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**BILATERAL AND AEROPOLITICAL DEVELOPMENTS**

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Most of this conference has been devoted to infrastructure: objects of concrete, steel and electronic technology. I, on the other hand, will discuss bilateral, aeropolitical relations, which form the superstructure for the international air transportation system. This superstructure has a direct impact on traffic levels and growth and on airport and infrastructure needs and planning. In addition, U.S. bilateral agreements contain provisions relating to safety and security, which impact directly on infrastructure needs.

A discussion of U.S. bilateral relations, whether it deals with Europe or Asia or any other area of the world, must begin with a broader analysis of U.S. international aviation policy, because it is critical to understand how, where and if the countries of a region fit into broader U.S. policy.

1. Three years ago the USDOT issued a formal Statement of U.S. International Aviation Policy, which attempts to explain the U.S. international aviation policy.

The key objectives of this policy are:

- to pursue liberalized and open bilateral agreements with countries around the world
- to promote marketing alliances such as codesharing because they are good for consumers and for competition
- most importantly, to create an industry that relies on the marketplace and competition, and not on governments, to determine the variety, quality and price of air service.

In a speech a few years ago, USDOT Assistant Secretary Charles Hunnicutt stated that the U.S. objective was "to melt the icy grip of overly restrictive government control that has held the industry back for so many years."<sup>1</sup>

2. The most visible element of the U.S. strategy to implement this policy has been to pursue open-skies agreements wherever it can.

The U.S. signed its first open-skies agreement with the Netherlands in 1992 and formally announced a European "open-skies initiative." The U.S. has also announced broad open skies initiatives in Central America and Asia.

As a result of these efforts, the U.S. has signed or at least initialed open skies agreements with 31 countries, most recently Uzbekistan, Korea and Peru. In Europe and Central Europe, the U.S. has open skies agreements with thirteen countries, including Germany in 1996, Austria in 1995, and the Czech Republic in 1995. The U.S. and Romania signed an open skies agreement earlier this year. The U.S. and Italy are meeting this week in Rome to negotiate the terms of a possible open skies agreement.

Within the last two years, the U.S. has signed open-skies agreements with six countries in Central America (Panama, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua) and with six countries in Asia (Singapore, Brunei, Malaysia, Taiwan, New Zealand and Korea).

The U.S. could, in fact, be accused of being promiscuous. It has open relationships with democracies, such as Austria, and with kingdoms, such as Jordan. It has open relationships with large countries, such as Germany, and with small countries, such as Aruba, and with cold countries, such as Finland and warm countries such as Aruba.

Despite its broad efforts, the U.S. does not have open skies agreements with certain of its major aviation partners. Earlier this year, the U.S. and Japan entered into an agreement that provides many new traffic rights but is not an open skies agreement. A similar sort of agreement was reached with France. And, of course, the U.S. does not have an open skies agreement with the United Kingdom. Based on last month's unproductive negotiations between the two governments and the active efforts of the European Commission to be involved in U.S.-U.K. relations, you have to wonder whether the U.S. and the U.K. will ever have a new agreement.

It is interesting to note that some of the countries with U.S. open skies agreements do not even have flag carriers operating to the United States. The governments of these countries must have concluded that the overall economic benefits of an open-skies regime -- in areas such as tourism and trade -- justified a new agreement even if there would be no immediate benefit to the airlines of those countries.

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<sup>1</sup> Remarks by Charles A. Hunnicutt before the Transportation Committee of the ABA Section of Administrative Law and Regulatory Practice, May 30, 1996.

On the other hand, a few countries have taken steps to ensure that their carriers will actually be able to use the opportunities that become available under open skies. For example, Germany and Chile have strongly insisted that open skies agreements can go into effect only if the U.S. authorizes specific alliances between carriers of those countries and carriers of the U.S.

To me this position is perfectly sensible, since the U.S. takes the position that it will not grant authorizations to alliances between U.S. and foreign airlines unless the foreign country in question has either an open skies agreement or a very liberal agreement with the U.S.

3. What benefit is there in this for the United States? Some U.S. officials will give you the impression that there is really very little in this for the U.S. and that the U.S. is simply trying to foster free competition, without regard to how it might affect U.S. carriers. I have participated in bilateral negotiations in which the opening U.S. argument was that the U.S. really had everything it wanted under the existing bilateral agreement and that the other country would gain far more from an open-skies agreement than the U.S. ever could. In fact, the U.S. negotiator said he thought foreign governments should be coming to the U.S. and asking the U.S. for open skies, instead of the U.S. making proposals to foreign governments.

The reality, of course, is somewhat different. U.S. carriers have a great deal to gain from unrestricted competition and open markets. They dwarf most of their foreign competitors in terms of financial resources and fleet size. Their costs are substantially lower. They have highly efficient hub and spoke systems, domestic feed systems and frequent flyer programs that no foreign carrier can duplicate. They also enjoy a protected domestic market that no foreign carrier may enter.

