Liberalized capacity principles were found in agreements with South Korea
(September 1978), Singapore (June 1979), Finland (March 1980) and Belgium (October 1980).

Liberal bilaterals used one of three different pricing schemes: double disapproval, country of origin and "zones of reasonableness" or "fare bands." Airlines were encouraged to file low scheduled tariffs in response to the market. No explicit reference was made to the rate-making machinery of IATA and like the Show Cause Order, these provisions in particular provided a direct challenge to the IATA cartel.

A double disapproval clause stipulated that fares could only be disapproved if both governments agreed to do so. Since such agreement was highly unlikely, this arrangement was viewed as the most liberal, almost replicating a market control situation. Agreements with Israel (August 1978), South Korea (September 1978), Belgium (November 1978), Jamaica (April 1979), Singapore (June 1979), Thailand (June 1979), Costa Rica (August 1979), Taiwan (October 1979), the Netherlands Antilles (January 1979), Finland (March 1980), and Jordan (June 1980) incorporated such a clause. A second, less liberal variation, was country of origin pricing. Under such an arrangement a government had exclusive control over tariffs on traffic originating in its territory. Thus a country could prevent the effecting of rates for third freedom traffic and round trips originating in its territory. Country of origin pricing characterized agreements with the Netherlands (March 1978), Papua New Guinea (October 1978), Germany (November 1978), Fiji (May 1979), and Australia (December 1978 and May 1980). Finally, in the 1980s, a new form of pricing arrangement appeared: "zones of reasonableness" or "fare band" systems. These were based on the establishment of reference prices. Different types of price control were used in specified zones around
reference points. In other words, within a certain band or zone above and below a reference price, one pricing rule existed, (e.g., double disapproval) while outside this zone another rule applied, (e.g., country of origin rules). This system characterized agreements with China (September 1980) and the Philippines (October 1980).

All three schemes tried to limit government intervention to the prevention of predatory practices or discriminatory pricing, to the protection of consumers from unduly high monopoly fares and to the protection of airlines from prices that were artificially low due to government subsidies.

Harbison describes U.S. charter policy as being directed by four objectives. First, the United States wanted to ensure that scheduled and charter services could directly compete (i.e., be allowed to match each other's prices). Second, it wanted to liberalize charter rules so that competitive restrictions were removed. Third, the United States wanted to expand charter opportunities. And finally, it wanted to remove any capacity restraints on charter services (Harbison 1982:42-43). The liberal bilateral agreements promoted such objectives by allowing countries to explicitly designate charter carriers. Previously, charter operations had been subject to a variety of informal rules which had made them vulnerable to unpredictable termination or suspension of operating rights. Unlike scheduled services, charters were not limited to operating on specified routes and could carry traffic between all points in both countries. Under liberal bilateral agreements charters were placed under country of origin rules or double country of origin rules. In the former, any charter flight (one-way or round trip) is governed by the national rules of the state from which its flight originates while in the latter a country is allowed to use either its own rules or those
of the country from where the traffic originates. Most liberal bilaterals also allow charters to operate third and fourth freedom (one-way or round trip flights with unlimited stopovers). They also grant beyond rights and the privilege of stopover or transit in the state granting the beyond right. For all these rights, most-favoured-nation rules apply; (i.e., the country of origin must apply uniform liberal rules to similar charters). This, of course, ensured equal opportunity in competition. Liberal bilaterals do not usually grant charters fifth or sixth freedom traffic rights unless a specific clause is included allowing the extension of such privileges on the basis of "comity and reciprocity." Liberal bilaterals also permitted "matching" of charter prices with scheduled prices. In other words, all designated carriers of one country could meet any price offered by their bilateral partner's airline (Harbison 1984:67-70). Some of these less restrictive charter measures were incorporated into agreements with South Korea (September 1978), Singapore (June 1979), Thailand (June 1979), Finland (March 1980), and Belgium (October 1980).

Finally, in almost all liberal bilaterals signed during this period, contracting parties agreed not to engage in discriminatory practices. The exception was Argentina, which refused to sign such a clause. However, as Shubat and Toh point out in their analysis of bilaterals signed between 1978 and 1983, de facto these agreements had little impact. The authors refer to the report of the Congressional House Committee hearing on discriminatory practices against the U.S. (July 1981-May 1982). The study found several states involved in the following discriminatory practices: Aer Lingus (Ireland), Alitalia (Italy), SAS (Scandinavian countries) were heavily subsidized; Canada charged the United States discriminatory fuel prices; English
and Australian airports charged the United States discriminatory user fees; Italy, Argentina, Canada, Ecuador, Japan, Kenya and Peru offered the United States the use of poor, expensive ground handling services; Belgium, Canada, France, West Germany, Italy, Mexico, Taiwan, Japan, South Korea and the United Kingdom practiced warehouse and custom discrimination against U.S. traffic; France, Italy and Germany used biased computerized reservation systems which did not give access to data on U.S. carrier operations; and Ghana, India, Kenya, Nigeria, Pakistan, Taiwan, and Zaire were slow in U.S. currency conversion and remittance (Shubat and Toh 1985:53).

As was noted earlier, liberal bilaterals took a variety of different forms. To further distinguish trends and arrive at some general conclusions it is useful to refer to Harbison's study of liberal bilaterals. Relevant information has been summarized and set out in tabular form:
<table>
<thead>
<tr>
<th>First Liberal Bilaterals</th>
<th>Designation</th>
<th>Capacity</th>
<th>Scheduled Pricing</th>
<th>Charter Rules</th>
<th>Comments</th>
</tr>
</thead>
</table>
| United States-Netherlands March 1978: protocol | No restriction    | No restrictions  | Country of origin   | Country of origin   | Netherlands:  
- received two new routes  
- depended heavily on fifth and sixth freedom traffic  
- agreement impeded ECAC development of multilateral charter rules on North Atlantic                                                |
| United States-Israel August 1978: protocol | No restrictions   | No restrictions  | Double disapproval  | Country of origin   | Israel received four new gateways expanded beyond and intermediate authority  
- depended on fifth and sixth freedom rights                                                   |
| United States-Korea September 1978: Memorandum of Understanding | No restrictions   | No restrictions  | Country of origin   | Country of origin   | - first liberal bilateral outside North Atlantic  
- received one new gateway  
- was potential threat to Japan which was resisting U.S. liberalization  
- Korea depended on fifth and sixth freedom rights                                                |
| United States-Papua New Guinea October 1978 | No restrictions   | No restrictions  | Country of origin   | Country of origin   | Papua New Guinea received two new gateways  
- was a sixth freedom country  
- was potential threat to Australia                                                               |
| United States-Fiji May 1979          | No restrictions   | No restrictions  | Country of origin   | Country of origin   | Received two new gateways and expanded intermediate rights  
- was a sixth freedom country  
- was potential threat to Australia                                                               |
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<tr>
<th>First Liberal Bilaterals</th>
<th>Designation</th>
<th>Capacity</th>
<th>Scheduled Pricing</th>
<th>Charter Rules</th>
<th>Comments</th>
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<tbody>
<tr>
<td>United States-Germany</td>
<td>No restrictions</td>
<td>No restrictions (except fifth freedom subject to Bermuda I capacity principles)</td>
<td>Country of origin</td>
<td>Country of origin</td>
<td>Germany received six new points and unlimited intermediate and beyond rights - United States got valuable rights to more than one major gateway (only agreement where this occurred)</td>
</tr>
<tr>
<td>Fully Liberal</td>
<td>Designation</td>
<td>Capacity</td>
<td>Scheduled Pricing</td>
<td>Charter Rules</td>
<td>Comments</td>
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| United States-Belgium: protocol November 1978 | No restrictions | No restrictions | Double disapproval | Double country of origin | - last formal liberalization on North Atlantic  
- Belgium received two new routes |
| United States-Jamaica protocol April 1979 | No restrictions | No restrictions | Double disapproval | Double country of origin | Jamaica:  
- received ten scheduled gateways and beyond rights to any three points in Canada and any one point in Europe  
- gateways were rover points  
- some restrictions on U.S. intermediate and beyond rights |
| United States-Singapore June 1979 | No restrictions | No restrictions | Double disapproval | Double country of origin | Singapore  
- received three new gateways (rover-points) and unlimited intermediate rights  
- was to increase pressure on larger markets of Philippines and Japan |
| United States-Thailand June 1979 | No restrictions | No restrictions | Double disapproval | Double country of origin | received one new route with intermediate rights via Tokyo |
| United States-Costa Rica Memorandum of Understanding August 1979 | Restrictions | Restrictions | Country of Origin | Certain restrictions | - first Latin American agreement  
- received new gateways |
<table>
<thead>
<tr>
<th>Fully Liberal</th>
<th>Designation</th>
<th>Capacity</th>
<th>Scheduled Pricing</th>
<th>Charter Rules</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States-Taiwan November 1979</td>
<td>No restrictions</td>
<td>No restrictions</td>
<td>Double disapproval</td>
<td>Double country of origin</td>
<td>- got first-time scheduled authority to the United States - Taiwan received rights to seven U.S. gateways via intermediate points and beyond to one point in Europe and one point in central or South America - was to increase pressure on Japan</td>
</tr>
<tr>
<td>United States-Netherlands Antilles protocol January 1980</td>
<td>Certain restrictions</td>
<td>Certain restrictions</td>
<td>Double disapproval</td>
<td>Double country of origin</td>
<td>- received new gateways</td>
</tr>
<tr>
<td>United States-Finland protocol February 1980</td>
<td>--</td>
<td>--</td>
<td>Double disapproval (with certain restrictions)</td>
<td>Double country of origin</td>
<td>- U.S. flag service did not exist, nor was it immediately expected - Finland received three new gateways</td>
</tr>
<tr>
<td>U.S.-Jordan February 1980</td>
<td></td>
<td></td>
<td>Double disapproval (with certain restrictions)</td>
<td>Double country of origin</td>
<td>Jordan granted routes to four new gateways via three rover points</td>
</tr>
<tr>
<td>Restrictive Liberal Bilaterals</td>
<td>Designation</td>
<td>Capacity</td>
<td>Scheduled Pricing</td>
<td>Charter Rules</td>
<td>Comments</td>
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<tr>
<td>United States-Australia</td>
<td>Restrictions</td>
<td>Restrictions</td>
<td>Country of origin</td>
<td>Restrictions</td>
<td>- Important traffic generator in South Pacific - Australia received new gateway</td>
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<tr>
<td>Exchange of Notes</td>
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<tr>
<td>December 1978/ May 1980</td>
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<tr>
<td>United States-New Zealand</td>
<td>Restrictions</td>
<td>--</td>
<td>Country of origin</td>
<td>Country of origin</td>
<td>- sixth freedom country - New Zealand received two new gateways (rover-points) with intermediate points in South Pacific and beyond rights to Canada, Europe and the U.K.</td>
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<td>Memorandum of Consultations</td>
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<tr>
<td>April 1980</td>
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<tr>
<td>United States-United Kingdom</td>
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<td></td>
<td>Some Liberalization - Bermuda II</td>
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<tr>
<td>July 1977</td>
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<tr>
<td>March/April 1978</td>
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<td>March 1980</td>
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<tr>
<td>United States-China</td>
<td>Restrictions</td>
<td>Restrictions</td>
<td>Band pricing</td>
<td>Country of origin subject to specific approval</td>
<td>United Kingdom accepted United States low fare suggestions probably in part due to pressure from Beligian and Netherlands agreement - formal Bermuda II framework retained</td>
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<tr>
<td>September 1980</td>
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<tr>
<td>United States-Philippines</td>
<td>Restrictions</td>
<td>Restriction</td>
<td>Band pricing</td>
<td>Charters not included</td>
<td>- for 20 years had no formal agreement - Philippines: received intermediate points in Japan and two new gateways with one new point beyond</td>
</tr>
</tbody>
</table>
Several important observations can be made about the liberal bilaterals described. First, the United States in all cases "paid" in some way for concessions given: as mentioned earlier usually in the form of giving access to new U.S. gateways and often granting intermediate and beyond rights. Second, the most liberal agreements were signed in the initial phases of U.S. procompetitive crusade. Shubat and Toh point out that the more liberal agreements were signed with smaller nations, many of which depended on fifth and sixth freedom traffic, e.g., Israel, Korea, Belgium, Jamaica, Singapore, Thailand, and Taiwan. Thirdly, the United States was willing to agree to several restrictive measures in certain negotiations with weak air powers, e.g., Costa Rica, and the Netherlands Antilles. Fourthly, in its negotiations with larger air powers which depended more heavily on third and fourth freedom traffic, the United States was able to get limited liberalization, e.g., Australia, United Kingdom, and China. It did not reach liberalizing agreements with African countries, most Latin American countries (with the exception of Costa Rica), Japan, France, and Italy. Finally, U.S. attempts to use the threat of traffic diversion to get agreement from less compliant states had only limited success. The United States was able to exert some pressure on the United Kingdom through the signing of bilaterals with Belgium, the Netherlands, and Germany, although French and Italian markets were not opened. Similarly, liberal bilaterals signed with Fiji, Papua New Guinea and Taiwan seemed to have encouraged the Philippines to engage in a liberalizing bilateral, although they had little effect on the U.S. major target in the Pacific--Japan. The signing of a liberal bilateral with Finland had little success in softening the adamant opposition to U.S deregulation maintained by the other Scandinavian countries. U.S. negotiations with New Zealand placed
limited pressure on Australia, although it is more likely that valuable new access to U.S. markets provided the key incentive. Finally, the liberal rules of these bilaterals constituted a break from the norms established by the cartel system. Specifically, they allowed market shares and prices to be the product of competitive forces.

**ICAO and Economic Regulations**

As was pointed out earlier, ICAO's involvement in economic regulation was minimal until the mid-1970s. The attempt to involve ICAO in the economic regulation of civil aviation did not undermine the principles of the cartel system. Rather, it provided a new forum where states could seek market-sharing schemes and multilateral price-fixing agreements. At the 21st session of the ICAO Assembly in 1974, it was decided that the Council should examine the problems associated with the regulation of flag carriers' economic activities. The Assembly set up a Panel of Experts on the Machinery for the Establishment of International Fares and Rates whose mandate was to develop an international ICAO standard tariff clause on an international agreement embodying such a clause (Azzie 1980:10). Debate at the 21st Assembly also provided the impetus for the calling of an ICAO Special Air Transport Conference to be held in Montreal from April 13 to 26, 1977.

For many years less developed countries had felt that their interests were being overlooked at IATA conferences. U.S. carriers comprised over 10% of the IATA membership and the concerns of the larger U.S. and European airlines predominated. As early as 1959, a Central African Airways executive complained that at the IATA Annual General Meetings:
there was a tendency in the Traffic Conferences to ask the small carriers to set aside their own problems until the big carriers had reached a measure of agreement, then when that stage was reached, the smaller carriers were expected to agree or else shoulder the whole responsibility for failure of the Conference to reach unanimity (qtd. in Pillai 1969:89,197).

