

U.S. **International**
Air Transportation
Policy
Statement

April 1995

STATEMENT OF THE SECRETARY OF TRANSPORTATION

Today, the United States is issuing its first formal statement of international air transportation policy in 17 years. Such a public articulation of national policy is particularly important now as the focus of the airline industry becomes increasingly global.

I first presented a draft of this Policy Statement at the commemoration of the 50th anniversary of the signing of the Chicago Convention last November. For the past half century, that multinational accord has played a seminal role in defining international aviation. As a direct result of the Chicago Convention, an air transport system has developed that consists primarily of national carriers offering point-to-point services, with international connections principally provided through interline arrangements between those airlines.

Although such operations continue to be important components of international air transport, major changes have occurred during the past few years that are challenging traditional notions of these services. Airlines are becoming increasingly global. Route networks are now being linked in alliances consisting of carriers from different nations, with international hub-and-spoke networks that offer passengers on-line service to cities around the world.

With these sweeping changes in progress, the Clinton Administration has taken steps to ensure that global marketing and services will lead to improved service for travelers and shippers. Fostering increased competition among airlines and combating protectionist restrictions on airline operations by foreign governments are ways to promote such improvements. We also sought to find ways to help strengthen the U.S. airline industry so that it may continue its leadership role in international air services. The President, together with the Congress, established the National Commission to Ensure a Strong Competitive Airline Industry. Shortly after the Commission delivered its final report, the Administration set forth its own initiative.

Even as we worked to make this Policy Statement final, we moved ahead to create open markets with one of our largest aviation partners. The principles contained in this Policy Statement guided our recent air services agreement with Canada which, after a brief transition period, will allow unrestricted access between our two nations. Similar initiatives in other aviation markets are also underway.

Our Policy Statement reaffirms our commitment to strive for new and less restricted markets for our carriers and more convenient access to international air services for our cities. Most importantly, as we move toward the 21st century, we intend to redouble our efforts to extend the benefits of safe and reliable international air transportation to our citizens, as well as to people throughout the world.



Federico Peña

UNITED STATES
INTERNATIONAL AIR TRANSPORTATION POLICY

Introduction

The availability of efficient international air transportation will greatly enhance the future expansion of international commerce and the development of the emerging global marketplace. Worldwide, travelers and shippers are demanding more and better quality service to more places. U.S. and foreign airlines are responding to this demand by expanding traditional forms of service and by developing new and innovative services. Increased demand and the variety of carrier responses to it challenge the existing intergovernmental system's ability to ensure the development of a competitive air transportation system that meets the needs of the rapidly evolving, expanding and increasingly integrated international aviation marketplace. In many cases, existing bilateral agreements impede the growth of the marketplace.

We must address the challenges presented by these rapid changes to meet our future civil and military air transportation needs, and to provide our aviation industry with the environment and the opportunities that will enable it to grow and compete effectively in the world market. This policy statement outlines our approach to addressing those challenges.

OUR GOAL:

SAFE, AFFORDABLE, CONVENIENT AND EFFICIENT AIR SERVICE
FOR CONSUMERS

As established in our last aviation policy statement in 1978, our overall goal continues to be to foster safe, affordable, convenient and efficient air service for consumers. We continue to believe that the best way to achieve this goal is to rely on the marketplace and unrestricted, fair competition to determine the variety, quality, and price of air service. We believe that this approach will provide consumers and shippers with more and better service options at costs that reflect economically efficient operations and work best to:

- Expand the international aviation market;
- Increase airlines' opportunities to expand their operations;

- Increase productivity and high-quality job opportunities within the aviation industry;
- Address the nation's defense air transportation needs; and
- Promote aerospace exports and general economic growth.

