



**REMARKS OF
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When I appeared before the International Aviation Club in November of last year, I talked about the unfinished business of aviation deregulation. I called aviation deregulation “a work in progress.” Today I want to pick up on two of the issues that we are continuing to work on, as we seek to move deregulation to the next level. The first is DOT’s proposal to liberalize the restrictions on the extent to which foreign investors can participate in the governance of U.S. airline companies. The second is our continuing quest for a transformational “open-skies-plus” agreement with the European Union.

As I look around the room, I am struck by the increasing proportion of the audience that has known the U.S. aviation industry only in its deregulated incarnation. At a time when deregulation is so widely accepted a public policy objective, it is all too easy to forget how immense an achievement it was. I think of it as the public policy equivalent of the bumblebee flying. Just as it’s not supposed to be physically possible for a bumblebee to fly, it shouldn’t have been *politically* possible to deregulate the airline industry. In the mid-1970’s deregulation was little more than a fashionable idea among a few academic economists. The process whereby an arcane economic proposition was placed on the national policy agenda with such prominence that it simply had to be addressed is one of the most interesting stories in the annals of Congress.

It had every indication of turning into one of those quixotic non-contests that we see so often in the legislative process: The public’s interest in deregulation was marginal and diffuse; the industry’s opposition intense and focused. And yet, in 1978 Congress passed the Airline Deregulation Act. Building further on that historic public policy choice, Congress went on to deregulate trucking, railroads, financial services, energy, and so on. Deregulation today is rapidly taking its place as the default economic policy around the world. But we shouldn’t forget that the deregulation of U.S. airlines came first.

Thanks to deregulation, the airlines have been given many of the tools necessary to reinvent themselves in response to evolving consumer demands and competitive challenges -- the flexibility to enter and exit markets at management's discretion, the scope to choose aircraft and service levels in response to market imperatives, and the opportunity to price services in any way that stimulates demand. Although commercial freedom in these areas is not yet universally enjoyed, regulatory constraints on these decisions are fast becoming aberrational rather than the norm.

In this context, as I have pointed out many times before, it is ironic in the extreme that the industry that was deregulated first and that has been the engine for the globalization of so much of the world's economic activity, is among the last to be able to take advantage of one of the most important features of globalization – cross-border capital flows. And that brings me to the first of my two topics – DOT's rulemaking on foreign investment in U.S. airlines.

Foreign investment in U.S. airlines. DOT's avowed view that it is time to increase the availability of offshore capital to the U.S. airline industry lies at the heart of that rulemaking -- a proposal to recalibrate how we determine whether U.S. citizens are in actual control of U.S. airlines. We proposed that change because we believe, subject to our review of the comments submitted, that it would positively influence the development of the U.S. airline industry. As set forth in both the original Notice of Proposed Rulemaking and a Supplemental Notice that we issued later, we think the economic benefits at stake are potentially substantial.

Our proposal is primarily designed to enhance U.S. airline access to the global capital marketplace. We think that, by expanding the pool of qualified investors, it would introduce new competition *among* investors and thereby provide U.S. airlines with better terms. The proposed change, in other words, might well lower the cost of capital for U.S. airlines, a benefit of particular importance at a time when the industry is restructuring to meet the demands of an increasingly competitive global marketplace. To the extent that overseas alliance partners might take advantage of the better climate for investment in U.S. airlines, the proposed change would also enhance the efficiency and durability of alliance relationships.

The proposal does not envision a one-way street for investment, however. One of its most important and yet most overlooked provisions is a reciprocity requirement. Under the proposal, only foreign investors who are from countries that have open-skies agreements with the United States and that permit similar investment opportunities for U.S. investors in their airlines would be eligible for this less stringent treatment. I call this one of the proposal's most important provisions because it has the potential to encourage a more liberal approach to capital flows in aviation on a global basis. It would not only afford U.S. carriers the opportunity to tap more global sources of capital; but also under the reciprocity requirement, U.S. carriers would be able to enhance their international presence by investing in foreign carriers.

To sum up, our proposal carries with it the prospect of a healthier and more efficient U.S. airline industry, enhanced international alliances, far more liberal treatment of airline investments everywhere, more competition for the benefit of travelers and shippers everywhere, and expanded job opportunities for airline employees. Those are the benefits we think would flow from the increased investor confidence engendered by a policy that enhanced their ability to protect their investments through greater input in commercial decision-making. And the proposal was designed to accomplish all of that without changing any of the statutory requirements that apply to U.S. airlines, most importantly the obligation that they remain under the actual control of U.S. citizens.

As many of you know, this proposal is only the most recent in a number of efforts to liberalize the nearly 70-year-old restrictions on foreign investment in U.S. airlines. The first that I remember was a bill introduced by Congressman Bill Clinger of Pennsylvania in 1991 to raise the statutory ceiling on foreign-owned voting shares from 25 percent to 49 percent. The first Bush Administration testified in favor of the proposal, but I don't think it ever left the House Aviation Subcommittee. This Administration had intended to include a similar proposal in the Administration's FAA reauthorization bill three years ago but delays in the interagency clearance process prevented us from transmitting it in time for consideration as part of what became Vision 100. We later requested that it be taken up as a free-standing bill but without success.

Those initiatives, dating back fifteen years, were all proposals to change the statute. None succeeded. In further pursuit of this objective, therefore, we decided to take a different tack. Rather than trying to amend the numerical limits in the legislation we would instead address the wholly administrative constraints that, by our assessment, unnecessarily and excessively restrict the activities even of those foreign investors who fully *comply* with the stringent statutory limits. We thought we were pursuing a far more moderate and evolutionary approach. While Congress is often reluctant to tamper with a well-established statute, after all, adjustments in interpretation happen within regulatory agencies all the time.