On several occasions, as has been previously described, Third World nations attempted to involve ICAO in economic regulation for they felt that the majority voting scheme prevalent in this forum would favour their interests (i.e., a one country, one vote resolution carried by a simple majority allowed bloc voting); moreover, unlike in IATA, developed states could not veto resolutions. In the 1970s there were over 140 ICAO members and the United States, whose traffic comprised 40% of the world total, only held one vote. Once again, in the mid-1970s, the Third World led the attempt to bring back issues of economic regulation into ICAO. Its renewed initiatives were part of a general wave of attempted assertiveness on the part of the Third World following the OPEC crisis. Claiming that concepts of economic competition and comparative advantage were "doctrines that merely allow rich nations to become richer at the expense of the poor," Third World nations demanded the establishment of a "new international economic order" whose principles were expressed in the Charter of Economic Rights and Duties of States presented and accepted at the General Assembly of the United Nations in 1975 (qtd. in Salacuse 1980:834). This particular document did not mention aviation concerns specifically; however, the position of the Third World nations at the ICAO Special Transport Conferences was very much a reflection of the
for general theme of the need to take measures to encourage the redistribution of wealth within the international economy. Not surprisingly, these conferences became a forum for sharp criticism of the U.S. procompetitive policy which was seen as antithetical to such concerns.

The preparatory work for the First Special Air Transport Conference was done by the ICAO Secretariat and the Panel of Experts selected at the 1974 ICAO meeting. The latter met in December 1976 and compiled both a list of complaints against IATA and a list of recommendations.

In their critique of the IATA mechanism the fourteen experts stated that the major deficiencies of the organization were: (1) that governments could unilaterally and indirectly interfere with and hinder IATA tariff agreement; (2) that governments had no direct means to participate in negotiations; (3) that governments' different philosophies interfered with agreement; (4) that IATA was insufficiently concerned with consumer interest; (5) that IATA was tardy in its decision-making and did not give governments sufficient time to review proposals; (6) that non-IATA members competed but did not participate in tariff-setting activities; (7) that non-scheduled carriers did not participate in tariff setting and consequently that it was difficult to manage the relationship between scheduled and non-scheduled carriers; (8) that non-scheduled carriers were subject to different regulations from scheduled carriers; (9) that IATA voting procedures were inadequate; (10) that IATA members were able to take restrictive action in markets that they dominated; (11) that tariff enforcement in practice was ineffective; (12) that IATA members did not consider non-IATA members' interests nor the needs of developing countries; and (13) that IATA was unable to obtain adequate cost data
In order to compensate at least partially for IATA shortcomings, the panel of experts made ten recommendations. These were: (1) that ICAO should develop regional cost and revenue data so that members could analyze differences among regions; (2) that governments in their review of tariffs take into consideration the needs of non-IATA members; (3) that ICAO encourage carriers to meet on a regional basis to ensure that non-IATA members' views were represented at IATA traffic conferences; (4) that ICAO encourage regular meetings between scheduled and non-scheduled carriers; (5) that governments provide appropriate enforcement machinery to ensure compliance with tariff agreements; (6) that governments refrain from taking unilateral action disrupting tariff agreements; (7) that ICAO pressure IATA to simplify its tariff structure and reduce the number of conferences to one annual meeting; (8) that governments require 60 days' advance notice of tariff changes and that carriers meet with governments to discuss possible tariff proposals; (9) that governments act swiftly on tariff agreements; and (10) that governments accept joint tariff agreements submitted by carriers (Aviation Week and Space Technology January 10, 1977: 24-25).

With these recommendations in view, representatives from 97 contracting states, 2 non-contracting states, and 11 international organizations met to discuss four general agenda items: tariff enforcement; non-scheduled air transport policy; capacity regulation; and tariff-setting machinery (ICAO Bulletin July 1977:14-15). The conference adopted a number of resolutions dealing with these issue areas. The first agenda item gave rise to recommendations that states enforce tariff agreements, take measures to prevent
illegal discounting, and support the IATA enforcement machinery. In addition, according to a proposal put forward by Canada, Japan, the Philippines, Spain, Switzerland, the United Kingdom, the U.S., and Venezuela, it was agreed that ICAO should engage in the study of tariff enforcement (ICAO Bulletin July 1977:16). In the area of non-scheduled air transport, it was recommended that the ICAO council undertake studies which would provide a suitable redefinition of scheduled versus non-scheduled services and which would propose policy for the regulation of international non-scheduled services (ICAO Bulletin July 1977:17). Although most delegates agreed that the regulations governing capacity were no longer adequate since they did not relate supply to demand and did not provide air carriers with "fair and equal opportunity," they did not agree on how the system should be changed. The developing nations pressed for predetermination (or a more restrictive interpretation of the Bermuda capacity principles), while the United States supported by Norway and Sweden, upheld a more liberal interpretation of the Bermuda principles. The conference proposed that the ICAO Council undertake studies to establish guidelines for capacity regulation of both scheduled and non-scheduled services with a view to producing a model capacity clause which could be incorporated into bilateral agreements. The council agreed that such a project should be guided by four considerations: relating capacity to demand; providing for "equality and mutual benefit" for carriers of both countries; encouraging development and expansion of air transport according to "a sound economic basis"; and relating capacity to the long-term planning needs of airlines and airports. Lebanon supported by the developing bloc also suggested that the study be guided by principles of capacity pre-determination and restricted granting of fifth freedom rights (Aviation Week and
Space Technology May 2, 1977:32-33). Fifteen recommendations were made with reference to international air fares and rates. The most important included: that ICAO representatives be sent as observers to IATA; that regional meetings between IATA and non-IATA carriers be encouraged; that airlines have advance discussions with governments prior to traffic conferences; and that ICAO study rate and fare determination by scheduled and non-scheduled carriers and determine whether a new intergovernmental system should be established (Haanappel 1984:168; Aviation Week and Space Technology May 2, 1977:33).

The First Special Air Transport Conference proposed that a second conference be held in 1980. Throughout the interim, numerous ICAO committees met to fulfill 1977 conference mandates. During this time, the most important ICAO achievement was the adoption in March 1978 of a model tariff clause which could be incorporated by states into their bilateral agreements. According to the proposal, tariff was defined to include "charges and conditions for agency and other auxiliary services." The clause advised that tariffs be discussed among airlines and with government authorities prior to the filing stage. It held that airlines filing tariffs should be prepared to provide aeronautical authorities with justification for their proposals. The clause called for a multilateral tariff-making mechanism but did not specifically refer to IATA. Finally, it encouraged governments to ensure the existence of an effective tariff enforcement machinery. The adoption of this tariff clause was optional (Azzie 1980:10).

The Second Special Air Transport Conference held in Montreal, from February 12 to 28, 1980, underlined the radical difference between U.S. and other nations' aviation policy and clearly became a forum for the expression
of discontent over U.S. attempts to deregulate international markets and increase competition through the signing of liberal bilaterals and the Show Cause Orders. Conference recommendations were developed in the course of the discussion of two agenda items: Regulation of International Air Transport Services and International Air Transport Fares and Rates.

The first item was concerned with developing guidelines for determining the distinction between scheduled and non-scheduled service and with the regulation of capacity. Although the First Special Air Transport Conference had suggested that a new definition of scheduled services be adopted, the second conference decided to continue to accept the 1952 definition with a few modifications (e.g., states were allowed to classify at their own discretion as "scheduled services" operations where a charter contract covering the entire capacity of the aircraft with one or more charterers existed and operated frequently and with regularity, and were required to assess the scope of "openness" to the public which would qualify the operation as being scheduled) (Haanappel 1984:16).

The United States presented a working paper proposing free determination of capacity. In the vote which followed the U.S. proposal supported by Israel, West Germany, Sweden, Switzerland, Singapore, Finland, Iceland, Jamaica, Belgium, and the Netherlands was overwhelmingly rejected by ICAO. The conference came out in favour of predetermination (Aviation Week and Space Technology February 25, 1980:30; Air Transport World, April 1980:21).

The United States suffered a similar setback during the discussion of rate regulation. It submitted a working paper suggesting that concepts of "double disapproval" and "country of origin" be recognized in ICAO bilateral tariff clauses. This proposal was met with such strong opposition that the
United States withdrew it. The conference ordered the study of several "suggestions" for solving international aviation policy with a view to having these incorporated into the Chicago Convention as annexes or laws at some later date. These proposals included: approval of a standard fare article in agreements between nations calling for dual approval of fares by countries involved, the adoption of a Bermuda-type agreement as an ICAO standard, and the establishment of an ICAO tariff commission which would serve as an official observer at IATA conferences.

Throughout the discussion it was clear that the Third World was pressing for a multilateral approach to aviation problems. This was reflected in three of the resolutions adopted by the conference. The first recommended the use of the multilateral IATA traffic conferences as a first choice in establishing international fares. The second stressed the need to involve the whole international aviation community in the study and establishment of any new multilateral tariff systems and criticized unilateral actions. On the latter point, member countries came out strongly against U.S. initiatives, claiming that:

Unilateral actions which disrupted multilateral tariff negotiations were contrary to the spirit of the Chicago Convention, placed international cooperation in peril and, through their destabilizing influence, threatened economic performance of the international system as a whole (qtd. in Dempsey 1987:578).

The third recommendation emphasized that any tariffs established regionally should take into consideration the interests of the world-wide multilateral system (Air Transport World April 1980:21). However, as a U.S. State
Department official commenting on this strong trend toward multilateralism said: "There was a good deal of talk about multilateralism, but not how to go about setting fares." He then added, "I believe ICAO wants to look at the IATA system and see what developments there are. If it doesn't work, what would substitute for it?" (qtd. in *Aviation Week and Space Technology* October 13, 1980:35).

Another State Department official admitted that the United States had seen the Second Special Air Transport Conference provide a good opportunity to gain state support for its liberalizing campaign (*Aviation Week and Space Technology* February 25, 1980:30). However, instead, the proceedings of the conference and in particular the rejection of U.S. recommendations in both issue areas made it clear that such support would not be forthcoming. A report in *Air Transport World* on the conference analyzing the positions taken by many states, said:

> it appeared that U.S. pressures on IATA and other parts of the international community had the effect of frightening nations, especially smaller ones, into adopting a more conservative approach than they ordinarily might have (*Air Transport World*, April 1980:20).

The State Department saw this response as a "setback but not a roadblock" to its attempts to deregulate the international industry. It commented that, although displeasure at the IATA incident was evident, some states were beginning to modify their stance and "no longer [had] hard feelings as they once did" (*Aviation Week and Space Technology* February 25, 1980:30).

The U.S. government throughout the proceedings and afterwards continued to voice its disapproval at the involvement of ICAO in economic regulation.
At a Congressional hearing following the conference, a Department of Transportation official articulated this general sentiment:

ICAO is basically responsible for safety and facilitation of international air transportation. Recently, efforts have been made to expand ICAO jurisdiction to economic matters including detailed traffic and financial reporting. This must be resisted. ICAO should have no role in these matters (qtd. in Dempsey 1987:539).

Following the approval of the conference results at the ICAO Assembly of September-October 1980, a Third Special Conference was not scheduled, although the council was given the mandate of calling such a meeting at its discretion (see Appendix IV).

In the two ICAO conferences held during this period, it seemed apparent that the United States, Canada, the United Kingdom, and Scandinavia had lost a great deal of influence. Opposition to U.S. policy was particularly evident when on numerous occasions developing nations consolidated their power by using bloc voting tactics to defeat U.S. proposals. However, in practical terms, the conferences had little real impact on the commercial operations of the aviation industry. The United States and many western European air powers were opposed to ICAO involvement in economic matters and refused to lend their support to many resolutions. It is important to note that ICAO resolutions were only unenforceable recommendations.

The Breakdown and Restructuring of IATA

The previous section has described how from the mid-1960s on, forces arose which began to challenge the operation of the cartel system. First,
there were difficulties associated with the fact that many important airlines both scheduled and charter, operated outside IATA jurisdiction. Second, beginning in the 1960s, but particularly gaining impetus in the 1970s, the conflict between developing and developed nations over aviation policies developed. Both parties, for different reasons, held that IATA multilateral price-fixing activity was unsatisfactory. As seen at the Special Air Transport Conferences the developing nations felt that IATA was too responsive to the interests of the major aviation powers and was not dealing adequately with changes in the economic environment: increased competition in the market; overcapacity accompanied by discriminatory practices; illegal discounting; and general lack of adherence to IATA agreements; as well as rising operating costs. Although the aviation powers had some similar concerns (i.e., rising costs, discriminatory practices, and illegal discounting), they felt that IATA, instead of increasing and enforcing protective measures as suggested by many less developed countries, should liberalize its policies. The culmination of the process of cartel weakening was the adoption of the procompetitive policy by the United States through changes in its national legislation, through the signing of liberal bilaterals and the issue of the Show Cause Order. The defection of major U.S. airlines from the cartel completely undermined price-fixing activities. The drastic effect of these forces on IATA activity was evident in the ICAO Bulletin summary of IATA traffic conference agreements in 1977:

Passenger fares were open for all or most of the year in more than half of the international conference negotiating areas and sub-areas despite a long series of conferences and meetings and various other efforts to achieve
closed situations, including use of the limited agreement approach. In many cases the agreements reached did not apply to certain states or territories, mainly due to government disapprovals (ICAO Bulletin May 1978:40).

The report noted that IATA was least successful on the North Atlantic route which had remained almost entirely open throughout the year. Instead, prices were fixed through unilateral and bilateral filings which intensified with the introduction of the non-IATA Laker Skytrain.2

Following a threat by Pan American that it would leave the IATA cartel if changes were not made, the November 1977 IATA Annual General Meeting in Madrid decided to set up a five-man task force to study the organization and provide recommendations for its restructuring. It presented nine recommendations at the first open Special IATA General Meeting on June 30 and July 1, 1978 in Montreal. These were: (1) that IATA activities be grouped into two categories: trade association and tariff coordination, membership being mandatory in the former and optional in the latter; (2) that the three individual traffic conferences and four joint conferences be retained but that sub-area priorities be redefined in response to regional market dynamics; (3) that the provisions of limited agreements be affirmed and be binding on members not present at conferences where such agreements are adopted; (4) that traffic conferences recognize the prime interest of third and fourth freedom carriers in establishing the fare levels for traffic carried at the lowest fares without veto from other interested members; (5) that members be allowed to introduce innovative fares on third and fourth freedom routes in response to changes in the market without rescinding existing fare agreements; (6) that conditions of service be eliminated from the scope of the
traffic conference regulation; (7) that the ICAO Secretariat be given observer status and that third parties be allowed to present their positions at traffic conferences; (8) that the compliance program be redefined to place more emphasis on preventative as opposed to punitive measures; and (9) that the executive committee redefine the IATA's traffic committee's terms of reference in order to embrace new changes (Taneja 1980:92-93; Air Transport World August 1978:29).

In order to guarantee wide acceptance of these proposals, the committee attempted to establish a framework in which the goals of the major civil aviation powers would be promoted while at the same time some of the concerns of the smaller airlines (e.g., from the Middle East and Africa) would be accommodated. To this end, the actual task force chosen was composed in such a way as to represent a wide-range of opinions (i.e., the five members were executives from Air Canada, Air India, Alitalia, British Airways, and TWA).

Initially, it seemed as though the recommendations would not be supported by a majority of delegates. The African and Middle Eastern Airlines provided the most vocal opposition. They complained that the new changes were being introduced in order to accommodate the interests of the larger members and were particularly designed to appease the United States. One chief executive commented that only "card holders" (members of the Executive Committee) would have any real say in the changes (qtd. in Air Transport World, August 1978:90). The proposals seemed for the most part to be responses to developments in the North Atlantic market and were felt by many states as having little relevance to their markets. This complaint was directed especially at innovative fares. A representative from Middle East Airlines said that this recommendation was "trespassing on the voting rights"
of IATA members where "markets are tidy" merely because of the chaotic situation on the North Atlantic (qtd. in *Air Transport World*, August 1978:30). Representatives from Air Afrique also complained that the ability of a member to initiate its own low fares in response to a competitor's action would reduce IATA activity to a "façade" (qtd. in *Air Transport World*, August 1978:30).

