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COMMUNICATION FROM THE COMMISSION

Developing a Common Aviation Area with the Republic of Azerbaijan

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1. INTRODUCTION

In its 2005 Communication “Developing the agenda for the Community’s external aviation policy”¹, the Commission highlighted the importance of creating a Common Aviation Area with its Eastern and Southern neighbours. The ultimate objective of such a Common Aviation Area is to create a large and open aviation market that is based on common rules. In June 2005, the Council of the European Union supported this objective and welcomed the progress made by incorporating EU neighbouring countries into such a framework.²

The Commission analysed the implementation of this process in its 2008 Communication “Common aviation area with the Neighbouring Countries by 2010: progress report”.³ It concluded that this process has shown positive results and should be accelerated. Furthermore, the Commission has in July 2011 published a Communication “The EU and its neighbouring regions: A renewed approach to transport cooperation”.⁴ This Communication reiterates that European Common Aviation Area (ECAA) policy has been designed to allow gradual market opening between the EU and its neighbours linked to regulatory convergence through gradual implementation of EU rules. The process of market opening and regulatory convergence take place in parallel in order to promote fair competition and the EU's safety, security, environmental and other standards. ECAA is implemented through comprehensive air services agreements that promote the overall economic, trade and tourism relations and offer new opportunities for operators and wider choice for consumers. Closer integration between the transport markets of the EU and those of the European Neighbourhood Policy countries can make transport connections faster, cheaper and more efficient, to the advantage of citizens and businesses.

The enlargement of the European Union of 2004 and 2007 has further reinforced the interdependence between the EU and its neighbours. In June 2006, the EU and its Member States signed the European Common Aviation Area Agreement with the Western Balkan countries. This was followed by the signature of the first Euro-Mediterranean Aviation Agreement with Morocco in December 2006. In December 2010, a Euro-Mediterranean Aviation Agreement was signed with Jordan and a Common Aviation Area Agreement was signed with Georgia. Negotiations are ongoing with Ukraine, Lebanon, Israel and Moldova, and are expected with Tunisia in the near future.

¹ COM(2005) 79 final, 11 March 2005.

² Council of the European Union, 27 June 2005: “Conclusions on developing the agenda for the Community’s external aviation policy”.

³ COM(2008) 596 final, 1 October 2008.

⁴ COM(2011) 415 final, 7 July 2011.

The creation of a wider Common Aviation Area creates benefits in various respects. It supports the:

- Implementation of the European Neighbourhood Policy by facilitating the development of an integrated aviation market and the creation of better transport links between all countries involved;
- Economic development of countries that have a perspective to become a member of the European Union;
- Promotion of high-level European aviation standards and thereby helps to secure high levels of aviation safety and aviation security across the wider region;
- Institutional cooperation between the responsible authorities such as on aviation safety;
- Future development of the overall European aviation industry by providing a coherent regulatory framework for an enlarged market place.

This Communication addresses the specific issue of aviation relations between the EU and the Republic of Azerbaijan (hereafter Azerbaijan). Given its geographical location, good air transport connections between Azerbaijan and the EU are crucial for the country's economic development. The strategic location at the crossroads of Europe and Asia make Azerbaijan an obvious candidate for a Common Aviation Area Agreement with the EU.

In January 2011, the Azeri authorities expressed their interest in negotiating a Common Aviation Area Agreement with the EU. Following this, an economic analysis of the possible impact of concluding such an agreement was undertaken.⁵

Based on this work which is summarised in this Communication, the Commission recommends the Council to authorise the Commission to negotiate a comprehensive Common Aviation Area Agreement with Azerbaijan. Following the logic of the agreements between the EU and other neighbouring countries, this should be based on a combination of gradual market opening with a parallel process of regulatory cooperation and gradual harmonisation. Priority areas should be market opening, freedom of establishment, equal conditions of competition and common rules in the areas of aviation safety, aviation security, air traffic management, social conditions and environmental protection. In the Caucasus region, such an agreement has already been signed with Georgia.