CHANGING ENVIRONMENT

Growing economic interdependence among nations -- the "globalization" of the world economy -- has expanded demand for convenient, reliable and affordable international air service. Demand for international service is growing faster than demand for U.S. domestic service, and most major U.S. airlines are now providing and planning to expand international operations. Between 1983 and 1993, the international component of U.S. airlines' route networks, measured in revenue passenger miles (RPMs), grew from around 16% to over 27%. U.S. airline revenues from international air service nearly tripled from \$6.3 billion to \$17.6 billion. Moreover, forecasts indicate that U.S. carrier international traffic, measured by RPMs, will increase to almost one-third of their total system traffic by the year 2000.

Just as important, the pattern of demand for international service has changed considerably. First, the regional distribution of U.S. carriers' international revenues has changed dramatically, as the primary focus of carriers' expansion moved beyond Europe to meet new demand in the emerging markets of Asia, the Pacific Rim and Latin America. In 1983, the Atlantic accounted for 48% of our carriers' international revenues, while the Pacific accounted for 32%. By 1993, the Pacific had grown to 46% while the Atlantic was only 37%. The fastest growing sectors of the international aviation market are new and relatively undeveloped markets. During this same period, revenues in the Pacific grew 286%, in Latin America 151% and in Europe 116%. Second, from 1983 to 1993, the number of international aviation city-pair markets in which U.S. airlines participate has grown by more than a third, reflecting the major expansion of air service and carrier networks throughout the world and the increased dispersion of demand. Many of these city-pair markets are relatively small, generating only a few passengers per day.

TOWARDS A GLOBALIZED AVIATION INDUSTRY

The rapid growth of demand for international air service and the wider dispersion of traffic in city-pair markets are primary factors influencing the development of the air service industry. Carriers are increasingly finding that they cannot remain profitable unless they can respond to this changed demand. To compete effectively, carriers today must have unrestricted access to as many markets and passengers as possible.

To meet demand and to improve their efficiency, many carriers are developing international hub-and-spoke systems that permit them to combine traffic flows from many routes (the "spokes") at a central point (the "hub") and transport them to another point either directly or through a hub in another region. Just as U.S. carriers developed hub-and-spoke systems to tap the broad traffic pool in the domestic market and to provide the most cost-efficient service for hundreds of communities that could not support direct service, international air carriers are developing world-wide hub-and-spoke systems to tap the substantial pool of international city-pairs. Internationally, an even larger portion of traffic moving over hub-and-spoke systems will require the use of at least two hubs (*e.g.*, a hub in both the U.S. and Europe for a passenger moving from an interior U.S. point to a point beyond the European hub). This increases the complexity and interdependence of the components of the system (both the spokes and hubs) and the importance of multinational traffic rights to the success of the system.

As a result, carriers wishing to establish global networks require a higher quality and quantity of supporting route authority than they have sought in the past. Airlines will become increasingly concerned with every market that enables them to flow passengers over any part of their system network. These airlines will be looking for broad, flexible authority to operate beyond and behind hub points, in addition to the hub-to-hub market between two countries. At present, governments operating in a bilateral context naturally focus on opportunities for their respective carriers to serve the local market between their two countries. In a bilateral context, services destined for or coming from third countries receive less consideration. In the future, governments will have to adjust their focus to bargain for the bundles of rights that will permit airlines to develop global networks.

Carriers can either serve markets themselves (direct service) or provide service through commercial arrangements with other carriers (indirect service), whether on a traditional interline connecting basis or under a closer commercial agreement between the carriers, such as code sharing. Carriers will develop service products — single-plane, on-line connecting, interline connecting, joint service — that respond to the preferences of the traveling public as measured by passenger willingness to pay for differences in the quality of service and that take into account their cost structure and market strategy. To the greatest extent possible, airlines should be free to set prices and offer various service products in response to passenger preferences.