On the other hand, executives from El Al and Air India supported the proposals arguing that if IATA did not adapt to the new environment, governments were likely to become more strongly involved in fare-setting. The vote swung in favour of the proposals with the unexpected support of certain more conservative European air powers. Air France gave its approval stating that the scheme was a "lesser evil" while KLM suggested that it would help avoid the "jungle of the North Atlantic" (*Air Transport World* August 1978:31). Even Alitalia's representative, Umberto Nordio cautioned IATA members "we are not the governors of the market, but the servants of the market." He further emphasized that IATA members were faced with "market problems, not political or philosophical problems" (qtd. in *Air Transport World*, August 1978:90). The proposals were given final approval at the Geneva, Annual General Meeting in November 1978. Prior to the meeting, IATA filed the new structure and procedures with the CAB and obtained interim approval. This measure was seen as essential to the viability of the agreement.

**Summary**

After 1977 challenges to the rigid market-sharing and multilateral tariff-fixing principles of the cartel system led to its breakdown. As the *ICAO Bulletin* reported in 1978, more than half of the international traffic
conference regions in 1977 were open (ICAO Bulletin May 1978:40). In other words, the rates adopted by carriers in these areas were not the product of multilateral tariff negotiations within IATA. The restructuring of IATA introduced more flexibility into multilateral rate-setting. First, states were not obliged to adhere to IATA rates, and second, they were allowed to introduce innovative fares. In effect, both these measures authorized carriers to violate the multilateral tariff-setting principle. Nevertheless, many carriers continued for the most part to support multilateral-tariff agreements. Similarly, many states in their bilateral negotiations with each other did not challenge the rigid market-sharing principles of the cartel system. The United States was the major exception. Changes in its national legislation reflected U.S. disapproval of market-sharing and tariff-setting by non-market forces. Its liberal bilaterals were aimed both at introducing greater pricing flexibility and less restrictive market-sharing schemes (i.e., it negotiated removal of restrictions on fifth freedom carriage, capacity, frequency, and gauge determination). Even U.S. negotiation of rover-points and unspecified gateways may be seen as a partial violation of the cartel system principle of bilateral negotiation on market entry. (In the cartel system routes were specified in the bilateral agreement. They were not to be determined or operated according to direct market forces.) Through these policies the United States ensured that its markets would not operate within the cartel system. In addition to the liberal bilaterals, the United States tried to undermine the cartel system more generally by using the Show Cause Order. In this way, it sought to undermine the principle of multilateral tariff-setting, not only in its own markets, but also in all international markets. The other development of this period which was
discussed was the Third World attempt to move the responsibility of the economic regulation of the aviation industry from IATA into the ICAO forum. This in itself did not reflect a weakening of support for cartel principles on its part. Rather, the Third World felt that within ICAO measures which would enforce rigid market-sharing and multilateral price-setting were more likely to be taken. In conclusion, one can generalize that after 1979 the cartel system continued to operate, although weakened, in most markets—the main exception being those international markets in which the United States played a dominant role.
ANALYSIS

During the period from 1977 to 1981, the operation of the IATA cartel was seriously challenged by U.S. initiatives: the Show Cause Order and the signing of liberal bilaterals. For the most part, the United States was alone in its opposition to the IATA cartel, although its activity was to a certain extent helped by the willingness of certain states to sign liberal bilaterals. States signing liberal bilaterals, whose air carriers were IATA members, were willing to see increased price flexibility but did not support the attempts of the United States to dismantle the IATA cartel completely. This was evident in the very vocal opposition to the Show Cause Order. The strongest defenders of the IATA cartel were the African, Middle Eastern, Latin American, and more conservative European states.

In order to understand the developments during this period, specifically the breakdown of IATA Traffic Conferences, it is necessary to turn to the three explanatory variables which provide insight into why states continue or cease to support a cartel.

States that continued to support IATA activity, reiterated economic arguments that they had used to justify cartel operations in previous periods. These states warned that deregulation would lead to chaos in the industry and to costly subsidy wars. They argued that in the long run deregulation would be detrimental to consumers for not only would they have to bear the burden of greater subsidization through government taxes, but the industry would eventually be monopolized by the most efficient carriers who would then be able to increase prices. These states asserted that, if necessary, they would support their flag carriers' operation through subsidies. The official economic justification for such activity was the public utility
argument which maintained that a flag carrier was an essential national service. The IATA supporters pointed out that, if market forces were allowed a greater role, many "service" routes would be abandoned due to their lack of profitability. Underlying these economic arguments, of course, were the basic "essential industry" motivations which, as will be discussed, did not change during this period.

A major shift, however, did occur in U.S. economic philosophy which led to the assertion that international deregulation was in the best interest of consumers and the industry. The shift resulted from several developments which coincided: the completion of new economic studies, the coming to power of an administration running on a platform of less government interference and composed of adamantly pro-deregulation individuals, the criticism within the United States of the effects of the Bermuda II agreement, the success of deregulation and the example of Laker Airways which showed that an airline could operate profitably at much lower prices.

The debate over the merits and costs of regulation versus deregulation in the aviation industry dates back to the 1930s; however, until the mid-'50s and '60s there had been no attempts to assess systematically the economic effects of either policy. Richard Caves in the introduction to his seminal work *Air Transport and its Regulators*, published in 1962, complained about the lack of scientific study in this area:

Debates have raged among economists and the general public alike about the usefulness of direct public control of business. Yet no techniques have emerged to guide an impartial investigator, and vague untested platonic generalities have ruled the field. No set of theoretical
tools or verified factual proposition guides the scholar who tries to decide what would be the net impact on economic welfare of imposing direct control on an industry, compared to permitting the free play of market forces or applying some other scheme of social control (Caves 1962:4).

Caves' work followed by a number of other studies in the 1960s tried to examine the impact of regulation on the aviation industry and assess the social costs of regulation in terms of inefficient resource allocations. In conjunction with Caves' pioneering study, two other works, one studying airline pricing by George W. Douglas and James C. Miller, and the other, by William A. Jordan, analyzing the California intrastate deregulation experience, seriously undermined assertions that deregulation would lead to market chaos, predatory pricing, loss of service, and monopolies. These studies had a significant impact on the Ford Administration in their drawing up of the Aviation Act and provided concrete support for the Carter Administration's assertion that IATA rate-fixing activity was detrimental to consumer welfare and was impeding the growth and development of the aviation industry (Macavoy and Snow 1977).

The publication of such studies, which were part of a growing body of literature criticizing excessive regulation in a variety of industries, contributed to growing pressure from both the academic community and the public at large on policy-makers to decrease government intervention in the market and increase the emphasis on furthering consumer welfare.

The Carter Administration was quick to respond to new voter concerns. Carter ran on the electoral pledge that he would reduce regulation and end
government involvement in the market place. As was evident from a memorandum sent to him by his policy advisors, deregulation of the highly visible aviation industry was seen as a quick way to fulfill campaign promises. The memorandum of December 22, 1976 said:

... support for aviation deregulation legislation may produce a 'quick hit,' to fulfill campaign commitments to cut outdated and unnecessary programs, benefit consumers, challenge special interest influence over the bureaucracy (Executive Summary: Options on Airline Regulation Reform addressed to President-elect from Members of the Transition Advisory team qtd. in Harbison 1982:23).

Carter's appointment of Alfred Kahn described by Anthony Sampson as "the high priest of deregulation" and Mike Levine described as "a supercharged economic lecturer from Los Angeles," to the CAB also had an impact on the direction U.S. policy took (Sampson 1985:70). Both these men, and particularly Kahn, who was said to be the author of the Show Cause Order, were academic economists heavily influenced by the pro-deregulation wave sweeping through university economics departments. In the words of Jönsson, these men "acted on the firm belief that greater competition and reliance on market forces nationally as well as internationally could yield substantial consumer benefits" (Jönsson 1987:147). Kahn, explained the underlying logic behind this view: the international aviation trading process was a variable-sum game where joint profits from cooperation would be made. Thus, Kahn rejected the previous conceptualization of the industry as "horse-trading," where the losses of one were the gains of another. In his words, "the equation was not what foreigners obtain from us. We lose, and conversely," Kahn argued, "we
gain both what we 'give' and by what we receive" (qtd. in Harbison 1982:46). This view, of course, emphasized 'consumer' gains for it was clear that certain airlines would suffer in the process.

The Carter Administration first tested deregulation in the domestic environment. Harbison points out that although it remained a popular assumption outside the United States that deregulation was essentially a domestic matter, it was quite clear that U.S. policy-makers saw international policy as an extension of domestic policy. This view was reflected by Senator Cannon's comment in his announcement of plans to hold hearings on U.S. aviation policy in August 1977. He voiced concern that domestic and international policies were operating in contradiction to each other:

at a time when we are trying to improve our domestic air transportation system by introducing more of the principles of free enterprise, we are agreeing to bilateral arrangements (Bermuda II) that increase the role of government regulation and restrict competition in international aviation to a greater degree than before (qtd. in Harbison 1982:23).

Lower prices, accelerated industrial growth, and increased company profits brought about by domestic deregulation increased the conviction of policymakers that deregulation should be introduced internationally.

The signing of the Bermuda II agreement and its after-effects also had a significant influence on the direction taken by U.S. policy-makers. It became clear very early that the agreement was not only unpopular but that it did not even reflect the policy positions of the various government sectors which were instrumental in the formation of aviation policy. Discontent with
Bermuda II increased when it was found that the British interpreted the agreement more restrictively than the United States had expected. And finally, an impetus to reverse the Bermuda II trend was added when it became clear that countries were already viewing it as a new model for bilateral negotiations and were beginning to press for more restrictions. The Japanese and the Italians were the first to call for renegotiation along Bermuda II lines.

U.S. carriers, in their criticism of the Bermuda II agreement, criticized the government for not using its strong position to the advantage of the United States. An official complained: "We held all of the cards if we had just been willing to stand our ground" (qtd. in Aviation Week and Space Technology July 18, 1977:25). Instead, airline officials complained that the United States had played into the hands of the British and in the process had encouraged other countries to try to pressure it into giving concessions. In the words of one airline executive:

What we gave the British was access to 90% of the U.S. with very little in exchange. . . . I have a major concern that U.S. government officials consider this a precedent-setting agreement--one from which all future agreements will be patterned, just like the old Bermuda. That really concerns me (qtd. in Aviation Week and Space Technology July 18, 1977:26).

The CAB was very upset by the signing of the Bermuda II agreement:

We object strongly on principle to the kind of governmental interference that this particular restrictive provision of Bermuda II has forced on us (single designation).
We would strongly have preferred to leave to the competitive market the decision of how many carriers the market can support—at Boston, Los Angeles, and other markets as well (qtd. in Dempsey 1978:422).

Alfred Kahn, who ironically was in office at the time of the signing of the agreement, was furious, calling it a "vehicle for anti-competitive intrusion into the international aviation marketplace," and referred to it as "that damned agreement" (qtd. in Aviation Week and Space Technology January 23, 1978:31; The Economist December 3, 1977:57-58).

Within Congress, opposition was also apparent. Senator Cannon described it as:

the greatest step backward in forty years of attempting to bring market-oriented competition to international aviation (qtd. in Dempsey 1978:443).

Even administration officials ceased to support the agreement. Administration officials told Aviation Week and Space Technology that once the full details of Bermuda II had been made clear to the President and his advisors, the White House "was less than pleased" (qtd. in Aviation Week and Space Technology September 12, 1977:29). A veteran aviation official explained that the Carter Administration had minimal background in aviation policy and had not, at the time of negotiation, realized the full competitive impact of the agreement. Public criticism had made the Administration aware of the full ramifications of their action.

Administration officials explained that there was "a desire not to let Bermuda II happen again" and that the new policy "would instruct negotiators to weigh carefully the consumer benefits and competitive impact of any
agreement. Political considerations, while remaining a large part of any international aviation negotiation, should not override consumer and competitive interests" (qtd. in Aviation Week and Space Technology September 12, 1977:29).

When the United States had negotiated the agreement with the British, it appears that the U.S. policy-makers believed that by making anti-competitive concessions on designation, capacity and pricing, they would be recompensed by the British adopting a more liberal policy towards charter flights. The British, however, did not oblige (The Economist December 3, 1977:57-58). To add to U.S. discontent, seven months after the Bermuda II agreement had been signed, the British stalled the inauguration of a new service by Braniff on the Dallas/Fort Worth-London route claiming that the prices were too low. The Economist described U.S. response to both these British actions:

The Americans are increasingly angry at the restrictive way the British have used Bermuda II to block competition and they complain that no agreements have been reached on looser rules for charter flights (qtd. in The Economist March 4, 1978:81-82).

Finally, the initial negotiation demands of the Japanese and Italians in the post-Bermuda II period (Gray 1978:18-20) reinforced the Administration's fears that other countries would ask for similar concessions as those granted to the United Kingdom. In a letter to Kahn, signed October 6, 1977 (prior to the beginning of negotiations with Japan), President Carter urged Kahn to avoid making anti-competitive concessions:

The work you are about to undertake in negotiating bilateral agreements with Japan is of great importance.
Two related problems face international aviation today: empty seats and high fares. Both problems can be resolved if we work to remove restrictions on low and innovative fares in both chartered and scheduled service. I am convinced that increased competition can make convenient, low-cost transportation available to many people who cannot afford it, while at the same time bringing greater prosperity to the international aviation industry. Our goal in international aviation should be to move toward a truly competitive system. Market forces should be the main determiner of the variety, quality and price of air services. We should seek international aviation agreements that permit low-fare innovations in scheduled service, expanded and liberalized charter operations, non-stop international service, and competition among multiple U.S. carriers in markets of sufficient size. We should also avoid government restrictions on airline capacity. While keeping in mind the importance of a healthy U.S. flag carrier industry, we should be bold in granting liberal and expanded access to foreign carriers in the United States in exchange for equally valuable benefits we receive from those countries. Our policy should be to trade opportunities rather than restrictions.
To achieve these goals will require close interagency cooperation and a firm negotiating posture. I am confident of the ability of you and your colleagues to achieve these objectives in our upcoming negotiations. I want you to keep me fully informed of your progress (qtd. in Gray 1978:19-20).

Chairman Kahn followed this advice and publicly declared that Bermuda II was an aberration which was "a substantial departure from the kind of system envisioned by Congress and generally incorporated in other bilateral agreements" (qtd. in Dempsey 1978:143).

The above discussion would suggest that there was both confusion initially over the ramifications of the Bermuda II agreement, and that there was division among the policy-makers with regard to policy priorities. The Bermuda II agreement was clearly the product of State Department desire to avoid unnecessary conflict with an ally. However, with the consolidation of power within the CAB under Kahn, the Bermuda II agreement was rejected and used as proof of the harmful consequences of a restrictionist policy on consumer welfare and industrial efficiency.

