

Speech by Willie Walsh,

British Airways CEO

Washington International Aviation Club

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Ladies and Gentlemen,

It's a huge pleasure to be here today to have the opportunity to address this very distinguished audience, who follow the development of the aviation industry more closely than any other in the world

First of all, let me thank Doug Lavin, the vice-president of the Washington International Aviation Club, for his invitation. I note I am the first British Airways chief executive to speak to the Club since Rod Eddington in 2004.

So you have lost one slightly curious English accent – but gained another.

Rod used to say that he had experienced plenty of luck at British Airways – all of it bad.

There have been times during my two years in charge when I wished that part of Rod's legacy hadn't been quite so enduring.

I dare say every airline executive in this room might tell you a similar tale. The influence of external forces beyond our control and the sheer unpredictability of our industry are part of what makes it so fascinating to the outside world.

But that is not what I want to talk about today. What I want to do is outline the progress we are making at British Airways to make ourselves as competitive as we can possibly be;

how we see ourselves expanding in the more liberalised aviation world we want to see in the future;

and how we should deal with some of the possible constraints on future growth.

Let me emphasise at the outset how committed British Airways is to the USA.

We have been flying here since 1946 – and we like coming back.

The US is British Airways' most important market outside the UK by a distance.

This winter, we are operating from 19 US cities to the UK a total of 41 times a day.

We are a big player across the Atlantic - and we intend to become bigger still, as I shall describe later.

BRITISH AIRWAYS' PROGRESS

Like many major carriers on both sides of the Atlantic, British Airways faced what could have been overwhelming challenges in the aftermath of the tragic events of 9/11 six years ago.

But gradually, under Rod Eddington's leadership, the company turned itself around – without any Government aid or Chapter 11 bankruptcy protection – and moved back into profitability.

In the last two years, since I became CEO, we have accelerated that process.

We have resolved our \$4 billion pension fund deficit which, relative to the company's size, was the biggest in UK business.

And we did so through amicable agreement with our labour unions and no industrial disruption – despite the pessimistic forecasts of others.

We have also taken action to dispose of unprofitable parts of our business – such as our UK regional airline.

We have cut our distribution costs, made our groundhandling operations more efficient, reduced our management headcount by around a third and are phasing out our use of UK franchise airlines.

All these measures have not only reduced our running costs – but lifted our credit ratings to the point this year where it became possible for us to invest again in new aircraft.

As we announced last week, in the first six months of this financial year, our overall costs fell by four per cent – a key factor in our record half-year operating profit of £556 million (or \$1.14 bn).

We now see every possibility of proceeding to achieve a 10 per cent operating margin for the full year.

In some industries, 10 per cent is nothing to write home about – but for established, full service airlines like ours, it is almost a holy grail. We have never done it before, but I believe there is every possibility we will succeed in our quest this time.

A few weeks ago, we were able to place our first orders for new longhaul aircraft for more than nine years.

We will be purchasing 24 Boeing 787 Dreamliners and 12 Airbus A380s for delivery between 2010 and 2014.

The two types will complement each other. The double-decker A380 – which has just come into passenger service - will be used to provide more capacity for the airline's key high-density markets and to maximise use of scarce Heathrow slots.

Services between London and the US West Coast are high up on the list of routes for which we will consider the A380.

Meanwhile, the 787 will be used to start new routes and increase frequencies in existing markets. It could well be deployed between London and the US East Coast.

So before we are much older, these new aircraft are likely to be in regular service crossing the Atlantic - taking full advantage of those Open Skies that have been cleared in such interesting fashion by the European Union and the US Administration.

OPEN SKIES

Everyone in this room will be aware that we in British Airways were not especially enthusiastic about the Stage One EU/US deal agreed back in March.

But perhaps not everyone is aware why we took the view we did.

We were critical of the agreement for two reasons:

Firstly, because we saw it as a poor deal for Europe.

It gave the US negotiators almost everything they wanted - access to Heathrow airport and the EU internal market, and the right for US carriers to pick up passengers in Europe and fly them on lucrative routes to the Middle East, Asia and Africa.

In return, the EU negotiators won no real concessions whatever.

No access for EU carriers to the US market.

No meaningful relaxation of the outrageously protective Fly America programme.

Less valuable rights for EU carriers to fly on beyond the US.

The second reason was that not only was the deal unbalanced, it was far too timid.

It made no move toward dismantling the nationality restrictions on airline ownership and control which have held back the global aviation industry for decades.

The negotiations were an unprecedented opportunity to pave the way for rational and efficient cross-border consolidation of the industry, such as has occurred in almost every other sector of economic activity.

It was an opportunity to break the bilateral mould and provide for transatlantic travellers the benefits that deregulation brought for US domestic passengers and the single market has for those flying within Europe.