Significant challenges face carriers wishing to develop international networks using their own direct services. They need:

- Substantial access not only to key hub cities overseas, but also through and beyond them to numerous other cities, mostly in third countries. This type of access is not readily obtainable in today's bilateral system of negotiating air rights, since governments can only exchange access rights to their own countries and cannot, between themselves, deliver access to third countries, thus requiring piecemeal negotiating efforts to build the necessary package of rights;

- Access to a large number of gates and takeoff/landing slots, frequently at some of the world's most congested airports. It may become increasingly difficult for carriers to gain effective, direct access to certain airport facilities, including some in the United States;
- Considerable financial resources to establish and sustain commercially successful overseas hub systems; and
- The ability to obtain infrastructure and establish market presence in a new region quickly. Existing foreign investment laws can effectively preclude airlines from entering new markets in one of the most efficient means available: merger or acquisition.

Some carriers are taking on these challenges directly and are striving to develop their own global systems of direct service. Other carriers have chosen to side-step the obstacles, turning instead to a new network-building technique: cross-border marketing alliances that link traffic flows between established hub-and-spoke systems in key cities of the Western Hemisphere, Europe and Asia. Some of these alliances involve cross ownership, while others do not. Under this strategy, the linking of hubs requires indirect market access through code-sharing or other cooperative marketing arrangements. Although code sharing has become a widely-used marketing device for airlines and is currently the most prevalent form of commercial arrangement, further evolution of the industry and its regulatory environment may lead to new marketing practices that could supplement or supplant code sharing.

Code sharing and other cooperative marketing arrangements can provide a cost-efficient way for carriers to enter new markets, expand their systems and obtain additional flow traffic to support their other operations by using existing facilities and scheduled operations. Because these cooperative arrangements can give the airline partners new or additional access to more markets, the partners will gain traffic, some stimulated by the new service, and some diverted from incumbents. In this way, cooperative arrangements can enhance the competitive positions of both partners in such a relationship.

Increased international code-sharing and other cooperative arrangements can benefit consumers by increasing international service options and enhancing competition between carriers, particularly for traffic to or from cities behind major gateways. By stimulating traffic, the increased competition and service options should expand the overall international market and increase overall opportunities for the aviation industry. U.S. airlines should be major beneficiaries of this expansion and the concomitant increased service opportunities, given their competitive advantages.

Moreover, code sharing should also enhance domestic competition. Many international passengers traveling to or from U.S. interior cities use domestic services for some portion of their international journey. Code sharing should increase competition among

domestic carriers to carry those passengers on the domestic segment of their international journey.

Although we expect the expansion of cooperative arrangements to be largely beneficial, there may be some negative effects. The greater traffic access of participants may give them considerable competitive muscle, and we may need to watch for harmful effects on competition. In addition, cooperative arrangements may affect the availability of civil aircraft to meet emergency airlift requirements. Our national defense establishment relies on U.S. civil aircraft committed to the Civil Reserve Air Fleet program to respond to worldwide crises. As set forth in our National Airlift Policy, the global mobility needs of our national defense establishment, and ensuring that the nation's defense air transportation needs are met during peace and contingency operations, are important considerations.

Global systems and the growing use of code sharing may put significant competitive pressure on carriers whose strategy does not include participation in such systems or in code-sharing alliances, or whose options to participate may be limited due to the lack of potential partners. Such carriers will have to develop other commercial responses to compete effectively. We expect these pressures and responses to lead to a restructuring of service and airlines, similar to the U.S. domestic experience in the 1980s. Overall, cities and consumers will probably enjoy improved service and access to the international transportation system, although some cities may have fewer or less convenient service options in some markets than they have today. Similarly, although some airlines will grow and prosper, others will not. Moreover, we recognize that the balance of benefits in any particular alliance will depend on the specific structure of that arrangement between the partners. Overall, this evolution should expand the level and quality of international air service for consumers.

Code-sharing arrangements are designed to address the preference of passengers and shippers for on-line service from beginning to end through coordinated scheduling, baggage- and cargo-handling, and other elements of single-carrier service. However, innovative service products, such as code sharing, can only respond to consumer preferences accurately, and thereby enable the marketplace to function efficiently, if consumers make choices based on full information. Therefore, we must ensure that airlines give consumers clear information about the characteristics of their service product, and that consumers can distinguish between code sharing and other forms of service.