The irony of the Bermuda II agreement was that it produced one of the major forces leading to deregulation of the industry: Laker. The impact of Laker on U.S. policy was twofold. First, policy-makers found themselves facing a dilemma. On the one hand, in order to meet Laker prices, the Administration wanted to approve three new scheduled fare proposals which would improve U.S. scheduled carriers' competitive position. On the other hand, the CAB warned the Administration that the new fares were predatory with respect to charters and threatened charter operation. As Harbison points
out, Carter's decision to approve the proposed fares signalled "the transition from reliance on charter price competition to low scheduled pricing" (Harbison 1982:32). Charter popularity was already declining prior to 1977, but the introduction of these new competitive fares clearly accelerated the process. On the North Atlantic, the key market where U.S. charter operations prevailed in 1977, one in four passengers travelled on a charter airline, while by 1981 this figure had dropped to one in sixteen (Adkin 1982:43).

The second consequence of the Laker phenomenon was that it provided evidence that air carriers offering lower fares could operate profitably. This evidence, combined with the domestic deregulation experience and the various economic studies, gave the Carter Administration sufficient ground for its philosophy: "competition is a more efficient price regulator than government" (qtd. in Dempsey 1978:398).

According to the second possible explanation for weakening support for a cartel, states will cease to support such a regime under one of two conditions: either they lose interest in the various economic, political and security benefits accruing to a state from ownership of a flag carrier or they no longer see a cartel system as optimal for the growth of their international industry. The African, Middle Eastern and Latin American states clearly continued to be interested in the former, and their strong support of IATA suggests that they continued to see its activity as necessary for the development of their flag carriers. They were quick to emphasize within both the IATA and ICAO forums that competition would have a negative impact on the survival of their respective air carriers and their economies in general. These states stressed the need for even stronger IATA action and their insistence on discussion of economic matters in ICAO can be seen as
symptomatic of their belief that IATA was being excessively flexible rather than too restrictive in its cartel activity. Similarly, the mobilization of regional organizations and the attempt to consolidate a unified position against U.S. policy initiatives reflected their strong commitment to cartel activity. Needless to say, underlying the opposition to U.S. anti-cartel activity was these states' realization that their carriers were inefficient and would not be able to meet the prices of U.S. and European carriers.

As has been seen, certain European States and Asian-Pacific States and even two less-developed countries, the Netherlands Antilles and Jamaica, were willing to sign liberal bilaterals with the United States and agree to greater price flexibility which would further weaken IATA price-fixing functions. The question arises: were these states different from the others? Were they not worried about the survival of their industry? In fact, their desire for a more competitive environment was precisely a consequence of such anxiety. The countries with which the United States signed liberal agreements were primarily carriers of fifth and sixth freedoms (for example, the Netherlands, Israel, Korea, and Singapore). It was in their interest to see fewer restrictions on this type of traffic and the United States found it fairly easy to bribe them with greater fifth freedom and beyond rights in return for price flexibility. Similarly, in the case of weaker states, the prospect of new gateways to "the most desirable market both from the standpoint of destination for other countries and also from the standpoint of generating business to go to (other) countries," in the words of Senator Cannon, was hard to refuse (Gertler 1979:108). The offer of substantial "hard rights" (i.e., gateways and routes) for "soft rights" (prices) explains why states agreed to greater price flexibility. However, they did not
support the actual cartel-breaking policy of the United States and many states which signed liberal bilaterals also criticized the U.S. Show Cause Order.

The third variable seeks to explain the weakening of a cartel in terms of change in the hegemon's activity. The fact that it was the United States which alone tried to undermine the operation of the cartel through the Show Cause Order and the bribing of other countries to sign liberal bilaterals indicates that this variable holds the key to explaining the developments of this period. This view is supported by the highly revealing action of the IATA executive in filing the recommendations for the organization's restructure with the CAB prior to their final approval at Geneva. This suggests not only that IATA members recognized that any policy adopted would be inoperable without U.S. sanction, but also that the move to restructure the organization was aimed at regaining U.S. support and cooperation. The flexible membership provision would allow U.S. airlines to participate in cartel operations but not force them to participate in traffic agreements. Furthermore, if they decided to join in traffic conference activity, the provision allowing innovative fares would lend some flexibility to price-setting agreements.

The question must then be posed: why did U.S. support for cartel activity wane? It has already been suggested that a shift in the economic philosophy towards a greater emphasis on consumer welfare played an important role. Economic studies brought home the costs of regulation in terms of industrial inefficiency. But, was concern for the development of the global aviation industry and consumer welfare at the heart of the U.S. policy change? Patrick Shovelton alluded to the motivation behind the United States' newly professed reliance on free competition and its interest in the
consumer, when he suggested that in plain fact the United States believed in mercantalism—"that is to say in promoting and developing our [U.S.] own commercial interests" (qtd. in Harbison 1982:47). A study made by Klem and Leister in 1979 for the first time explicitly recognized the connection between the "attitudinal shift" in U.S. policy and national benefits to be derived from such a policy. They wrote that the United States, extrapolating from its domestic deregulation experience, realized that "aggressively pursuing increased competition would yield substantial benefits to U.S. carriers" (qtd. in Harbison 1982:50). Thus, U.S. policy change was in actual fact a new strategy, following the example of U.S. charter policy in the '60s and early '70s, to gain dominance in the aviation industry. The question then arises, was the attempt at regime change and concern over improving the U.S. industrial position in the long-run the consequence of a declining ability to support the costs of cartel activity; or was it a reflection of changes in security-related motivations which had partially explained U.S. charter promotion in the previous period?

It appears that in its relations with industrialized states, the United States did not feel that it needed to make economic concessions in order to bolster their economies. Thus, security-related motivations for cartel support continued to be "de-linked" during this period. In the case of weaker states, it appears that the United States continued to make an effort to give economic concessions which would help develop their airline industries. For example, in its bilateral negotiations with Jamaica, Netherlands Antilles, Costa Rica, and Papua New Guinea, the United States provided huge concessions in the form of valuable gateways or actual anti-competitive restrictions. Unlike supporting the cartel, a strategy which aided
indiscriminately all countries with less efficient air carriers than the United States, these unilateral concessions were country-specific and allowed the United States to pick and choose which states it ought to help and befriend. Such a policy was also less costly to the United States in terms of economic losses. One can conclude from both these examples that, where the United States saw its security interests at issue, it was willing to sacrifice its own economic welfare.

The questions then arise: why was the United States unsuccessful in changing the regime? Why was it unable to extract all the concessions it wanted from other states? Was it no longer powerful enough to shape the regime? If the United States had in fact lost power, one would be tempted to suggest that its procompetitive policy was not just a result of changed security interests, but also a consequence of its no longer being able to support a cartel. The resort to more discriminating and less costly methods of aiding Third World countries develop their aviation industries would further support this view.

Jönsson argues that U.S. power was not declining and explains attempts at regime change in the following way:

In sum, it was the underlying strength of the United States in the aviation issue-area, not American weakness or decline, that explained the attempted regime change. The United States tried to exploit its traffic generating capacity to the full by pressing for free competition and by letting its powerful domestic airlines enter the international market (Jönsson 1987:49).
To a certain degree, Jönsson is correct in his analysis. The United States clearly remained the dominant actor in terms of traffic generation and traffic attraction, and continued to produce over 80% of the airline manufacture industry. In terms of general economic and military power, it clearly dominated its bilateral partners. Moreover, the fact that the United States was able to introduce some liberalization into the market and disrupt IATA operations leading to the complete restructuring of the organization would also suggest that it continued to be very powerful. Nevertheless, a number of factors indicate that in terms of relative power the United States had lost some leverage vis-à-vis other states and was concerned with reestablishing its dominance in the industry.

First, if the United States was so powerful, why was it unable to extract concessions from such countries as Japan, the United Kingdom, France and Italy? Furthermore, why did it have to pay for price flexibility by offering new gateways and extended rights which were clearly disadvantageous to the development of its own industry? Second, there is significant evidence that the United States perceived its power in the industry to be declining. Chairman Kahn implied in an interview, that government officials saw U.S. aviation power to be under siege. Kahn explained:

I was privileged to have a discussion of international bilateral aviation policy with one of our government officials, who began the conversation by observing to me that the next several years were going to be very trying for us, since our airlines enjoyed a very large share of world markets, and one foreign government after another could be depended upon to insist on negotiations looking
to expand the landing rights of its carriers in our country, the best we could hope to do, he said, would be to dig in our heels, "give" up as little as possible, and in this way hold our losses to a minimum (qtd. in Harbison 1982:51).

A more extreme version of this view was the CAB's actual admission that U.S. power had declined. In the introduction to the Show Cause Order, the CAB stated:

U.S. carriers no longer dominate international aviation and the bargaining power of our allies is now much more equal to our own (qtd. in Aviation Week and Space Technology January 9, 1979;27)

Industry data supported the view that U.S. dominance was on the decline. For example, in 1972 U.S. citizens had composed 61% of the international market while in 1979 they represented 50.4% (Rosenfield 1982:482). U.S. citizen travel had grown at a rate of 3.3% a year in the 1970s while foreign citizen travel had grown at a rate of 9.4% per year. Furthermore, U.S. carriers' share of the international market had fallen from 56.5% in 1971 to 50.0% in 1978. On the North Atlantic, the United States' most valuable market, U.S. carriers' share of traffic fell from 48% in 1971 to 45.4% in 1977 (Adkin 1982:35-36). (See Table 7.)

Both Jönsson's comment and evidence indicating an actual decline in U.S. power may be reconciled. U.S. dominance in the industry had decreased; however, it continued to be the strongest actor in the international system. Ultimately, it probably had the power resources to pressure states to accede
to its interests. However, the costs of using such resources, alienating its allies, were so high that the U.S. was unwilling to use them. Reluctance to use power, de facto, translates into a loss of leverage power. For example, in order to gain concessions from the United Kingdom and Japan while avoiding direct conflict, the United States resorted to indirect pressures as opposed to more confrontational forms of leverage. This tactic did not prove to be particularly successful in forwarding U.S. economic objectives. Thus, concern for U.S. and Japanese friendship modified the type of leverage that the United States was willing to employ which resulted in thwarting the pursuit of its economic interests. The fact that U.S. allies were now able to modify U.S. behaviour by threatening to withdraw their "friendship" simply illustrates a gain in their relative power.

In conclusion, it would appear that U.S. behaviour can be explained: first, by a delinkage in old security interests which had conditioned its previous support of the cartel. This delinkage was symptomatic of the gain in the economic power of U.S. allies which translated into U.S. power loss. In the second place, U.S. interests in promoting the economic welfare of its industry gained urgency in the context of its relative economic decline. And thirdly, U.S. behaviour was then modified by different security interests: anxiety about not alienating its allies, which, in turn was a reflection of a certain loss in leverage power. It found itself in the paradoxical situation where it had the potential resources to shape the aviation environment according to its own economic interests, but it now was subject to the leverage of its allies who were prepared to threaten a withdrawal of their support from its global activities.
Chairman Kahn's brief tenure as CAB chairman ran from June 1977 to October 1978 when he was elevated to the position of top inflation fighter of the Carter Administration.

The Laker "Skytrain" was a "no frills" service charging the lowest fares available from New York to London. Laker was issued a license by the British Civil Aviation Authority (CAA) to operate the London-New York route in 1972, and the following year applied to the CAB for a scheduled foreign air carrier permit. The CAB granted the permit subject to presidential approval.

Meanwhile, in response to large decreases in traffic on British carriers in 1974, the British Board of Trade issued a policy guidance statement proposing that only one carrier be designated to serve long-haul international routes. Consequently, the CAA withdrew its conditional approval of Laker designation. Laker challenged the CAA decision in British courts claiming that the Trade Board's action was ultra vires. Laker won its case in the Court of Appeals and its licence was revalidated. Under the renegotiated bilateral between the United Kingdom and the United States, Bermuda II, Laker was permitted to operate the London-New York route. On September 27, 1977, Skytrain service began and quickly gained popularity operating at load factors averaging 80% of capacity (Dempsey 1978:406).

IATA scheduled carriers responded quickly to the new competition by introducing three new competitive fares. These were: budget fares which were to be purchased at least 21 days prior to the week of departure, with airlines designating the day of departure and return 10 days prior to
departures, and would have a proposed price 8% above Laker fares; standby
departure with prices 8% above Laker fares; 
fares which were to be available on the day of departure and were to be sold
no more than three hours before departure with prices 8% above Laker fares;
and Super-Apex fares taking the form of advance purchase excursion fares,
with the price being lowered by 17%. After some dispute with the CAB which
viewed these new fares as being directed against charter services rather than
against Laker, the State Department approved the proposed fares (Harbison
1982:30-37).
6. THE RESTRUCTURED REGIME AND NEW CHALLENGES: 1981-

DESCRIPTION

Buffeted from both without and within, the restructured organization sailed away... with its sails tattered, some masts down, some leaks below the water line and some squabbling among the crew. But it was still afloat, and the banner of multilateralism was still flying. And although the more stormy weather lies ahead, the feeling... was that greater safety lies in remaining aboard rather than jumping ship (Air Transport World January 1980:58).

The events of the tumultuous period from 1977 to 1981 have left an indelible mark on the international regime regulating the commercial aspects of civil aviation. Although IATA continues to play a role in tariff coordination, its significance has diminished. This is particularly true in U.S. and European markets. Following 1981, the U.S. drive towards international deregulation was to a certain extent contained as seen in its abandoning of the Show Cause Order, and in its adopting a more pragmatic policy in its negotiation of liberal bilaterals. U.S. airlines were not prohibited from participating in IATA traffic conferences and on a number of occasions did so; however, following 1981, much pricing, as in the previous period, occurred outside the IATA regulatory framework. The diminished tariff fixing importance of IATA in Europe resulted from three factors: a stronger belief in liberalization; the threat of the application of Treaty of Rome anti-trust principles against tariff coordinating activity; and the growth of
regionalism as reflected in tariff coordination initiatives in the Association of European Airlines (AEA). In both North America and Europe, IATA's role as a trade association has grown in importance. IATA traffic coordination continues to be quite important in the Pacific, although it is encountering challenges to its authority. In Australia and New Zealand as in Europe, there have been moves towards applying anti-trust laws against IATA activity. Regionalism has also gained in importance and the Orient Airlines Association (OAA) plays a key role in coordinating regional tariffs. The shift towards greater tariff coordination by regional organizations (e.g., the African Airlines Association [AFRAA], the Arab Air Carriers' Organization [AACO], and the Asociación Internacional de Transporte Aéreo de America [AITAL]) is also apparent in Africa, the Middle East and Latin America, respectively. Nevertheless, IATA's tariff fixing function continues to be very important in these regions, where countries remain opposed to liberalization.

A Pragmatic U.S. policy

The U.S. retreat from the aggressive pursuit of a procompetitive policy followed the election of President Reagan in 1981. In his first written statement addressing issues related to civil aviation, Reagan stated that it was

essential that the United States take every reasonable step to reassure the international aviation community of our willingness to address matters of common concern in a cooperative manner (qtd. in Aviation Week and Space Technology August 31, 1981:30).
Accordingly, he encouraged the CAB to extend the Show Cause Order deadline beyond September 15, 1981 saying that such an action was both "appropriate and in the best interest of our foreign policy" (qtd. in *Aviation Week and Space Technology* August 31, 1981:30). The CAB order was delayed until January 15, 1982 and was followed by a further stay granted on January 7, 1982. On May 6, 1982 the U.S. Transportation Department issued an order closing the proceedings. The United States gave IATA traffic machinery anti-trust immunity for the next five years (Haanappel 1984:162-164).

