

SPEECH BY DANIEL CALLEJA TO INTERNATIONAL AVIATION CLUB, WASHINGTON DC, 16 NOVEMBER 2004

It is a genuine privilege and indeed a real pleasure to have the opportunity to speak at the International Aviation Club of Washington DC, even before I formally take up my post as the new Director of the Air Transport Directorate of the European Commission. At least this gives me the benefit to pretend ignorance when your questions are hard to answer

We are at an important moment in EU/US relations. On both sides of the Atlantic we have new Administrations taking office – the newly re-elected Administration of President Bush in the United States and, hopefully in two days following the vote of the European Parliament, the new European Commission under President Barroso. This is therefore a highly opportune moment for me to give you some reflections on some key features of EU Aviation Policy, and to discuss where we stand in transatlantic air transport relations.

The importance of the transatlantic link

The EU/US transatlantic relationship has, of course, many dimensions – political, economic, social and cultural. But it is above all a progressive relationship, based on shared values. We both aim to promote the rule of law, justice, democracy and security. As was said two weeks ago by the political leaders of the European Community when congratulating President

Bush on his re-election, *“the relationship with the United States is fundamental to Europe's approach of building international peace, security and prosperity, and the ties between us make us each other's natural and indispensable partners.”*

The strength of this common bond between us is demonstrated most clearly when one considers the sheer scale of our economic relationship. The EU and US form the largest trade and investment partnership in the world. The volume of trade in 2003 comprised more than \$ 725 billion worth of goods and services. But even this enormous figure is now far outweighed by the flow of investment. In 2003, the US had \$ 785 billion dollars of direct investment in the EU while the EU had just over \$ 1 trillion dollars in the US; a total of over \$ 1.8 trillion.

Compare these figures with investments in Asia, where total US investments are equal to what it invests in only one EU Member State, i.e. Holland. Today investment constitutes the most significant element of our economic relationship, and this of course means jobs, millions of jobs on both sides of the Atlantic.

But these figures are not the result of accident or chance. They are the consequence of increasing integration between the economies on each side of the Atlantic and of the dismantling of barriers to trade and investment. Yet more can be done, and that is why our leaders at the EU/US Summit in Ireland in June earlier this year called on stakeholders on both sides to engage in a vigorous discussion of concrete ideas on how to further transatlantic economic integration to the fullest. They also asked officials on

both sides to explore means to eliminate trade, regulatory and investment impediments to further economic integration.

Since aviation is recognized as a very important aspect of the EU-US relationship, the Summit specifically called on the negotiators to continue their efforts on a comprehensive aviation accord. Indeed the successful conclusion of a forward-looking and innovative new aviation accord would be a major economic and political achievement.

We share the comments made on behalf of President Bush during the US election campaign that we need to usher in a new era in international aviation. That indeed is the challenge that is also recognized by the Commission and reaching an agreement between the EU and the US would be a major driver for this change.

EU Aviation Policy

Before commenting on the substance of the negotiations, I want to recall briefly some of the history behind the EU's unique experience in creating a single aviation market from different national markets and its evolving role in international air transport. There are a number of conclusions to be drawn which we believe have important implications for the path we should follow at international level.

Only 15 years ago the European landscape in aviation looked very different from what we have today: massive State intervention, fragmentation, national monopolies.....

The liberalisation of the European Community's internal air transport market was only achieved in a number of steps. Prior to 1987, air transport within the Community was subject to the traditional restrictive bilateral agreements between the Member States. In three steps this situation was changed fundamentally, creating a single integrated aviation market that today comprises 25 Member States.

National rules requiring an airline's ownership and control to be in the hands of Member State nationals were replaced with a Community rule requiring ownership and control by Community nationals, resulting in the creation of the concept of the "Community air carrier". Any Community air carrier that meets the requirements for the grant of an Operating Licence has the right to operate freely between any two points within the European Community.

