STATEMENT OF
FEDERICO PEÑA
SECRETARY OF TRANSPORTATION
BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
CONCERNING INTERNATIONAL AVIATION AGREEMENTS
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Good morning Mr. Chairman and Members of the Committee. I appreciate this opportunity to discuss one of the most important transportation and economic issues for the United States -- international commercial aviation -- and recent developments with respect to our efforts toward expanding and liberalizing our aviation agreement with the U.K.

I welcome this opportunity because it enables us to examine where we have been, where we are today, and, most critically, where we are going with respect to international aviation. It is important that the discussion of any particular aspect of our policies or any individual negotiation be considered in the broader context of our overall goals and strategy for expanding services for the traveling public, for increasing opportunities for our aviation industry and the cities they serve, and for creating the most efficient and dynamic aviation system possible.

When I became Secretary of Transportation, the situation confronting us in international aviation was daunting. Major problems existed between foreign aviation partners and the United States, and the situation was getting worse. The French had renounced our bilateral aviation agreement, with the possibility that they could reduce services between our two countries at any time. The Germans had become exceedingly unhappy with our relationship and were threatening renunciation. Japan was indicating that it might take steps to limit our carriers from exercising their rights and to limit future growth in service.

No progress had been made despite countless rounds of talks with Canada about liberalizing air service in this, our largest international aviation and trade market. Overall, no new significant service opportunities were becoming available to our carriers. Furthermore, the United States was operating under a 17 year old international aviation policy. We merely reacted to events out of our control.

Coupled with those problems, our aviation industry was experiencing disastrous financial results, particularly in the international sector. The U.S. had just lost two major airlines, including our dominant international airline -- Pan American. Three more major airlines were in bankruptcy at the beginning of this administration. In 1992, the U.S. aviation industry recorded its third straight year of huge losses. In 1992, we saw an operating loss of $2.4 billion. The international sector, which accounted for approximately one-fourth of our airline industry's business, was registering over half of this loss, $1.3 billion. These financial results were weakening our industry and diminishing its competitive advantage in the international marketplace.

These circumstances did not bode well either in the short term or long term for U.S. international aviation interests. Something had to be done, and we immediately set to work on the problems.

Right from the beginning, this Administration worked to assist the recovery of the U.S. aviation industry. With the support of Congress, we established the Commission to Ensure a Strong and Competitive Airline Industry -- almost immediately on taking office -- and we have already acted on more than 80% of its recommendations.

The Administration took major steps to address the national deficit problem. The resulting economic recovery and period of expansion have done more than anything else to assist the economic recovery of the U.S. airline industry. In turn, our airline industry's financial recovery has strengthened its ability to compete in the international aviation market.

And we are seeing results: Last year more than 555 million passengers flew in the United States, up 8% from the year before. Revenues, traffic and load factors are all up. None of our major airlines is in bankruptcy. Most importantly, in the international sector, our industry has turned the corner and reported an operating profit of $500 million for 1994, and the profit picture is improving further. Airline analysts project that 1995 will be a good year. Also, the U.S. share of the growing international market is up to 53%.

To anticipate the rapidly changing environment in aviation, we conducted the first comprehensive review of our international aviation policy since 1978. This culminated in the adoption of our International Air Transportation Policy Statement last November. In developing our policy statement, we placed considerable emphasis on evaluating the economic forces in the marketplace, how those forces are shaping the evolution of the industry, and how our policies should relate to those developments to enhance the opportunities and economic prospects for our industry, communities and the traveling public.

In one area -- code-sharing -- we undertook the first comprehensive study to understand the effects of this major marketing practice and to quantify the impact on competition in the market.

In our policy statement, we laid out our broad and fundamental policy goals and objectives. We announced initiatives that we would pursue to achieve those goals. And we indicated how we would respond to countries with differing levels of interest in liberalization and opening up market opportunities.

Our goal is to encourage the expansion of service in light of market demand and the development of the most efficient and competitive international airline operations. Enhanced competition and greater service opportunities will lead to significant benefits for travelers, shippers and communities, greater general economic development, and greater financial rewards for carriers and their employees.

We outlined more specific objectives designed to meet this goal and to serve as the basis for developing our positions for international negotiations. They include the following:

* Increase the variety of price and service options available to consumers;

* Enhance access of U.S. cities to the international air transportation system;

* Provide carriers with unrestricted opportunities to develop types of service and systems based on their assessment of marketplace demand;

* Ensure that competition is fair and playing field is level by eliminating marketplace distortions such as state subsidies;

* Encourage the development of the most cost-efficient and productive air transportation system that will be best equipped to compete in the global market at all levels and with all types of service.

Our stated commitment to these goals and objectives has provided the basis for us to pursue a number of initiatives that are already demonstrating the validity of our policy and bringing enormous benefits to the United States.