In addition to the two types of global networks (sole-carrier systems and joint carrier systems), there will continue to be a role for air services outside of global networks. The U.S. experience with deregulation indicates that — absent legal barriers to entry — specialized competitors will enter the market and discipline the pricing and service behavior of the larger network operators. The introduction of technologically advanced aircraft such as the B-767, the MD-11 and the B-777 make direct service on longer or thinner routes economically viable. Moreover, airlines can viably serve heavily traveled routes with point-to-point service.

In short, as indicated by our domestic experience, a variety of service forms — global networks with carriers participating either as the sole provider or as participant in a joint network, and regional niche carriers — can exist in the international aviation market and the competition among these services will enhance consumer benefits through efficient operations and low fares. Thus, our international aviation strategy should provide opportunities for all of these forms of service so that we realize the benefits from maximum competition among them.

Our airlines are well positioned to be primary participants in all aspects of the future global marketplace. In recent years, our largest domestic carriers have become our primary international carriers, replacing specialized international operators. After operating in a deregulated domestic market for more than 15 years, our carriers have developed operating efficiencies that give them a cost advantage over their major foreign competitors. Moreover, the financial positions of our carriers are improving due to their cost-cutting measures and improving economic conditions. Coupled with their cost efficiencies, their improving financial status will further enhance their competitive capabilities. Over time, however, trends toward privatization and increased productivity of major foreign competitors may affect the current cost advantage U.S. airlines enjoy. We must try to provide our carriers with the flexible rights and economic environment that will enable them to respond to the dynamics of the marketplace.

INTERGOVERNMENT AVIATION RELATIONS

International air services between two nations have traditionally been conducted pursuant to bilateral agreements. The U.S. National Commission to Ensure a Strong Competitive Airline Industry and the European Union's Comité des Sages for Air Transport have both recognized that the bilateral system is limited in its ability to encompass the broad, multinational market access required by the new global operating systems. Consequently, progress in developing global networks has been and will be extremely fragmented and may preclude or limit the development of efficient operations. We must consider alternative forums for international aviation negotiations and agreements in which we can obtain the necessary broad access rights. We should examine the feasibility of achieving multilateral air service agreements among trading partners. Although such negotiations may be more complex and difficult because of the number of parties involved, they should be undertaken when they present a reasonable prospect for further liberalization.

Moreover, some governments are taking steps to enhance their airlines' positions both by restricting the development of new, competitive services and by trying to overcome, through government fiat, their carriers' cost disadvantages that make it difficult for them to compete against U.S. airlines in a free market. These efforts underlie many of the disputes we face in international negotiations today.

Such countries are responding to the highly competitive integrated and global air transportation market, in which their airlines may not be fully prepared to compete. Most foreign airlines are only beginning to adapt to the more competitive operating environment through such mechanisms as streamlining costs and realigning their operations to achieve greater productivity and operating economies. For state-owned airlines, privatization is an important initial step as it will lead those airlines to develop cost-efficient operations and, in the longer term, to expand their markets. These governments also may be reacting to the U.S. airlines' recent operating successes in the international aviation market, which are largely attributable to the U.S. airlines' productivity and competitive gains.

Some national governments continue to give their national airlines financial aid. Some also distort the marketplace by permitting their national airlines to maintain ground-handling and other monopolies, by denying airlines access to necessary airport facilities, or by allowing user fees that equalize cost differentials between carriers. These actions distort competition and deprive the aviation system and consumers of the benefits that greater cost efficiency and lower prices would encourage. In the long run, these efforts will work against the overall best interest of the world economy. Moreover, they will be unsuccessful in providing long-term protection against the developing global aviation systems because no individual government can control all facets of its airlines' marketplace.