As a consequence, we have seen more flexible patterns of operation, and airlines establishing themselves outside their home state and developing subsidiaries in other Member States. These developments have generated significant economic benefits in terms of expanded service, lower fares, and more aviation jobs, and are precisely the sort of pro-competitive results that one would expect to see when government-imposed barriers are removed.

So... conclusion one: Relaxing restrictions on foreign ownership and control and removing all restrictions on market access, including in

domestic markets can be done and generates significant economic benefits

It is also important to understand that opening up market access and foreign investment inside the Community is only one of three main elements in the success of the single market. There have been two others.

The second has been the progressive development of EU regulatory standards and policies across a number of fields, a process which is still ongoing inside the Community. Contrary to what you may think this is not because we Europeans love to regulate, but because we recognized that if competition is free, but the competitors operate according to different safety standards, different security requirements, or different environmental regulations, then this leads to distortions in competition. The most obvious outcome of this process has been the establishment of EASA, the European Aviation Safety Agency. This is a major step towards the full harmonisation of safety standards and oversight across the Community. .

Other examples are the adoption of the Single Sky legislation earlier this year, aimed at simplifying the air traffic control systems of Europe, reducing delays and improving the overall efficiency of ATM systems. There has also been important Community legislation in the fields of aviation security, environmental rules and passenger protection. At the same time, there is a body of generally applicable, non-aviation-specific, Community legislation covering matters relating to employment and workers' rights.

This brings me to conclusion two: Opening up market access alone is not sufficient to maximise the benefits – States must have comparable levels of safety, security and other essential regulatory standards in order to avoid market distortions.

And the third element of the single market has been the application to air transport of the Treaty's competition and state aid rules. Aviation within the EU has been subject to the same competition rules that apply to all other industries, and earlier this year legislation was adopted that gives the Commission the same powers in respect of international aviation on routes to and from the Community. The Community has also taken a robust stance against state aids in the air transport sector, to the point where we have seen that even national flag carriers were forced out of business. Politically of course this has not always been easy, but the Commission's adherence to its "one time last time" policy for the grant of state aids has undoubtedly been a major factor in ensuring fair competition across the internal market.

So the final conclusion of our European experience is that liberalisation of this kind must be accompanied by strict application of competition and state aid policies.

External Aviation Relations

However, it is clear that this Single aviation Market requires an external policy. We find that the European airline industry continues to be structured along national lines. And there is no doubt that the principal reason for this has been that there is no external dimension to the single market, but that

each Member State has continued to follow its own course in its bilateral air services agreements.

To put an end to this situation, the Commission, as it had done in the past to force the establishment of the Single Market, requested from the European Court of Justice a ruling on a number of open skies agreements. For most of you this will be familiar, but it is worth recalling the key elements of these judgements. They were two-fold. First, the traditional nationality provisions in these bilateral agreements were considered to be against the EC Treaty, because they prevent Community air carriers from benefiting fully from the general right of establishment laid down by that Treaty.

And second, Member States had acted illegally by entering into commitments in areas where legislation exists at Community level. I will spare you the intricate details of European Community law, but the bottom line is that these judgements mean that, legally, Member States are no longer free to negotiate with third countries alone. They may only do so within a Community framework.

Today, these judgements have still not been executed. The legal situation is fragile. The Commission, as guardian of the Treaties has taken steps to ensure the respect of the Treaty.

The EU-US negotiations:

I would now like to turn to the EU-US negotiations. In June last year Member States agreed to a mandate for the Commission to negotiate with the United States a new agreement.

The United States has been at the leading edge of efforts to liberalise international aviation for many years now. We acknowledge and recognise how important your contribution has been to open markets and make aviation a competitive industry.

Although the European Union has the unique experience of having established a single internal aviation market that now covers the 25 Member States of the European Union and 450 million people. And, naturally, that experience shapes how we look at the future regulation of international air transport.