2. EU-AZERBAIJAN: POLITICAL RELATIONS

Over the last decade, the EU and Azerbaijan have established a close relationship:

- The EU-Azerbaijan Partnership and Cooperation Agreement (PCA) was signed in 1996 and entered into force in 1999.⁶ It covers a broad range of issues including

⁵ The economic study was done by Steer Davies Gleave, "Study on the economic benefit of a Common Aviation Area Agreement between the EU and the Republic of Azerbaijan", London, July 2011.

trade, economic cooperation and law approximation. According to the provisions on law approximation (Article 43 of the PCA), Azerbaijan shall endeavour to ensure that its legislation (including in the transport sector) will gradually be made compatible with that of the EU. The transport area and the need for Azerbaijan to restructure and modernise its transport systems and networks to strengthen EU-Azerbaijan cooperation is particularly highlighted in Article 57 of the PCA. The need to cooperate on modernising airports and air navigation infrastructure and to promote trans-European links is particularly highlighted. The EU and Azerbaijan are currently negotiating an Association Agreement to succeed the PCA. This Association Agreement will significantly deepen Azerbaijan's political association and economic integration with the EU including in the transport sector.

- In parallel to this process, the European Neighbourhood Policy (ENP) has been developed and Azerbaijan became part of this policy in 2004. The ENP aims at strengthening the prosperity, stability and security of the EU's neighbouring countries and at avoiding the emergence of new dividing lines with the enlarged EU. This policy is implemented through European Neighbourhood Policy Action Plans (ENPAPs) which are agreed between the EU and each partner country individually. The EU-Azerbaijan European Neighbourhood Policy Action Plan was adopted in 2006. ENPAP provisions on transport include (for Azerbaijan) the development and implementation of a national sustainable transport policy, with a focus, where appropriate, on further approximation of legislative and regulatory frameworks with European and international standards, in particular for safety and security (all transport modes) and, in the aviation sector, the introduction of new regulatory mechanisms, including on safety and security issues.
- The Eastern Partnership initiative was launched in 2009 to deepen the EU's relations with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. The concept of a more ambitious partnership between the European Union and the partner countries is reflected in the Joint Declaration of the Prague Eastern Partnership Summit, signed on 7 May 2009, in Prague.
- The main EU co-operation objectives, policy responses and priority fields as far as Azerbaijan is concerned are laid down in the Azerbaijan Country Strategy Paper 2007-2013. Azerbaijan has also presented a national development strategy, which includes a plan to adopt various EU legislation, including in relation with the common rules for the operation of air services (Regulation (EC) No 1008/2008 of the European Parliament and of the Council on common rules for the operation of air services in the Community), the rules on the limitation of noise emission from civil subsonic jet airplanes and the rules on the investigation of civil aviation accidents and incidents.
- More specifically on aviation, Azerbaijan is actively participating in various pan-European aviation structures. Azerbaijan is a member of ECAC (European Civil Aviation Conference) since 2002. It has applied for membership in Eurocontrol. In the field of aviation safety, two working arrangements have been signed in

⁶ OJ L 246/1999, p. 3, 17 September 1999.

2006 and in 2009 with the European Aviation Safety Agency (EASA).⁷ A "Horizontal Agreement" between the EU and Azerbaijan, which brings the bilateral agreements between Azerbaijan and EU Member States in line with EU law, was signed in July 2009 (there were 19 initialled bilateral agreements when the horizontal agreement was signed).⁸

3. THE EU-AZERBAIJAN AVIATION MARKET AND ECONOMIC RELATIONS

Given the distance between the EU and Azerbaijan and the relatively poor land transport infrastructure, aviation is the single most important mode of transport to link Azerbaijan to most EU Member States.