U.S. OBJECTIVES

We have outlined above our expectations about the future of the world air transportation industry and the role of U.S. airlines. We expect that international operations will depend more on traffic flows from multiple countries. In light of our goals, recent developments in the market and industry, and the positions and actions of our trading partners, we have designed our international aviation strategy to meet the following objectives:

- Increase the variety of price and service options available to consumers.
- Enhance the access of U.S. cities to the international air transportation system.
- Provide carriers with unrestricted opportunities to develop types of service and systems based on their assessment of marketplace demand:
 - These opportunities should include unrestricted rights for airlines to operate between international gateways by way of any point and beyond to any point, at the discretion of airline management. Carriers should be able to pursue both direct service using their own equipment and indirect service through commercial relationships with other carriers;

- Service opportunities should not be restricted in any manner, such as restrictions on frequencies, capacity or equipment, so that carriers may provide levels of service commensurate with market demand;
- Carriers' ability to set prices should also be unrestricted to create maximum incentives for cost efficiencies and to provide consumers with the benefits of price competition and lower fares; and
- These opportunities should apply not only to scheduled passenger services, but also to cargo and charter opportunities, because of their growing importance to the world's economy. We have long recognized the significant differences among these types of operations. In particular, air cargo services have specific qualities and requirements that are significantly different from the passenger market. We will continue to follow our long-standing policy of seeking an open, liberal operating environment to facilitate the establishment and expansion of efficient, innovative and competitive air cargo services.
- Recognize the importance of military and civil airlift resources being able to meet defense mobilization and deployment requirements in support of U.S. defense and foreign policies.
- Ensure that competition is fair and the playing field is level by eliminating marketplace distortions, such as government subsidies, restrictions on carriers' ability to conduct their own operations and ground-handling, and unequal access to infrastructure, facilities, or marketing channels.
- Encourage the development of the most cost-effective and productive air transportation industry that will be best equipped to compete in the global aviation marketplace at all levels and with all types of service:
 - Infrastructure needs should be addressed and unnecessary regulatory barriers eliminated.
 - Privately held airlines have better incentives to reduce costs and respond to public demand. Therefore, as we have in the past, we will be supportive of governments wishing to privatize their airlines so that their privatization efforts will be successful; and
 - Reduce barriers to the creation of global aviation systems, such as limitations on cross-border investments wherever possible.

PLAN OF ACTION

We recognize that considerable time and effort will be required to achieve an open aviation regime worldwide. We can get there by making a concerted effort to eliminate

the obstacles to that regime and by taking a more strategic and long-term approach to our overall international aviation policies. At a minimum, we must increase our focus on emerging markets and their contribution to global networks; build a coalition of like-minded trading partners committed to the principles of free trade in aviation services; work closely with our trading partners to address their concerns; develop new incentives for encouraging market reform, such as increased opportunities for cross-border investment in airlines; and devise alternatives to the bilateral aviation system for achieving our objectives. We are launching our new initiatives to create freer trade in aviation services by taking the following steps:

- Extend invitations to enter into open aviation agreements to a group of countries that share our vision of liberalization and offer important flow traffic potential for our carriers even though they may have limited Third and Fourth Freedom traffic potential. This would assist the development of global systems and increase the momentum for further worldwide liberalization.
- Give priority to building aviation relationships between the United States and potential growth areas in Asia, South America and Central Europe. This recognizes the importance of these trading partners and the need to provide air transportation to support those developing trade markets. It will also make available new markets to build global networks.
- Renew efforts to achieve liberal agreements with trading partners with which our aviation relationships lag behind those of our general trade advancements, as we have done successfully with Canada.
- Emphasize the importance of sound economic analysis based on sufficient data in developing policies and strategies for achieving our overall aviation goals. This will enable us to remain focused on the overall strategic objectives, understand developments in the industry and market, and plan for the future.
- Seek changes in U.S. airline foreign investment law, if necessary, to enable us to obtain our trading partners' agreement to liberal arrangements to the extent it is consistent with U.S. economic and security interests.
- Increase our efforts to reach out to Congress and constituent groups, such as consumers, corporations with international perspectives (aircraft manufacturers, telecommunications, travel and tourism industries), cities, airports, airlines, labor and travel agents to learn their anticipated needs over a 3-5 year period. This will provide us with valuable information for developing our positions, as well as enlisting their support in pushing for greater liberalization.
- Establish stronger connections among U.S. government agencies whose functions are to promote U.S. business and trade interests (*e.g.*, Departments of Commerce, State, and Transportation, Office of the United States Trade Representative, and the Export/Import Bank) as well as the Department of Defense, to ensure that we

