

THE FIFTH FREEDOM AND THE SOUTHERN CONE: A NEW PERSPECTIVE

An ECLAC document to be published in the near future examines a subject that has become a frequent topic of discussion in recent years, particularly in the Southern Cone of Latin America (Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay), where the greatest volume of land transport in South America is concentrated. Against a background of economic liberalization and integration in the region, and at a time when the development of regional transport infrastructures is growing in importance, the ECLAC Transport Unit analyses the Southern Cone Agreement on International Land Transport (Valparaíso, 1989) in an effort to give it fresh relevance and to determine whether its provisions can cope with the new challenges thrown up by more open international transport markets and management. Comments, suggestions or further information on this subject should be addressed to José María Rubiato, Email: jrubiato@eclac.cl

The central thesis of the document is that far-reaching changes could be made in the production patterns of the international land transport services market without altering the market's institutional structure, and that the introduction of the fifth freedom would not disrupt the equilibria of bilateral traffic flows but would rather enhance them by eliminating some of the imbalances due to a lack of return consignments.

This argument is developed in three stages, starting with a discussion of the concept, purpose and function of the fifth freedom, and how it relates to the concept of nationality. Next, the provisions of the Southern Cone Agreement on International Land Transport are analysed to see whether they permit the introduction of the fifth freedom. Lastly, on the basis of two hypothetical cases, the possible effects and consequences of the application of the fifth freedom in the region are examined.

What is the fifth freedom?

Just as the expression "cargo preference" comes from maritime transport and "traction capacity" is normally applied to rail transport, so the expression "the fifth freedom", which was formally defined in the Convention on International Civil Aviation (Chicago, 1944), is borrowed from air transport, although in fact the term applies to all forms of transport. The fifth freedom is basically the

right to take on passengers, freight or mail consignments in a country other than the transporter's country of nationality, for transport to a country other than the transporter's country of nationality. Thus, in terms of land transport, a Uruguayan road transporter may carry freight or passengers from Argentina to Chile, or a Bolivian rail company may operate between Brazil and Peru carrying freight or passengers from either of those countries.

Traffic of this kind is routine in maritime transport, whose services are normally available for use by any nationality, and in air transport, through prior agreements between air traffic authorities. However, it does not occur in land transport, simply because the agreement regulating international land transport in the Southern Cone makes no mention of such operations. That, at any rate, is the general impression both the transport companies and the sector authorities have had up to now. The ECLAC study on the subject shows that this need not continue to be the case.

What is the main issue?

The fifth freedom concerns the right of nationals of third countries to offer land transport services in markets traditionally reserved for nationals of the countries of origin and of destination, and this is what distinguishes it from other modes of operation. The granting of this right is highly controversial, and calls to oppose the fifth freedom, or at least exercise caution in its introduction, are made on the grounds of protecting the domestic transport sector.

The world is changing, however, and economic liberalization has given fresh impetus to international commerce and transport. It is a process which requires the defence of free competition by mechanisms running counter to the old systems of trade protection and restriction of access to markets. The new economic realities governing the world of international commerce and transport have little place for nationality as a factor restricting the provision of international transport services.

The fifth freedom is compatible

with the current regulations, according to the study

In its preamble, the Southern Cone Agreement establishes three basic principles: that international land transport is a public service; that the relationship between the contracting States is one of reciprocity; and that transport is an efficient means of integrating the countries of the region, given their individual needs and geographical characteristics. These principles, together with the overall aim of promoting integration, constitute the spirit of the Agreement, while its operational basis is a multilateral framework that takes the form of bilateral agreements between pairs of countries.

Insofar as the fifth freedom seeks to make better use of the various means of transport, it is in keeping with the principle of the efficiency of international land transport. Since agreement must be reached before mutual fifth-freedom rights can be granted, it is in keeping with the principle of reciprocity under bilateral agreements between signatories to the Agreement. The exercise of the fifth freedom as a means of opening up markets is in keeping with the aim of any process of economic or commercial integration. Lastly, the public service nature of international land transport is independent of the operator's nationality, and there is no reason to believe that its nature in this respect should be adversely affected by the introduction of the fifth freedom.

As to the text of the Agreement, the ECLAC study makes a functional analysis of the text, in order to determine whether the introduction of the fifth freedom contravenes any of its provisions. The analysis is done in the full knowledge that the exercise of the fifth freedom --that is, the operation of traffic originating in and bound for countries other than the transporter's country of nationality-- is not explicitly regulated by the Agreement. Thus the study frequently relies on a double-negative reading of the text, on the grounds that whatever is not prohibited is permissible and does not contravene the letter of the Agreement.

Can provision legitimately be made for the fifth freedom under the current regulations?

Since it is not clear, either from the text of the Agreement or from the information available on the drafting process, whether the legislator was in favour of the fifth freedom or not, it can legitimately be the subject of an analysis of the regulations, as suggested in the ECLAC document. It may, however, not be legitimate to interpret the text and the spirit of the Agreement as permitting the establishment of fifth-freedom traffic operations simply because they do not prohibit it.

Strictly speaking, it is up to the committee established under article 16 of the Agreement to provide a definitive interpretation of the text on this issue and to determine the legitimacy of one interpretation or the other.

Lastly, the promotion of the fifth freedom in the Southern Cone should be the result of a joint decision on the part of all the members of the Agreement rather than an initiative taken by a certain group, partly for the reasons discussed in the following section, but also --and principally-- out of respect for the spirit of consensus that has always guided the negotiation of agreements in the Southern Cone.