Azerbaijan has a population of 8.4 million inhabitants which is more than the combined populations of neighbouring Georgia and Armenia. Azerbaijan's GDP per capita has risen over recent years and Azerbaijan has a comparably high GDP per capita as a consequence of its oil and gas industry, similar to the level of Turkey.⁹

The EU-Azerbaijan bilateral trade was growing rapidly since the beginning of the decade until early 2009 when negatively impacted by the global economic crisis, also linked to a fall in international oil prices. In 2009 the total turnover of the bilateral trade was €8.9 billion (€12.7 billion in 2008), EU's exports to Azerbaijan €1.6 billion (€2.1 billion in 2008) and Azerbaijan's exports to the EU €7.3 billion (€10.6 billion in 2008). Despite the economic crisis, the EU remained Azerbaijan's main trading partner with 42.8% share in Azerbaijan's overall external trade (before Turkey and India with 8.1% share each, US with 7.5% share and Russia with 5.9% share). Azerbaijan is by far the largest EU's trading partner among the three South Caucasus countries. The EU exports to Azerbaijan mainly machinery and transport equipment (45.1% of the EU's total exports to Azerbaijan in 2009) and also chemicals (9.8%), precious and semi-precious stones (9.0%), foodstuff (8.0%) and base metals and products made of them (6.0%). Azerbaijan's export structure consists almost exclusively of mineral fuels.

International air transport to and from Azerbaijan is concentrated on Heydar Aliyev International Airport in Baku.¹⁰ The airport's traffic figures have grown rapidly over the past decade. There were around one million passengers in 2002 and approximately 1 900 000 passengers in 2010.¹¹ The passenger terminals were

⁷ Working Arrangement between the European Aviation Safety Agency (EASA) and the State Concern of Civil Aviation "Azerbaijan Hava Yollari" on collection and exchange of information on the safety of aircraft using Community airports and airports of the Republic of Azerbaijan, Working Arrangement between the European Aviation Safety Agency (EASA) and the State Civil Aviation Administration of the Republic of Azerbaijan.

⁸ OJ L 265/2009, p. 25, 9 October 2009.

⁹ According to World Economic Outlook Database, April 2011, Azerbaijan's GDP per capita was 6 008 US dollars (approximately € 230) in 2010. Azerbaijan's GDP based on purchasing-power-parity per capita was 10 033 current international dollars in 2010.

¹⁰ The Aeronautical Information Publication lists four other international airports in Azerbaijan, but there are no scheduled services to EU Member States from these airports. International destinations served from these airports are limited to Moscow, Kiev, St. Petersburg and Istanbul.

¹¹ The numbers refer to passengers to/from Heydar Aliyev International Airport. Steer Davies Gleave: Study on the economic benefit of a Common Aviation Area Agreement between the EU and the Republic of Azerbaijan.

modernised in the late 1990s and construction of a new international terminal is currently underway. This is scheduled for completion in 2012 and will have capacity for 3 million passengers per year.

Passenger traffic between the EU and Azerbaijan is still at a relatively low level; traffic to/from EU Member States represents approximately 10% of the total passenger traffic to/from Azerbaijan. For 2009, about 194 200 passengers were carried on flights between airports in the EU27 and Azerbaijan.¹² In 2009, the top six markets (UK – 35%, Germany – 23%, Austria – 17%, France – 8%, Sweden – 6% and Latvia – 6 %) accounted for 95% of the total EU-Azerbaijan passenger traffic. The city pair with the highest passenger volume in 2009 was London-Baku, followed by Frankfurt-Baku and Vienna-Baku. The Azerbaijan market can be attractive to EU airlines in terms of yields and revenues, due to a high share of business travel related to the oil and gas industry.

Azerbaijan has negotiated an air services agreement (ASAs) with 21 EU Member States (Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Romania, Slovakia, Spain, Sweden and the UK). Although some agreements have started to become more open, the ASAs with EU Member States are rather restrictive in particular with regard to the capacity arrangements (e.g. number of frequencies) and in some cases in relation with the routing possibilities. The current system of bilateral air services agreements between the Member States and Azerbaijan may therefore disadvantage a number of EU carriers as well as consumers in some Member States. The economic study contracted by the Commission has concluded that demand for air travel between the EU and Azerbaijan exceeds supply.