Before making a public statement on international aviation policy, key Reagan Administration officials from the White House and the Departments of Transportation and State met with executives of five major U.S. airlines (Braniff International, Flying Tiger Line, Northwest Airlines, Pan American World Airways, and Trans World Airlines) to discuss aviation issues. The airlines pointed to their weakened international presence: U.S. market share dropped from 45.4% in 1977 to 42.3% in 1980 in the Atlantic and from 45% to 43.9% in the Pacific during the same period. In addition, U.S. profits in international operations fell from $292 million in 1978 to $92 million in 1979 and to $152 million in 1980). The airlines blamed the Carter Administration for this (*Aviation Week and Space Technology* May 11, 1981:32).

C. E. Meyer Jr., president of Trans World and spokesman for the five airlines, stressed that the problem was not the result of the inability of U.S. carriers to succeed in a competitive environment, but due to Carter's inability to understand the international marketplace. Meyer said, "Give us the free market environment and we will make it because U.S. carriers are efficient, but," he added, "the government must recognize realities and try to have a competitive market in the framework that exists." He continued:
In fact, outside the U.S. there is no "free market" in international air transportation. The international market is characterized by foreign government subsidies and other 'mercantalist' practices by foreign governments designed to bolster the performance of each nation's own carrier at the expense of U.S. flag carriers (qtd. in Aviation Week and Space Technology May 11, 1981:31-32).

The airlines prepared a memorandum recommending five directives for a new aviation policy. These were: 1) ensure that the U.S. bargains for and obtains fair value for all rights traded to foreign governments; 2) pursue route awards for U.S. and foreign flag carriers only if they make "good economic sense" and contribute to the strengthening of the U.S. position; 3) be accommodating to legitimate interests of "friendly" foreign governments (i.e., those not engaging in discriminatory practices); 4) eliminate discrimination against U.S. carriers and ensure access to foreign markets; and 5) allow airlines maximum pricing flexibility without stressing non-economic low fares (qtd. in Aviation Week and Space Technology May 11, 1981:31).

The Reagan Administration responded by undertaking a policy review. Policy-makers concluded that it would not be necessary to make a formal declaration on international policy since existing policy embodied in the International Air Transportation Act of 1979 met with their approval. Robert D. Hormats, Assistant Secretary for Economics and Business Affairs stated: "there are no major quarrels with that legislation in this Administration" (qtd. in Aviation Week and Space Technology November 9, 1981:83). However, it soon became clear that in fact there had been a major shift in U.S.
policy. Matthew V. Scocozza, Assistant Secretary for Policy and International Affairs at the Transportation Department, described in very general terms the nature of the change:

We have taken a pragmatic approach, tempered with realism, over the last three years (qtd. in Aviation Week and Space Technology April 9, 1984:28).

In contrast to the Carter Administration policy that had stressed consumer interest and the advancing of competition at all costs, along with the long-run objective of strengthening the U.S. industry, it became clear that the Reagan Administration was emphasizing the third tenet of the 1979 Competition Act. Clearly, its main concern was supporting the immediate health of the U.S. airline industry as a whole. A Department of Transportation official explained that the new U.S. policy wanted to achieve "efficient, reasonably priced, unrestricted and accessible international air service" while at the same time ensuring "at least equality with foreign carriers in improving profitability in foreign air transportation" (qtd. in Air Transport World October 1984:29). Consequently, the United States followed an often contradictory policy: it tried to expand rights and increase price flexibility with some countries, while at the same time attempting to renege on concessions given to other countries by the previous administration. A reporter, writing for Air Transport World, commented that this pragmatic approach was leading to a great deal of confusion among U.S. bargaining partners who observed that:

[the] U.S. seems to be going in both directions simultaneously, particularly when one country receives significant U.S. rights and another is given crumbs (Air Transport World October 1984:29).
U.S. policy-makers, in explaining their new policy, stressed that they were seeking a balancing of benefits. Scocozza contrasted the Carter attitude to the Reagan policy: "It used to be easy to get things. Three years ago they would just scream and shout, and we bleeding hearts over here would give them what they wanted. While now," he added, "we won't give an inch where we don't see our negotiating partners being forthcoming" (qtd. in Aviation Week and Space Technology April 9, 1984:28). An important aspect of this "give and take" stance was a negotiating strategy based on a case by case approach. In other words, officials stressed the need to consider each bilateral negotiation within the context of specific gains to be made in that particular market, as opposed to granting a blanket endorsement for some general policy. A U.S. official expressed this "less theological and more practical" approach saying, "If you try to make a generalization in the international marketplace, you're going to be wrong more than right" (qtd. in Aviation Week and Space Technology November 8, 1982:28). Franklin Willis, Deputy Assistant Secretary of State for Transportation and Telecommunications, in an interview with Air Transport World explicitly described this "case by case" approach and explained why certain policies were being adopted in specific countries:

A pro-competitive model agreement doesn't apply unqualifiedly everywhere. It does in big or medium-size countries, such as the United Kingdom, Italy and Japan known as mature markets in economic parlance. In all of those, you'll see a consistent push to deregulate, against some very unwilling partners. But where we don't need unlimited beyond rights in less-developed or in less-dense
markets such as Chile, Singapore or Korea, the U.S. will be more conservative (qtd. in *Air Transport World* October 1984:29).

When one turns to some of the actual negotiations during the period following 1981, this pragmatic policy is clearly reflected. One interesting example of the "balancing of benefits" is seen in the different approaches taken by the United States to its bilateral negotiations with Switzerland and the Scandinavian countries in 1984. Both states carry a very large share of the traffic between their countries and the United States (Swissair carries more than 90% of U.S.-Swiss traffic over the Atlantic, while SAS carries 85% of Scandinavian traffic.) Both countries were interested in gaining new points of entry (Atlanta and Houston) to the United States. The U.S. was willing to make such concessions to the former but not the latter. In the case of Switzerland, the United States gave such concessions because it was able to get additional price flexibility. Policy-makers also suggested that the imbalance in traffic shares was a consequence of Swiss efficiency saying that it "does better because it markets harder," the implication being that the U.S. government appreciated this type of competitiveness (*Air Transport World* September 1984:29-30). In contrast, the United States was unwilling to give SAS additional gateways because it was hindering U.S. attempts to lower prices (*Air Transport World* 1984:29-30).

Perhaps the greatest achievement of the United States in the promotion of its pro-competitive policy during this period was the signing of a Memorandum of Understanding with the ECAC allowing for greater price flexibility with Europe over North Atlantic routes. The victory was in no way complete for it required a compromise on the part of the United States. As James H.
Burnley, General Council to the Transportation Department, commenting on the agreement, told the International Aviation Club:

"Our preferred approach, of course, is completely deregulated pricing. In many cases, however, we have compromised with governments by agreeing to certain ranges within which proposed fares may not be disapproved (qtd. in Aviation Week and Space Technology October 3, 1983: 41)."

The Memorandum of Understanding, signed in May 1982 and initialled by nine European countries (Britain, Ireland, West Germany, Italy, Spain, Greece, Belgium, Holland, Yugoslavia, and Portugal) established a "band" system or "zones of reasonableness." The system included intergovernmental involvement in the rate-making process through the setting of reference fares and pricing zones. It gave airlines the freedom to set prices within the "zones of reasonableness." It allowed unilateral government tariff disapproval outside the zones. And it did not prohibit multilateral carrier tariff coordination (Haanappel 1984:157). In fact, in September 1983 the U.S. State Department sent a letter to European governments explaining that IATA procedures would be required for all North Atlantic airline meetings whether between IATA members or IATA and non-IATA members or any other groups. It further stressed that bilateral rate meetings between airlines would not be permitted. Consequently, a dual system was established. On the one hand, many fares fell outside the zones and required government approval on a bilateral basis; on the other, fares were established through IATA rate-making conferences. The irony of the system, which among other things tried to decrease government involvement, was that the setting of multilateral
zones, fares and cost required a great deal of government activity (Air
Transport World October 1983:37).

A second Memorandum of Understanding was signed by 16 European countries in early 1983. The new signatories were: Italy, France, Switzerland, Finland, Denmark, Norway, and Sweden (Aviation Week and Space Technology October 22, 1984:33). A third Memorandum came into force in November 1983 and was extended for two more years in 1985. In early 1987 a new two-year Memorandum of Understanding was signed which allowed fare zones to be lower and expanded the ability of airlines to offer deep discounts (Aviation Week and Space

U.S. negotiations and attempts to liberalize U.S.-Japanese markets were fruitless for a long time. Japanese officials were adamantly opposed to a procompetitive policy. Early in 1981 a JAL representative articulated the Japanese position:

As there are ample air carriers in the U.S. the survival of the strongest theory can be acceptable there but it is unacceptable in Japan (qtd. in Aviation Week and Space

Nevertheless, that same year the United States was able to gain certain liberalizing concessions from the Japanese. In what Department officials said was a "major achievement," Japan allowed United Airlines entry into the U.S.-Japanese market. It also allowed more competitive pricing but retained the right to restrict capacity. In return, the Japanese received new U.S. gateways and beyond rights (Aviation Week and Space Technology June 14, 1982: 32; Aviation Week and Space Technology November 8, 1982:28).
The new "conservative" policy in less-developed markets or less-dense markets described by Willis was quickly apparent in U.S. negotiations with Thailand and Singapore in 1984. Thailand asked the United States for the right to carry fifth freedom traffic through Tokyo to Seattle and Dallas. The United States was prepared to give such concessions on the condition that Thailand promise not to exercise certain rights obtained in its liberal bilateral signed when the Carter Administration was in office. A U.S. official explained the policy:

Our approach, which the Thais call 'restrictive' is based on our assessment of our own opportunities in the Thai market (qtd. in Air Transport World October 1984:31).

Similarly, Singapore asked for more U.S. gateways. The United States agreed on the condition that SIA did not fly through Tokyo. In this case, the United States wanted to reduce third country competition in a market where it found itself at a competitive disadvantage (Air Transport World October 10, 1984:31).

In recent years, following the success of the ECAC-U.S. Memorandum of Understanding, the United States has taken the initial step towards promoting the concept of a multilateral tariff agreement in the Far East and South America (AWST May 30, 1983:233).

Two final bilaterals, one signed in the early stages of the Reagan Administration and one in 1986, throw further light on new trends in U.S. policy. In 1981 Brazil denounced the U.S.-Brazil bilateral due to the attempt by American Airlines to introduce a new low fare. In response, President Reagan wrote to the CAB urging it to reconsider giving its permission to this:
Review of this order has brought to my attention recent events that have damaged the relations of the U.S. and Brazilian aviation authorities. I am concerned that the U.S. relations with Brazil may deteriorate further (qtd. in *Aviation Week and Space Technology* December 21, 1981:2).

An administration official added that emphasizing low fares was unrealistic. "It doesn't make sense any longer" (*Aviation Week and Space Technology* December 21, 1981:23). The CAB took the advice of the President and the dispute was settled.

The second interesting negotiation occurred between the United States and the Soviet Union in 1986. Departing from its usual policy (one would surmise for political reasons), the United States agreed to a bilateral which allowed frequency to be fixed and incorporated a revenue sharing scheme (*Aviation Week and Space Technology* May 5, 1986:32).

**Changes in Europe**

The move towards deregulation in Europe followed in the wake of U.S. deregulation. It gained momentum after 1981 and developed within the multilateral forums of the European Economic Community (EEC), the European Civil Aviation Conference (ECAC), and through the unilateral action of a few states, in particular, the United Kingdom. The process of liberalization has been slow and, on numerous occasions, has come to a standstill due to the fact that, not only are countries wary of the consequences of a U.S. style deregulation, but also a number of countries are directly opposed to such
initiatives. The major proponents of liberalization, Britain, the Netherlands, and Ireland, and to a lesser extent, Switzerland and Finland feel that state subsidies should be eliminated as should pooling agreements; while market access, capacity and fare control should be liberalized. The main opponents of these policies (i.e., France, Italy, Greece, and Austria) support subsidization, market access, capacity and fare control. They argue that air service is a national public utility which needs government protection. They warn that the unleashing of competitive forces will lead to subsidization wars and will in the long run be detrimental to public interest. Specifically, they point to the increase in mergers in the United States following deregulation and warn that this phenomenon is likely to occur in Europe leading to monopolization of the industry by a few strong carriers. Some concede to allowing limited liberalization. The division between the two groups is reflected in the multilateral deliberations of the EEC and ECAC as power shifts from one group to the other.

Several actors have been involved in the very slow movement towards liberalization in the European Economic Community: the EEC Commission, the European Parliament, the European Court of Justice, and the Council of Ministers.

In the fall of 1981 the EEC approved a report critical of passenger fares in the Common Market. The report indicated the inadequacies of the price-fixing system stating that the procedure for setting scheduled fares was time consuming. It added that profits were too high on certain routes, and as evidence of this fact, pointed out that many routes were being cross-subsidized by other operations. (The report suggested that this practice was inefficient and should be severely restricted.) It further added that a
comparison of charter and scheduled fares showing variations in price levels of 5 to 25% further suggested that scheduled prices were excessively high. The report concluded that European governments were being given little information on airline costs and revenue and were therefore not in a position to determine if fares being charged were reasonable (Aviation Week and Space Technology August 3, 1981:28).

This study, along with other studies undertaken around the same time by the ECAC and consumer groups, served to make both European governments and the public more aware of cartel costs. This new awareness was reflected in a directive of the European Parliament which gave the EEC two months to develop a transport policy allowing for some liberalization. Otherwise, the Parliament warned, it would take the EEC to the European Court of Justice charging that it had violated the Treaty of Rome by encouraging anti-competitive practices. (As will be discussed, the Treaty of Rome forbids anti-competitive practices. However, it does not include a specific regulation on air transport. This fact has given rise to a great deal of debate over whether the terms of the treaty are applicable to fare collusion in the aviation industry.)

Since the EEC was not forthcoming with a policy, the Parliament filed a complaint with the European Court of Justice. Responding to this action, the EEC Commission recommended a policy that would provide a compromise between the demands of the Treaty of Rome without resorting to full deregulation as adopted in the United States. Frederik Sorensen, head of the EEC Air Transport Division, explained:

The airlines application of the competition rules would lead to revolution. The task is to establish fair and
equal opportunities for the airlines, but ... the degree of competition needs to be controlled (qtd. in *Aviation Week and Space Technology* January 30, 1984:28).

The Commission proposal or Memorandum 2 suggested that: (1) governments be forbidden to subsidize airlines (permission to provide aid in order to promote regional development could be obtained from the council but members would have to prove that the airline in question would be self-sufficient in the future); (2) governments be prohibited from giving route grants subject to an airline's agreeing to participate in revenue pooling or other cooperative agreements; (3) governments could allow pools or cooperative agreements but less than 1% of an airline's revenue should be allowed to pass between carriers; (4) capacity limits on specific routes be allowed if both states agreed; and (5) "zones of reasonableness" be agreed on by countries and used as a means to increase price flexibility within the region (*Aviation Week and Space Technology* January 30, 1984:28). A European official explained the philosophy behind this approach:

> We do not believe we can use regulations to force airlines to be more efficient and reduce costs. We believe the way to increase efficiency is to allow some competition as a spur to efficiency. The airlines must become more cost conscious (qtd. in *Aviation Week and Space Technology* January 30, 1984:29).