Today, our airlines are doing well in terms of share of the international aviation market. Regional maps showing our carriers' market share in the largest country markets demonstrate this point. In the Western Hemisphere, our carriers have a strong position, particularly in the two largest markets -- Canada and Mexico -- which together account for half of the total traffic in this region. Our carriers have 67% of the Canadian market and 58% of the Mexican market. To Central and South America, our carriers have 60% of the traffic. In Europe, in the three largest markets -- the U.K., Germany and France -- which account for two-thirds of all traffic between the United States and Europe, our carriers have almost 52% of the total traffic, with 45% of the British market, 58% of the German market and 64% of the French market. In Asia and the South Pacific, U.S. carriers have 61% of U.S.-Japan traffic, and this single market accounts for over half of the traffic from the Far East and South Pacific.

In February, we signed a breakthrough agreement with Canada that is immediately expanding service and fare options between our countries and will result in a fully open air service regime. Scores of new services have already begun. Every one of our major carriers has new services between the two countries. In short, there will be more service, greater efficiency and better fares. Consumers, cities, airlines and both nations all gain. Estimates of the value of this agreement to our economy have been in the range of $15 billion per year.

We have also made progress in reaching open-skies agreements with nine European countries which will also allow our carriers unlimited access to provide direct service, either on their own or under a commercial arrangement with the foreign carrier, or indirect service under a code-sharing arrangement with carriers of third countries.

These steps have resulted in new opportunities for our airline industry. They will bring greater operating efficiencies for our carriers and enable them to maintain their competitive edge in the international marketplace.

Building on this progress, we have indicated our willingness and determination to pursue open skies and liberalization with other countries. As part of our 1994 agreement with Germany, we are committed to working toward an open skies agreement with that major trading partner. We recently held talks with Poland. While no agreement was reached, significant progress was made and I remain optimistic about the liberalization of that market in the near future. And we continue to seek expanded service opportunities and reliance on market forces in developing regimes with the new governments in eastern Europe.

In Latin America our position has improved dramatically as that market has grown rapidly and our carriers have strengthened their position. We have just concluded an agreement with Peru which will allow for a substantial expansion of service between the two countries.

At the same time, despite enormous efforts, and I might add a great deal of frustration for me, some of our attempts to achieve greater liberalization of our international aviation markets have not yet met with any success. At the top of this list is the United Kingdom.

I believe that it is widely known that ever since I became Secretary I have not been satisfied with the existing air service agreement with the United Kingdom that this administration inherited. I have repeatedly said that it is our most restrictive air service regime, with all of its restrictions on service frequencies, airports and carrier designations.

A brief review of the history of our bilateral relationship with the U.K. underscores the difficulties with this relationship. In the mid-1970's the British renounced our aviation agreement and the U.S. Government was confronted with reaching agreement on a new regime or facing reductions in service between the two countries. In 1977, the U.S. Government reluctantly agreed to a restrictive and structured air service regime known as Bermuda II, which is fundamentally the regime that governs air service today. During the 1980's, the U.S. was able to secure limited opportunities for new service on a reciprocal basis, but the stringent structural constraints of the agreement continued to hamper the development of market-oriented service. This is particularly due to Annex II, which created a mechanical formula for setting frequencies that carriers are allowed to operate on each route. Then in 1991, the United States was confronted with the need to replace our two carriers at Heathrow given the precarious financial condition of Pan American and TWA and their decision to sell their operating rights to London. The British took this opportunity to require us to negotiate and pay for succession rights, an unprecedented step in bilateral history. From these negotiations, the British secured additional operating rights, including their current extensive right to code share. While the U.S. was allowed to replace our carriers at Heathrow with American and United, we did not obtain significant additional opportunities to offset the new rights obtained by the British.

In 1992, USAir and British Airways proposed a massive $750 million investment and ownership proposal. When this administration took office, we made it clear that the original, massive investment package would not be approved because it did not comport with U.S.

investment law. British Airways and USAir broke the investment into three tranches in order to fall within the legal constraints and we had no choice but to approve it. Obviously, this package played a significant role in the strengthening of USAir and its 40,000 employees and permitted British Airways to use code share rights. When we approved the arrangement, I indicated that I wanted to liberalize the bilateral agreement and I went to London to meet with Mr. McGregor. We issued a joint statement committing to achieving a liberal aviation agreement within one year. In early 1994, it became clear the British would not liberalize the agreement because their desire to invest in USAir had waned in light of USAir's financial condition. At that point, when it was clear they would not move forward, I considered renouncing our aviation agreement. But it was clear that the issue was so divisive that I could not get sufficient support from our airlines and cities. It was then that we began to consider incremental deals.

