STATEMENT OF
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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. Today, I know that you are primarily interested in the current status of our aviation relationships with the United Kingdom and Japan, but I would also like to take the opportunity of my first appearance before this Subcommittee to bring you up to date on the substantial progress the airline industry has made under the Clinton Administration.

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 when it was facing a financial crisis domestically and a resurgence in protectionism internationally.

The major passenger and cargo airlines reported combined net profits of $2.2 billion and operating profits of $5.46 billion for 1995. International operations alone generated combined operating profits of $929 million. The financial community and airline industry experts are predicting that 1996 will be another solid year for the airlines, with operating revenues growing as much as 4 percent. In fact, despite severe weather conditions in the mid-Atlantic and northeast earlier this year, the major airlines may report a combined net profit for the first quarter of 1996. The major airlines have not shown a first quarter profit since 1979.

Internationally, we have significantly improved our aviation relations with other countries. We have signed liberal aviation agreements with many nations, and as I shall highlight later, we have had tremendous success creating new opportunities for airline services around the world.

Against this backdrop of a recovering 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 to transatlantic liberalization shown 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. The U.K.'s attitude towards transatlantic aviation liberalization might be understandable, although still unacceptable, if British airlines were struggling to restructure and achieve profitability. However, the reverse is the case. For its most recent financial year, Virgin Atlantic posted over a $60 million profit. For the nine months ending December 31, 1995, British Airways had profits of over $1 billion, up 16.6%. These airlines are indeed formidable competitors.

Some of you may be wondering about the recent assertion by British Airways' Chairman, Sir Colin Marshall, that the fairness of Bermuda 2 is demonstrated by the fact that U.S. and U.K. airlines offer nearly the same number of flights between the United States and the United Kingdom. He went on to attribute the current market-share differential solely to the larger aircraft, and consequent higher number of seats, flown by British carriers. What he failed to mention is that, in an unrestricted market, U.S. carriers could offer a comparable number of seats by increasing the number of flights that they operate, particularly at their U.S. hubs. However, U.K. authorities have intervened traffic season after traffic season to restrict U.S. airline proposals to increase flights from their primary U.S. gateways to London even though their existing flights were nearly full.

In addition to intervening in U.S. carrier scheduling decisions, U.K. authorities have also consistently disapproved U.S. airline pricing initiatives that would have stimulated traffic by giving more attractive fares to passengers to interior U.S. cities.

It is also extraordinary and unacceptable that the U.S. and the U.K. have an agreement that limits the U.S. passenger carriers at Heathrow to only two. Some U.K. interests try to justify that restriction by asserting that slot constraints at Heathrow prevent commercially viable new entry at the airport. However, our analysis indicates that, in addition to American and United replacing TWA and Pan American at Heathrow, 24 of the airlines operating at Heathrow in July 1995 did not have any services there in July 1990. In that time, departures from Heathrow have increased over 16 percent, and the airlines and airport authorities continue to work together to use the available capacity more efficiently. So, my answer to the congestion argument is: get rid of the Bermuda 2 barriers to Heathrow access and let U.S. carriers compete for slots.

I can assure you that U.S. aviation authorities recognize the importance to U.S. airlines and cities of expanding opportunities in the U.K. market, and immediate full-scale liberalization is our preferred option. Since the British were 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, an incremental approach to liberalization appeared to be the only effective way to make progress. In adopting a step-by-step approach, Secretary Peña 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, we will not accept proposals that do not meet the standard set out by Secretary Peña. Consequently, we suspended the second-phase negotiations because the British proposals on Heathrow were not sufficient to form a basis for agreement. They were structured to prevent certain U.S. airlines and cities from even competing for limited new Heathrow opportunities.

Moreover, despite the recommendations of their own Parliamentary Select Committee that all-cargo services be opened up, the British were not prepared during the second-phase talks 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. I had an informal discussion with my U.K. counterpart last month and a follow-up conversation last week. 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 we still do not have a basis for resuming talks, these contacts allow us to explore possible ways of moving the process forward, and we will be evaluating what we have learned. We have not closed the doors on any options and we are continuing to assess all possible ways to make progress.

Although any optimism for an early resumption of talks must be tempered by the experience of those who have preceded me, commercial pressure is our ally. The European open-skies initiative and competing carrier alliances between U.S. and European airlines are already affecting transatlantic traffic flows. As these alliances mature and the expanded opportunities in the open-skies regimes are exploited, the British will not be able to ignore their impacts if London's preeminence as a gateway to the world is to be maintained. Moreover, with its aspirations to complete a worldwide integrated service network, British Airways will have to take into consideration the possibility that some of its European competitors, such as KLM, will be able to perfect their alliances with antitrust immunity. Thus, the ramifications of our open-skies initiative are far from being played out.

I would like to turn now to 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.

