

"U.S.-EU Aviation Relations -- Charting the Course for Success"

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International Aviation Club, Washington, D.C.

July 13, 2004

For me, as one who has benefited enormously over the years from the wealth of knowledge and friendships offered by the International Aviation Club, it is a true honor to speak here. The IAC is a treasure for all who have a passion for civil aviation. Diverse perspectives coupled with a unity of commitment to aviation make the Club an invaluable Washington institution.

Today, I will focus on aviation relations with the European Union: a look at the past, a snapshot of the present, and an assessment of the future. Our negotiations with the Community over the past year have offered us insights and most certainly kept us busy. I'll do my best to avoid the most obscure subjects. For example, I'll not offer legal perorations on the division of treaty-making authority between the Community and the Member States, a subject known as "mixity." Suffice it to say that "mixity" has nothing to do with bartending, although a White Russian or Purple Zombie might have facilitated our understanding of the more subtle points.

Just a year ago, at the U.S.-EU Summit in June 2003, President Bush and his European Union counterparts announced the start of comprehensive air services

negotiations. It was, they said, “an historic opportunity to build upon the framework of existing agreements with the goal of opening access to markets and maximizing benefits for consumers, airlines, and communities on both sides of the Atlantic.”

Less than a year later—by early June 2004—after six formal rounds of talks and countless interim contacts by phone, by videoconference, and in person, we had largely completed the negotiation of what would have been:

- an historic agreement representing a major advance beyond traditional Open Skies;
- a comprehensive agreement replacing all our bilateral agreements and arrangements with the twenty-five EU Member States;
- a commercially valuable agreement benefiting consumers, airlines, workers, airports, and communities, here and in Europe; and
- a "first-step" agreement legally committing the two sides to continue the negotiations to attain further liberalization in the future.

I use the words “would have been” because on June 11 the EU Transport Ministers rejected the agreement presented to them by Commission Vice President Loyola de Palacio. We understand that there was a lively debate, that a majority of countries supported moving ahead, but that other countries were opposed. The United Kingdom, to no one’s surprise, led the naysayers. But other countries, reportedly including some of our major Open Skies partners, also voiced opposition.

The United States remains firmly committed to trans-Atlantic aviation liberalization. At this year's U.S.-EU Summit in Ireland on June 26, President Bush and his Irish and Commission counterparts called on the two sides' negotiators to continue efforts toward a comprehensive aviation accord "that will expand opportunities not only for airlines, but also for airports, tourism, business links, and cargo transport." Thus, we have our instructions. But how now to carry them out?

To explore this question, let's turn the clock back a dozen years. In 1992, at the end of the first Bush Administration, the United States concluded with the Netherlands our first Open Skies agreement. After a pause for evaluation, the Clinton Administration embraced the Open Skies concept and, in rapid order, reached agreements with nine more European countries in 1995. A landmark Open Skies accord with Germany in 1996 was followed by agreements with the Czech Republic, Italy, and Portugal. The second Bush Administration has continued the momentum, concluding Open Skies with the Slovak Republic, Malta, Poland, and, in 2002, with France. Indeed, of the twenty-five current EU Member States, we have Open Skies agreements with fifteen, as well as with Norway, Switzerland, and Iceland, all of which are associated by treaty with the EU aviation market.

The Open Skies success story—and it is a remarkable success—was possible because of a unity of vision and purpose among successive Administrations, both sides of the aisle in Congress, our airports and communities, our airlines, and our labor unions. All have come together behind the Open Skies banner to advance the

view that governments should get out of the business of counterproductive economic regulation and endorse a market-based approach to global aviation—one that serves consumers, helps communities, and creates jobs.

Contrast the picture in Brussels. In the early 1990's, the Commission criticized Member States' bilateral Open Skies agreements on two grounds. First, the Commission argued that it could obtain a better deal if it negotiated for the Community as a whole. Second, the Commission contended that the Member States violated European law by continuing to negotiate bilaterally.