Sadly, the opportunity was missed.

However, there is now a mechanism for achieving a genuine liberalisation - with equal traffic rights and removal of ownership restrictions - through Stage Two of the EU/US discussions.

I hope the US will go into this stage of the discussions, which is aimed at creating a truly Open Aviation Area across the Atlantic, with sincerity and commitment.

I look forward to real progress in Stage Two, mindful of the fact that if sufficient progress is not made by 2010, any individual EU state has the right to terminate the Stage One deal.

The termination clause has not made a bad deal good, but it has made it better.

At British Airways, we will monitor these negotiations very closely over the next three years – and we will hold the UK Government to its word to nullify the existing deal if a true liberalisation is not achieved.

The whole industry urgently needs liberalisation. Not just to benefit consumers – but to drive efficiency within our businesses so that we are in a position to compete with the emerging force of lower-cost longhaul carriers in the Middle East and Asia.

The effective response to this challenge is not to retreat into protectionism.

In the globalised economy of today, protectionism can never be a solution.

In Europe and the US, there are examples of established carriers that have faced up to the challenge of low-cost competition on shorthaul routes – and have found that they can compete profitably.

At British Airways, we have adapted some of the best things the shorthaul low-cost operators introduced, while retaining our competitive advantages – particularly in terms of product.

And last year, we registered our first shorthaul profit for a decade.

The same principles must underpin our approach to dealing with low or lower-cost competition on longhaul.

To help us, we need a regulatory framework that can facilitate competitiveness and drive efficiency through sensible cross-border consolidation.

That is the prize that can come from genuine liberalisation of this industry – and, while I do not underestimate the difficulties, it is what all parties should strive for in Stage Two of the EU/US discussions.

Stage Two is in the future. Despite our misgivings about it, we at British Airways recognise that Stage One is very much part of the here and now - and we are engaging energetically with the opportunities it affords.

As you will be aware, we are working very hard on plans to launch new services, flying Boeing 757s from the US to major business centres in continental Europe.

This would be an historic development for British Airways.

Of course, there are challenges. The markets are thinner than those between the US and London, and some of the most promising are currently dominated by alliances that have been given anti-trust immunity.

But we have real advantages too. These new services would be a natural extension of our long-established expertise in providing for the transatlantic business market.

We have deep roots here in the US, an established reputation and a strong brand.

Our project team is currently working up the proposals in great detail – and we expect to be able to say more in the not-too-distant future.

That is not the only opportunity we will exploit under the revised Open Skies regulations.

We have extended our summer transatlantic schedule and will continue to offer the best schedule, frequency and network to the major US gateways.

Our daily service to Dallas Fort Worth and double-daily to Houston, which we currently fly from London Gatwick, will be moved to Heathrow from next spring.

Both routes will benefit from the much stronger feeder traffic at our main base. In particular, customers in the oil industry landing at Heathrow will have a far greater range of connections to destinations in the Middle East and North Africa.

In addition, we will increase frequency on our Heathrow-New York JFK route from 51 flights a week to 55.

Heathrow to Seattle will rise from 10 flights a week to 13.

And Heathrow-Washington will go up from 21 services a week to 24.

From Gatwick, flights to Orlando will increase from seven a week to 10.

Overall, British Airways will reinforce its position as market-leader between London and America, offering customers 41 flights every day to 18 destinations across the US.

Transatlantic customers will also be able to enjoy our new Club World cabin – which offers more comfort, more space, more choice, more privacy and an even better sleep in fully-flat beds that are 25 per cent wider than our original industry-leading version.

The new cabin has been very well received to date. It is already guaranteed on the Heathrow-JFK route, and has been fitted out across nearly all our 747-400 fleet.

The process will be completed across the remainder of our long-haul aircraft in the course of next year.

TERMINAL 5

Stage One of the Open Skies agreement takes effect at the end of March – just as we move into our new \$9 billion home at Heathrow's Terminal 5.

Terminal 5 opens in just 140 days time. Not counting the nine (?) hours and 14(?) minutes.

It will be an outstanding facility – far better than anything Heathrow has ever offered. And it will be for the exclusive use of customers flying with British Airways.

Customers will enjoy a far more comfortable airport experience, with less queuing, faster baggage systems, smoother connections and better punctuality.

We have invested £60 million in the world's largest airport lounge complex, which will offer the highest standards of luxury and refreshment for customers, whether they are departing on their journeys, or just arriving.

In recent times, the customer experience at Heathrow has left a good deal to be desired. The terminals and baggage systems have struggled to cope with passenger volumes 50 per cent higher than the existing airport buildings were designed for.

And I know many of our US customers have been particularly irritated by the UK's unique one-bag limit on carry-on luggage.

At British Airways, we have been lobbying for most of the last year to have this restriction lifted as it makes no security sense whatever.

