STATEMENT OF
CHARLES A. HUNNICUTT
ASSISTANT SECRETARY FOR AVIATION
AND INTERNATIONAL AFFAIRS
DEPARTMENT OF TRANSPORTATION
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Thank you, Mr. Chairman, Members of the Subcommittee. I appreciate the opportunity to discuss the important subject of commercial international aviation with you. Although I have been involved in this arena for only a short time, I can tell you that the Clinton Administration has placed high priorities on the recovery of the U.S. aviation sector and expanded opportunities for U.S. airlines and cities to participate in the international aviation network. Today, I would like to set the context for our discussion of the U.S.-U.K. relationship by bringing you up to date on the substantial progress that has been made in our overall aviation opportunities.

Let me set the scene by recalling that, at the beginning of the 1990s, the industry was in the midst of a serious crisis. The United States had just lost two major airlines and three others were in bankruptcy. New entry -- that important spur to competition and innovation -- had almost disappeared. The industry's financial results for 1990, 1991, and 1992 were disastrous. The international sector accounted for more than half of the record $2.4 billion operating loss in 1992.

In addition, not only were we making no significant progress in opening new international markets, even worse, we were facing a resurgence in protectionism in that critical economic sector. France and Thailand had renounced their liberal bilateral aviation agreements with us. Germany was threatening to do the same. And some members of the European Union were urging it to develop a unified, restrictive aviation relationship with us.

I am pleased to report that our airline industry is much better off today than it was during the dark days of the early 1990s. None of our major airlines is in bankruptcy. New entry has increased dramatically -- and successfully. U.S. airlines enjoyed significant increases in traffic, revenues, and load factors in 1994 and 1995. The international sector of U.S. airline operations reported an operating profit of $1/2 billion in 1994. Based on preliminary financial results for 1995, clearly the industry's significant turnaround is continuing. The major passenger airlines reported combined net profits of nearly $2 billion and operating profits of $5 billion. International operations are expected to yield operating profits in excess of $1 billion. The financial community and the airline industry are predicting that 1996 will be another solid year for the airlines, with operating revenues growing as much as 4 percent.

We have significantly improved our aviation relations with other countries. We have signed liberal aviation agreements with many nations, including members of the European Union, and as I shall discuss in a moment, we have had tremendous success creating new opportunities for airline services around the world.

The remarkable recovery of our airline industry is a success story of which we can be proud, just as we are proud of the bipartisan support for that recovery and the promotion of growth and expansion of international aviation services.

The appointment by President Clinton and the Congress of a talented, bipartisan National Commission to examine the airline industry helped to move us forward. We are now implementing the recommendations we adopted, and they are working. Secretary Peña's issuance of a new international aviation policy statement has provided the first comprehensive articulation of U.S. policy in this area in nearly two decades.

In formulating the Policy Statement, we sought broad-ranging input from all parties interested in the international aviation sector. We took nothing for granted and reevaluated all assumptions on which our negotiations had been based. The Policy Statement reaffirms our commitment to an open, competitive international aviation market. However, it doesn't stop there. The Policy Statement also contains specific negotiating objectives and lays out strategies for reaching those objectives. We are implementing the strategies, and as I will outline, we are achieving the objectives. The guidance of the Policy Statement is an integral part of our negotiating strategy and will foster U.S. carrier participation in the global economy.

It is now evident that this Administration's focused approach to aviation has created an environment in which the airline industry can and does operate profitably -- an environment that has permitted this nation to benefit richly from the new aviation opportunities that we have produced.

As to the last point, I would like to emphasize that our aviation policy statement marked the beginning of a dramatically productive era in the history of international aviation relations. Our approach to this subject is based on a number of core principles, including the recognition that it is our responsibility to lead, to create new pathways for commercial activity, and to allow market forces to shape service patterns to the benefit of users and providers of air transportation. With these considerations in mind, we are taking a fresh look at aviation issues, fashioning innovative strategies for achieving our objectives, and placing greater emphasis on economic analysis. We will be pragmatic in dealing with other countries, and engage their leadership personally and professionally so as to enhance our ability to reach mutually satisfactory solutions to problems that have impeded progress towards liberalization.

