



## KEY POLICY ISSUE

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# US / EU OPEN SKIES NEGOTIATIONS: THE SECOND STAGE BEGINS

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### **Introduction**

On 30<sup>th</sup> March 2008, a date which EU air transport officials have colourfully dubbed “Super Sunday,” the historic US / EU Air Transport Agreement went into provisional effect (pending full ratification by all 27 EU Member States). Popularly referred to as “Open Skies”, the Agreement marks a significant step towards aviation liberalisation between the players who together hold 60% of the international air transport market.

Yet, despite its significance, the Agreement is in reality more of a staging-post on the journey to a truly open transatlantic aviation marketplace. Almost as soon as the Agreement was finalised, attention turned immediately to the future that is foreshadowed in the Agreement’s provision for a second stage of negotiations. This second stage would make further – perhaps even more substantial – advancements towards the one thing the EU negotiators want most to achieve: an authentically “open” aviation area. For the EU, that means no more restrictions on foreign investment, no more disputes over cabotage rights, no more Fly America-type restrictions, and unrestricted wet leasing of aircraft. Additionally, the European vision seeks to achieve regulatory convergence and the harmonization of standards at a high common level in safety, security, operations, competition, State subsidies, and environmental protection.

The primary question considered in this article is whether the goal of ending foreign investment restrictions can be met in the context of second stage talks. A secondary inquiry, which is dealt with briefly below, asks whether the Open Skies Agreement between the US and EU could be opened up to draw other countries and regions into a fully liberalised aviation market

### **The Coming Second Stage**

Despite the clear advances towards liberalising traffic rights between the US and EU under the first-stage Open Skies Agreement, discontent abounds. Prior to the signing of the first Agreement, the United Kingdom and its primary carrier, British Airways, were especially vocal in asserting that the US had been unduly favored in the first stage negotiations. Central to their concerns was the plan to grant unfettered access to EU airports to US carriers – including full access to London Heathrow – without the Europeans being given the right to substantially invest in and control US carriers. Other issues, such as the environment, regulatory convergence, and cabotage, were also identified as points of concern but were not dealt with in the first stage.

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To establish a workable first stage agreement, and to mollify its critics, language was placed in Article 21 of the US / EU Agreement which specified both a list of issues to be discussed during the second stage and a strict timetable for that discussion. Beginning on May 15 of this year in Slovenia, the US and EU will commence the second stage of negotiations.

Under the treaty timetable, the parties will review progress no later than 18 months after the start of the negotiations. If no second stage agreement can be reached within 12 months after the review of progress, any party to the Agreement – including individual Member States of the EU acting autonomously with respect to their own territories – may suspend any or all of the rights specified in the Agreement. Any such suspension would not come into effect, however, until the start of the next IATA traffic season beginning no less than 12 months from the date that a notice of suspension has been provided. Therefore, the earliest we may see a suspension of rights under the first Agreement is March 2012.

The EU negotiators are anticipating substantial results from the second stage. According to EU Transport Commissioner Jacques Barrot,

"[the second stage negotiations] will aim to achieve full liberalisation in traffic rights, new possibilities for investments by European companies in the United States and for US companies in Europe, [examine] the effect on the environment and constraints on exercising traffic rights, [as well as] access to transport programs financed by the US government, and leasing aircrafts with crew."

In the long term, the EU wants a comprehensive liberalisation agreement in place. As good as that may sound, we should be careful to note that substantial barriers of politics and perspective may stand between the concept and the end result.

### **A Different Vision?**

There is little doubt that, for most of air transport's relatively short history, the United States has taken the lead role in international civil aviation. Its capacity to overpower was recognized as early as 1944 during negotiations for the Chicago Convention on International Civil Aviation. The British expressed fears that, in the wake of World War II, US carriers would simply move into Europe and dominate the skies. Establishing an economic climate which would allow indigenous European carriers to get established in their own markets was one of the animating concerns behind the Chicago Convention and the system of restrictive bilateral agreements which followed.

Beginning in the 1970s, the US moved unilaterally to deregulate its domestic marketplace while European air transport and its national flag carriers remained tightly controlled, territorialized, and unready for a truly open market. This polarity began to change in the 1990s as the EU, imbued with a new vision of regulatory freedom, made large strides towards full market integration for air transport. Since then, many of its flagship carriers have thrived in a common market environment, while a profusion of low-cost operators began to create a new demand structure for airline services in Europe. The fallout from 9/11 and other public scares such as the SARS epidemic largely remained American problems, and allowed a newly-assertive EU aviation sector to position itself ahead of the US for the first time in its history. For the EU policymakers, the task is no longer simply one of establishing liberalisation within the European Union itself; now it is about making EU-style liberalisation a reality on a global scale.