If the authorities consider it safe and secure for customers to fly into the UK with two items of cabin baggage (as they do), why must they fly out of the UK with only one?

I know the new UK Secretary of State for Transport, Ruth Kelly, sees the force of our argument on this issue – and I am very hopeful that we will see the removal of the one-bag rule in the coming weeks.

More generally on security, I am concerned that procedures are not always as efficient as they could be, creating tiresome burdens for all travellers – but especially those who fly regularly.

I am sure the desire to minimise the security hassle of the big airports is a factor behind the increased usage of private jets in the last few years.

Too often the procedures duplicate each other. For example, on passenger data we have both the PNR agreement and the APIS requirements.

On top of those, we now have two new proposals – firstly, the ‘secure flight’ initiative, and secondly, an electronic clearance system for passengers travelling under the visa waiver scheme.

These are competing proposals from different arms of the US Administration trying to achieve same result by different means.

To achieve this, we need joined-up government from the US Administration to deliver a single coherent process that is based on the best available assessment of risk and makes use of proven technology.

I cannot guarantee that we will have made adequate progress on all these security issues by the time Heathrow's Terminal 5 opens next March.

But I can guarantee that the overall customer experience in T5 will be a vast improvement on recent standards at Heathrow, and will rival that at any other airport in the world.

So our new longhaul aircraft, the Open Skies agreement and Terminal 5 are all crucial components of our strategy for growth in the years ahead.

But there are potential constraints. A crucial one is runway capacity.

RUNWAY CAPACITY

The UK Government is on the point of launching a public consultation on its plans to allow full utilisation of the two existing runways and the construction of a short, third runway – subject to meeting stringent environmental safeguards.

British Airways backs these proposals 100 per cent.

Full utilisation of the existing runways, with more efficient sequencing of take-offs and landings, would immediately create sufficient extra capacity to slash delays and build robustness into Heathrow's flight schedules.

Typical peak runway delays would fall from 25 minutes to 10 minutes.

And an end to stacking before landing and queuing on the taxiways would cut Heathrow's CO₂ emissions by 500,000 tonnes a year.

A third runway would make all these gains permanent – and allow Heathrow to add 75-80 new destinations to its existing global network.

Such expansion would enable the airport at last to catch up with higher-capacity European hubs such as Paris, Amsterdam or Frankfurt.

Infrastructure constraints are not confined to Heathrow. As is well known, New York JFK has problems of its own.

The runway congestion at JFK has resulted mainly from the growth of small commuter-type operations. JFK is the major international gateway for one of the world's elite business cities – and we believe that slot allocation arrangements should reflect this.

The FAA has met carriers to discuss possible ways forward, and we will play our full part in the consultation with a view to achieving a fair and appropriate solution.

We have no doubt that such a solution should exclude any arbitrary limit on the growth of foreign airlines or international services.

CLIMATE CHANGE

A second potential constraint will be regulation on the environment.

I have no doubt whatever that as an industry, aviation must meet its environmental obligations in full.

Many parts of the industry are working toward that objective.

At British Airways, we have taken climate change seriously for a long time. More than a decade ago, we became the first airline to set a target for improving fuel efficiency – aiming for a 30 per cent improvement by 2010, compared with 1990.

Up to now, we have achieved a 28 per cent improvement, cutting carbon dioxide emissions by more than 60 million tonnes during this period.

And this year we set a new target: for a further 25 per cent improvement in fuel efficiency by 2025, compared with 2005.

We have led the way in advocating carbon emissions trading as the most environmentally effective means of dealing with aviation's climate change impact.

We are the only airline in the world to have actual experience of emissions trading – through our participation in the UK Government's voluntary scheme.

And we were the first airline to introduce a carbon offset scheme for customers.

Offsetting works on much the same principle as carbon trading: you cancel out the emissions from your flight by paying for an equivalent emissions reduction somewhere else in the global economy – for example, by helping to finance a hydro-electric project in the developing world.

I know that not everyone in the industry is convinced of the value of emissions trading.

Some people, and there may be some here today, believe that technology will provide all the answers – and reduce the industry's carbon footprint by an adequate degree.

I fully agree that technology can help us a great deal. Aircraft and aero-engines are becoming more fuel efficient all the time.

The A380s and Dreamliners we have ordered will be between 17 and 30 per cent more fuel efficient per seat than the aircraft they replace.

Better infrastructure can help too. More efficient air traffic routings can yield big savings in emissions.

We have called repeatedly for the EU to make much faster progress in rationalising Europe's airspace.

The European Commission has been talking about a Single European Sky for more than a decade – with little tangible result.

Yet there is good reason to believe that the project could make a major contribution to emissions reduction – with more direct routings cutting aircraft's CO₂ output by about 12 per cent.