The recent negotiations reflect our policy statement's recognition that there are countries like the United Kingdom that are unwilling to take major steps to open up our air service market. Our policy statement indicated that we would consider transitional agreements with a phased removal of restrictions and liberalization of the air service market or sectoral agreements, such as cargo or charter services. Both of these approaches are attempts to achieve some progress rather than allowing a service regime to stall and remain static.

We also recognized that we would have to address limited, ad hoc proposals for specific new services. These could be in the form of extra-bilateral authority or, as we are having to deal with pertaining to the U.K., in the form of amendments to the existing bilateral agreement. In either case, our willingness to agree to such a proposal should be determined on the basis of the standards outlined in our Policy Statement. The applicable standards are:

* Whether approval will increase the variety of pricing and service options available to consumers;
* Whether approval will improve the access of cities, shippers and travelers to the international air transportation system;
* The effect of the proposed transaction on the U.S. airline industry and its employees; and
* Whether the transaction will advance our goals of eliminating operating and market restrictions and achieving liberalization.

With this background, I would like to review the situation with the U.K. negotiations. There are two aspects of this I would like to address. First is the appropriateness of the elements under consideration in the immediate package. Second is the effect of reaching agreement regarding a limited package of rights on the feasibility and timing of achieving our long-term objective of complete liberalization of the market.

The items under consideration in the immediate package are formalization of open rights for all U.S. and U.K. carriers between U.K. regional airports and the U.S., greatly expanded code-sharing opportunities for all U.S. carriers, very limited access to U.S. government-financed traffic for the USAir-British Airways code-share alliance (U.S. carriers already enjoy access to British government traffic), additional frequency authorizations for British Airways in the Philadelphia-London market, and a Chicago-London operation for a second U.S. airline. Chicago is the largest U.S. gateway without authority for two U.S. carriers and is close to reaching the threshold of 600,000 annual passengers that would allow us to designate a second carrier. Thus, the elements of the deal have benefits for a number of U.S. carriers.

In addition, we have also discussed with the U.K. an agenda for the next round of talks and a timetable for beginning such talks. The agenda items for that round would include the very significant items of cargo, pricing and charter liberalization, limited additional access to Heathrow and/or Gatwick for U.S. and U.K. carriers and additional access for U.S.-U.K. alliances to U.S. government-financed traffic. While we would have preferred to include some additional access to Heathrow and Gatwick in the first phase, that would have significantly imbalanced the deal in our favor and the British would not agree.

Agreement on specific scope, limits or conditions on elements in the immediate package have not been reached, and therefore I do not want to discuss specific aspects of these elements at this time. Rather I would like to consider the nature of the package, how it comports with our policy as I outlined above, and how it fits into our longer-term strategy.

First, the elements in this package are limited, particularly when compared to the overall level of service between the two countries and the revenue value of the U.S.-U.K. market, which is more than $5 billion. Second, the additional service and marketing opportunities will enhance competition in the marketplace and provide desired additional access to the international air transportation system for travelers and shippers. Third, I will insist that the specific final elements provide a fair balance of benefits for the United States versus the United Kingdom.

That leaves the issue of how agreeing to a short-term package affects our ability to achieve our longer term liberalization objectives. The British position is that they are unwilling to move forward to talks on other areas until the short-term package is agreed. Our position has been that, even if agreement on the immediate package elements is reached, we will not accept the deal unless there is commitment by the British on the agenda and dates for the next round of talks. The British have generally agreed to the agenda items and indicated a willingness to agree to dates for starting second-round talks.

The existing controversy surrounding the U.K. negotiations highlights a more generic problem that I would like to address.

Ultimately, every new agreement must be in the overall best interest of the U.S., irrespective of a particular carrier. The fact that we have numerous international carriers with different service needs and objectives makes it tougher for the United States government to negotiate international air service agreements. The process naturally is more contentious. But we cannot afford to allow the individual interests of one particular carrier to obstruct meaningful progress for the U.S. as a whole and the benefits of expanded services for consumers and cities. As long as the expansion of the marketplace represents a balanced movement forward between the United States and our bilateral partner and it provides progress toward our ultimate goal of liberalization or open skies, we must be willing to move forward.

Our ultimate goal is complete liberalization of the international aviation market. As we stated in our International Air Transportation Policy Statement attempts to slow down or resist the movement toward the development of aviation systems and markets driven by economic factors in order to enhance or protect the competitive position of individual carriers will not succeed. Countries that are not willing to move forward and expand opportunities for their carriers are going to be left in the dust. In the long run, those countries that do not seize opportunities to expand operations for their carriers will weaken the competitive position of their carriers. Our commitment should be to the expansion of opportunities for our carriers and consumers at every opportunity as long as it is done fairly. That is the guiding principle for our negotiations, including those with the United Kingdom.