4. What are foreign governments supposed to do in response to this U.S. open-skies initiative? That depends on the country, of course. It seems to me, however, that governments should use the process to promote the interests of their carriers, just as the U.S. does. If there is no domestic economic pressure for open skies or pressure from the flag carriers, one option is to do nothing. In the long run, however, it is probably in most carriers' interests for their governments to establish liberalized agreements -- not necessarily open-skies agreements -- with the U.S.

The chief reason for this is that the establishment of a codeshare relationship with a strong U.S. carrier may be vital. The most expedient -- and generally the only -- way for a foreign carrier to gain access to all those interior U.S. points is through codesharing. Almost without exception, the U.S. is not going to allow codesharing operations unless it has a liberal agreement and a codesharing provision with the country in question.

This does not mean that foreign governments should immediately accept U.S. offers of open skies. To the contrary, foreign governments are well advised to negotiate arrangements that ensure that their carriers will be able to survive in an open skies environment. Such assurances

may, in fact, be the only way of ensuring that an open-skies agreement will be truly open for those carriers.

I say this because the U.S. reserves to itself the right to approve or disapprove alliances on broad “public interest” grounds, despite the fact that it has an open skies agreement with the country in question. This public interest test has the potential to deprive foreign carriers of the benefits that their governments thought they had gained in signing open skies agreements.

For example, in July 1996 American Airlines and the six Central American airlines known as the TACA Group asked the USDOT to authorize codesharing operations between the U.S. and their home countries. In May 1997, each of those countries signed an open skies agreement with the U.S. I am sure that those governments were surprised and disappointed that the codesharing authorizations did not quickly follow, especially since other U.S. carriers immediately took advantage of the new agreements and increased service to those countries. Unfortunately, when they signed the agreements those governments lost a significant degree of aeropolitical leverage in their relations with the U.S. It was not until May 1998, a year after the opens skies agreements were signed, that the USDOT finally granted the codeshare authorizations to American and the TACA Group, and this did not occur until after extensive and detailed reviews by both the USDOT and the U.S. Department of Justice were completed.

In short, the “icy grip” of restrictive government control has not melted in the United States. For this reason, it is completely reasonable for a foreign government to take such steps as specifying it will sign an open skies agreement only if the U.S. grants regulatory approvals to specific alliances. This is what the German Government did successfully in 1996 and is also the position currently taken by the Government of Chile, which initialed an open skies agreement one year ago but will not sign it until the U.S. approves the alliance between Lan Chile and American Airlines.

#### 5. How is U.S. policy relevant to Central Europe?

This region seems to pose an interesting challenge to the U.S. In both Asia and Western Europe, the U.S. has a single bilateral partner -- I am referring to Japan and the U.K. -- that is uniquely critical in terms of its market size and its geographic proximity to other beyond markets. In both Asia and Europe, the U.S. has a single bilateral partner - again Japan and the U.K. -- with which the U.S. has an extraordinary history of friction, including charges and counter-charges of bilateral violations. In those regions, U.S. strategies are necessarily profoundly influenced by U.S. objectives vis-a-vis those two countries and U.S. policies in those regions have been aimed, at least in part, at putting pressure on those countries to liberalize their markets.

In this region, there is currently no strategic equivalent of the U.K. or Japan for policy purposes. Russia, of course, is a huge potential aviation partner for the United States and is the only country that U.S. carriers could logically serve via both transatlantic and transpacific routings. However, despite Russia's size and strategic location, the U.S.-Russia aviation market is not large. Therefore, U.S. objectives and policy in the region are not particularly influenced by Russia or any other single country.

Nevertheless, a U.S. open-skies agreement appears to be available to almost every country in the region. The U.S. has open-skies agreements with Austria, the Czech Republic and Romania and has offered open skies agreements to Poland, Hungary and certain of the countries of the former Yugoslavia.

It appears that what the U.S. wants most from Central European countries is third-country codeshare rights, so that U.S. carriers may codeshare with carriers from outside of the region via points outside the region to points within the region, without operating their own aircraft there. The agreements with the Czech Republic and Romania demonstrate the value of these rights.

In December 1995, the United States and the Czech Republic signed the first open-skies agreement in the region. At the time, this agreement was unique because it provided for a phasing-in of certain important rights, instead of the immediate complete opening of all markets. Of greatest importance, until November 1999 third-country codesharing operations are restricted. Limitations apply to the number of carriers of both sides who may codeshare with third-country carriers and to the number of frequencies that may be operated. This restriction was designed to give Czech carriers some protection from full competition from large codeshare alliances. In exchange, the agreement also temporarily allows Czech carriers to serve only three U.S. points instead of an unlimited number of U.S. points. This was the price paid by the Czechs for the restrictions on third country codesharing.

The U.S. and Romania formally signed an open skies agreement in July of this year. Like the agreement with the Czech Republic, this is a phased-in agreement that imposes temporary restrictions on third-country codesharing in exchange for temporary restrictions on service by Romanian carriers. In particular, until November 2001, restrictions apply to the number of carriers that may engage in third-country codesharing between Romania and the U.S. This, obviously, protects Romanian carriers. The price for this protection is basically the same as in the Czech agreement: until 2001, limitations apply to the number of U.S. points Romanian carriers may serve and the number of frequencies they may operate.

