



**AIR TRANSPORT LIBERALIZATION:
THE U.S. EXPERIENCE**

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I am grateful to the ICAO Secretariat for the invitation to participate in this important symposium and to explore the U.S. experience with aviation liberalization. I would like to offer a brief history of that experience and to discuss a few conclusions that may be relevant to the policy deliberations of other governments.

Domestic Airline Deregulation in the U.S.

Nearly thirty years after the U.S. liberalized its domestic airline industry, at a time when aviation liberalization is so widely accepted, it is easy to forget what an immense public policy achievement deregulation was, and how difficult it was to accomplish – even in a country as committed to market-based policies as the United States.

Airline deregulation was still a novel idea in the mid-1970s. The U.S. Civil Aeronautics Board had launched some interesting experiments, but they were fairly narrow in scope. Thus, when the United States Senate began to explore the possibility of deregulating the airline industry through legislation in 1975, many observers treated the effort as wholly fanciful. The public's support for the idea was lukewarm at best. The U.S. airline industry's opposition, on the other hand, was intense and focused. The outlook for success, many thought, was marginal.

The legislative process wound on for three years. Thanks to some colorful Congressional hearings, the issue acquired far greater public visibility. When they noticed that the most enthusiastic supporters of continued regulation were the airlines themselves, Americans

began to understand what was at stake. And so, in 1978, against all odds, Congress passed the Airline Deregulation Act. It was one of the most important economic policy departures in American history.

Based on benefits to consumers that became apparent almost immediately, Congress went on to relax the regulatory regimes that governed a host of other sectors – motor carriers, railroads, financial services, energy, telecommunications, and ocean shipping. For the U.S. and a great many other countries, the elimination of unnecessary and archaic regulatory models and reliance on market forces has now become a mainstream policy.

Spreading Liberalization to International Aviation

In the late 1970s the U.S. also began to re-examine its traditional approach to international aviation regulation. Bilateral agreements forged since the advent of the Chicago Convention of 1944, after all, had been highly regulatory and largely protectionist instruments. Orderly markets and carefully calibrated, reciprocal exchanges of rights had been the hallmarks of those agreements, and the United States – no stranger to classic horse trading -- had long enjoyed the advantage of bargaining from strength -- leveraging access to the hugely attractive U.S. market in return for opportunities abroad for U.S. carriers.

Beginning in 1977, however, the administration of President Jimmy Carter crafted an international aviation policy more in keeping with the push to deregulate the U.S. domestic aviation market. U.S. aviation negotiators thus began the quest for more *liberal* bilateral agreements – offering the airlines of other countries expanded access to the U.S. market – including new, interior gateways -- in return for provisions guaranteeing open entry, freedom to set fares, and liberal charter provisions.

The Carter Administration negotiated a number of important bilateral breakthroughs. New, liberalized agreements with trading partners in Europe, the Middle East, and Asia established an important new model for international aviation relations.

Domestic Criticism of International Aviation Liberalization

The established U.S. international airlines – primarily Pan Am, TWA, Northwest, Braniff, and Flying Tiger – found nothing to like in the newfound U.S. determination to inject meaningful competition into international markets that had long been protected by the limits enshrined in traditional bilaterals. They knew that the real threat would not be from foreign airlines but rather from home, where deregulation was quickly spawning a new generation of highly efficient and aggressive carriers whose international flights – once they were permitted – would be fed by huge domestic networks. From the outset, therefore, the “incumbent airlines,” as they were called, were hostile to the entire enterprise.

They complained bitterly to Congress that the U.S. was giving away “hard rights” – new U.S. gateways for the benefit of foreign airlines – in return for “soft rights” – nothing

more than the willingness of foreign governments to stop regulating entry, fares, and schedules.

Taking these criticisms seriously, Congress in late 1979 passed a new law – the International Air Transportation Competition Act – that instructed U.S. aviation negotiators to place a new and greater emphasis on the consequences of liberal aviation agreements for U.S. carriers.

