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STRIVING FOR A LEVEL PLAYING FIELD?

-- SOME OBSERVATIONS AND COMMENTS ON THE DRAFT EC – US AIR TRANSPORT AGREEMENT

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1. INTRODUCTION

1.1 The observations and comments which follow are presented in the broad public interest, solely as the personal views of the writer. They are intended to provide food for thought in the public debate of the implications of the EC – US air transport agreement², which is also an item on the agenda of this Symposium. They arose due to the very controversial nature of this draft agreement (often seen in reports in the general press), its novel features, the concerns it has engendered among some non-participants, its at times technically confusing texts, and its role in the global air transport regulatory picture. The topics chosen for discussion below are the **level playing field, domestic market access, safeguards, London Heathrow access, potential alternative agreements, and concluding remarks**, in that order. Annex A considers several **technical matters**.

2. LEVEL PLAYING FIELD

2.1 Impossible! Geography alone dictates this. All that negotiators can do is to attempt an honest overall balance in opportunities for carriers of each side. The “mounds” and “trenches” on the playing field that favor one side or the other can, however, be weighed and balanced against each other. If well done, an overall balance of opportunities for each side’s carriers can be achieved. Upon reading all that follows, the reader can reach his or her own conclusions about this tentative agreement either creating or not establishing a level playing field (an objective often stated by the European side).

2.2 Consider first the hundreds of small cities in the United States that can originate and terminate transatlantic traffic, but only if moved through a gateway city...one reached solely by U.S. domestic flights. Although this traffic is far outweighed in volume to that which originates and/or terminates at much larger gateway cities to which EC carriers could operate viable flights, it still constitutes a playing field “mound”, however small, favoring the US side on the balancing scale. (Offsetting this imbalance are the facts that as traffic grows these cities will gain their own transatlantic flights, and an EC ability to employ code sharing on US carriers over gateway to small city sectors.) Apart from this, Third and Fourth Freedom traffic rights appear equal.

¹ The writer first entered the field of international air transport negotiations 41 years ago as an American Foreign Service Officer. He remained in the field, retiring in 1984 as the Senior Advisor for International Air Transport Negotiations at the U.S. Civil Aeronautics Board. He retired again in 1994 as ICAO’s first Chief of Economic Policy in Air Transport. Now fully retired, he has no relevant ties to any governmental, non-governmental, or industry entity.

² Based on the agreed text of the Agreement as appeared in the annex to the EC Communication Brussels 21.4.2006 COM (2006) 169, 2006/0058 (CNS).

2.3 Fifth Freedom intermediate points...there are virtually none of any traffic consequence for either side. One small exception, solely for EC carriers with appropriate beyond rights from Canada, could be their possible taking on, in Toronto for example, of Canada-USA fifth freedom traffic. Not much weight here in the overall balance.

2.4 Fifth Freedom beyond points for EC carriers...well, there are the small Pacific island nations such as Fiji, Kiribati, Nauru, etc. But all can be reached as readily or quicker from Europe by eastward flight of about the same length or shorter. As to Mexico, Central America, or Caribbean nations, they can better be served nonstop or through a remote hub without all the difficulties and complexities of trying to transit a US airport, such as Miami, which has no facilities for bypassing US entry procedures. Again, not much weight here.

2.5 Fifth Freedom beyond rights for US carriers are much more substantial. They are of most practical value when traffic to/from two intermediate sized Western European cities is combined on the same transatlantic flight. They also have practical value in serving points in Eastern Europe, Africa, the Middle East, and even South Asia, when anticipated traffic demand between the US and such points suffices to support their being served via Europe, but is insufficient to support nonstop flights to/from the US, at least not in the immediate future. The conclusion here...a moderately sized "mound" favoring the US side on the playing field.

2.6 To adequately explore Sixth Freedom opportunities in the overall level playing picture, consider first the remarkable value of a vibrant hub, such as Dubai and Singapore. Now apply that to the planet itself. In doing so, one sees that the continent of Europe constitutes the world's ONLY GLOBAL AIR TRANSPORT HUB! Its air route spokes reach out to every inhabited continent. A European carrier can fly its spokes nonstop to virtually every world city! Moreover, a European carrier can take traffic from one of its intercontinental spokes and competitively move it out over another spoke. For example, a person can travel about as easily between Washington DC and Bangkok, Thailand, flying an EC carrier through one of several European hubs with the same single connection and about the same travel time as going through Japan or Korea on a US or Asian airline. The transatlantic routes of EC carriers constitute valuable spokes of this European hub. The transatlantic routes of US carriers have virtually no Sixth Freedom opportunities at all! All of this is very relevant to the "level playing field" (sought especially by the EC). It presents an enormous "mound" for the European side, a good part of it scooped out of the US side by taking its Third and Fourth Freedom traffic to and from States geographically behind Europe. On this would-be "level" field we have a "mini-mountain" next to a sizeable "trench"!