Piece o' cake, we thought.

Well, you don't have to be a pundit to have figured out how wrong we were. We didn't actually think it would be easy, of course; we knew there would be some controversy. But none of us guessed how *much* controversy there would be. Our first response to Congressional opponents of the change was to slow down the process by issuing a supplemental notice of proposed rulemaking explaining somewhat more clearly what we had intended to express in the original NPRM – the reasons why we felt that U.S. citizens would remain in actual control of U.S. carriers even if we implemented the change along the lines proposed.

By all accounts, the clarification did little to mollify the opposition. So we decided in August to announce that we were slowing down the process yet again. That decision reflected the Administration's view that a change of this importance, even if wholly

within the purview of the Executive Branch – as we maintain that it is -- should not and probably cannot be implemented over significant opposition from members of Congress.

We again put the proceeding on a slower track, therefore, in order to engage members and staff more aggressively, listening to the reasons for their objections and discussing the likely consequences of the proposed change. There will be no point in promulgating a new rule unless it is clearly sustainable.

So the rulemaking process continues, but further steps will await further consultations. I will not speculate on when the proceeding will be finalized. However, since everybody knows that the EU has drawn a linkage between the rule and acceptance of the U.S.-EU aviation agreement, let me make clear that we do not expect the proceeding to be finalized prior to the October 12 meeting of the European Union Transport Council.

U.S.-EU Agreement. That brings me to the second major issue that I want to discuss today -- the U.S.-EU Air Transport Agreement negotiated last November. The text is done; it merely needs to be ratified by the parties. Nearly a year's reflection has only served to confirm my assessment that our negotiators have crafted a classic "win-win" in that document. In its potential for transforming the transatlantic market, the agreement represents the next important step in deregulation and globalization -- the removal of regulatory barriers to the emergence of the European airline, the establishment of an EU-wide open-skies regime with the United States, and trans-Atlantic cooperation in areas such as security, competition policy, and consumer protection that goes well beyond what is contemplated in our more traditional open-skies agreements. Moreover, the EU and the U.S. agreed to begin a second stage of negotiations within 60 days of the effective date of the agreement.

We are eager to begin reaping the benefits of the agreement, which has the potential to fundamentally transform the framework within which transatlantic air services operate, increasing dramatically the quality of competition in the market and benefiting consumers, communities, and employees who rely on air transport services both directly and indirectly. We believe that these benefits will transcend anything achieved through our bilateral open-skies agreements. Moreover, alliances between U.S. and EU airlines and the cross-border mergers that are already occurring in Europe are dependent on having a stable open-skies underpinning.

Completion of the U.S.-EU Agreement would not only enhance airline competition across the Atlantic, it can also be expected to become the template for liberalization around the globe, loosening the grip of protectionism on markets worldwide.

As persuasive as the affirmative reasons for proceeding with a U.S.-EU Agreement are, the consequences of failure to achieve that objective also need to be understood. The European Court of Justice decided nearly four years ago that the nationality clauses in bilateral aviation agreements were inconsistent with the EU Member States' obligations under the Treaty of Rome. That's a complicated way of saying that EU law requires that EU airlines be permitted to compete with each other for international traffic at their hubs.

The nationality clauses in our current agreements prevent that competition from taking place. The new Agreement would solve that problem on day one. The European Commission has made clear that, given the mandate of the Court of Justice, the status quo will not be an acceptable option if the U.S.-EU Agreement is not implemented.

If, or perhaps more appropriately when, the Commission were to act against the bilateral aviation agreements because of the nationality clause, the consequences would include not only forgone benefits, but also serious disruption to the carrier networks that have developed under open skies. And lest there be any doubt, there's no way to address the problems identified by the Court of Justice except through a solution that involves the entire EU.

In short, there are likely to be serious repercussions if we do not move forward with the negotiated Agreement. We would not put in place the new template for international aviation, forgoing the incremental benefits for consumers of new competitive initiatives and derailing long-overdue, broad-based structural changes in the industry. We would put in jeopardy the economic benefits of fifteen bilateral open-skies agreements, defer open-skies with ten additional partners, and once again fail to remove the regulatory impediments to more competitive service at London's Heathrow and Gatwick Airports. If we lose the current open-skies agreements, we face the very real prospect of dismantling the U.S.-EU airline alliance structure that provides so much international aviation competition today, as well as the emerging cross-border airline mergers.

Antitrust immunity, which has helped to facilitate the efficient operation of many of the current alliances, is necessarily predicated on underlying open-skies agreements. Without legally secure open-skies agreements with their guarantee of open market entry, it is very difficult to see how we could continue to justify immunity from antitrust enforcement for airlines that are potential competitors. And we should not forget that the U.S. operations of the emerging European airlines that are the product of cross-border mergers within Europe are, in part, similarly predicated on the continuance of the open-skies agreements between the U.S. and the countries of the merger partners.

Very clearly, we have before us some very important opportunities to advance the cause of deregulation in the interest of enhanced competition and a stronger U.S. airline industry. Some controversial issues are on the table. But we have an obligation to address those issues in a deliberate way, ensuring that the choices we make are consistent with the long-term prosperity of this most important of industries. The Administration looks forward to continuing to work with Congress as we address these important issues.

By the way, the last time I checked, bumblebees were still flying.

Thank you for allowing me to share these thoughts with you today.

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