And in the medium-term, there is reason to hope that we may see advances in fuel technology that would allow aircraft to use a lower-carbon variant of kerosene – with potentially very significant emissions savings.

However, in the short term, I do not believe that fuel efficiency improvements will be enough to reduce the industry's carbon impact if airlines wish to continue to grow. And I speak for one airline that certainly does.

So we need a mechanism that will allow us to continue to meet the rising demand for air travel until more fundamental technological breakthroughs are made.

Emissions trading is the only credible mechanism that can bridge this gap. That is why it is vital we bring a viable, effective scheme into operation as quickly as possible.

Aviation will be included in the EU's carbon trading system from 2011 under the European Commission's existing proposals. For the first year, the scheme will be confined to flights that take off and land within the EU.

It is then proposed to extend the scheme to all flights in and out of the EU.

Carriers from the US, Asia, the Middle East and all the other regions of the world would then be included and have to meet the emissions costs of their European services.

I know the US industry is unhappy about this. And I share its concerns. The EU scheme is a world first. It is a pioneering initiative that has the potential to lead to a global solution for airlines.

But pioneering initiatives do not always get everything right first time. I do not believe the EU should over-complicate this scheme within 12 months of introducing it.

We must develop international consensus to generate the global solutions that are essential to combat a global problem.

Rushing ahead with efforts to impose an untried scheme on airlines and governments from outside the EU risks discrediting the idea of emissions trading before it has had a chance to prove itself.

Almost certainly, there would be legal challenges from non-EU carriers and perhaps outright retaliation against European airlines.

As a global industry, we simply cannot afford to give the impression of being in disarray over our response to climate change – or, worse still, of not being interested in making a worthwhile response.

So while I would urge the EU to show more patience before attempting to spread the emissions trading net, I would also caution the US aviation industry that it cannot oppose carbon trading indefinitely.

Political sentiment on global warming seems to be changing on this side of the Atlantic, and may change more after next year's presidential election.

The painful lesson airlines have learned in the UK and elsewhere in Europe is this:

If the politicians or public conclude that you have responded too slowly on climate change, you will become an easy target for unjustified extra taxation.

Less than 12 months ago, the UK Government doubled the air passenger tax – to \$160 for a return club-class trip across the Atlantic – and already it is proposing a reform of the tax which would almost certainly increase revenue further, without doing anything specific to assist the environment.

In point of fact, the amount of tax British Airways pays – some \$800 million a year – would be enough to offset our fleet's entire carbon emissions four or five times over.

So I urge you to be on your guard. Debate about aviation and climate change may not be as intense in the US as it is in the UK... yet.

But it is coming your way.

CONCLUSION

Ladies and Gentlemen, I have tried to set out for you the progress we have made at British Airways in the two years since I became CEO.

Progress in resolving our \$4 billion pension fund deficit.

Progress in reducing our costs and disposing of non-core activities.

Progress in improving our credit status and placing our first order for new longhaul aircraft for nine years.

And progress toward what could well be our highest-ever operating margin at the end of this financial year.

I have spoken about the benefits of our new home at Heathrow's Terminal 5 – and of our plans to take full advantage of Stage One of the EU/US Open Skies agreement.

I have mentioned some of the possible constraints on future growth – runway capacity and environmental regulation – and how I believe we should deal with them.

I hope you will reflect on all these issues. But I hope you will reflect most of all on the need for further liberalisation of the airline industry.

In different ways, the US and Europe have led the world industry since its organised beginnings in the 1940s.

We have shown leadership in the past – and we must show it now.

Establishment of a genuine Open Aviation Area between the EU and the US – with abolition of nationality restrictions on ownership and control – would transform the industry.

It would create a template for reform of bilateral restrictions around the globe - and give aviation a rational economic world order for the 21st Century after the inefficiencies, subsidies and state-sponsored failures that dominated the 20th.

Airlines on both sides of the Atlantic would be strengthened by the opportunities cross-border consolidation would create – and put themselves in a much better position to confront the challenges from the emerging aviation regions.

In two days' time in this city, there will be an historic event - the first meeting of the Transatlantic Economic Council.

The Council was set up at this year's EU/US summit by President Bush, Chancellor Merkl, and the President of the European Commission, Jose Manuel Barroso, as part of a framework agreement designed to progress economic integration between the EU and US markets.

The Council's goal is to oversee the removal of all unnecessary barriers to the free flow of capital, goods and people between the US and Europe.

What better demonstration could there be of the Council's seriousness of intent than to give new impetus to the creation of a genuine Open Aviation Area?

Ladies and Gentlemen, neither the EU nor the US can set the agenda for aviation's future if they try to act alone.

They can do it if they act together. The opportunity is there. Let us do everything we can to ensure it is taken.

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