

**SUSTAINABLE AVIATION POLICIES  
FOR AMERICA AND THE WORLD:  
COMPLETING THE WORK OF DEREGULATION**

**REMARKS OF ANDREW B. STEINBERG  
ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS**

**BEFORE THE CHICAGO COUNCIL ON GLOBAL AFFAIRS**

October 19, 2006

GOOD MORNING AND THANKS JAMIE FOR THE INTRODUCTION. I AM VERY PLEASED TO BE HERE TODAY AMONG SUCH A DISTINGUISHED GROUP -- SOME MIGHT EVEN SAY **RELIEVED** TO BE HERE! AS YOU MAY KNOW, WHILE I'VE ONLY BEEN ON THE JOB FOR TEN DAYS OR SO, I HAD LOTS OF SPARE TIME THIS PAST YEAR TO REFLECT UPON SOME OF THE POLICY ISSUES RAISED ON TODAY'S AGENDA. SO I'D LIKE TO THANK OUR HOSTS FOR GIVING ME AN EARLY OPPORTUNITY TO EXPRESS MY VIEWS. IT'S ALSO AN HONOR FOR ME TO FOLLOW MARION BLAKEY THIS MORNING -- OVER THE LAST THREE YEARS I HAVE BEEN FORTUNATE TO BE A PART OF HER TEAM, HELPING TO BRING TO FRUITION HER VISION OF AN FAA THAT RUNS MORE LIKE A BUSINESS. SHE'S TRULY A GREAT LEADER.

I'VE BEEN ASKED TO ADDRESS TWO QUESTIONS THIS MORNING. THE FIRST QUESTION IS: SHOULD THE U.S. **HAVE** A NATIONAL INDUSTRIAL POLICY REGARDING AVIATION? THE SECOND: SHOULD U.S. DOMESTIC AVIATION POLICY PROMOTE **NEW ENTRY OR CONSOLIDATION**? WITH THE FOLLOW-ON: WHAT IS THE RIGHT BALANCE FOR POLICYMAKERS TO STRIKE? . . . I'M GLAD

THAT YOU WENT EASY ON ME FOR MY FIRST SPEECH AS ASSISTANT SECRETARY!

LET ME BEGIN BY ADDRESSING THE ISSUE OF A NATIONAL INDUSTRIAL POLICY. THE QUESTION PRESUPPOSES THAT WE DON'T HAVE ANY POLICY IN PLACE. THAT'S RIGHT **ONLY** IF THE TERM 'INDUSTRIAL POLICY' IS MEANT TO EVOKE THE NOTION OF AN INTERVENTIONIST CENTRAL GOVERNMENT ORCHESTRATING A PARTICULAR OUTCOME IN THE MARKETPLACE. I THINK WE CAN ALL AGREE THAT BEGINNING IN 1978, CONGRESS SET THE DEPARTMENT PERMANENTLY ON THE PATH AWAY FROM INTERVENTION. AIRLINE DEREGULATION WAS THUS EITHER THE ANTITHESIS OF AN **INDUSTRIAL** POLICY OR PERHAPS AN AFFIRMATIVE POLICY OF FACILITATING COMPETITION AND THEN LETTING THE CHIPS FALL WHERE THEY MAY. AND IT'S BEEN A LONG HELD VIEW OF THE DEPARTMENT OF TRANSPORTATION THAT DEREGULATION HAS BEEN A SUCCESS, PRODUCING AN ABUNDANCE OF SERVICE WITH LOW FARES – ALL THE WHILE ACHIEVING A SPECTACULAR SAFETY RECORD. SO I DOUBT YOU WILL EVER SEE THE DEPARTMENT DO AN ABOUT FACE AND MICROMANAGE THE AIRLINE INDUSTRY.