The new, forward-looking approach has already paid off. We have opened many new markets. Over the past year and a half, we have created more new opportunities for international aviation services than during any other comparable period in our aviation history. As a result of our efforts, there are now new U.S. flag services around the globe -- in North America, South America, Europe, and Asia.

In achieving those successes, the Department has been flexible in matching negotiating strategy to individual situations and objectives. In addition, we have recognized that the items of trade in negotiations have altered. Facilitation of alliances has, in more mature markets, assumed more importance than requests for additional gateway cities. This element will be an essential factor as we move increasingly towards a globally integrated air transportation system. Code-share access and antitrust immunity are among the tools to complement an aviation system that can be shaped by competitive market forces -- one that has been freed from unnecessary bilateral restrictions. We will depend on extensive, careful, and thorough analysis to ensure that investment and competition policy decisions contribute to the momentum towards open competitive markets.

In this respect, I welcome the initiative of Chairman Pressler to move forward in the airline investment area. "Fly America" access is another area of potential appeal to our foreign partners, but we will proceed cautiously in this area. I want to assure the Subcommittee that, as Fly America issues are raised, we are working closely with the Department of Defense to ensure that Civil Reserve Air Fleet issues are taken into consideration in assessing access for foreign airlines to U.S. Government-financed traffic.

Putting the new approaches I have outlined into practice has yielded specific, concrete results. Our new transborder aviation agreement with Canada opened the largest single bilateral aviation market in the world. The new agreement has led to an avalanche of applications both from U.S. and Canadian airlines. Airlines of both countries are going all-out to stimulate business and tourism by aggressively expanding transborder scheduled services. Forty-five city-pair markets have received first-time scheduled service and another 14 city-pair markets have received additional airline competition. As we mark the first anniversary of this new open transborder aviation agreement, traffic growth has exceeded one million passengers. Never in commercial aviation history has a new agreement spurred growth of that level.

In the coming years, the new agreement will stimulate millions of travelers, thousands of new jobs and billions of dollars in expanded economic activity on both sides of the border at no cost to either government -- indeed, to the benefit of both countries.

As you know, demand for aviation services is now global, and many of our airlines are responding through arrangements such as code sharing, joint marketing agreements, and cross-border investments. Traffic growth over the European gateways of each of the three largest strategic alliances has averaged about nine percent per year, compared with little change in traffic in the balance of the transatlantic market. Our landmark open-skies agreements with ten European countries have provided important public benefits by allowing airlines to respond to this commercial imperative. For the first time, we were able to reach accords with multiple countries, which laid the foundation for providing the industry with the infrastructure it needs to meet the growing demand for worldwide air service. New services between the United States and the open-skies countries are already being put in place. SAS (the Scandinavian carrier) entered into a code-share arrangement with United to provide code-share services on United flights to eleven U.S. points. United will offer similar code-share services on SAS flights to Copenhagen, Oslo, Stockholm and Helsinki. Other code-share arrangements involve Delta-Finnair to New York and Delta/Austrian/Swissair to Washington, D.C. As additional new air services are inaugurated under these open-skies agreements, the result will be to stimulate tourist and other traffic to the United States.

The code-sharing relationship between Northwest and KLM, the flag carrier of our first open-skies partner -- The Netherlands, has demonstrated the potential of airline alliances. That relationship is continuing to develop, bringing important strategic and economic benefits to both alliance partners and to the market as a whole. Amsterdam has surpassed Paris' Charles De Gaulle Airport as the fourth largest European gateway airport. Despite the presence of the alliance, competition between the United States and Amsterdam has not diminished, and the traffic of U.S. carriers competing with the alliance has increased significantly.

Building on the success of last year's open-skies initiative, we have continued our liberalization efforts in Europe, and those efforts are yielding more successes. The United States has reached agreement on an open-skies aviation relationship with Germany, our second largest European aviation partner with close to six million passengers. When the German agreement comes into force, nearly 40 percent of the passenger traffic between the United States and Europe will be travelling under open skies arrangements. The German agreement, which contains all the elements of our model open-skies agreement, can dramatically expand service and price options for consumers and encourage a more dynamic and competitive marketplace throughout the continent.

These initiatives collectively represent by far the largest effort to deregulate airline services since domestic deregulation over 15 years ago.