As you know, our aviation relationship with Japan in recent years has not always gone smoothly. The United States and Japan have very different aviation policies. While the United States favors a market-based regime and minimal restrictions on entry, routing, pricing and the amount of service that airlines may provide, Japan favors a more regulated approach. Japan favors this protective approach since its airlines are not yet as efficient as the U.S. carriers.

In the last two or three years the Japanese have focused increasing attention on U.S. airline operations beyond Japan. It is clear from statements of Japanese officials that one of Japan's primary objectives is to impose constraints on U.S.

carrier operations beyond Japan to other Asian points. We have repeatedly advised the Japanese that any actions to deny our carriers' rights to operate beyond Japan would be viewed as a serious violation of the U.S.-Japan Air Services Agreement.

An example of Japan's approach toward U.S. carrier beyond services occurred approximately eighteen months ago when the Japanese refused to approve several new routings proposed by Federal Express to Asian points, including Subic Bay in the Philippines where FedEx was establishing a new air cargo hub. Several rounds of talks took place with Japan to address this matter. Finally, in July last year Secretary Peña and his counterpart, Minister Kamei, met in Los Angeles and resolved that cargo dispute. The Japanese agreed to approve the Federal Express flights.

As a consequence of our resolution of the FedEx issue, we agreed to begin broad-scale cargo negotiations in order to liberalize the regime for cargo services. As you may have heard, these negotiations led to the two sides reaching an agreement in the last week of March which permits significant expansion of all-cargo services. The final text of this agreement was negotiated earlier this month.

In the early rounds of our cargo negotiations with Japan, the U.S. side proposed that a liberal regime for cargo services be phased in over five years. We argued that it would serve the interests of both countries to remove restrictions on such services. We indicated that we had considerable flexibility on the time period and the manner in which this would be done. The Japanese rejected this concept. As a result, the agreement we reached is not as expansive as we would have preferred. Nevertheless, it represents a significant step forward. It removes all restrictions on the U.S. gateway points that may be served with all-cargo services by United, Northwest and Federal Express and it permits these carriers to serve three additional points in Japan. It enables UPS to serve the new Kansai International Airport at Osaka and permits the United States to name a new entrant, which will be permitted to serve any one point in Japan except Tokyo six times per week. Although we continue to desire a fully liberal cargo regime, these are welcome improvements to the air cargo regime. The incremental nature of these improvements, however, are instructive of Japan's approach to expanding U.S.-Japan air service opportunities.

With the cargo talks completed, we are now considering how to move the relationship forward in the passenger area.

Some are reluctant to engage Japan in passenger talks now. They believe that Japan's primary objective is to curtail existing U.S. rights to operate beyond Japan. They believe that Japan will use the U.S. desire for additional U.S.-Japan routes as leverage to achieve this objective. They note that Japan has not indicated much interest in obtaining substantial new opportunities for its own carriers to serve the United States.

Others have a different view. They believe that it would be in the overall interest of the United States to negotiate for new U.S.-Japan routes even if the cost of obtaining such routes is acceptance of constraints on U.S. beyond-Japan services. They believe that an agreement could be struck that would preserve all existing beyond operations of U.S. carriers and that constraints would apply only to the rate of future growth of such services. In their view, this would be a reasonable price to pay for opening up the market to more service.

We are continuing to evaluate both sides of this question. In this regard, we have received four studies that relate directly to this subject. We have the Booz Allen & Hamilton study, produced for United Airlines, which focuses on the projected benefits to the U.S. trade balance that would flow from the beyond networks operated by United and Northwest. There is the ACCESS U.S.-Japan study, prepared by Coopers and Lybrand, which emphasizes the benefits that would flow from additional U.S.-Japan services to U.S. cities not now enjoying direct air service to Japan.

A third study, prepared by Roberts, Roach & Associates and

Northwest, attempts to rebut the ACCESS U.S.-Japan study. It underscores the benefits inherent in the existing aviation bilateral which permits carriers like Northwest to operate extensive Asian networks based on their hub operation at Tokyo.

The assumptions made and the methodologies used for each study vary greatly. Each attempts to address the question of the relative value of additional U.S.-Japan operations versus the value of beyond rights.

The fourth study by the Economic Strategy Institute (ESI) lays out an approach to assess the value of the market to the United States in 2010 under four different policy options: open skies, continuation of the existing regime, trading future expansion of beyond operations for additional U.S.-Japan services and trading both future and existing beyond operations for more U.S.-Japan services. Forecasting the U.S.-Japan market at some future point under different policy scenarios, particularly if the point is as far away as 2010, requires major assumptions on a number of complex issues. It is not clear what foundation exists for many of the critical assumptions made in any of these four studies. As part of our evaluation of the four studies, we have asked such questions as: What would be the value of enhanced competition between the United States and Japan for U.S. consumers in terms of service and fare competition? What evidence is there regarding potential demand in the U.S.-Japan market and what overall level of increased service between our two countries could be sustained? What air fare assumptions should apply if new U.S.-Japan routes are added? What assumptions were made regarding the availability of slots at Tokyo in calculating the value of future services?