What are the potential effects of the fifth freedom in the Southern Cone?

The consequences of implementing fifth-freedom schemes in the Southern Cone depends largely on the geographical scope of the schemes and the degree of liberalization involved. The study presents two scenarios, one based on a generalized introduction of the fifth freedom and one in which some countries implement it while others do not, and reaches some surprising conclusions.

Implementing the fifth freedom on an open, generalized basis would benefit regional transport in at least three ways: 1) the competitiveness of international multimodal transport would be enhanced; 2) vehicles could be used more efficiently for return consignments, and consequently 3) the total number of trips in the region could be reduced. However, a regionwide introduction could also have undesirable effects, which, while none of them would be directly attributable to the exercise of the fifth freedom, per se, could exacerbate existing situations and therefore affect the award of transport rights. The most important of these effects are: 1) an increase in the inequity between modes of transport; 2) a widening of existing disparities; and 3) a geographical concentration of

traffic.

If the fifth freedom was introduced in only some countries of the region, both providers and users of international land transport services in those countries would gain an advantage over their counterparts in the other countries (see table below).

Effects of partial geographical implementation of the fifth freedom

(Fifth freedom not adopted in countries A and B
and adopted in countries C, D and E)

Competitiveness	Rates per ton-km and per pax-km higher for traffic from A to B and B to A, between B and CDE and between A and CDE. Rates within CDE lower owing to greater competition in supply.
Subsidization	In certain circumstances, companies from CDE operating to and from AB can subsidize operations in CDE with the higher margins obtained from traffic with AB, where rates are determined by competition with companies located in AB.
Distortion of competition	Companies in CDE have advantage in competition with companies from AB: cost structure in AB less favourable owing to more restricted choice of traffic.
Economies and diseconomies of scale	Companies in CDE obtain higher overall traffic volumes and economies of scale by making use of return trip. Companies in AB have slower turnaround owing to wait for return consignment or because their passenger trips are less frequent; or they are liable to travel empty (diseconomies of scale).
Traffic displacement	Companies in CDE tend to plan operations with AB via storage/distribution centres in their own territory so as to take advantage of benefits of intra-CDE operations.
Differentials in externalities	Countries A and B receive more traffic than necessary because of empty trips, and suffer from deteriorating infrastructure, environmental impact and accident risk, without benefiting from transport of freight or passengers.
Cost and price differentials	Companies in AB are at a cost disadvantage relative to those in CDE; users at a price disadvantage.
Investment diversion	Companies in AB tend to invest in setting up in CDE so as to be able to compete on equal terms with companies in CDE.

Final comments

The aim of the ECLAC document is not to suggest any given course of action as regards the implementation of the fifth freedom in the Southern Cone, but to contribute to the debate by pointing out that, under one interpretation at least, this controversial and much-discussed mechanism is already implicitly recognized in the region's regulatory framework and that its

introduction awaits only the decision of the competent authorities, in consultation with those sectors that may be affected.

Even so, given the outcome of the discussion thus far, it would seem reasonable for the reader, whether government decision-maker, trade union leader or business executive, to ask more questions and seek further guidance as regards such a course of action. In any case, it would be premature to opt for either course without giving due consideration to the following points.

Introduction under the terms of the Agreement: It is true that the fifth freedom does not contravene either the spirit or the text of the Southern Cone Agreement on International Land Transport, but why is the concept not explicitly mentioned in the text, even under some other name? Would it not be more appropriate to go beyond the text and spirit of the Agreement and consider the legislator's intent? Did the fifth freedom figure in that intent? If not, that may have been because it was not a propitious moment for historical reasons, but in that case would it be appropriate to incorporate it at this stage --even through interpretation-- into a text which, while not expressly prohibiting such operations, was not drafted with the fifth freedom in mind? Is it legitimate to adopt a course of action that makes it unnecessary to even consider reforming or modifying the regulations?

Extra-sectoral regulations and factors: As the ECLAC document notes, the fifth freedom could aggravate the transport sector's existing asymmetries, which arise mainly from exogenous events or circumstances, that is, from factors unconnected with the ability of operators to develop their business and compete on the international market. Is it then appropriate to implement, simply because the regulations allow it, a mechanism to enhance transparency and business efficiency in a market where external competition-distorting factors continue to place constraints on some while leaving others unaffected? To turn the question round, would this not be a good opportunity to bring such distortions into the open in order to force a resolution by the agencies concerned? In other words, is it not time to expose the market's shortcomings and correct deficiencies due to factors external to the sector, which may be masking other, internal flaws?

The regulatory framework and integration: The discovery of a hitherto unsuspected means of resolving an inconclusive debate should not delude us into believing that the discussion and its causes will suddenly go away. The Agreement on International Land Transport was drafted in other times and under different circumstances, and it may not meet today's regional integration needs or those likely to arise in the future. The fifth freedom is simply a mechanism for overcoming the limitations of bilateralism. In a multilateral framework allowing free movement of goods and passengers there is no need for such an arrangement, as shown by the NAFTA and European Union free-traffic agreements. Even before those two agreements existed, international maritime cargo preferences had already been lifted in the region. In this light, and looking to the region's future, would it not be as well to consider a thorough reform of the institutional and regulatory framework of international land transport in the Southern Cone to bring it into line with economic integration and globalization requirements?

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Interested parties can access this library by e-mail, Ms. Bárbara Donoso: bdonoso@eclac.cl, telephone: 56-2-2102217, Transport Unit, ECLAC, Santiago, Chile.

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