2.7 Seventh Freedom opportunities (nonstop turnaround flights between two States neither of which is the home State of the carrier) also play a role in judging the levelness of the "playing field". Each of the 25 EC States parties to the draft agreement would be granted Seventh Freedom rights from every other EC State. That is 24 country-pair Seventh Freedom markets for each of 25 States. Thus the EC would get no fewer than 600 COUNTRY PAIR MARKETS! And that translates into literally THOUSANDS of city-pair transatlantic markets, notwithstanding that a sizeable majority would probably not be flown. In contrast, the US side would have a grand total of ZERO Seventh Freedom markets! Now, the actual use of such rights still being unknown, this may turn out to be another "mini-mountain" or maybe just a "huge mound" on the playing field! Bear in mind also that the EC side has perhaps forty or so airlines experienced in international operations, many State supported. The US has about a half dozen airlines with international experience (even if all are largely focused on domestic markets), none of which is State owned or subsidized, and all of which have gone into or approached bankruptcy, leaving most in a fragile condition.

2.8 Also very much related to the "level playing field" is a clause in the draft agreement that reads "Each airline may...serve points behind any point in its territory with or without change of aircraft or flight number and hold out and advertise such services to the public as through services". In other words, every EC carrier would be able to offer travelers to and from the US, highly competitive single-plane, single flight number, one-stop services from and to literally hundreds of points in Eastern Europe, Africa, the Middle East, and South and Southeast Asia, all behind their European homelands. US carriers would have the same rights behind their homeland...to and from Pacific island nations such as Fiji, Nauru, Kiribati, etc.! Were the US airlines to try to exercise such rights from major traffic points in say, East Asia, South America, or Australia the greater distances

of such highly indirect routings would render them non-competitive. A caveat to the possibilities is that any third country involved might withhold its approval of the through flights.

2.9 The exchange of all-cargo rights (presumably but not expressly including express/small package services) appears in the grant of rights to be quite liberal and balanced. US carriers will be able to transport cargo between every EC State and any other State anywhere. EC carriers will be able to transport cargo between the US and any other State anywhere. Nevertheless, Section 3 of the Annex withholds this right from US carriers in all but three relatively large and five very small EC States, unless the service is part of one that includes the US. There is NO reciprocal limitation on EC carriers. This seems to be at least a moderate “trench” for the US side.

2.10 So, how “level” is the “playing field” created by the above rights? The US side has a small “mound” and a moderate “mound” favoring it, offset by a moderate “trench” and a deep “trench”. The EC side has a huge “mound” and a “mini-mountain”! So which way is the “game” likely to go, should this draft agreement, unchanged, ever be implemented?

3. DOMESTIC MARKET ACCESS

3.1 The draft agreement strongly links the EC’s desired access to the US domestic air transport market to its signature and its ongoing life. There would appear to be no corresponding desire on the US part to access domestic travel markets within any of the 25 EC States. Indeed, such markets are relatively small and would be difficult to serve by US companies. The trans-border markets within the EC are larger. An EC classification of them as “domestic” merely applies a new restriction on markets which, from a non-European perspective, will remain international until and unless the sovereign States involved all become part of a single European State and give up their separate seats in ICAO.

3.2 The current EC desire, expressed in the draft agreement, to have the ability to be well represented in the decision making bodies of US airlines in which they have invested seems curious at best when found in an agreement that supposedly promotes competition! Take the hypothetical case of a staff recommendation to the management of Continental Airlines to reopen, from its Newark hub, the old Pan American Airways New York – Frankfurt – Nairobi route. A British Airways person in Continental’s management learns of this and expresses strong disagreement. “You do not want to go to Nairobi! Better to open a new route into the growing Asian market!” And he is persuasive. The US airline route is not reopened. The New York – Nairobi market is a relatively valuable one for British Airways, of course.