As it were, the sovereign states of Europe—each a party to the Chicago Convention with a vote at ICAO, each with an embassy in Washington, each clearly focused on what was in its own interest—disagreed. The Commission attempted in the early 1990's to start negotiations with us on a cargo-only agreement but had the carpet pulled out from under it by the Member States. In 1996, the Member States refused Commission entreaties for a full mandate, authorizing it to negotiate only soft rights, things like groundhandling and dispute settlement. We held informal talks, but little progress was possible where one side lacked the ability to address the very core of an air services agreement: routes and rates.

Thwarted in its efforts to secure a mandate consensually, the Commission went to the European Court of Justice in 1998 to force the issue, challenging seven Open Skies agreements as well as the Bermuda 2 accord with the UK. While the litigation proceeded, however, so did our bilateral Open Skies negotiations with

additional partners in Europe: with Italy, Portugal, the Slovak Republic, Malta, Poland, and France. Had the Commission not intervened with questions related to their accession to the EU, I am confident that we would have reached Open Skies with at least another three or four European countries.

In November 2002, the ECJ issued judgments in the eight cases. It found that Member States retained authority to negotiate bilateral agreements but declared inconsistent with European law the provisions in the bilaterals on pricing within the European Union and computer reservation systems, as well as the traditional article on ownership and control. After several months of internal debate, the Member States granted the Commission a negotiating mandate in June 2003.

Let me offer two observations on that mandate. First, it was not given easily, coming only after litigation that had generated considerable tension and acrimony. In the United States, we have a broad consensus of government and private sector stakeholders as well as over a decade of success with our Open Skies policy. The Commission, in contrast, took up its negotiating responsibilities in 2003 with still resentful Member States and without the same bond of experience and trust that we have built up over the years with airline, labor, and airport stakeholders.

A second observation: the mandate given to the Commission, sweeping in its broad vision of an "Open Aviation Area," was at the same time neither fully complete nor truly unitary. Not fully complete because the Commission was

denied authority by the Member States to negotiate fifth and seventh freedom rights outside the U.S.-EU market. Not truly unitary because any accord that emerged from the negotiations would likely take the form of a mixed agreement, with each Member State retaining a legal veto over the results. In essence, we found ourselves not with one, but rather with twenty-six potential negotiating partners.

In retrospect, it's clear that the odds were stacked against the Commission—and also against those in the United States who saw in these negotiations not something that had to be done, not a negotiation of immediate commercial necessity, but rather a unique opportunity to build upon past successes, to go beyond the traditional Open Skies approach, and potentially to set an historic precedent of global significance. As Under Secretary of Transportation Jeff Shane put it in late 2002, we saw a chance to consider how to "take liberalization to the next level" and to think seriously about "how the transatlantic market can be made more robust and competitive." We saw in the European Union, again to use Jeff's words, "a like-minded partner on the other side of the negotiating table that represents an airline industry and an aviation market comparable to our own."

As formal talks began in October 2003, we set about our work with focus and energy. We took to heart the German philosopher Hegel's observation that "nothing great in the world has been accomplished without passion." The U.S. delegation included representatives from State, DOT including the FAA, Commerce, Defense, Justice, Homeland Security, and the General Services Administration. At U.S. urging, representatives of industry—from airlines,

airports, labor, and computer reservation system associations—were also included in the negotiating sessions. Stakeholder participation is established practice in our aviation talks, but that's not the case for the Commission's conduct of trade negotiations. We were pleased that the EU ultimately accepted our approach—one that recognizes the essential role of the private sector in the negotiations. I do believe, however, that the Commission's initial opposition to this approach soured somewhat its relationship with European stakeholders.

Progress in our talks came surprisingly fast—exceeding what most observers had expected. Vice President de Palacio recently commented that the progress we achieved in such a short period was nothing short of "spectacular." Indeed, when British Airways' Rod Eddington suggested early on that the talks needed to slow down to the pace of a marathon, I was sure we were on the right path.