The European Parliament responded with a more conservative policy urging a "go slow" approach to European deregulation. The proposal, like Memorandum 2 urged governments to "promote a more consumer orientated European air transport system" (*Aviation Week and Space Technology* June 17, 1985). It
also proposed the establishment of "zones of reasonableness." However, it did not call for any significant liberalization of capacity or market entry restrictions or for the abolition of revenue pooling (Aviation Week and Space Technology November 4, 1985:29).

The Parliament proposal was supported by the Association of European Airlines and IATA at the October IATA Annual General Meeting. Support for these recommendations was not easily acquired within the AEA. The organization composed of 13 European airlines has representatives from both the more liberal and more conservative states. Six of its members: Aer Lingus, British Airways, Iberia, KLM Royal Dutch Airlines, and UTA would have preferred a more liberal approach, although they agreed to support the policy unlike British Caledonian which dissociated itself from the activities of the organization. Members who supported the conservative policy were Air France, Alitalia, Olympic Scandinavian Airline System, TAP Air Portugal, Sabena and Lufthansa (Aviation Week and Space Technology November 4, 1985:29). IATA support of the policy led the secretary general of European charter airlines, R. Paul Holubowicz, to accuse the European Parliament of having "sold out to the big business cartel lobby of IATA" (qtd. in Aviation Week and Space Technology September 23, 1985:39).

The European Commission criticized the conservative European Parliament proposal and urged the Council of Ministers to follow the recommendations of Memorandum 2. They warned the Council that if it did not act on proposals for deregulation, the Commission would pursue legal action against airline and government practices which it believed to be contrary to free and fair competition (Aviation Week and Space Technology September 23, 1985:29).
Meanwhile, during this period, the European Court of Justice was also being called on to take a position on airline regulation. As mentioned earlier, it was not clear whether the anti-trust legislation found in Article 85-94 of the Treaty Establishing the European Economic Community (Treaty of Rome) applied to air transport. In 1974 the Court of Justice in the Case of the Commission of European Communities versus the French Republic had judged that all forms of transport are subject to the "general rules of the treaty." Nevertheless, this judgement continued to be surrounded by controversy (Haanappel 1984:86-87). Then, in the summer of 1985, the European Court of Justice was asked once again to examine the jurisdiction of the Treaty of Rome anti-trust laws. Specifically, it was asked to pass judgement on whether EEC member airlines have the right to regulate the price of airline tickets within its borders and whether they have the right to limit the regulation of capacity and entry (Aviation Week and Space Technology July 5, 1985:28). In this instance, however, the European Court of Justice declined to make a decisive judgement. It stated that such a decision was political and could only be made by national governments. The Court supported the general concept of liberalizing the airline environment saying that the Treaty of Rome competition rules should apply to air transport. However, it stressed that since the EEC had never adopted specific regulations on competition within the transport industry, neither the national courts nor the Court of Justice could force nations to abandon fare regulation. The decision did not require states and the EEC commission to take action against fare agreements which restrict trade; however, it opened the way for them to do so (Aviation Week and Space Technology May 5, 1986:34).
For the time being, liberalization has been stalled in the EEC. The EEC Commissioner for Competition, Mr. Sutherland, annoyed at the apparent unwillingness of the Council of Ministers to abandon restrictive policies and break the IATA cartel warned several airlines (i.e., Lufthansa, Alitalia, and Olympic) that he would start legal action against them for anti-competitive practices. The EEC Commission has also warned the Council of Ministers that if they did not agree on a plan for the liberalization of the airline industry by the summer of 1987, the Commission would withdraw draft EEC regulations excluding airlines from full competition rules of the Treaty of Rome (The Economist March 21, 1987:7).

Paralleling developments in the smaller forum of the EEC, initiatives have been taken within the ECAC (composed of Director Generals of Civil Aviation from 22 European countries) to liberalize the aviation industry in Europe.

As in the EEC, the momentum toward deregulation within the ECAC increased following the issue of a report of a study on the effects of cartel activity in Europe. In 1982 for the first time the ECAC documented the extent to which airline and government agreements were hindering competition. It reported that 90% of European routes had capacity limits. In addition, 75% to 80% of all ton-kilometres performed on intra-European flights were subject to pooling agreements (i.e. cost or revenue sharing) (Aviation Week and Space Technology November 8, 1982:51). The study recommended that countries begin to deregulate the industry by establishing "zones of reasonableness" which would allow airlines a certain degree of price flexibility, as well as by limiting government interference in service patterns and capacity levels. The report recognized that such action would meet with
resistance since anti-competitive measures were adopted in order to protect the many inefficient European airlines from competition. The report also commented that it is "inconceivable that any European government would accept the elimination of its flag carrier" for reasons of prestige, public policy, foreign exchange, political and other reasons (qtd. in *Aviation Week and Space Technology* September 6, 1982:54-55). It concluded that change should be evolutionary as opposed to revolutionary:

> ECAC states wish to avoid disruptive effects which could undermine the stability inherent in the present framework of bilateral and multilateral arrangements between European states by exposing it to radical rather than revolutionary change (qtd. in *Aviation Week and Space Technology* September 6, 1982:54-55).

Three years later, at the same time that the two EEC proposals were being debated, the ECAC issued its own policy. It called for commitment to:

1. the liberal granting of traffic rights, multiple designation and increasing foreign carrier access to routes not served by national carriers;
2. reducing capacity restrictions and giving airlines more decision-making flexibility;
3. ensuring fair and equal opportunity in airline service (this did not mean ensuring equal benefits and the report dissuaded states from engaging in revenue pools or traffic sharing schemes);
4. more freedom for regional airline operations;
5. the adoption of "zones of reasonableness" for pricing; and
6. eliminating regulations which limited the ability of nonscheduled airlines to compete (qtd. in *Aviation Week and Space Technology* June 17, 1985:29).
The adoption of such a policy was not legally binding on national governments, although it was the first step in encouraging further ECAC agreements on liberalization. Consequently, a number of ECAC working groups began to draft a new multilateral agreement comparable to the Memorandum of Understanding on the North Atlantic which could govern European transport. As of May 4, 1987 two agreements had been drafted. The first dealt with tariffs and proposed the establishment of zones of reasonableness for discount and deep discount fares. It allowed airlines to propose tariffs to governments unilaterally without initial approval by other airlines. The proposal also incorporated a system for rapid arbitration in the event of tariff disputes. The second agreement dealt with capacity sharing and proposed an end to the 50/50 split policy promulgated by certain European countries. The new agreement allowed airlines to offer up to a 55% share of the total capacity between two countries over two years. The drafts were to be available for signing later in the year (Aviation Week and Space Technology May 4, 1987).

Although the activity within various multilateral forums such as the EEC and ECAC has led to a move towards deregulation, the most effective initiatives have been taken through the unilateral action of a few procompetitive states (i.e., Britain especially and second, Holland). The British move towards promoting liberalization in Europe followed the election of the Thatcher government in 1979. The House of Lords undertook a policy investigation into European scheduled fares and reported in the summer of 1980 that European fares were too high due to the regulated, protective regime formed around them. The report urged that European governments should be persuaded that the "benefits of more competition would not be more than offset by the
disruption of the existing regulatory system" (qtd. in Aviation Week and Space Technology June 30, 1980:29). Four years later, the British, following the example of earlier U.S. liberal bilaterals, signed an agreement with Holland in June 1984 which allowed airlines to fly between any points in the United Kingdom and Holland, and gave airlines autonomy in capacity and frequency decisions and provided a system of country of origin tariff regulation. The threat of traffic diversion resulting from this agreement led West Germany, Belgium, Luxembourg and even France to sign similar liberalizing agreements with Britain (The Economist September 28, 1985; Aviation Week and Space Technology December 2, 1985:36).

Developments in the Pacific

The Pacific Basin is the fastest growing market in the aviation industry. ICAO has predicted that traffic will grow at an average annual rate of 10% through 1992 and airlines originating from the region will gain over 33% of world traffic. Although U.S. initiatives in the area have helped to introduce competitive forces, the prospects for rapid future deregulation are mixed. The strongest moves have been taken in recent years by Australia and New Zealand. The Australian Trade Practices Commission has withdrawn antitrust immunity from a wide range of IATA activity. As of mid 1985, the action was under appeal. Similar legislation is being considered in New Zealand (Dempsey 1987:iv.; Aviation Week and Space Technology October 28, 1985:31). At a conference on the Pacific market at the Lloyd's of London Press International Civil Aviation Conference, Pacific countries voiced their support for more competition and less regulation of pricing but were not on the whole in favour of complete deregulation (Air Transport World December
The major forum for tariff coordination in the region is the Orient Airlines Association (OAA). IATA also plays an important role in the development of tariffs although it is rare that prices are directly established at traffic conferences. Rather, the many non-IATA airlines in conjunction with the IATA airlines and with the active involvement of governments establish fares following guidelines provided by IATA. Illegal discounting is very widely practiced, perhaps more than in any other region.

**Developments in Africa, the Middle East and Latin America**

IATA continues to play an important role in Africa, the Middle East and Latin America although the regional organizations AFRAA, AACO, and AITAL are becoming involved in tariff coordination. Since its restructuring, IATA has supported this regional initiative by trying to establish a closer rapport with the various organizations. For the most part, countries in these regions continue to oppose deregulation. Officials feel that their smaller, younger airlines must be protected from the large, efficient, established European and U.S. carriers. The president of AFRAA, Mohamed Faheem Kayan, expressed this view:

> Aviation is so sensitive that it cannot be left to free and uncontrolled competition. It has resulted in bankruptcies and unemployment in the U.S. The effect could be even worse in the developing countries (qtd. in *Aviation Week and Space Technology* November 4, 1985:32).

These countries are particularly concerned that the economic preponderance of the major aviation powers will impose deregulation upon their own countries through a variety of methods. First, European and U.S. airlines will be able
to "dump" capacity in less developed countries. For example, Frank Okyne, Chairman of Ghana Airways, has pointed out that about 70% of African traffic originates in Europe. Consequently, he argues, it would be very easy for the European airlines to cross-subsidize their African operations and offer low prices which would break the African airlines. S. M. Kheir, General Manager of Sudan Airways, pointed out that although strictly speaking governments have the authority to control services to their countries, there is always a way for airlines to circumvent regulations. A second way in which liberalization is likely to enter unwilling developing countries is through pressure exerted by the European and U.S. governments. One country which has suffered as a consequence of such pressure is Chile. Patricio Sepulveda, President of AITAL, has claimed that the Chilean aviation industry has taken great losses since the government's adoption of an open sky policy in 1978. Sepulveda has said:

Even though the law said we [Lan-Chile Airlines] should have reciprocal rights, in practice the government never demanded them (qtd. in Aviation Week and Space Technology November 4, 1985:32).

Summary

Since 1981 the principles of the cartel system have continued to be upheld by states in the Middle East, Africa, and Latin America. The move towards tariff negotiation within regional forums represents a change in the decision-making procedure of the regime. It does not constitute a change in the principle of multilateral tariff-setting. In the United States there has been a move away from liberalization. Whether U.S. traffic may be said to be
operating within the cartel system is open to question. On the one hand, it would appear that in certain markets (e.g., the North Atlantic) the United States continues to oppose 40-60 market-sharing parameters and multilateral price-setting. (Although, the United States-ECAC memorandum may be seen as a partial concession to the latter principle since it allows a certain degree of multilateral tariff-setting.) In other markets (e.g., the Soviet and Thai markets) U.S. policy seems to be moving back towards rigid market-sharing, although multilateral tariff-setting is not practiced in these markets. In Europe there has been a move away from supporting cartel principles (particularly by Britain and Holland which have signed a liberal bilateral with each other). Certain European states have threatened to wage an anti-trust battle against IATA and many support the adoption of an intra-European agreement on zones of reasonableness. In the case of the Europeans, who in the past agreed on strict multilateral tariff setting on intra-European routes, this action would represent a move away from the cartel system. (Within certain bands airlines set prices unilaterally according to market forces.) Similarly, talk of movement away from a 50-50 traffic split indicates a slight weakening of support for cartel principles. Nevertheless, at the time of the writing of the thesis, European traffic outside shared U.S. markets, operates for the most part within the cartel system. In the Asian/Pacific region, some traffic operates outside the cartel system (i.e., tariffs are not directly set through IATA); nevertheless, it appears that many of these countries adhere either to regional multilateral tariff agreements or follow IATA guidelines. De facto this can be seen as support for cartel principles. Finally, new moves to apply anti-trust legislation against IATA by New Zealand and Australia signal weakening support for the cartel system. In
conclusion, it is clear that the principles of the cartel system no longer have the same support as in the heyday of the cartel. Nevertheless, they continue to dominate in many markets.
ANALYSIS

Recent years have seen the consolidation of support for the restructured cartel. Following 1981, the U.S. tempered its aggressive pursuit of deregulation. Not only did it abandon the Show Cause Order, but it also implicitly permitted its carriers to participate in North Atlantic traffic conferences by becoming party to the ECAC-U.S. Memorandum of Understanding. It also changed its policy towards liberal bilaterals and adopted a more pragmatic approach. Curiously, this period has seen new challenges to the IATA cartel originating from Europe, New Zealand and Australia, although for the time being these initiatives have been stalled. Both within North America and Europe, IATA's control over tariff-fixing has weakened as other forums (i.e., regional organizations and bilateral government negotiations) have become new loci of negotiations. In these regions, IATA's role as a trade association has gained in importance. In Africa, the Middle East and Latin America (i.e., regions where airlines are the least competitive and require some form of government support) IATA price-fixing is still very important. These states fear, however, that deregulation from North America and Europe will make inroads into their controlled systems.

Thus the three new developments in the aviation regime since 1981 have been a move to international deregulation in Europe, a move away from international deregulation in the United States, and a growing trend toward regionalism in developing countries. The analysis will focus on explaining these three dynamics.

The first question to be asked is to what extent were changes in economic theory or information responsible for the behaviour of certain states in Europe, the United States, and in the developing world? It is interesting
to note that, as seen in the United States in the previous period, in Europe the move towards deregulation was preceded by a number of economic studies calculating the costs of regulation. The significance of these studies should not be underestimated. For the first time, the extent of pooling and other restrictive arrangements were made public. Similarly, prices and costs of European operations were calculated so that European efficiency levels could be compared with some precision to those in North America. The conclusions of these studies were for the most part critical of the anti-competitive arrangements. They stressed that liberalization would lead to both higher efficiency, lower prices and industrial growth, and urged policymakers to act accordingly.

The acceptance of the idea that market forces should play a greater role in the commercial regulation of civil aviation characterized to a certain extent the general European atmosphere. Although the Europeans were quick to stress that they were pursuing controlled liberalization as opposed to deregulation American-style. It would appear that the economic studies had some impact on the change in attitude, although it was clear that countries with more efficient industries, such as Britain, and countries not primarily dependent on third and fourth freedoms were the most affected by these studies. In other words, there were other more important dynamics behind the change.