The broader question is what model we should follow in international aviation relations generally. If you ask airlines today: does the present model meet the long-term requirements of the industry? I think the answer of many would be, no, it doesn't. I was very struck by comments made by Glenn Tilton, CEO of United, on his recent visit to Europe when he spoke at the Brussels version of the International Aviation Club. He described the aviation industry as "dysfunctional". In referring to United's efforts to restructure, he asked what he described as a fundamental question – "what is the reward that will be available to us when we are at the other end of the tunnel and out of the pressure cooker?"

No doubt his views are shared by many in the industry in Europe, the US and elsewhere in the world.

His was a call to governments and regulators to act to scrap the obstacles that prevent the airline business from operating like any other business. We have to normalize the industry to allow it to perform efficiently in a global context. We have to avoid that the industry finds itself in – what Mrs de Palacio called in a newspaper article– a Jurassic Park, due to restrictions from the past.

One of the lessons we have learnt in Europe is that it is not enough to deregulate only internally. If this industry is going to operate as any other normal business, it requires some major changes to the way in it is regulated internationally. This is what the European airlines are seeking, and I think it is an agenda that even IATA has taken on board.

It is also important to bear in mind that the EU and US aviation markets together account for about 60% of global civil aviation output. This means that any agreement we reach will be of global significance. Our negotiations are being followed with keen interest by other nations around the world because whatever we agree has the potential to set the benchmark for the future regulation of the international air transport industry. That is quite a responsibility. And that is why we must consider not only the level of, and conditions for, market opening that we wish to achieve between us, but also the level of market opening that we aim for worldwide.

In facing the global challenges of the future – whether they are to do with aviation security, aviation safety or fighting against plain old-fashioned protectionism, the EU and the US have much to gain from a co-operative approach. This should be the context in which a potential EU/US agreement should be seen – not just as another bilateral negotiation with a balance sheet on either side, but as a real opportunity that has the potential to set the model for future regulation of international air transport, and that can thereby serve our mutual interests.

The EU/US negotiations offer the regulators a unique chance to reshape the regulatory structure of the industry, for the long-term benefit of airlines and consumers.

What are the EU objectives:

And what do we want to see in this air transport agreement, which will be the first of its kind negotiated by the Community, and therefore of major importance for our future?

The EU's basic objective is to foster safe, affordable, convenient and efficient air service for consumers. We 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. I am sure that all of you can agree with this objective. I should hope so, as it is taken directly from the Statement of United States International Air Transportation Policy dated almost 10 years ago, 25 April 1995.

My point is that the basic, underlying economic approach of the EU is the same as that of the US – let the market decide.

In preparing for my new job I have been reading that 1995 “open skies” policy statement, with close interest. I was expecting to learn a few lessons. And indeed I found many things with which I can agree. Let me give you two more examples. In summarising US objectives, the policy statement reads:

“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.”

Another section reads:

“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.... Reduce barriers to the creation of global aviation systems, such as limitations on cross-border investments wherever possible.”

The “Open skies” policy statement was thus quite far-reaching and forward-looking. And indeed not very different from our own internal market process, which also encompassed the three elements of opening market

access and investment, ensuring a level playing field through harmonisation and ensuring fair competition.

When adopting the mandate for negotiations between the EU and the US the Ministers of Transport of the 25 Member States had a clear logic in mind:, which is, I think, compelling. You in the US have deregulated **your** domestic aviation market. We, in the EU, have deregulated **our** internal aviation market. Both sides believe that the interests of consumers and the wider economy are best served by opening markets and allowing competition to determine which airlines fly where, when and at what price.

So putting the US market and the EU market together in order to create one open market for aviation area makes, to us, eminent sense.

Of course the devil is in the detail. What do we mean by an open market place or the Open Aviation Area as it was baptized in Europe.

We see three main elements and we think all three are crucial to the creation of an international framework that will meet the interests of the airline industry in the long-term.

The three elements are:

- Regulatory co-operation,
- Market access; and
- Foreign investment.

These three elements reflect the open skies philosophy. I want to spell out clearly but briefly here what we wish to achieve under each of these headings and why we wish to achieve it.