In addition, we reached agreement to phase-in an open-skies regime with the Czech Republic and to liberalize operations to Ukraine. To complement those successes, we are currently moving forward to introduce new opportunities in the U.S.-Poland market. We will work to see that these initiatives lead to liberalization throughout the broader Central European area.

We have not ignored other areas of the world. I would point to successes in securing new rights with our South American partners. In particular, we have provided new opportunities for growth in both the U.S.-Peru and U.S.-Brazil markets, which together represent more than a third of the passenger traffic between the United States and South America. We will be seeking additional progress with Brazil, our largest South American market, in talks next month.

Talks with South Africa are also coming up this month. We will be working hard to establish an aviation relationship that will allow all interested U.S. airlines to participate in this market.

The fastest growing region for aviation services is Asia, with more than half of the world's population and most of the fastest-growing economies. Last June, Secretary Peña hosted a meeting of the Asia-Pacific Economic Cooperation transport ministers, which produced a landmark joint ministerial statement. We agreed to reduce trade barriers, to encourage competition in the transport sector, to improve global transportation systems, and to enhance cooperation in training, safety, and security. The United States has aggressively pursued those objectives, and we have successfully negotiated expanded opportunities for U.S. airlines to participate in the Asian market.

New rights have been introduced in Hong Kong, Macau, India, Fiji, the People's Republic of China, and the Philippines. Hong Kong is our fourth largest market in the Far East. Although the other markets have not reached Hong Kong's maturity, their growth potential is undeniable, and we are working to ensure that U.S. carriers can participate in their development. In addition, after five years without an aviation agreement, the U.S. and Thailand have achieved a new aviation bilateral that introduces new opportunities for service expansion. These new and expanded agreements will provide the stability and flexibility to allow U.S. airlines to integrate these Asian destinations into the systems of services that are being developed in the fast-growing Pacific rim region.

No overview of developments in Asia would be complete without discussion of Japan, our largest air market in terms of revenues. Although there are a few other Asian destinations, such as Korea, Taiwan and Hong Kong, that can support direct nonstop service from the U.S. mainland, Japan is easily the primary gateway to Asia due to its geographic location and its size as an aviation market. Japan, where U.S. carriers do very well, will remain a key market for U.S. carriers operating transpacific services for the foreseeable future. Consequently, one of our objectives is to maintain an operating environment with Japan that will enable our carriers to continue to succeed in this important trade sector.

Currently, we are engaged in cargo talks with Japan. The fourth round of those talks took place February 28-March 1 in Washington. Initially, our goal for these talks was to reach an agreement that would phase in a liberal, procompetitive regime for cargo services over a reasonable period. Such a regime would afford the airlines of both countries maximum flexibility to respond to market needs. It would not only benefit the airlines, it would benefit consumers and facilitate trade in this, the world's largest trade relationship. Having held four rounds of talks, it is clear that Japan is opposed to such a regime. We are very disappointed by the approach that Japan has adopted in these discussions. We are now discussing a much smaller exchange of new opportunities for cargo flights.

The most difficult issue we have with Japan concerns the "beyond rights" issue. Japan has long maintained that the current aviation bilateral is "imbalanced" in favor of the United States and needs to be revised to make it more fair to Japan. In recent years, Japan's arguments concerning "imbalance" have focused increasingly on the rights U.S. carriers have under the existing bilateral to operate beyond Japan to other Asian points. Japan maintains that U.S. airlines carry excessive amounts of Japan-Asia traffic and rely too much on local Japan-Asia traffic to support their operations beyond Japan.

The bilateral includes general language concerning how much "fifth freedom" traffic beyond Japan may be carried; a variety of interpretations of the language have been argued. Japan would like to negotiate specific, enforceable restrictions on the amount of local Japan-Asia traffic U.S. airlines may carry. I believe not only that the Japanese interpretation of the present language is erroneous, but that the imposition of such constraints is entirely inappropriate, given that both countries have mature aviation industries capable of competing in a market-based environment. In our view, Japan should be working with us to liberalize the regime for air services rather than moving to impose new restrictions on airline operations.