The new law wasn't enough for the unhappy U.S. international airlines. They submitted a "white paper" to the incoming administration of President Ronald Reagan. It denounced the Carter Administration's aviation policy, saying that the United States was "worse off . . . in market shares than at any time in the last decade."¹ In response, the Reagan Administration instituted a moratorium on further negotiations that lasted several months while it reconsidered U.S. international aviation policy.

The airlines also renewed their complaints to Congress. No less than nine public hearings were conducted by the House of Representatives on the conduct of international aviation negotiations in 1981 and 1982. In August 1983, a House Subcommittee issued a report denouncing the performance of the government agencies responsible for aviation policy. "Our carriers' economic viability has been adversely affected," the Subcommittee said, "by an Open Skies policy which has extended domestic deregulation to the international arena." "Our agencies," it continued, ". . . have not forcefully negotiated bilateral agreements that support our air industry...."²

Quiet and Consolidation

Mindful of the criticism, the Reagan Administration was less aggressive in the pursuit of liberal agreements for the next few years. It was during this period, ironically, that U.S. airlines began exploiting more effectively the broad new freedoms that had been delivered – sometimes over their own vehement objections -- in the earlier liberal bilateral agreements.

In fact, the performance of U.S. airlines in international markets during the 1980s was extraordinary. They carried nearly twice the number of passengers in 1990 as in 1980; their market share grew by about 20 percent; their revenues attributable to international operations more than doubled; and the percentage contribution of international services to their overall system-wide revenues increased by about 20 percent.

Consumers benefited in even more dramatic ways. In 1980 there had been 17 U.S. gateways with nonstop services to Europe; by 1990 that number had increased to 25. The number of nonstop routes across the North Atlantic – city-pairs with nonstop service – grew from 92 in 1980 to 161 in 1990. Similarly dramatic increases were seen in the number of gateways and nonstop routes to the Asia/Pacific region and to Latin America.

¹ "Aviation Services in America's International Trade: A Review Under Open Skies," International Economic Policy Association (December 1981), at 23.

² H.R. Rept. No. 98-19, 98th Cong., 1st Sess. (1983).

Passenger growth was consistently stronger in liberalized markets than in non-liberalized markets. Cargo carried by U.S. airlines more than doubled between 1980 and 1990.³

Open Skies: Broadening the Definition

The policy clearly had been a success, but it didn't go far enough. Even our most liberal bilateral agreements still contained major restrictions. Many of those restrictions had been maintained for the protection of U.S. airlines, particularly after the Congressional criticism of the late 1970s and early 1980s. In many cases, they prevented foreign airlines from bringing international service to U.S. communities that badly wanted it.

Unless a U.S. airline was seeking new opportunities in a foreign airline's home country, the traditional bilateral approach left us no easy way to grant new rights to that carrier. Instead, our answer was likely to be "not now." We would wait until some U.S. carrier needed something, and then we would talk.

Because so many of our newer agreements delivered such broad market access to U.S. carriers, however, there was often nothing to talk about. When we asked ourselves what value this restrictive approach brought to the U.S. economy, we found that we had no good answer. In fact, it was clear that the restrictions actually reduced the value of our agreements by limiting competition unnecessarily.

To overcome that anomaly, Secretary of Transportation Samuel Skinner in 1990 proposed a new "Cities Program." The idea was simple: If an airline from a liberal trading partner wished to serve a U.S. gateway city that was not listed for service in the applicable bilateral agreement and no U.S. airline was offering to serve the same city, we would permit the new service without the need for a new negotiation. DOT decided, in other words, not to let the traditional bilateral negotiating process stand in the way of beneficial air service without a good reason.

It sounds simple enough, but the program represented a dramatic departure from past policy. There was some complaining from U.S. airlines, but nothing like the attacks of a decade before. DOT finalized the proposal,⁴ and a number of new services to the U.S. were launched without the need for any negotiations whatsoever.