BUT I RECOGNIZE THAT UNDERLYING THIS QUESTION IS A BROADER AND LEGITIMATE ASPIRATION THAT IN AN INCREASINGLY **GLOBAL MARKETPLACE** THE U.S. GOVERNMENT SHOULD TRY TO ENSURE THAT OUR CARRIERS ARE POSITIONED TO SUCCEED RELATIVE TO THEIR FOREIGN COMPETITORS -- NOT

GUARANTEEING SUCH SUCCESS, BUT GIVING THEM EVERY OPPORTUNITY TO WIN ON THE MERITS. PUT DIFFERENTLY, THAT THE RULES AND POLICIES WE FOLLOW DOMESTICALLY SHOULDN'T INADVERTENTLY TILT THE PLAYING FIELD AGAINST AMERICAN COMPANIES. TODAY, DESPITE THE ADVANTAGE THAT NORMALLY ACCRUES TO AIRLINES THAT HAVE THE BEST DOMESTIC MARKETS, THE COMBINED MARKET CAPITALIZATION OF BRITISH AIRWAYS, AIR FRANCE, CATHAY PACIFIC AND SINGAPORE IS ALMOST THREE TIMES THAT OF THE FOUR SOLVENT INTERNATIONAL U.S. AIRLINES: AMERICAN, CONTINENTAL, UNITED AND USAIRWAYS. AS U.S. AIR CARRIERS HAVE WATCHED THEIR FOREIGN RIVALS FIRST GROW AND THEN SURPASS THEM IN PROFITABILITY AND SHAREHOLDER VALUE, WE ARE INCREASINGLY ASKED WHAT IF ANYTHING THE U.S. GOVERNMENT SHOULD DO ABOUT IT.

IT'S A FAIR QUESTION. GIVEN THE VITAL ROLE AIR TRANSPORTATION PLAYS IN THIS COUNTRY, A HEALTHY INDUSTRY **IS** A NATIONAL PRIORITY, AND SEPT. 11 SHOWED US HOW THE EFFECTS OF A DISRUPTION IN AIR COMMERCE REVERBERATE THROUGHOUT THE ECONOMY. OVER THE LONGER TERM AN INDUSTRY THAT PERENNIALY EITHER LOSES MONEY OR MAKES SUBOPTIMAL RETURNS CANNOT CONSISTENTLY OFFER THE QUALITY AND BREADTH OF SERVICE CONSUMERS EXPECT. WE'VE SEEN EVIDENCE OF THIS IN RECENT YEARS, AS THE FINANCIAL WOES OF THE NETWORK AIRLINES HAS FACTORED INTO A DECLINE IN SERVICE TO SMALLER COMMUNITIES, WITH THE TAXPAYER BEING ASKED TO PICK UP THE TAB FOR MAINTAINING A BASIC LEVEL OF

ACCESS TO THESE COMMUNITIES THROUGH THE ESSENTIAL AIR SERVICE (EAS) PROGRAM .

WHILE MUCH ATTENTION HAS BEEN PAID TO THE ROLE OF HIGH FUEL PRICES IN DESTROYING OR FACILITATING AIRLINE PROFITABILITY, THE TRUTH IS THAT OTHER INDUSTRIES HAVE SIMILAR COST INPUTS – WITHOUT THE SAME VOLATILITY IN THEIR FINANCIAL RESULTS. THESE INDUSTRIES SIMPLY PASS ON THE COSTS -- OR SAVINGS -- TO THEIR CUSTOMERS. IF YOU WANT AN EXAMPLE CLOSE TO HOME, YOU NEED ONLY CONSIDER THE CONTRAST BETWEEN PASSENGER AND EXPRESS CARRIERS, WHICH IS STRIKING. EVEN AS BOTH RELY ON JET FUEL, ONLY THE LATTER HAVE BEEN CONSISTENTLY PROFITABLE, THEIR SERVICES ARE INNOVATIVE, THEY ARE WORLD LEADERS IN TECHNOLOGY, AND THEY OFFER CUSTOMERS GREAT VALUE AT REASONABLE PRICES. 30 YEARS AGO WHO WOULD HAVE PREDICTED THAT TWO EXPRESS AIR CARRIERS IN THE UNITED STATES WOULD HAVE HELPED INVENT AND THEN BECOME WORLD LEADERS IN LOGISTICS MANAGEMENT.

MY POINT IS THAT WE NEED TO FULLY UNDERSTAND THE PROBLEMS AFFECTING DOMESTIC AIRLINES, AND WE SHOULD TAKE ADVANTAGE OF THE CURRENT ENVIRONMENT – IN WHICH THE DOMESTIC AIRLINE INDUSTRY APPEARS TO BE IN THE MIDST OF A ROBUST RECOVERY – TO DO SO. IF WE WANT SUSTAINED PROFITABILITY – AND NOT JUST A FEW QUARTERS OF

POSITIVE EARNINGS – WE NEED TO IDENTIFY **STRUCTURAL** OBSTACLES TO SUCCESS CREATED BY LAW OR POLICY, AND REMOVE THEM.