3.3 The idea of foreign airlines operating domestic air services within another country is, in itself, not anti-competitive. It could indeed be competitive, good for labor and consumers, and internal market expanding. Could the US DOT not seek relevant legislation to permit 100 percent conditional foreign ownership of an airline such owners would start up new? The conditions would be that the airline’s aircraft would all have to be registered and maintained in the US. All crew members would have to be based in the US and citizens or legal residents, and flight certificated in the US. All routes flown would be US domestic only. In comparable EC legislation, “country” would be replaced by the entire EC.

3.4 One small cabotage related move the US could take would be to reclassify as international and not cabotage four traffic types to enable their foreign airline carriage between two US points with foreign aircraft and crews. The US has always maintained that it is the initial origin and final destination that determine the international Freedom classification, not the coupon or flight sector origin and destination. So should not on-line connecting, on-line stopover, interline connecting, and interline stopover traffic that has an initial origin and/or ultimate destination in another country be legitimately boarded and deplaned by a foreign airline on a US flight sector?

4. SAFEGUARDS

4.1 Every agreement needs safeguards, if only to provide fallbacks in the event of any major failure of its workability or damage to the other Party's air transport system. And safeguards can also regulate balance where it is impossible to predict with any certainty the final levelness of the playing field. The US side particularly needs safeguards. After a quarter century of deregulation its large hub-operating "legacy" carriers have seen many bankruptcies, or near bankruptcies, and most are now in rather fragile condition. Unlike Europe, which has thousands of intercity trains, many high-speed, the US has extremely few, and only one relatively high-speed route. Thus the US is highly dependent upon its domestic air transport network. At a minimum in the US-EC market, the US side needs to have relevant bilateral air transport agreements kept alive indefinitely, if only as fallbacks.

4.2 A simple and viable dispute resolution mechanism is another essential safeguard. What is wrong with keeping issue resolution simple? There appears to be no allowance in the draft agreement for one Party's people to simply pick up the phone, or engage in an internet conversation, to resolve any of the many problems likely to arise! Rather, a "joint committee" meeting must be called (to consist of at least 25 people on the European side?). And, if so, would such meetings always be in Brussels? What is wrong with embassy and foreign office officials working with each other to resolve problems in coordination with transport officials? If the EC wants Brussels to handle all disputes so be it. But let it be fast, not through some "joint committee".

4.3 If the two sides still want to go ahead with the agreement as drafted, might they consider adding some safeguard where particular right exchanges are radically imbalanced? For example, what if they were to agree that the total scheduled plane miles over a period of say, one month, on Fifth, Seventh and the thru-plane Sixth behind sectors not exceed by more than 20 or 25 percent the total of all such sector plane miles scheduled by carriers of the other Party?

4.4 If the relative revenue values for each side of the rights to be exchanged are now a matter of widely differing perceptions, could the parties not agree to an ongoing exchange of samples (say, 10 percent) of complete ticket information, as has been done for many years between Canada and the US? This would soon reveal how valuable the rights to be exchanged or actually exchanged are to each Party, thus showing how level a playing field they have created?

5. LONDON HEATHROW ACCESS

5.1 The largest single potential access gain for the US side is fair access for nonstop flights from all its cities to London's Heathrow airport. The limitation to only two US airlines at Heathrow is a holdover from a long passed negotiation in which the US negotiator decided to accept a British demand and agreed to access solely for Pan American and TWA, which were then the only US carriers in the market. They were later replaced by United and American Airlines. But this left several major US cities that are hubs for other carriers, for example Atlanta, which is Delta's major hub, and numerous other hub cities without Heathrow access.

5.2 The basic draft agreement is silent on this issue. If there is a side agreement on Heathrow access, will it compel a transfer of scarce and expensive landing and takeoff slots to carriers such as Continental, Delta, Northwest, and US Airways? And what if Lufthansa were to convert a pair of its London-Frankfurt slots into London-Atlanta, or London-Houston, takeoff and landing slots? Would it be or not be obliged to convert another pair into matching slots for Delta or Continental...which most likely could not get them any other way?

5.3 Given the importance of Heathrow access to airlines of all the other continents, to the high costs and limited availability of such access, and to the need of at least four more US airlines to get numerous intercontinental flights into Heathrow, could consideration be given to limiting UK domestic flight access to use by traffic connecting to and from international flights? Over time, could Heathrow use by intra-Europe relatively

short haul flights be moved to Gatwick or elsewhere, to open more slots to intercontinental flights? (The writer apologizes if he is not up-to-date on today's situation at Heathrow.)