6. Finally, in discussing aeropolitical matters, I must say that it is possible that the most dramatic developments in U.S. aeropolitical relations over the next few years will occur in Brussels and not in the U.S. Eight EU member countries – including Austria - have open skies agreements with the U.S. The European Commission takes the position that these agreements grant undue commercial advantages to U.S. carriers, do not offer reciprocal rights to EU carriers and violate EU law because they lead to distortions of competition and discrimination against EU carriers. The EC believes that the EU should have a single unified approach to dealing with the U.S. and that the EC has – or should have – exclusive authority to negotiate a comprehensive air transport agreements with the U.S. that creates a so-called Transatlantic Common Aviation Area.

In support of its position, the EC has taken two major steps in recent months:

In July, the Commission recommended that conditions be imposed both on the American-British Airways alliance, which is not yet in effect, and on the United-Lufthansa-SAS alliance, which

has been in effect for several years. In the case of United-Lufthansa, the EC recommended that the airlines should reduce their frequencies on certain routes and also give up an appropriate amount of airport slots in order to alleviate perceived violations of EU competition laws. In response to this, United filed a complaint against the EC with the USDOT (which puts the DOT in a rather delicate position). United's position is that if any EU member country attempted to implement the actions recommended by the EC, this would violate the country's open skies agreement with the U.S., which is probably correct.

Last week the EC submitted a complaint to the Court of Justice of the European Union against the eight EC member countries that have open skies agreements with the U.S. The complaint charges that those agreements violate EU law. Regarding this complaint, Neil Kinnock, the EC Commissioner for Transport, said "Of course, I am certain that the European law is on our side." He would also, no doubt, prefer to achieve a negotiated solution. Needless to say, it will be several years before this matter is resolved.

This completes my report. I hope that it has been useful. Thank you very much for your attention.

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Hungary. The existing U.S.-Hungary agreement allows Hungarian carriers to serve three U.S. points. Service to the U.S. is provided by MALEV, with codesharing by Delta. The U.S. proposed an open-skies agreement to the Hungarian Government in April 1996, and the U.S. is hopeful that additional talks will produce an open-skies agreement within the next year. The U.S. is aware that Hungary is concerned about the reaction of the European Union to such an agreement and is also aware that a potential privatization of MALEV could affect the development of this process.

Poland. The U.S. view toward Poland is similar to its view toward Hungary.

The U.S. is hopeful that the two sides can hold talks this winter in order to develop an open-skies agreement that, like the possible agreement with Hungary, would contain phase-in provisions. The existing bilateral agreement, however, is relatively liberal. Polish carriers may serve up to six U.S. points and allows third-country codesharing, although on a frequency-restricted basis. Thus, at least as far as traffic rights are concerned, replacing the existing agreement with a phased-in open-skies agreement would not result in a major change.

Bulgaria. The United States does not have a bilateral agreement with Bulgaria. Nevertheless, the U.S. has authorized Balkan Bulgarian Airlines to serve New York and Detroit. This situation is not expected to change in the near future.

Russia. The U.S. aviation relationship with the Russian Federation is experiencing difficulties at the present time. There is not a large amount of direct air service between the two countries and a surprisingly small amount of traffic, considering the populations of the two countries.

The bilateral agreement, which was signed in 1993, places limits on the number of airlines that serve the market. The route annexes of the bilateral agreement expired in May of this year. The two governments will meet next month in Moscow to discuss possible changes to the annexes.

A dispute has developed over the Russian Government's refusal to allow United Air Lines to conduct codeshare operations with Lufthansa to Moscow via Frankfurt. United has formally complained to the USDOT and claims that Russia's refusal violates the bilateral agreement, which expressly allows such third-country codeshare operations. United has asked DOT to prohibit Aeroflot from operating to Chicago, San Francisco and Washington until such time as the Russian Government allows United and Lufthansa to conduct their codeshare operation. This matter remains unresolved and is an issue that will have to be addressed during the bilateral talks next month.

Ukraine. The U.S. agreement with Ukraine is the old U.S.-U.S.S.R. agreement, with various amendments. Air Ukraine holds authority from the U.S. to operate to four U.S. points. No U.S. carrier serves Ukraine, and there does not appear to be any current activity regarding this relationship. With a population of over 50 million and a central location for hubbing purposes, however, Ukraine would seem to have great potential for U.S. carriers.

Baltic Countries. The U.S. does not have air transport agreements with the three Baltic Countries, and there is no direct air service between them and the U.S. There does not appear to be any significant current activity involving these bilateral relationships.

Former Yugoslavia. The U.S. has offered open-skies agreements to Croatia, Slovenia and Bosnia. The U.S. feels that these countries could support service to the United States and hopes to expand its relationships with those countries. On the other hand, the overall U.S. relationship with Serbia is poor. Not only has the U.S. not offered Serbia an open-skies agreement, it has barred Serbian airlines from serving the United States.