In July 2010, four EU carriers served the Azerbaijan market: airBaltic from Riga, Austrian Airlines from Vienna, British Midland Airways from London and Lufthansa from Frankfurt. The market share of these EU carriers in the EU-Azerbaijan market is 72% of all passengers carried. Also for air passenger traffic between Azerbaijan and North America, EU carriers and hubs have a high market share.¹³ On the other hand, during the period from 2008 to 2010, Turkish Airlines increased its operations to Baku significantly and Istanbul has become a growing competitor for traffic between Azerbaijan and the EU and between Azerbaijan and North America.¹⁴ During 2008-2010, traffic growth between EU27 and Azerbaijan was +10.9%.

Azerbaijan Airlines is the only Azeri airline that operates scheduled services between Azerbaijan and the EU. Azerbaijan Airlines' most important international route is to Moscow, Istanbul being the next most operated route. In 2010, Azerbaijan Airlines

¹² All transport figures stem from the study that was contracted by the Commission (Steer Davies Gleave: Study on the economic benefit of a Common Aviation Area Agreement between the EU and the Republic of Azerbaijan). The traffic figures are based on EUROSTAT information and include all passengers travelling on a flight segment, including transit passengers as well as transfer passengers via an EU Member State / Azerbaijan.

¹³ In 2010, more than 7 000 OD-passengers (origin-destination passengers) travelled from Azerbaijan to North America. Almost two-thirds of these passengers used either Frankfurt or London-Heathrow as transfer points.

¹⁴ More than 2 300 passengers travelled through Istanbul to North America in 2010. This level of transfer passengers is similar to that seen at London-Heathrow.

carried 800 000 passengers (the passenger number reached approximately 1 450 000 in 2007). Of the total flights in July 2010, 8% were to/from EU Member States. In 2010, Azerbaijan Airlines served Paris, London, Milan, Prague and Riga, of which Prague, Paris and Milan were served exclusively by Azerbaijan Airlines (no EU-carrier was operating these routes). Azerbaijan Airlines started operations to Aberdeen in June 2011. Azerbaijan Airlines operates a relatively modern fleet using A319 aircraft to the EU, supplemented by Boeing 757.

Air fares from Baku to EU destinations (and vice-versa) are relatively high. In the market between the EU and Azerbaijan, a combination of limited network competition and an affluent business demand segment (oil/gas industry) has resulted in air fares remaining relatively high. Analysis of fares in comparable markets suggests that demand for travel between the EU and Azerbaijan exceeds supply. The result is a market in which fares are held artificially high and leisure travel is suppressed. An increase in competition following liberalisation (especially of the restrictions in capacity arrangements) can lead to a drop in fares for the benefit of passengers.

4. BENEFITS OF AN EU – AZERBAIJAN COMMON AVIATION AREA AGREEMENT

The creation of the EU's single aviation market since the early 1990s has significantly contributed to make the sector more dynamic and efficient and has created significant economic and social benefits.

The conclusion of Common Aviation Area agreements with the Union's Eastern and Southern neighbouring countries has demonstrated that similar positive effects in terms of transport volumes and efficiency can also be achieved for these markets. In this respect, annual growth-rates of about 12% in seats available were achieved between the EU and the Western Balkans since the liberalisation of this market in 2006 and 2010.

The economic study referred to above examined the possible effects of an EU-Azerbaijan Common Aviation Area Agreement. The study forecasts that from 2010 to 2020, higher growth rates can be achieved with liberalisation. In a “No Change” scenario, passenger numbers would increase by 77% from 2010 levels, equivalent to an annual average of 5.9 %. In the “Full liberalisation” scenario (immediate or in a phased approach), however, passenger numbers would grow by a total of 98% from 2010 to 2020, or an annual average of 7 %.¹⁵