The American approach was different from the carpet-trader patterns of traditional negotiations. We did our best to listen to European requests and to be responsive on every issue where possible. We made clear that we could meet Europe's most immediate requirement—or, at least, the requirement that we perceived to be the most immediate—namely, to remedy the deficiencies under EU law identified by the European Court of Justice. We also listened carefully to Vice President de Palacio's view that consolidation of the European airline industry was a pressing need. We responded with a new ownership and control clause that would have authorized every European carrier to operate to the United States from any and all points in the EU—for example, BA from Frankfurt, Lufthansa from Warsaw, Virgin Atlantic from Brussels, or EasyJet from Paris. Moreover, our

proposal would have eliminated immediately, fully, and permanently all legal barriers in a comprehensive agreement to the merger of EU carriers, such as the planned combination of Air France and KLM.

Listening also to EU calls for changes in traditional inward investment rules, we proposed to secure Congress's approval to increase foreign ownership limits for voting stock from 25% to 49%, the current EU standard. We were also prepared to make further liberalization in the investment area a priority subject for consideration in follow-on negotiations, upon implementation of the first stage.

But the list of areas in which the United States sought to be responsive to European requests doesn't end with these examples. Let me mention a few more:

- We agreed to eliminate the longstanding requirement for formal designation of airlines;
- We agreed on an Annex for cooperation in airline competition matters between the Commission and the Department of Transportation;
- We worked out changes sought by the EU in the safety article of our model bilateral;
- We added, at European request, new provisions on state aids, the environment, and consumer protection;
- We agreed to authorize EU carriers to make use of U.S. airlines to provide indirect carriage of passengers and cargo in our domestic market—a right the U.S. has never before granted in any agreement;

- ➔ We agreed to include authorization for EU airlines to provide aircraft with crew to U.S. carriers for international operations, subject to appropriate measures to protect aviation safety and legitimate labor interests; and
- ➔ We accepted the EU proposal for a Joint Committee to review implementation of the agreement.

For its part, the United States focused on a handful of core objectives. First, and most important, we asked that Open Skies principles extend to all of the EU, not just the fifteen Member States with which we have Open Skies bilaterals. From our perspective, it was important to eliminate discrimination tied to nationality and to establish a common foundation of traffic rights, including unrestricted market entry, unlimited frequencies, open route descriptions with open beyonds, and market-based pricing. We viewed this proposal as one of mutual benefit, not a one-sided U.S. demand. Benefits would flow not just to the EU accession states, where Open Skies could attract cargo operations and valuable codeshare service in the near term. Not just to Spain, where Iberia is today ineligible to apply for antitrust immunity from DOT because of the absence of Open Skies. Not just to Ireland, where Aer Lingus is held back from offering service to more U.S. cities by a restrictive bilateral agreement. No, it was and is our view that Open Skies would also benefit British consumers, British shippers, British airports, British cities, and the British economy.

In addition to Open Skies, the United States raised three other issues worth noting. First, because of concerns about night curfews at European airports, we

asked that both sides affirm their commitment to the principle of the balanced approach to noise management adopted by the ICAO Assembly in 2001. We did not demand a moratorium on night curfews or any other rules at variance with the global consensus. Second, we noted that slot limitations at European airports could affect the implementation of an agreement and thus sought a reference to infrastructure constraints in the article on the Joint Committee. Importantly, we did not seek in this first-step agreement to require the European Union to carve out special advantages for American carriers, such as designated slots at Heathrow. Third, we raised issues important to U.S. labor. We sought clarification of EU rules addressing flag of convenience issues, a concern heightened by the expansion of the EU to twenty-five states. We also asked that the Joint Committee review after one year the effects of the new agreement on workers. And we stipulated that the provision of foreign aircraft with crew to U.S. carriers would not be permitted during labor disputes.