IF YOU ARE LOOKING FOR AN INDUSTRIAL POLICY THE U.S. CAN DEVELOP AND PURSUE, I WOULD SAY IT WOULD BE TO **COMPLETE** THE WORK OF **DE-**REGULATION. TO THAT END, UNDER JEFF SHANE’S LEADERSHIP, THE DEPARTMENT HAS HAD AN OVER-ARCHING CONVICTION THAT REGULATORY OVERSIGHT OF THE AIRLINE INDUSTRY NEEDS TO BE LIMITED TO THOSE AREAS IN WHICH THAT OVERSIGHT ACTUALLY ADDS VALUE. WHERE IT DOESN’T, THE DEPARTMENT CONSIDERS GETTING RID OF THE REGULATION IN QUESTION. DOT HAS MADE MUCH PROGRESS HERE .... EASING THE REQUIREMENTS ON AIRPORTS RELATING TO THE FILING OF COMPETITION PLANS. . . . REPEALING THE REGULATIONS GOVERNING THE USE OF COMPUTER RESERVATION SYSTEMS. . . . STREAMLINING PROCEDURES ON LICENSING OF U.S. AND FOREIGN AIR CARRIERS IN UNCONTROVERTED CASES. . . . EASING TARIFF FILING REQUIREMENTS FOR THE AIRLINES OF COUNTRIES WITH WHICH THE U.S. ENJOYS A LIBERAL AVIATION RELATIONSHIPS . . . SIMPLIFYING THE REQUIREMENT FOR DISCLOSURE OF CODE-SHARE AND LONG-TERM WET LEASE ARRANGEMENTS IN PRINT ADVERTISEMENTS OF SCHEDULED PASSENGER SERVICES, AND SO ON.

WE CERTAINLY DON’T INTEND TO STOP THERE. . . . REGULATION CAN TAKE MANY FORMS. WE MUST BE OPEN TO REEXAMINING REGULATORY AND

POLICY ASSUMPTIONS IN KEY AREAS LIKE BANKRUPTCY, PENSION FUNDING, COMPETITION ANALYSIS AND ANTITRUST REVIEW, LABOR RELATIONS, AND AVIATION INFRASTRUCTURE FINANCING AND DEVELOPMENT, AS WELL AS THE MYRIAD COMMON CARRIER REQUIREMENTS WE IMPOSE ON AIRLINES, SOME OF WHICH HOLD OVER FROM THE DAYS OF THE C.A.B. OUR POLICIES IN EACH OF THESE AREAS UNDOUBTEDLY COME WITH BURDENS AND BENEFITS FOR NOT ONLY FOR THE FLYING PUBLIC, BUT ALSO FOR TAXPAYERS, INVESTORS AND EMPLOYEES. WE NEED TO UNDERSTAND THE **AGGREGATE** IMPACT OF THESE POLICIES IN BETTER DETAIL AND ENSURE THAT THEY DO NOT INADVERTENTLY CREATE OBSTACLES TO LONG-TERM SUCCESS.

OF COURSE, OUR EFFORTS TO GET UNNECESSARY GOVERNMENT CONSTRAINTS OUT OF THE WAY OF THE AIRLINE INDUSTRY SHOULD AND DO EXTEND TO INTERNATIONAL MARKETS AS WELL AS DOMESTIC. BY NEGOTIATING LIBERALIZED BILATERAL AIR SERVICES AGREEMENTS – AND ADHERING TO THE OPEN SKIES MODEL WHEREVER POSSIBLE – WE HAVE CREATED NEW COMMERCIAL OPPORTUNITIES FOR U.S. CARRIERS WHILE BRINGING THE BENEFITS OF AFFORDABLE AIR TRAVEL TO CONSUMERS AROUND THE WORLD. BUT SEVERAL OF THE BIGGEST AND MOST IMPORTANT INTERNATIONAL MARKETS STILL HAVE UNNECESSARY CONSTRAINTS ON COMPETITION – INCLUDING OF COURSE THE UNITED KINGDOM, CHINA, JAPAN, AND SEVERAL COUNTRIES IN LATIN AMERICA. I KNOW WE WILL HEAR MORE FROM OTHER PANELISTS ON OUR EFFORTS TO

LIBERALIZE THESE TRADING REGIMES. BUT THE POINT IS THAT ENABLING U.S. CARRIERS TO SUCCEED INTERNATIONALLY MUST CLEARLY REMAIN A PART OF OUR AVIATION POLICY.