The economic benefit of such a Common Aviation Area Agreement is estimated at around €44.2 million during the first five years after liberalisation (mainly due to increased connectivity, lower air fares, increased air travel and associated economic activity). The analysis also shows that air fares on routes where there is / will be competition are likely to fall. An EU-Azerbaijan agreement would create new market opportunities for air carriers in the EU, some of which have expressed interest in operating additional services or starting new services to Baku, if the present capacity restrictions would be lifted. A Common Aviation Area Agreement could also

¹⁵ The "Full liberalisation" scenario includes an assumption that 3rd, 4th and 5th freedom traffic rights would be granted (immediately or in a phased approach).

facilitate the integration of Azeri carriers into existing alliances of EU air carriers thus allowing for the development of integrated products and better services to passengers and higher efficiency through economies of scale. Furthermore, experience shows that the implementation mechanism of Common Aviation Area Agreements helps solving possible doing business issues (mainly through the Joint Committee).

At least equally important to these economic benefits are, however, overall political considerations as such an agreement would significantly support the objectives of the European Neighbourhood Policy, the Eastern Partnership as well as the Partnership and Cooperation Agreement and the future Association Agreement with Azerbaijan, and promote the high-level EU aviation safety, aviation security and other standards.

It should be expected that there would be some costs for Azerbaijan stemming from the requirement to adopt and implement a Common Aviation Area Agreement. These costs would, however, be far lower than the expected benefits from such an agreement. The economic study referred to above has estimated a total discounted staff cost of between €1.8 million and €2.2 million during a five year period. It should be noted, though, that the requirement to enhance standards could stem also from other international commitments of Azerbaijan (ICAO, agreements with third countries such as USA).

An EU-Azerbaijan Common Aviation Area Agreement would establish a level playing field for all EU air carriers and allow passengers in all Member States to benefit from similar conditions and increased traffic between the EU and Azerbaijan and vice versa. In addition, an EU–Azerbaijan Common Aviation Area Agreement would provide the legal basis for the establishment of air services from those Member States which currently do not have bilateral ASAs with Azerbaijan.

5. CONCLUSIONS

As a consequence of market opening, travel opportunities for EU and Azeri passengers would improve and there would be economic benefits for EU and Azeri airlines and airports. Improved connectivity and access to a broader range of destinations is likely to act as a catalyst for the development of business in Azerbaijan and foreign inward investment.

It will be important to ensure that the opening and the integration of the markets is undertaken in a balanced manner taking into account other important policy objectives and mitigating potential adverse impacts. In this context, it will be essential to ensure that the process of market opening is accompanied by a parallel process of regulatory co-operation and gradual convergence. This is particularly important in crucial areas such as safety, security, environmental protection and application of competition law.

Open markets need a framework that ensures fair competition and high standards for safety and security. With regard to environmental issues, the agreement must be consistent with the EU's commitment to sustainable development. It is particularly important that the agreement does not restrict the EU's ability to apply regulatory or economic instruments to mitigate unwanted side-effects of growth in air traffic,

notably on the air quality and noise levels around airports and through the contribution to global climate change. In the field of air traffic management, the possibility to extend the Single European Sky to Azerbaijan would contribute to enhance current safety standards, optimise efficiency and capacity, reduce emissions per flight and minimise delays.

A comprehensive mandate for the negotiations with Azerbaijan should be based on two equally important strands: on one hand market opening and liberalisation and on the other hand regulatory harmonisation of aviation safety, aviation security and other standards beyond the EU borders. In this respect the conclusion of an EU-Azerbaijan Common Aviation Area Agreement would make a major contribution to reaching the objectives of the European Neighbourhood Policy, the Eastern Partnership, the EU–Azerbaijan Partnership and Cooperation Agreement as well as the future Association Agreement.

In the light of the above, the Commission proposes the negotiation and conclusion of a comprehensive Common Aviation Area Agreement with Azerbaijan and invites the Council to authorise the Commission to enter into negotiations on such an agreement. The negotiations will be conducted by the Commission services, fully involving the European External Action Service (EEAS), taking duly into account Council Decision 2010/427/EU.

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