It is not immediately obvious from the economic data why the United States should modify its procompetitive policy. Information on growth and fare patterns gathered over the period from 1979 to 1981 would suggest that the United States was successful in achieving its publicly declared objectives: stimulating industry growth and lowering prices. An analysis of
growth in liberal European-U.S. markets from 1977 to 1980 showed that scheduled traffic had increased by 99.4%, while in the less liberal European markets traffic had increased only by 41.1% (Rosenfield 1987:481). Similarly, it was calculated that a procompetitive policy on the North Atlantic had saved consumers between $1.6 billion and $1.8 billion in fares from 1978 to 1980 (Aviation Week and Space Technology April 12, 1982:31). Thus, U.S. behaviour could not be explained simply on the basis of new knowledge about the effects of deregulation on consumer welfare or on the development of the world industry.

The move towards greater reliance on regionalism in the developing world is not explained by any new economic studies or by changes in economic philosophy. Rather, as will be argued, it was a new tactic used to pursue unchanging objectives: tariff-fixing specifically and market regulation in general.

The second question to be asked is to what extent was European, U.S. or the developing countries' behaviour the result of changes in attitude to developing their aviation industry? The behaviour of the anti-competitive European states suggests that these countries were interested in lending support to the loose tariff-fixing functions of the new cartel which would provide some protection to their industries. The anomaly which must be explained is why do certain European states suddenly turn in favour of deregulation? Why are they no longer concerned with protecting their industry? Once again, it is not surprising that the states which press for deregulation and lead the anti-IATA crusade are the more efficient carriers and those which benefit from fifth and sixth freedoms. In other words, these countries have every reason to believe that their market shares will increase in a
deregulated environment. The economic studies made of the industry gave them the needed public platform (i.e., consumer welfare) to press for liberalization. It is interesting to note that their initiatives have not to this point been highly successful. This would suggest that the pro-deregulation group is not powerful enough to force their policies on the more conservative states. In effect, it would appear that Europe has become in the last few years the playground for a never-ending tug-of-war between the two forces.

The reasons for the U.S. acceptance of the IATA multilateral price-fixing will be explained shortly; however, it is worth noting at this point that the action of the United States was not primarily motivated by concern about the effect of competitive market pricing on the development of its industry. Developing countries continued to support the cartel in order to ensure the development of their aviation industry for the various reasons which have been already discussed. Their new interest in regional tariff coordinating organizations reflects their discontent with weakened IATA authority. As was clearly shown at the ICAO conferences, they see IATA as being controlled by industrialized states which have been successful in restructuring the organization in response to developments in their mature markets. These countries feel that regional organizations will not only be more responsive to their direct concerns, but will also help to consolidate their policy positions. In turn, this will allow them to have more influence in international forums such as IATA and ICAO.

U.S. renewed support for the cartel should be examined within the framework of the hegemonic stability theory. It will be recalled that in previous periods the United States supported the cartel not because it found it in its economic interest to do so, but because there were external reasons for doing
so (i.e., security interests). When these concerns diminished, the United States took action to introduce greater price flexibility in the market, and thereby challenged cartel activity. The question must be asked: why did the U.S. abandon its procompetitive crusade?

The U.S. adoption of a more pragmatic approach to bilaterals and in particular its diminished willingness to try to bribe states to introduce price flexibility by offering new rights and gateways would suggest two things. First, that the United States was not satisfied with the results of this policy and, as a corollary, that it was not powerful enough to ensure that this policy achieved its objective. Both propositions appear to be true.

It should be recalled that the most important motivation behind U.S. procompetitive policy from 1979 to 1981 was not to improve consumer welfare or ensure world-wide traffic growth. Rather, it was a long-run objective to regain dominance in the industry by securing greater market shares. While consumers were making great savings on the North Atlantic and while traffic was growing faster in liberalized markets, U.S. market shares were declining and not increasing. Already in 1979 Aviation Week and Space Technology reported that:

> Concern is growing among airline executives here that the new low country-of-origin fares adopted bilaterally by the U.S. with West Germany, Netherlands and Belgium outside the auspices of the IATA could backlash into competitive advantages for the European carriers at the expense of U.S. airlines (Aviation Week and Space Technology April 23, 1979:26).

Data on market shares suggest that during the period 1977-1981, the U.S. share of international traffic fell from 45.4% to 41.0% on the North Atlantic, and 43.7% to 38.7% on the Pacific. In all world markets it fell from 50.4% to 48.7% over the same period of time (Adkin 1982:36). (See Table 7.) Adkin has argued that this trend, particularly in the North Atlantic market, is a consequence of the declining U.S. traffic generating power, (thus, U.S. citizens represented 50.4% of the international market in 1979 and 46% in 1981) and the decline in charter traffic.

U.S. carriers, of course, lost business when the volume of U.S. citizens travelling fell since travelers have been found to prefer to travel on their national carrier provided prices are comparable. Similarly, the United States had a dominant share of charter traffic and hence when charter traffic declined, its world share also declined.

These results lead to the conclusion that U.S. procompetitive policy simply did not account for the reality of the international market. Prior to their procompetitive offensive U.S. policy-makers assumed that the domestic environment mirrored the international environment. They believed that they had the power to dictate market conditions. When Senator Cannon was asked during an interview in the late '70s if the United States could exercise influence in aviation, he responded:

I think we can sustain it to the extent that we have up to this time. . . . I would think we should be the dominant force in describing what the market conditions are . . . (qtd. in Gertler 1979:108).

And yet the developments from 1979 to 1981 suggest the contrary. The United States found that it was not able to negotiate liberal bilaterals with
certain countries even by offering fairly lucrative bribes. *Aviation Week* and *Space Technology* reported in 1979:

> According to a number of observers here, a majority of foreign flag carriers and their governments are not likely to yield in the foreseeable future to U.S. demands for unrestricted competition, regardless of the lure of attractive tradeoffs, such as wider entry into U.S. markets (*Aviation Week and Space Technology* April 23, 1979:27).

Not only did the United States have difficulty in securing its favoured negotiating outcomes but it was also unable to prevent foreign countries from taking direct measures to protect their airlines from U.S. competition by means of subsidies and restrictive practices. Willis Player, retired Pan Am executive, criticized U.S. policy for having failed to recognize the true nature of the environment in which the United States was competing:

> We hate to see our government giving away real, hard, intrinsic, measurable values--our geography, if you will--for value that is only nominal at worst and short-termed at best. We're competing in a world that does not exist the way these instant experts think it exists. We're not corporations competing on equal footing with other corporations. We're competing with other governments that have firm, consistent and mostly protective aviation policies (qtd. in Jönsson 1987:126).

Pan American Chairman, William Seawell, in a letter to CAB Chairman Marvin Cohen, made similar observations and complained that the policies of the
preceding four years through their failure to recognize the inequities of the international marketplace and to account for the competitive advantage of foreign carriers was to a great extent responsible for "compounding the serious financial problems being faced not only by Pan American, but also by the U.S. international industry in general" (qtd. in Jönsson 1987:126).

In response to the realization that the Carter policy had led to a weakening of the U.S. industry, the Reagan administration adopted a new protective policy. One of its main concerns was to ensure that further erosion of U.S. market shares was prevented, and that the concessions it gave received reciprocal concessions from its bilateral partners. Clearly, it was no longer playing the role of a hegemon which was bolstering the economies of the industrialized nations.

It has been suggested that one of the reasons why the United States ceased to be willing to pay a high cost for price flexibility (which indirectly challenged IATA operations) in liberal bilaterals was because this policy was too expensive. Furthermore, lowered prices due to the protective policies of other states had not provided the expected boost to U.S. industrial growth. Thus, one of the key reasons for destroying the IATA cartel (i.e., introducing lower fares) had not been found to be the panacea that it was thought to be. There are four other reasons why the United States modified its behaviour, and in particular, recalled the Show Cause Order. The first is that the modifications made to IATA through its restructuring decreased the urgency for U.S. action. After all, the way had been opened for a greater interplay of market forces in the aviation industry. In particular, the United States was able to benefit from the organization's facilitation functions without being tied to cartel tariff control. Second, it is
not inconceivable that doubts about the long-run benefits of complete deregulation (as reflected in new U.S. initiatives to regulate foreign markets' entry) made the United States more sympathetic to IATA regulation of tariff levels. Thirdly, new security concerns over alienating its allies through the Show Cause Order provide a persuasive explanation of the retraction of the U.S. challenge to the cartel. At the time of the issue of the Show Cause Order it appears that U.S. policy-makers did not expect much opposition to their action. James Atwood, who served as Deputy Assistant Secretary in the Department of State with responsibility for aviation affairs in 1978-1979, noted:

The CAB did not act wisely by attacking IATA's antitrust immunity. The Board was on sound ground under both domestic and international law for opening its investigation, and it presumably did not predict the degree of reaction abroad. But the threat to apply U.S. antitrust to IATA simply hardened foreign opposition to U.S. policies . . . (qtd. in Jönsson 1987:147).

However, when governments began to complain and opposition grew, the United States realized that its policy initiatives were a threat to its security. President Reagan's letter to the CAB stressing the need to cooperate with foreign governments and urging the CAB to take appropriate action is proof of this fact. It is also not a coincidence that the Reagan policy, which is in many ways more sensitive to foreign policy concerns, is a product of a domestic environment where aviation policy is primarily formulated by the Department of Transportation and the Department of State. The final reason for U.S. abandonment of the Show Cause Order has been suggested by Taneja. He
points to the fact that concerns over the fate of the aerospace manufacturing industry may have influenced U.S. policy. The export value of commercial transport aircraft in 1978 was $2.5 billion. In past years the United States manufactured 96% of all commercial jets built; however, in recent years its share has fallen to 80% while European states' shares have increased from 4% to 20%. The United States has been concerned with this trend and with the effect the Show Cause Order might have on future sales. Taneja writes:

Given the irritation the policy has caused abroad, there is a serious risk of confrontation and conflict, and the loss of sales of future U.S. aircraft to some foreign airline is not inconceivable (qtd. in Taneja 1980:142).

Since Reagan stressed his intention to strengthen the U.S. aerospace manufacturing industry, it would not be surprising if the considerations outlined by Taneja played a role in determining U.S. policy change.

The concern for ally friendship and the fear of foreign reprisals in the manufacturing industry would give further credence to the view that the U.S. has lost leverage power. The events of the period suggest that the U.S. position as hegemon in the industry has been seriously undermined. Although it continues to be a very powerful state, and was able to bring about the restructuring of the IATA cartel, it was not able to change the regime globally. Its policies following 1981 reflect the realization that it must work within the confines of an environment shaped not only by its own objectives, but also by the objectives of other states. No longer is it the only actor who can shape the future of the aviation industry.
The case centered on a charge by the French government that Air France, British Airways, KLM Royal Dutch Airlines, Air Lanka had violated French law by selling tickets below rates approved by the French government (Aviation Week and Space Technology July 5, 1985:28).
CONCLUSION

This study initially proposed three reasons why states might support the operation of a cartel: to promote consumer welfare and the growth of the industry; to ensure the development and protection of their national carrier; and as a consequence of hegemonic activity. It then suggested why they might cease to participate: if states no longer saw the cartel as promoting consumer welfare and industrial growth; if they were not interested in gaining benefits associated with having international carriers; if they felt that their industry no longer benefited from protection or if the hegemon was unable or unwilling or both to support the regime. The ultimate objective was to isolate one of the three variables, thereby arriving at a parsimonious theory which would explain all post-World War II developments in this issue area. It became apparent quickly that no single variable could provide a comprehensive explanation of state behaviour. Rather, all three gave valuable insights. Nevertheless, it is possible to establish a hierarchy of usefulness according to the depth and scope of understanding which each explanation can provide.

Concern about consumer welfare and the global industry has been of least importance in motivating state behaviour. One instance where this variable may have affected state policy was at the Chicago Conference. The Australian and New Zealand proposals to establish an International Air Authority which owned and managed international services indicated that these states were willing to abandon the idea of owning their own national industry in favour of a system which they believed would be best for the global development of the industry. It may also be argued that U.S. policy from 1978 to 1981 and
European policy after 1981 were influenced by various economic studies which suggested that deregulation and particularly price flexibility would be both beneficial to consumer welfare and would stimulate the growth of the industry. However, it would appear that rather than directing policy these arguments' public popularity was exploited by policy-makers who were more interested in increasing their state's share of the international market.

The second explanation, which claims that states will support a cartel if it promotes the development of their own aviation industry, provides a more powerful explanation of state behaviour. In fact, throughout the development of the international aviation regime, it is clear that for all states interest in establishing and then developing their own industry for any combination of economic, political, and security reasons has been very significant. It was found that willingness to support cartel activity depended on whether a state viewed its air carrier as being inefficient and requiring cartel protection. Until the 1980s, with the exception of the United States, all states seem to have lacked confidence in the competitive strength of their scheduled air carriers. However, this explanation provides no insight into why the regime actually formed, nor why the United States, whose industry would have benefited from a more competitive environment, supported the organization for many years, nor why the cartel first weakened and then broke up during a period when most states supported tariff-fixing in principle.

These questions are answered by reference to the third and most valuable explanation: hegemonic stability theory. The theory proposes that the formation of a regime requires the presence of a hegemon which is able and willing to facilitate cooperation and, if necessary, pay the costs associated
with the establishment of the regime, as well as enforce the terms of the agreement. If one examines the pre-World War II period, it is clear that states would have benefited from a cartel arrangement (i.e., their operations were highly inefficient), and yet they engaged in rate warfare. At this point in time there was no single dominant air power which could set and enforce the terms of the regime. Without a hegemon, states were afraid that if their carriers supported a tariff-fixing agreement, their cooperative efforts would be exploited by other states' carriers which would find it to their advantage to undercut set prices. After the war, the United States emerged as the most powerful actor not only in terms of air power, but also with respect to its position in the international system. It built a network of bilateral agreements which legitimized cartel activity. By giving its support to the cartel the United States lent credibility to the organization's tariff-setting mechanism.

The United States also provided loans and transport aircraft to states desiring to establish their own carriers. This activity not only helped develop the industry, but also ensured that the United States had a great deal of influence over the aviation policies of its allies. Thus, it was in a position to prevent states from violating cartel agreements.

The United States supported the cartel initially because it found its security interests linked to bolstering the economies of its allies. It was willing to pay the "economic costs" associated with cartel support for nearly twenty years. However, as its allies grew economically stronger, the United States no longer felt that it needed to aid their development. Consequently, it turned to establishing an environment in which its airlines would flourish: a competitive system where prices were not fixed at levels reflecting
the costs of less efficient airlines. First, the United States tried to lower prices within IATA. However, this initiative was met with a great deal of foreign opposition. A different security interest began to modify U.S. behaviour: it wanted to avoid alienating its allies. The United States then turned to pursuing its economic objectives through a more subtle assault on IATA pricing: charters. The introduction of charters led to chaos in the North Atlantic market. Other factors such as overcapacity, the fuel crisis, and recession combined to challenge cartel operation. Without U.S. support, IATA was unable to restore order in most traffic conference regions. Then the United States employed even more aggressive tactics to undermine the cartel: liberal bilaterals and the Show Cause Order. Once more the United States retreated from its procompetitive assault owing to foreign policy concerns. Although the United States was unable to change the regime globally, it was successful in introducing more flexibility into IATA traffic conferences and in weakening the authority of the cartel.