Regulatory co-operation and convergence

On regulatory co-operation and what we call “convergence” - I hate that word – but this is what we mean by them - we wish to ensure that wherever the two sides have regulatory requirements or policies that affect each other’s airlines – such as aviation security, aviation safety, competition, state aids, environment, among others – we should minimise the risks, first, of distortions of competition and, second, of having conflicting rules that put our airlines in an impossible position.

Why?

I think the reasons for this are self-evident, we have a responsibility to minimise the administrative burden we place on our airlines. At a time when costs are being cut by airlines with far-reaching social consequences, it is incumbent on governments to avoid imposing unnecessary costs arising from competing or conflicting requirements or standards. Of course we have also to be realistic. We are not seeking to harmonise all of our security and safety requirements and standards. It is obvious that sovereign States retain their right to legislate as they see fit.

But by engaging in a process of regular consultation and co-operation, the aim would be that over time our requirements would tend to converge.

And the same principle applies equally in relation to competition matters, where there are clearly benefits to be gained from ensuring that any decisions taken by our competition authorities are as consistent with one another as possible, and at least do not produce remedies that conflict with one another.

Market Access

On market access our proposal is a simple one. We wish to allow carriers licensed in the United States and carriers licensed in the European Community, who thereby meet the highest safety and security standards, the freedom to operate as they choose between any two points within the combined territories of the EU and the US.

Why?

Because, put at its most basic, we believe in open markets.

It is what we have done within the EU, and it has proved a success.

We are also of course well aware of the fact that, according to the textbook wisdom, access to the internal US market for EU carriers has a different legal status from access to routes between Member States within the European Community.

But in practice and economically speaking, we see no rationale for maintaining restrictions on market access, not even to domestic markets. And in political terms, the Council of Ministers of Transport of the 25 Member States of the EU considered it impossible to defend a situation where US airlines can exercise traffic rights inside the European Community but European airlines are denied the right to exercise traffic rights inside the United States.

We know that in an EU/US context this is an ambitious goal. And for that reason we recognise that it may not be possible to achieve this in a single step or in the near term.

Foreign Investment

On foreign investment, again our proposal is a simple one and I think well-known to you. We wish to remove the restrictions on the foreign ownership and control of EU and US airlines in respect of EU and US nationals. In other words, to allow US nationals to own or control EU airlines and vice versa.

Why?

Because the foreign investment restrictions serve no purpose other than to constrain the normal development of the industry!

What sense does it make that we have rules that result, for example, in US investors having to pay a 20% premium to acquire shares in a European

airline because the sale of shares to US investors has to be artificially limited so as to preserve majority EU ownership?

We accept that there are issues to be resolved before such a step could be taken. They are three-fold – national security, labour, and third countries.

We understand and we do not underestimate the importance for the US of national security, and the role that the CRAF programme plays. But we do not see why allowing US airlines to be owned or controlled by EU nationals need put at risk US national security requirements. If special provisions or conditions are needed to safeguard the policy, let's discuss them. But I find it hard to imagine that no solution can be found.

Labour is concerned that opening up foreign ownership would open the door for substitution of US jobs with lower-paid EU workers. Without wishing to diminish the strength of this concern, we have serious doubts as to whether they would prove justified. Our own experience in the Community does not show that there is much scope in this concern. In the EU-US relationship there is even less reason for concern.

The General Accounting Office looked at this issue in some detail in its July 2004 report and concluded that there is no evidence to indicate that airlines would relocate operations or establish “flags of convenience” subsidiaries in lower wage EU countries in the foreseeable future.

Also other studies, such as the one done by the UK Civil Aviation Authority in 2004 suggest that there are substantial wage differentials between

categories of airlines, depending on their size, type of aircraft and sort of operation **within** countries. However, the high end airlines in the US, in Europe and in the Asia Pacific all pay more or less the same salary levels to their flight crews. And in any event, in a competitive market I would expect to see wage levels converge over time to reduce any such differentials.