The most important contribution of the Cities Program, in retrospect, was the revelation that we could actually give routes away free of charge to the airlines of liberal trading partners. It wasn't long before that discovery led to a new and even more exciting concept: the possibility of launching a new "Open Skies" approach to international air services. DOT adopted the new policy in August 1992.⁵ It was even simpler than the Cities Program: The airlines of countries that agreed to open their air services markets to U.S. carriers would receive, in return, open access to and through the entire United States. The U.S. would not count the number of new destinations, or designations, or

³ Unpublished DOT study, December 1992.

⁴ DOT Docket 46534, Order 90-1-62, Jan. 30, 1990, modified by Order 91-11-26, Nov. 20, 1991.

⁵ DOT Docket 48130, Order 42-8132, Aug. 5, 1992.

frequencies in its assessment of the value of such agreements; rather, it would evaluate them on the basis of the extent to which they gave the airlines of each side fair and equal access to the entire basket of traffic seeking to move between the two countries and beyond.

The importance of that new measure could not have been more clearly underscored by the first Open Skies agreement negotiated under the new policy -- with the Netherlands. Because U.S. airlines already enjoyed virtually open rights to serve the Netherlands under the previous U.S.-Dutch agreement, they complained that an Open Skies agreement with the Netherlands would offer them no incremental market access whatsoever. At the same time, it would grant KLM access to every point in the United States and from any U.S. point to any point in the world. It was, some said, an outrageous giveaway.

DOT had already addressed the “imbalance” issue in the order announcing the new Open Skies policy. “We have seen much larger dividends in those markets which allow greater scope for airline prices and service initiatives,” the Department had written. “Indeed, if we were to embark on negotiation initiatives only where we could anticipate precisely equal economic benefits we would have been deterred from some of the most successful agreements we have achieved in the last decade.”⁶

We signed that agreement with the Netherlands in 1992. It was the first of nearly 80 Open Skies agreements that the U.S. enjoys today around the world. The U.S. and the EU are currently working together to forge an “Open Skies Plus” agreement across the North Atlantic that would take liberalization to an entirely new level and offer a fresh new framework for international air services that, you can be certain, would be emulated elsewhere before very long.

Lessons from the U.S. Experience

A number of conclusions can be drawn from this short history of U.S. aviation policy.

First, aviation liberalization is not for the faint of heart. It is the classic good deed that will not go unpunished. The U.S. has long favored reliance on market forces and competition as a core economic policy, and yet even in the U.S. liberalization was a highly controversial proposition.

Second, liberalization gets easier with time. Skeptics discover that those initially icy waters really aren't that bad once you have been swimming in them for a while, and once the benefits have been made clear through experience.

Third, liberalization begets more liberalization. The U.S. first sought some loosening of the rules governing entry, pricing, capacity, routes and the like in the late 1970s, and gave away some new market access in return. The success engendered by those agreements

⁶ *Id.* at 2.

made it possible to launch the Cities Program in 1990. And the Cities Program made the Open Skies policy possible two years later.

Fourth, you can never predict what will happen in a more open market. When the U.S. launched its Open Skies policy, we did not fully anticipate the extent to which it would encourage the formation of more robust cross-border alliances – facilitating a more effective global presence for U.S. airlines and their overseas partners than had been possible before. The changes within the industry engendered by Open Skies have been an endless source of wonder.

Finally, once liberalization is embraced as policy, there is no turning back. The U.S. airline industry has been through three historic downturns since deregulation, spaced about a decade apart, each worst than the last. Even during the worst downturn of all – the one that began in late 2000 and that the industry is only now beginning to emerge from – there were no proposals to turn back the clock and begin regulating again.

I don't mean to suggest that it is easy even now, or even in the U.S. The adverse Congressional reaction to the Bush administration's recent initiative to relax the current restrictions on offshore investment in U.S. airlines reminds us that big changes can only be made cautiously, and only after careful deliberation.

History teaches, however, that these changes are inevitable. Aviation is, after all, a global industry and it will insist on being treated like one. Those of us who toil in the ministries, departments, and agencies that have responsibility for air transport need to focus our attention on those elements of oversight that clearly add value in terms of the public interest. Beyond that, we should just get out of the way.

Many thanks for allowing me to share these thoughts with you this morning.

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