Although we look forward to negotiating opportunities for additional U.S. carrier combination services to Japan, including rights to increase services to the new Kansai Airport at Osaka, we realize that such negotiations are likely to be extremely difficult, given that Japan is not seeking substantial expansion in opportunities for its own carriers to serve the U.S., but seeks instead to impose restrictions on existing U.S. rights. Nevertheless, given the strong interest on the part of several U.S. carriers and cities in opening up more opportunities, we are continually evaluating the question of reengaging Japan in comprehensive talks. The outcome of the ongoing cargo negotiations will be significant in this evaluation process.

Against this backdrop of a recovering world aviation industry and a growing number of liberalization successes, we continue to be disappointed by the narrow, tit-for-tat approach to liberalization taken by the British. Their position stands in stark contrast to the progressive approach being taken by most of our European aviation partners, as well as to the market-oriented approach that the United Kingdom itself takes to trade matters in other economic sectors. Given the leadership role that the British have taken in European liberalization, it is particularly frustrating that they have been unwilling to move forward in an acceptable manner towards transatlantic liberalization. The British have been simply unwilling to expand their focus beyond the immediate needs of their airlines or to allow market forces to shape the development of aviation services.

When Secretary Peña last discussed U.K. aviation issues with the Committee, he noted that the most effective way to make progress in these circumstances was to engage the United Kingdom in an incremental approach to liberalization. In adopting a step-by-step approach, the Secretary emphasized that each incremental increase in opportunities must bring benefits to U.S. airlines and consumers and be defensible on its own merits. The June 1995 deal met those tests. American Airlines, Continental Airlines, Northwest Airlines, and United Airlines are all using new opportunities that were secured last year. This first-stage agreement was also a prerequisite, from the British perspective, for moving on to discuss further liberalizations. I recognize, and share, your concern that a second-stage agreement has not yet been reached. However, although quick successes are more popular, we must also work hard to maximize the benefits from an incremental approach and not accept proposals that do not meet the standard set out by Secretary Peña.

These considerations are reflected in our ongoing aviation contacts with the British. Unfortunately, we suspended the second-phase negotiations because the British proposals were not sufficient to form a basis for discussion. They were structured to prevent certain U.S. airlines and cities from even competing for limited new Heathrow opportunities. As an aside, let me differentiate this situation from the phase one deal. In phase one, we received early entry of a second carrier on the Chicago-London route, a route that was approaching the traffic trigger for additional entry. In the second phase, we are talking about new opportunities for Heathrow services, and our objective is to allow all interested U.S. carriers to have an opportunity to compete for them.

Moreover, despite the recommendations of their own Parliamentary Select Committee that all-cargo services be opened up, the British were not prepared to move aggressively to full cargo liberalization. Their approach ignored the broader benefits that flow throughout the economy from an expanded network of cargo services. The U.K. offer was again narrowly focused to satisfy the immediate interests of U.K. carriers. For example, U.K. carriers are not interested in U.S.-Philippines rights and consequently, under the U.K. proposal, Federal Express would have been unable to feed U.K. traffic into its Pacific hub at Subic Bay.

Despite the suspension of formal negotiations, contacts between the U.S. and the U.K. continue, and I returned from an informal discussion with my U.K. counterpart in London just prior to this hearing. I confirmed to the U.K. officials that the Department's goal remains the negotiation of the best possible deal for U.S. airlines and cities, based on competitive considerations in the marketplace. I also communicated the U.S. frustration that, despite a healthy and growing U.K. carrier presence in the market, U.K. authorities have been unwilling to loosen the constraints of the Bermuda 2 regime even sufficiently for us to move forward on a small, incremental deal. Although I cannot announce that there is now a basis for resuming talks, the meeting was useful. I had a chance to explore possible ways of moving the process forward, and we will be evaluating what we have learned. Any optimism for an early resumption of talks, however, must be tempered by the experience of those who have preceded me. We have not closed the doors on any options and we are continuing to assess all possible ways to make progress.

In conclusion, I appreciate your support during my first six weeks as Assistant Secretary. I recognize that the backing of this admirable bipartisan forum has been an important contributing factor to the success of the Administration and Secretary Peña in achieving our national goals in international aviation. I look forward to your continuing input as we work together to address 1996's international aviation challenges.