share a single vision of the future global marketplace while meeting national security requirements.

Given the diverse positions of our trading partners and their varying degrees of willingness to liberalize aviation relations, we must also have a strategy for dealing with countries that are not prepared or willing to join us in moving quickly to an unrestricted air service regime. Our approach is a practical one: it proposes to advance the liberalization of air service regimes as far as our partners are willing to go, and to withhold benefits from those countries that are not willing to move forward. Specifically, we will pursue the following strategy:

1. We will offer liberal agreements to a country or group of countries if it can be justified economically or strategically. We will view economic value more broadly than we have in the past, in terms of both direct and indirect access and in terms of potential future development. Moreover, there may be strategic value in adopting liberal agreements with smaller countries where doing so puts competitive pressure on neighboring countries to follow suit.
2. We recognize that some countries believe that they can resist the trend of economic forces and continue to control access to their markets tightly. We believe that they cannot, and that attempts to do so will ultimately fail. Nevertheless, we will work with these countries to develop alternatives that address their immediate concerns where this will advance our international aviation policy objectives. We will examine alternative approaches that may include departing from established methods of negotiation (perhaps negotiations with two or more trading partners); trying to develop service opportunities for the foreign airline to make service to the U.S. more economically advantageous for it; and continuing our efforts to help those governments and their constituencies appreciate the benefits that unrestricted air services can bring to their economies and industries.

While we work with such countries, we can consider, in the interim, transitional or sectoral agreements.

Transitional agreements — Under this approach, we would agree to a specified phased removal of restrictions and liberalization of the air service market. This approach contemplates that both sides would agree, from the beginning, to a completely liberalized air service regime that would come into effect at the end of a certain period of time.

Sectoral agreements — Traditionally, aviation agreements have covered all elements of air transportation between two countries. However, as a first step, we can consider agreements that eliminate restrictions only on services in specific aviation sectors, such as air cargo or charter services.

3. For countries that are not willing to advance liberalization of the market, we will maintain maximum leverage to achieve our procompetitive objectives. We can limit

their airlines' access to the U.S. market and restrict commercial relations with U.S. airlines. When airlines request authority to serve restricted bilateral markets that is not provided for under an international agreement, we will consider their requests on a case-by-case basis in light of all our policy objectives, including, *inter alia*:

- whether approval will increase the variety of pricing and service options available to consumers;
- whether approval will improve the access of cities, shippers and travelers to the international air transportation system;
- the effect of granting code-sharing authority on the Civil Reserve Air Fleet program;
- the effect of the proposed transaction on the U.S. airline industry and its employees. In this regard, we will ascribe greater value to code-sharing arrangements where U.S. airlines provide the long-haul operations. We will also recognize the greater economic value of such arrangements where the services connect one hub to another; and
- whether the transaction will advance our goals of eliminating operating and market restrictions and achieving liberalization.

If aviation partners fail to observe existing U.S. bilateral rights, or discriminate against U.S. airlines, we will act vigorously, through all appropriate means, to defend our rights and protect our airlines.

CONCLUSION

We are living through a period in which international aviation rules must change. Privatization, competition, and globalization are trends fueled by economic and political forces that will ultimately prevail. Governments and airlines that embrace these trends will far outpace those that do not. The U.S. government will be among those that embrace the future.