Hegemonic stability theory states that as the hegemon weakens, the regime breaks down. The study suggests that over the years, within the issue area of aviation U.S. power in terms of traffic generation and market shares has declined. However, it continues to be the dominant air power. It has been argued that U.S. withdrawal and assault on the cartel reflected a shift in its immediate policy objectives as opposed to its "hegemonic decline." As was pointed out, however, the shift in policy objectives was indirectly symptomatic of the United States' loss of power. As the Europeans developed their aviation industries and in general revitalized their economies, they gained power. This translated into a loss of power for the United States.
As this thesis demonstrates, the study of the economic regulation of international civil aviation can provide many useful insights into the complex dynamics behind state support of a cartel.
ton-kilometers: sum of products obtained by multiplying the total number of tons of each category of revenue load (passengers, baggage, freight and mail) carried on each sector of a flight by flight stage distance.

passenger-kilometers: sum of the product obtained by multiplying the number of revenue passengers carried on each flight stage by the flight stage distance.
TABLE 1

WORLD SCHEDULED INTERNATIONAL AIR TRANSPORT

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<th>ton-kilometers (all services)</th>
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Source: Civil Aviation Statistics of the World.
### TABLE 2

**OPERATING REVENUES AND EXPENSES OF THE WORLD'S SCHEDULED AIRLINES**  
(millions of U.S. Dollars)

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<th>Operating Expenses</th>
<th>Operating Results $^1$</th>
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$^1$ Excludes interest and income tax.

$^2$ 1953-1978: Data excludes USSR and People's Republic of China  

Source: Civil Aviation Statistics of the World.
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### TABLE 4

**IATA TRAFFIC ON NORTH ATLANTIC**

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# TABLE 5

**TOTAL NORTH ATLANTIC PASSENGER TRAFFIC**

* (market shares %)

<table>
<thead>
<tr>
<th>Year</th>
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<th>Non-IATA Scheduled</th>
<th>Non-IATA Charter</th>
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*Source: World Air Transport Statistics*
### TABLE 6

**REGIONAL PERCENTAGE DISTRIBUTION OF TOTAL TON-KILOMETERS PERFORMED ON SCHEDULED INTERNATIONAL AIR SERVICES**

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<thead>
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<th>Europe</th>
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1 1965, 1968: excludes USSR.
1970-1985: includes USSR.

Source: ICAO Bulletin.
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a First three quarters of 1981 only
b Calendar year 1981
c Includes U.S.-Africa/Mideast/Caribbean/Central America

Source: Adkins 1982:36
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The International Civil Aviation Organization (ICAO) was established on April 4, 1947 with the coming into effect of the International Civil Aviation Convention (Chicago Convention). ICAO obtained the status of a specialized agency of the United Nations on May 13, 1947. The aims and objectives of the organization were outlined in article 44 of the Chicago Convention. It was to: develop the principles and techniques of international air navigation; foster the planning and development of international air transport; ensure the safe and orderly growth of international civil aviation throughout the world; encourage the arts of aircraft design and the operation of peaceful purposes; encourage the development of airways, airports, and air navigation facilities for international civil aviation; meet the needs of the people of the world for safe, regular, efficient, and economical air transport; prevent economic waste caused by unregulated competition; ensure that the rights of contracting states are fully respected and that every contracting state has a fair opportunity to operate international airlines; avoid discrimination between contracting states; promote safety of flight in international air navigation; and generally foster the development of all aspects of international civil aeronautics (Chicago Convention Art. 44(a), (b), (c), (h) qtd. in Dempsey 1987:531).

The structure of ICAO is modelled after the United Nations. The Assembly is composed of all contracting states of the Chicago Convention.
Each state in the assembly has one vote and most decisions are adopted by a majority vote (provided there is a quorum). The Assembly meets at least once every year and is responsible for establishing general policy guidelines and reviewing ICAO activity.

The Council performs a quasi-executive function. Membership is limited (thirty-three states are elected for three-year terms). The Assembly which selects Council members ensures that this body adequately represents the states of chief importance in air transport and the states which make the largest contribution to the provision of facilities for international civil air navigation. Finally, the Assembly ensures that all major geographic areas of the world are represented on the Council (Chicago Convention Article 50(a) and (b) qtd. in Botsford and Gariepy;1976:353). As Gidwitz writes, in actual fact, major powers are given permanent membership through re-election while other council positions are rotated between NATO and Warsaw Pact states and other states representing geographic areas (Gidwitz 1980:82). The Council elects a president who holds a long tenure and one or more vice presidents. Decisions are reached by majority vote and no council member has veto power.

Council activities can be relegated to three realms: legislative, judicial, and administrative. The Council's legislative function consists of adopting various ICAO air navigation and air transport regulations. In its judicial capacity, the council is empowered to adjudicate disputes between contracting parties relating to the interpretation of the Convention. Its administrative functions include: administrating the organization's finances, appointing the Secretary General, and members of committees and commissions, executing Assembly directives and supervising international
agreements for the joint financing of air navigation facilities and services (Gidwitz 1980:82-83; Gariepy and Botsford 1976:353-354).

The functions of the Council are supported by the work of six standing committees or commissions. The Air Navigation Commission is concerned with developing and ensuring the acceptance by states of international air navigation standards. The Committee on Joint Support of Air Navigation Services provides financial and technical support for air navigation facilities and services on international routes (Gidwitz 1980:83.) The Air Transport Committee studies the development of air transport, air financing, charter services, fares and rates. It also attempts to facilitate transport through standardization of customs, immigration, and public health requirements and by ensuring that appropriate passenger and shipping facilities are made available. In addition, it attempts to simplify cargo, mail and baggage handling and clearance (Gidwitz 1980:83). The Legal Committee drafts air law conventions and analyzes international air law (Gidwitz 1980:83). ICAO finances are administered by the Financial Committee. Policy and protection against terrorism and unlawful interference is developed by the Committee on Unlawful Interference of Aircraft.

The civil servant branch of ICAO, the Secretariat, implements the decisions of the various branches of ICAO. It is organized into bureaus (e.g., the Technical Assistance bureau which provides assistance to developing countries). The headquarters of the Secretariat is located in Montreal and it has regional offices in Mexico City, Lima, Paris, Dakar, Cairo, and Bangkok (Gidwitz 1980:83).
One of the proposals submitted at the Chicago Conference was that airline operators be given some special status in the regulation of international air services. It was suggested that a meeting of members of delegations who were operators of services be held concurrently with the meetings between the Heads of State. The United States opposed this suggestion maintaining that the convening of such a meeting under the auspices of the Chicago Conference would contravene U.S. anti-trust laws. However, as long as the U.S. government was not officially associated with the joint activities of private airlines; it had nothing against the operators meeting on some other occasion (Chuang 1972:23-26).

Shortly after government sessions had ended, a meeting was called by representatives of BOAC, Misr Airlines (Egypt), and Transports Ariens Français (the interim French company). On December 6, 1944 airline executives from Europe, North and South America, Asia and Australia met. They appointed a committee to draft articles of association for a new, world-wide carrier organization and agreed to convene in Havana in April 1945.

At Havana, representatives from 31 nations met to enact the Articles of Association. Shortly afterwards IATA was incorporated at Montreal by a Special Act of the Canadian Parliament (Koffler 1966:224). The Bermuda I agreement and the many bilaterals signed according to the Bermuda model gave IATA the legal authority to fix tariffs.
IATA membership is open to all airlines authorized by their governments to operate international services. Two types of membership are available: Active and Associate membership. The latter does not offer full privileges. Ultimate authority lies in the General Meeting composed of representatives of Active members. Each member has one vote. An elected executive committee headed by a director-general and five assistant directors run the day-to-day operations of the organization from its headquarters in Montreal and Geneva. Most of the work of the organization is conducted by four standing committees: the Financial committee, the Legal committee, the Technical committee, and the Traffic advisory committee. The Financial committee is responsible for the standardization of accounting procedures and the settlements of accounts. It also operates a Clearing House which accepts claims from member airlines against other member airlines and matches the claims with payments due to them according to the same procedures. This function allows individuals to buy a single ticket in one currency and travel on one or more airlines. Account settlement by the airlines occurs through the Clearing House which divides the proceeds from the purchase of this ticket. The legal committee deals with legal issues related to civil aviation. It is concerned with the legal relationship between airlines, and travel agents, liability issues, security standards, crime and traffic documentation (i.e., tickets and cargo waybills). The technical committee is in charge of standardizing technical facilities and procedures in order to improve safety and efficiency of international operations. The Medical Advisory Committee, working under the aegis of the Technical Committee, concerns itself with health related issues; health of crews, ground-workers, passengers, problems of sanitation, quarantine and immunization. Finally, there is the IATA Traffic Committee
which, in conjunction with the Secretariat, coordinates IATA procedures, conferences and, most importantly, in the context of this thesis, tariff coordinating conferences.

Traffic Conferences have two important functions: they set international airline rates for passenger and cargo services and they deal with issues involved in interline facilitation.

Meetings are held at least once every two years and are divided into three Traffic Conference Areas. TC1 consists of all of North and South America and adjacent islands, Greenland, Bermuda, the West Indies and islands of the Caribbean Sea, and the Hawaiian Islands. TC2 covers all of Europe and adjacent islands, Iceland, the Azores, all of Africa and adjacent islands and all of Asia lying west of and including Iran. TC3 consists of all of Asia and adjacent islands not included in TC2, all of the East Indies, Australia, New Zealand and adjacent islands, all of the Pacific Ocean islands except those belonging to TC1. Any airline operating scheduled international routes within a traffic area becomes a member of that Traffic Conference. Joint meetings of Traffic Conferences are also held to resolve traffic issues which pertain to more than one traffic area.

Until the late '70s, conference meetings were held in secret. Each member had one vote and affirmative unanimity was necessary to pass resolutions. Conferences usually met in the summer to decide what rates would be charged over various routes for the following year. Fares between pairs of points were negotiated, along with stipulations and conditions of service. In the event that a conference failed to reach a compromise on fares for a given route, or, if a government refused a conference decision, an open rate situation would occur.
APPENDIX III

THE BILATERAL AGREEMENT

The format of a bilateral usually included the following articles:

- preamble or statement of purpose
- choice of languages; i.e., if there is a dispute over which language (if more than one is used) should be used to interpret the terms of the agreement
- definitions of territory, airports, specified routes, all-cargo service, designated airline, revenue passengers, tariff, user changes, and other terms to be used in the agreement and annexes
- granting of rights—general statement of principles, referral to specification in annexes
- designation and authorization of airlines
- application of laws including jurisdiction over foreign airlines
- designation of competent authorities including responsibilities of specific government aviation and other relevant agencies in both countries
- mutual recognition of each country's documentation, such as certificates of airworthiness, crew licenses
- documents that must be kept on board aircraft, including registration, Certificate of Airworthiness, crew licenses, log books, passenger lists, and freight manifests
- agreement to adhere to relevant ICAO standards such as navigation aids, registration of agreements and others
- procedures to be followed; i.e., emergency landings, accidents, or disasters on or over territory of signatory states; access to accident-involved aircraft, crew passengers, freight; investigation procedures
- security procedures
- environmental protection and noise abatement procedures
- procedures for notification of schedule changes
- procedures for commercial operations, such as maintenance of technical and commercial staff in foreign country (housing, location, and other necessities), issuance of long-term crew visas, advertising and sales regulations, and remittance of revenues
- tariffs and commissions
- user charges
- customs duties, including exemptions for spare parts, full lubricants and food on board aircraft
- flight planning and air control procedures
- charter flights
- consultations
- procedures for amending the agreement
- procedures for terminating the agreement (Gidwitz 1980:152-153).
The Third Special Air Transport Conference was convened from October 22 to November 7, 1985. Four hundred senior civil aviation officials from 93 contracting states, one non-contracting state and ten international and regional organizations attended. Discussion focussed on two agenda items: air transportation regulation and tariffs (ICAO Bulletin January 1986:11).

One of the main contentious issues was a state's application of procompetitive laws extra-territorially. Once more U.S. policy was the focus of debate, although a new development, potential deregulation by the European Economic Community was also discussed. The conference condemned the unilateral application of domestic competition law to the international system stating that not only was it destabilizing but it also violated certain bilateral agreements (Aviation Week and Space Technology November 11, 1985: 33). States were encouraged to apply their competition laws in accordance with international agreements so as to avoid extraterritorial effects. They were also urged to adopt policies which would ensure that fair and equal opportunities existed for the sharing of international traffic carriage among states. In addition, the council was urged to undertake a study to provide guidelines for the resolution of conflict arising when national laws were applied to international agreements (Aviation Week and Space Technology November 11, 1985:33). The U.S. opposed these recommendations stating that it believed:
that ICAO should avoid any suggestion that it is attempting to direct states to alter their basic economic policies. In dealing with competition laws, we believe that the committee's recommendations would take ICAO beyond its appropriate role. This is a matter where ICAO's inherent institutional competence to make recommendations to states is in question (qtd. in Dempsey 1987:541).

Other topics of discussion centered around currency conversion, noise regulations, detention or seizure of aircraft where drugs or prohibited goods were found on board, and the U.S. policy which disapproved tariff filings where baggage allowances and charges were specified by weight as opposed to baggage pieces.

In the area of regulation, the conference studied three main topics. First, there was discussion of the declining North Atlantic market shares and the developing European-Mediterranean market for non-scheduled carriers. The conference recommended that the council study charter market shares, and the feasibility of reducing and simplifying rules regulating charter operations, (ICAO Bulletin January 1986:9-10). Second, the ICAO conference examined the role of governments in establishing tariffs and their authority with respect to airline discriminatory practices. Delegates noted that the definition of an international tariff was being obscured by a variety of innovations in the aviation industry and recommended that the council undertake studies which would provide better guidelines. In particular, delegates argued that low-priced domestic fares, add-on services made available with the purchase of an international ticket, and frequent flyer programs should be considered as
fare discounts and be filed for approval in accordance with bilateral agree-
ments (ICAO Bulletin January 1986:28). Finally, the conference recommended
that ICAO study how to avoid preemption of its role in international air
transport by a number of international organizations interested in trade in
services (e.g., within the General Agreement on Trade and Tariffs [GATT], the
Organization for Economic Cooperation and Development [OECD], and the United
Nations Conference on Trade and Development [UNCTAD]) (Aviation Week and
NOTES

1 The Latin American states complained that the IATA system of currency conversion adopted in 1973 was unresponsive to fluctuating exchange rates and could be easily manipulated by governments or airlines leading to directional imbalances and fare discounting. The conference recommended that IATA establish a new multilateral currency conversion system which would calculate and establish passenger fares (Aviation Week and Space Technology November 11, 1985:33).

2 The Africans, through AFCAC, complained that new noise regulations required aircraft modifications which they were unable to finance. It was agreed that ICAO should make a further study of the issue and delay a compliance deadline scheduled for January 1, 1988, which set maximum levels of noise for subsonic aircraft (Aviation Week and Space Technology November 11, 1985:33).

3 LACAC (Latin American Civil Aviation Council) stressed that an air carrier had no legal obligation under the Warsaw Convention to guarantee the contents of goods it carried and therefore detention or seizure of aircraft in cases where drugs or prohibited goods were found on board was inappropriate. The conference accepted the LACAC position, provided there was insufficient evidence linking the carrier to the offence (Aviation Week and Space Technology November 11, 1985:33).

4 In response to LACAC criticism of U.S. policy on the baggage issue, the conference recommended that an ICAO panel of experts develop a formula which would standardize baggage piece and weight allowances (Aviation Week and Space Technology November 11, 1985:33).