We made important progress on all of these issues and were convinced that a first-step accord not only could meet the near-term objectives of both sides but also could provide impetus for progress in follow-on negotiations.

We were disappointed, therefore, when European Transport Ministers rejected what we had negotiated. We should examine carefully why this happened.

The reasons offered publicly are far from convincing, tending to shed more heat than light. For example, some argued that the absence of cabotage rights for EU carriers in the U.S. domestic market created an "imbalance" when contrasted

with the rights of U.S. carriers to operate between, but not within, the EU Member States. This rationale is both a legal and a commercial red herring. From a legal perspective, as long as the EU Member States are just that—sovereign states under international law, each with a separate vote in the International Civil Aviation Organization—it is simply incorrect to equate cabotage with fifth freedoms. But just as important is the limited commercial relevance of cabotage: no EU carrier has approached us in recent years with a serious request to operate cabotage flights, just as no American carrier today operates passenger aircraft between any points in Europe and only a few carriers have historically operated a modest number of all-cargo flights.

A similarly fishy red herring was the demand that the United States provide a binding commitment to permit European carriers to establish subsidiaries in the U.S. In an era of expansive codesharing, this seems to us rather disconnected from today's commercial needs. In any event, we made clear early in the talks that right of establishment was simply not doable in a first-step agreement that could be signed this year. Those in Europe who insisted on this right were fully aware that they were sounding the death knell for early progress.

Another asserted rationale for the June 11 rejection was the allegation of "insufficiency." The argument goes as follows. The EU seeks a radical change in international aviation by establishing with the United States an Open Aviation Area with unlimited traffic rights and harmonized rules on competition, safety, security, consumer protection, and the like. For the EU to accept a first-step agreement that "concedes" Open Skies, including a thorough purging of the

restrictions in Bermuda 2, would rob the EU of its “leverage” to make this vision a reality. Thus, the EU should hold back Open Skies rights—for example, new fifth freedoms—to maintain the ability to force the "recalcitrant" Americans back to the table.

There is a certain Machiavellian appeal to this rhetoric, but the argument is fundamentally flawed. As noted earlier, a comprehensive U.S.-EU aviation agreement is, for us, primarily an opportunity for the future, not something that our carriers insist that we achieve today. Whatever the value of new Heathrow rights in the past, their luster has dimmed in recent years. Ask our British counterparts, who approached us in the summer of 2002 with a deal that would have permitted each of two additional U.S. carriers to provide a pair of daily services to Heathrow as well as allowing FedEx to connect Stansted to its Paris hub. After consulting all our carriers and other stakeholders, we rejected the UK proposal as not of interest: too little, too late.

We thus view with skepticism the assertion that the EU needed cabotage or the right of establishment in order to approve a first-step agreement. We take the same view of the suggestion that full Open Skies rights should be withheld from ten of twenty-five EU Member States—a perverse suggestion for aviation apartheid. Based on an evaluation of commercial needs and many discussions with government and private sector Europeans, my personal view is that the opposition of some EU member states and airlines to a first-step agreement had little to do with the sufficiency of the U.S. offer and much more to do with relationships within the EU itself.

As noted earlier, the Member States granted the Commission a mandate only after litigation forced the issue. The mandate was neither complete nor unitary, and the Member States retained power to thwart the Commission's efforts. We have also heard the many rumors of wheeling and dealing among the Member States on the eve of the June 11 Council meeting. One or more countries reportedly agreed to oppose a first-step agreement in order to secure other states' support on unrelated EU issues, such as controversial trucking regulations. Politics as usual, I suppose; but disappointing, if true.

