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# Mexico, Brazil Skies: Closed No More?

**Mexican and Brazilian aviation markets start to see liberalization.**

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The United States has been a leader in advocating the removal of barriers to competition in the civil aviation market and to this effect has signed more than 120 bilateral Open Skies Agreements with countries around the world. However, not all of Latin America has embraced this policy, with Mexico and Brazil being two of the largest holdouts. However, recently, with respect to the two largest economies of Latin America, there have been important developments in liberalized flying between the countries, as well as the possible reduction of foreign investment restrictions (in the case of Brazil).

## MEXICO

Some observers may be surprised that until recently the U.S. and Mexico had a restrictive bilateral air services agreement, given the fact that cross-border trade and services has grown tremendously since the entering into effect of the North American Free Trade Agreement in 1994. The prior air services agreement was designed to protect the incumbent Mexican airlines, and particularly the second largest carrier, Mexicana de Aviacion, which has since filed for bankruptcy and ceased operation. The old bilateral agreement restricted cross-border air service to the “2+2” formula for city pairs involving the largest markets (e.g. NYC-Mexico City) and a slightly more relaxed variation of “3+3” allowing three carriers from each country to serve smaller city pairs between countries. With Mexicana’s bankruptcy the basis for a more open treaty emerged with a key trade-off being the potential granting of Aeromexico, the largest Mexican carrier, a closer alliance with its Sky Team partner Delta that would give them antitrust immunity in exchange for the removal of the restrictions of U.S. carriers to fly to Mexican markets (although Mexico City International Airport remains subject to slot controls until a new expanded airport can be built by 2020). Mexico’s competition authority (COFECE) has since approved the request of Delta and Aeromexico to integrate their cross-border operations, although the U.S. Department of Transportation (DOT) has not yet approved the application to date.

The new U.S.-Mexico Air Transport Agreement was signed in December 2015 and was the product of four years of negotiations between the governments. It entered into effect in August. The new U.S.-Mexico bilateral agreement is an important development in terms of the lifting of many of the restrictions found in the old agreement and hence is being characterized as an Open Skies Agreement, although it strictly speaking does not allow for unrestricted fifth freedom passenger rights. As mentioned above, regularly scheduled flights for passengers combinations services are to be provided without restrictions for any number of airlines and in any city pairs (compared to the “2+2” or “3+3” formula under the old agreement). Moreover, cargo operators ill have even more expanded rights and are authorized to operate flights to and from Mexico, and beyond to third-party countries (i.e. fifth freedom rights).

This bilateral agreement did not address foreign investment limits for the respective foreign airlines and in the case of Mexico, this level remains at 25 percent voting shares with the opportunity to increase such participation under a form of non-voting shares (“inversion neutral”).

**BRAZIL**

Brazil has undergone a tumultuous period culminating with the impeachment of former President **Dilma Rousseff**. Brazil’s new President **Michel Temer** is perceived as more committed to free market reforms than his predecessor and has announced several privatization initiatives, including Brazilian airports. At this time, Brazil is considering raising the maximum foreign investment in a Brazilian airline from 20 to 49 percent. Specifically, Bill 258/16, introduced by Senator **Vicentinho Alves**, would amend the Brazilian Aeronautical Code to achieve this objective. The bill is supported by Brazilian airlines Azul (formed by Jet Blue founder **David Neelman**, a dual national), Avianca, LATAM (which includes within its corporate group LAN Chile and TAM), and Gol. In a recent interview, Senator Alves formed to amend the Brazilian Aeronautical Code, mentioned that in the future, 100 percent foreign participation may be possible, provided there is reciprocity between the countries involved (President Temer previously vetoed a bill that would grant unconditional 100 percent foreign investment opportunity although analysts view him as amenable to increasing the limit to 49 percent).

At this time, many Brazilian carriers in general would welcome the ability to raise additional capital, as the drop in the Brazilian economy has hurt the local airlines and flights by foreign airlines have also been cut in the last year as well (the Rio Olympics were a brief welcomed respite). However, it is not 100 percent clear that leaving the threshold at this minority level will be sufficient to induce foreign capital (particularly private equity groups) to enter the market, given the existing market conditions. That said, Brazil has a large domestic and largely untapped market, an attractively priced currency, and a strong local aircraft manufacturer in Embraer, and Brazilian policymakers may be counting on these factors to win them over.

In addition, the U.S. and Brazil have signed, but the Brazilian Congress has not ratified the proposed and more open Air Services Agreement, which would remove restrictions to flying between the two countries. Brazil may now be reluctant to expose its local airlines to additional competition, but Mexico made the politically difficult (but arguably economically sound) decision to permit greater additional competition in exchange for the broader benefits that accrue to the economy of greater transportation ties.

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