Contrast this with the US approach. For years American carriers were able to enjoy an international market dominance that was virtually structural. Increasing liberalisation could only be seen as a boon for US airlines and so a project to conclude a long series of liberalising bilaterals – the so-called "Open Skies" policy that led eventually to the US / EU agreement – was pursued with vigor. The tyranny of events, lately including high-profile US carrier bankruptcies, has tilted the US toward a policy of pragmatism. While US negotiators have promised that the second stage will not be a "clever foxtrot to the side," and

that longstanding US policies such as investment limits will be fairly reassessed, it is clear that the Americans do not share the visionary perspective that animates their European confreres.

Undoubtedly, the first stage US / EU agreement advanced the liberalisation agenda. Its achievements, notably the increased market access to EU airports, will benefit US carriers in their future market planning. Yet these carriers remain insulated from the perceived “threat” of foreign investment and control. Their domestic routes remain securely in their hands, out of reach for EU competitors which would dearly like to bring their branded services to a marketplace that is two and half times the size of Western Europe. The last 60 years, therefore, have seen a renversement, moving from a US aviation industry that stands ready, willing, and able to go forth and conquer the world’s aviation market, to an EU (and, in particular, an EU policy leadership) that wishes to achieve a full “normalisation” of the global air transport industry – including reciprocal investment rights and common regulatory standards and rules. In that global arena, the EU’s “Community champions” are set to prosper.

### **Political Realities**

As must now be evident, the issue of foreign investment and control of airlines remains at the heart of the second stage negotiations. US negotiators and many US industry leaders favour, in principle, the full relaxation of the foreign investment restrictions on a reciprocal basis. The great hurdle remains the clear and present political opposition to such relaxation, exemplified in US House Transportation Committee Chairman James Oberstar’s amendment to the FAA Reauthorization Bill. The proposed amendment, which would be added to existing generic provisions denying foreigners “actual control” over a US airline, would prohibit foreign citizens from having any degree of business or managerial involvement in running a US airline.

The surface rationale for this kind of provision is, of course, national security. Recall that this same concern prompted the US Congress to shut down the Department of Transportation’s efforts to moderate its standards for determining whether a foreign investor has actual control over a US airline. Beneath the surface, however, lies the equally powerful resistance of the airline labor sector and of old-fashioned chauvinism. The former has routinely made its voice heard against foreign investment using arguments of pervasive US job losses, while the latter persists as a relic from the construct of air sovereignty found in the Chicago Convention itself.

What is especially troubling about these political realities is that airlines in the US are in such a precarious position. Numerous carriers have recently filed for bankruptcy or have shut down operations in the face of rising fuel prices and a lack of investment capital. Even stalwarts like American Airlines and United Airlines have found themselves thirsting for more money which, by and large, is simply not flowing from domestic sources now that the liquidity pool has largely evaporated.

Lacking non-US alternatives, Delta Airlines and Northwest Airlines have announced plans to merge in an effort to streamline their businesses, link each other’s strong coastal routes, and hopefully share enough financial resources to withstand the current economic downturn. Should American or United find themselves compelled to take similar measures in order to survive, where would they turn? The press speaks of a United/Continental merger, but little else. More resilient EU carriers like British Airways and Lufthansa might welcome mergers with their US alliance partners, but find these sensible market options locked up and no discernible indication that the political will exists in the US to unbolt them.

### **Opening the Skies to Other Markets**

For the EU, opening the skies with the US is only one component in a larger agenda for global air liberalisation. Currently the EU is in negotiations with Canada to establish an open aviation relationship. Since the Canadians already enjoy full access to Heathrow, it is unclear what additional enticements the

EU can offer to secure investment rights in Canada. But the EU will certainly try to prise open the Canadian market in order to leverage its second stage negotiations with the US. These negotiations are in addition to the EU's vigorous promotion of a common aviation area policy towards its immediate geographic neighbours. What is uncertain is how far the US might be willing to join the EU in these ventures and whether or not it is prepared to open up the rights offered by the first stage (or the second stage) to other, more distant, market actors.

In any event, with the ever-present possibility that frustrations over a lack of advancement in the second stage may lead to a cascading suspension of rights, it is probably premature to contemplate which new parties could or should be added to the current US / EU partnership. In time, if "Open Skies" does what its advocates say it will do – create jobs, lower fares, open more routes, establish regulatory convergence – and there still exists the political will to extend this model to other regions of the globe, then certainly both sides will take steps to make that vision a reality. For now, however, the negotiators have just begun to address the formidable challenges of the second stage, and visions of a global settlement must await the hard and unpredictable days and months that lie ahead.

***The views expressed in this article are the author's and not necessarily those of IATA.***