6. **POTENTIAL ALTERNATIVE AGREEMENTS**

6.1 The transatlantic draft agreement is novel and innovative in many respects. But it also leaves out other potential partners, such as Canada and Mexico. Might it not be redrafted to allow others to join, perhaps even the UAE and Singapore? Note that as presently drafted it has no potential value to other States. To the contrary, it could even be harmful to other States, for example where EC negotiating leverage might be applied to force small States to allow EC carriers to have through plane services to the US.

6.2 An even better alternative would be to draft it for global coverage, so that any States could sign on to it. It could apply between the territories of the first two signatories, then expand to add on the markets between all signatories as others signed on. It would need to have added safeguards which developing States could choose to apply. This writer devised just such a draft agreement in 1994, but liberalization advocates who saw its safeguards for developing States thought it too restrictive. Developing State's people found it too liberal. Perhaps views have since changed somewhat. Perhaps a limited group of other experts, working under the impartial auspices of ICAO and including EC and US experts, could devise just such an agreement, which could then be opened for signatures. Over time, many of the existing 4000 or so air transport agreements, many never registered with ICAO as required, could eventually be replaced by a single one.

7. **CONCLUDING REMARKS**

7.1 Numerous press stories over the past many months report a seeming frustration, on the parts of US officials in particular, over the widespread opposition to the DOT rulemaking to allow foreign managers in US airlines, and to a lesser extent opposition to the draft agreement. Yet there are no explanations of why it is a good idea to have a foreign competitor's people within US airline managements in positions where they would be able to adversely affect competition. Nothing has been reported about why the US side even entertains the idea of agreeing to a non-level "playing field", much less to working towards opening US airline ownership by foreign competitors in order to have a big new "open skies" agreement. One wonders, do more than a few individuals, if any, have access to all the details, for example of a side agreement on London Heathrow access, if one exists. If similar concerns exist in Europe, or among countries that might be unduly affected by this agreement, are they being given any attention? The idea of open skies over the Atlantic is a highly commendable one. Balanced market penetration is an outdated concept. Balanced market access need not always be present in country-pair markets (as it never has been in markets between the US and States such as Austria, Belgium, Denmark, Finland, Iceland, Norway, Sweden, and others whose airlines rely heavily on Sixth Freedom traffic). But gross inter-continental imbalances in market access are dangerous. A truly equitable agreement with safeguards and durability, particularly one open to all States, could be a great addition to the global regulatory scene!

7.2 Finally, the writer of this paper has been out of the international air transport regulatory field for many years. It was researched and drafted in only a few days, so he would welcome any corrections to the facts offered above. Similarly, if any of the assumptions and analyses above are in error, the writer, and presumably any interested readers of this paper, would welcome fully explained corrections.

ANNEX A

Technical Matters

A.1. Nowhere does the draft agreement state that it covers only scheduled air services, or that it covers both scheduled and non-scheduled air services. One is left to infer that it covers both types. Nevertheless, if this is true, then why does it exclude from traffic rights all but airlines. Presumably, non-scheduled services by air carriers that offer only air charter services and are not considered “airlines” are not covered, leaving a small void.

A.2 To free airlines from all price regulation, as the draft agreement would do, may not be a sound idea from a consumer’s point of view. What about tariffs that are clearly discriminatory, or that impose unreasonable cancellation, refund, or baggage charges and conditions? When the only airlines serving a city-pair market team up to offer consumer harmful tariffs, where can the consumer go for recourse, even if his government is willing to help, but its hands are tied by the draft agreement? And what about tariffs that could drive a new market entrant out of the market? That could happen before the cumbersome consultation process ever got started.

A.3 Article 3, paragraph 2.g grants each airline the right to make “stopovers”. A passenger’s “stopover” has a clear meaning. An airline can make a “stop” with its aircraft. But what is an airline “stopover”?

A.4 Presumably an EC airline will continue to be able to have its code and flight number applied to an intra-US flight operated by a US airline. But Article 3, paragraph 6.b. denies the EC airline the right to take on traffic in the US destined for another US point. So it would appear that it is permissible for the EC code share numbered flight to be announced as “now boarding”, and for its passengers to be welcomed once on board, but not permissible for them to be “taken on board”...or is this incorrect? Code sharing really complicates agreement drafting, it seems. Yet the use of code sharing appears to be growing rapidly.