In order to get a better understanding of what assumptions were made, we have sent follow-up questions to United and the ACCESS U.S.-Japan groups. We have received a response from the later and expect a response from United soon. All of these studies are helpful in that they focus attention on some of the variables that we need to take into account as we develop a strategy for furthering our aviation policy goals with respect to Japan.

I would like to note that despite the ongoing debate about whether the U.S. should accept constraints on future growth of beyond operations to obtain additional U.S.-Japan routes, we are not prepared to subscribe to an "either-or" philosophy on this issue. Rather, our goal is to mutually expand opportunities. We achieved this in air cargo. It is vital that our carriers be able to compete effectively for Asian traffic. It is also desirable that we increase opportunities for additional services in this rapidly growing market. Our job is to develop a strategy that best serves the overall interests of the United States.

Even before such a strategy can be implemented, we have several outstanding issues in the passenger area. One issue concerns a longstanding request by United Airlines to operate beyond the new Kansai International Airport at Osaka to Seoul, Korea. United has also recently filed in Japan to operate beyond Kansai to Jakarta. Neither of these requests have been approved. These proposed services are, in our view, authorized by the existing bilateral agreement. Northwest also seeks to initiate this summer a new service from Osaka to Jakarta, which it is entitled to operate under the U.S.-Japan bilateral. The Japanese have indicated that the approval of this service is in question.

Another issue concerns Japan Airlines' request to operate three weekly flights to Kona, Hawaii from Tokyo. JAL proposed to begin this service on April 1. We have not acted on JAL's request. Since this application is contested and remains pending before the Department, I am not at liberty to talk about its merits. However, I can say that we appreciate the importance of this proposed service to Hawaii. At the same time we must also consider the implications of approving a request of JAL to operate a service authorized by the bilateral while Japan is refusing to approve requests by a U.S. carrier which are also authorized by the bilateral. In response to our inaction on JAL's Kona application, Japan's Ministry of Transport has deferred action on a United proposed increase in frequencies in the Los Angeles-Tokyo market planned for May 2. We began yesterday, and are continuing today, meeting with Japanese officials here in Washington to seek to reach an accord on the initiation of these services.

If the several outstanding issues in the passenger area are resolved, we believe it would be appropriate to meet with the Japanese this summer in government-to-government meetings to agree on a possible framework for passenger negotiations. If an acceptable approach for passenger talks can be worked out, then I would anticipate the two sides would begin formal talks with Japan soon thereafter.

The importance of aviation trade with the U.K. and Japan is undeniable; however, we cannot ignore the commercially significant developments that are continuing to occur throughout the airline industry.

At the beginning of the 1990s, the aviation 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.

The remarkable recovery of our airline industry, which I highlighted at the beginning of my statement, 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.

Today, none of our major airlines is in bankruptcy. The industry turn around that became evident in 1994 is continuing into 1996. New entry has increased dramatically -- and successfully. Since the Administration took office over three years ago, the Department has authorized 27 new entrant jet air carriers that have started commercial air service. Today, we have 12 more pending applications for new carrier jet service.

This economic resurgence and growth were complemented by two government initiatives. Domestically, President Clinton and the Congress appointed a talented, bipartisan National Commission to examine the airline industry, and we are implementing the recommendations. In addition, Secretary Peña issued a new international aviation policy statement, the first comprehensive articulation of U.S. policy in nearly two decades, that is guiding us as we move forward internationally.

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 will continue to take a fresh look at aviation issues, fashion innovative strategies for achieving our objectives, and place 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.

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 the possibility of 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.

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. We marked the first anniversary of this agreement last month, with traffic growth exceeding one million passengers. Never in commercial aviation history has a new agreement spurred growth of that level.

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. Current and additional new air services will 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. The United States has reached agreement on an open-skies aviation relationship with Germany, our second largest European aviation market 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.

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, to liberalize operations to Ukraine, and to introduce new opportunities in the U.S.-Poland market. We held exploratory discussions with Hungary two weeks ago. The talks were useful in answering questions that the Hungarians had about our open-skies approach, and we plan future contacts to pursue an agreement. 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 this week.

Last month, the United States and South Africa reached a new aviation agreement that significantly expands opportunities for U.S.- South Africa air service. The agreement is the first with an African nation to allow airlines from each country to operate code-share services.

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, the Philippines, and Thailand.

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.

Just last week, we met with Singapore, one of our most liberal Asian partners, to discuss possibilities for moving forward with liberalization in Asia.

We are proud of the successes that we have achieved. However, we have not lost sight of what remains to be done. We are continuing our efforts to allow competitive forces to direct the development of international air services so that the full potential contribution of aviation to the global economy can be realized.

In conclusion, I appreciate your support during my first months 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.