The position of European carriers also bears close examination. Publicly, the Association of European Airlines had long called for a Commission mandate and for EU-wide negotiations with the United States. Privately, however, individual European carriers—many of which enjoy protected positions on international routes to third countries negotiated by their national governments—expressed concern that the Commission might pursue a more independent course, one that could work to their commercial disadvantage. Why, they implied, should Member States give the Commission an early win that could only bolster its quest to negotiate market-opening agreements with other countries? I believe that Vice President de Palacio was voicing the same assessment when she spoke publicly on June 23 about some European carriers' desire to maintain "closed market shares" that make "victims" of consumers.

It is impossible, of course, to know with precision the factors that informed the decisions of the twenty-five EU Member States and their airlines. I do not

wish to suggest that national authorities are mere mouthpieces for their flag carriers or that the Commission did not reach out to European industry when formulating positions. Nor do I wish to denigrate the commitment to competition of our European Open Skies partners and their airlines. At the same time, it serves no purpose to gloss over the tensions that so obviously exist within the European Union as we chart a course for the future.

Where, then, do we stand and what lessons can we draw from the past year?

Obviously, we lost a golden opportunity in the near-term to liberalize the trans-Atlantic market for mutual benefit, a striking contrast to our recent remarkable progress with China and in the Asia-Pacific region. It's appropriate for us in the weeks ahead to assess, with our stakeholders, how we can move forward with the EU. During this period, we will stay in contact with the Commission. We expect to consult informally in early autumn to take stock of developments. Similarly, if individual Member States come knocking, we will most definitely answer the door. It is not our intention to disappear from the scene, cicada-like, for a long period.

When we re-engage, however, we will draw on our experience. I can offer four lessons from the past that may help us in the future.

First, it is essential that government negotiators and private sector stakeholders work closely and honestly with one another. Negotiators—both in Washington and in Brussels—have a duty to lead, to make tough decisions, and to

strike a balance among competing interests. At the same time, an agreement that fails to address stakeholders' real needs and legitimate concerns won't fly. By the same token, stakeholders have an obligation to be honest: demanding cabotage or the right of establishment with no near-term intention of making use of such rights was a one-way ticket to failure. If there are unstated concerns that need to be addressed, then lay them out openly, and we'll see what can be done.

A second lesson: the European Union must ensure that it can address the full range of rights that are traditionally included in an air services agreement, including fifth freedom rights outside the EU. We can accept that the European Commission and the Member States may not be able for legal reasons to speak with a single voice on all subjects. But we will ask that they find a more workable way to deal with all relevant issues.

A third lesson: we need to be realistic about what is achievable in the near term and how, in practical terms, to make progress toward broader liberalization. As Assistant Secretary Karan Bhatia commented in his speech to the Club two months ago, "responsible authorities on both sides of the Atlantic cannot be so implacable as to reject any agreement until the 'perfect' agreement is reached." As Karan noted, "significant change in the aviation industry has almost always come incrementally." For the United States, a step-by-step approach means one step at a time coupled with a commitment to keep working. It cannot mean that the United States will bind itself up front to the abstract concept of an Open Aviation Area and treat the negotiations merely as a mechanism for working out the phases of implementation.

A fourth and final lesson: we take very seriously the joint commitment of our leaders at the 2003 Summit to "build upon the framework of existing agreements." This instruction from the highest level simply cannot be squared with calls for denunciation of those very same agreements. Internal EU squabbling over denunciation can only distract us from a focus on substantive negotiations. It would introduce yet more uncertainty for an already weakened industry. And far from creating an incentive for reaching an early agreement, denunciation would disrupt and might even prevent the resumption of our negotiations.

In closing, I know that I have spoken bluntly. I've done so as a longstanding friend of Europe, one who is doubtless the first IAC speaker to quote Georg Wilhelm Friedrich Hegel. But the most important reason I've spoken so directly is because the Administration remains committed to liberalization of transatlantic aviation, liberalization that must transcend traditional bilaterals. To achieve this goal, we need a clear assessment of the past, clear thinking about our options today, and a clear vision for the future. I hope that I've helped move this important endeavor forward.

Thank you.