We know also that there are issues relating to the right of representation for airline workers in the event of cross-border mergers. But these do not seem to us to be insurmountable barriers. The issues need to be aired honestly and openly, and then we can see how to deal with them.

Third, allowing foreign ownership of our airlines would potentially give rise to problems under the relevant bilateral agreements if those airlines should wish to operate to third countries. The solution to this of course would be for the EU and US jointly to persuade the third country to accept the airline concerned irrespective of its ownership and control. This would not be guaranteed to succeed every time, but if our ultimate aim is to put the aviation industry on the same footing as other businesses, third countries will at some point have to agree.

Let me make one final comment in relation to foreign investment. The US Administration's proposal to raise the limit on foreign ownership of a US airline's voting stock from 25% to 49% was made before our negotiations started and even before the mandate was granted. In and of itself, such a change would be of little or no value to the EU or its airlines. Its value as part of a first stage agreement would be primarily symbolic because it would bring the US rules into line with EU rules. But I must be clear that it would

not meet the EU's objective which is to allow 100% foreign ownership on both sides. We are open to considering intermediate steps if such steps make sense in commercial terms and if they help rather than hinder subsequent moves towards our ultimate goal.

So these are our objectives and it comes somewhat as a surprise to me that they are not met with more enthusiasm on this side of the Atlantic. Normally it is Europe that is showing some cynicism over ambitious projects, but here I have a feeling that the roles are reversed. With the exception to what was said in the Bush re-election campaign: *“Simply put, we cannot let old labor/management paradigms or protectionism hold hostage the enormous benefits to consumers from removing price, capacity, frequency, destination, and ownership restrictions between the United States and 25 European Union countries.”* We could not agree more.

Of course we do realize that the industry is going through very tough times. The combined effect of low cost penetration in core markets, the 9/11 effect, the SARS crisis, increasing security costs and sky rocket oil prices takes its toll and create little appetite for any adventures.

However, I would argue the contrary. It is because the industry is in crisis that we need to rethink our regulatory model. It is an unsustainable situation that in this business, with its impressive growth potential, its fundamentally international character, and its high capital needs, access to capital is restricted by government regulation.

That we remain confronted, both between the EU and the US, but even more so in other international markets, with government imposed restrictions on competition and with large scale state subsidies, and I have to express our concern at the level of financial assistance given to US airlines and its negative effect on competition.

We should be working towards the longer term perspective of creating a new model for aviation which would give airlines the flexibility to overcome crises and start making a profit.

There are some interesting immediate benefits in the Open Aviation Area:

The Brattle Group concluded that the OAA would generate upwards of 17 million extra passengers a year, consumer benefits of at least \$5 billion a year, and would boost employment on both sides of the Atlantic. These estimates were regarded as conservative because not all of the likely benefits of an OAA were calculated. What the Brattle report did not calculate was the wider effects of an EU-US agreement. The potential it creates to bring other States into the same structure and to eliminate restrictions worldwide.

So we think that the arguments in favour of an Open Aviation Area are undeniable.

Conclusion:

Last June it was not possible to reach a first stage agreement. But it must nonetheless be recognised that the negotiations have already made

substantial progress. Probably much more than most observers would have predicted or expected. That is due in no small part to the determination and commitment of the two negotiators on each side, John Byerly on the US side and my predecessor, Michel Ayrat on the EU side.

I strongly believe that an EU-US agreement is achievable in 2005. We Europeans are genuinely committed to seek solutions to the different issues. I also believe that we cannot delay it any longer. Time is running out. Not reaching an Agreement would give a very negative signal. The status quo is not an option, neither legally, or economically.

We have a unique opportunity to create better conditions for this ailing industry. I believe that this industry has a future – it should not be condemned to endless bankruptcies – but that future is a global one. The EU and the US have to work together in reaching this objective and we must both aim high.

I am hopeful that in 2005 we shall be able to report the successful conclusion of an agreement that will bring benefits to airlines, airports and above all to consumers.

Thank you for your attention.