LET ME MOVE ON TO THE NEXT QUESTION, WHICH IS CLEARLY RELATED -- ABOUT WHETHER THE DEPARTMENT SHOULD PROMOTE CONSOLIDATION **OR** NEW ENTRY. THAT'S A FALSE CHOICE IN MY OPINION -- I DO NOT BELIEVE THAT CONSOLIDATION AND NEW ENTRY ARE MUTUALLY EXCLUSIVE. A TRULY HEALTHY INDUSTRY WILL TYPICALLY FEATURE BOTH, AND A TRULY HEALTHY INDUSTRIAL POLICY IS TO MAKE SURE THAT OUR REGULATORY REGIME DOES NOT STAND IN THE WAY OF MARKETPLACE FORCES THAT WOULD OTHERWISE RESULT IN BUSINESS COMBINATIONS OR ENTRY -- OR EXIT FOR THAT MATTER.

IN A DYNAMIC MARKET, ACTUAL AND POTENTIAL ENTRY ACTS AS A FORCE THAT DISCIPLINES INCUMBENTS AND THUS IDEALLY FOSTERS INNOVATION AND EFFICIENCY. AND GOOD IDEAS CAN COME FROM ANY QUARTER, INCLUDING ESTABLISHED COMPANIES, AS CAN COMPETITION; SO NEW ENTRY IS **NOT** THE SAME THING AS NEW ENTRANTS. AFTER DEREGULATION MANY OF THE MARKETING AND OPERATIONAL INNOVATIONS THAT CHARACTERIZE TODAY'S INDUSTRY ORIGINALLY CAME FROM NETWORK CARRIERS TRYING TO GAIN A COMPETITIVE ADVANTAGE OVER EACH OTHER AND OVER NEW ENTRANTS -- RANGING FROM FREQUENT FLYER PROGRAMS, TO

COMPUTERIZED RESERVATION SYSTEMS, TO YIELD MANAGEMENT AND EVEN THE HUB AND SPOKE STRUCTURE. THE USE OF THE INTERNET FOR E-COMMERCE ITSELF ARGUABLY BEGAN IN TRAVEL, A DIRECT RESULT OF THE DISTRIBUTION SYSTEMS THAT THE SO-CALLED LEGACY CARRIERS PIONEERED IN THE EARLY DAYS. BUT MORE RECENTLY, INNOVATION HAS TENDED TO COME FROM THE LOW COST CARRIERS WHO HAVE HAD THE ADVANTAGE OF STARTING FROM A CLEAN SLATE AND HAVE COME UP WITH COMPELLING PRODUCT OFFERINGS.

JUST LIKE NEW ENTRY, CONSOLIDATION CAN AND PROBABLY SHOULD PLAY AN IMPORTANT ROLE IN ACHIEVING SUSTAINED COMPETITIVENESS IN A MATURE INDUSTRY. THE U.S. AIRLINE PASSENGER INDUSTRY IS QUITE UNUSUAL IN THIS REGARD BECAUSE IT REMAINS -- NEARLY 30 YEARS AFTER DEREGULATION -- RELATIVELY UNCONCENTRATED WHEN COMPARED TO OTHER DEREGULATED INDUSTRIES THAT ARE EQUALLY CRITICAL TO OUR ECONOMY -- ENERGY, TELECOMMUNICATIONS, AND FINANCIAL SERVICES. THESE INDUSTRIES, HOWEVER, DID NOT ACHIEVE CONSOLIDATION SOLELY THROUGH MERGERS AND ACQUISITIONS.

CONSOLIDATION CAN OCCUR IN TWO DIFFERENT WAYS -- THROUGH THE COMBINATION OF FIRMS **OR** THROUGH THE EXIT OF FAILED COMPANIES. BUSINESS COMBINATIONS ARE NOT NECESSARILY AN ELIXIR FOR THE DOMESTIC AIRLINE INDUSTRY. MERGING TWO AIRLINES IS A DEMANDING

ENDEAVOR THAT MEANS COMBINING ROUTE NETWORKS, INFORMATION TECHNOLOGY SYSTEMS, AIRCRAFT FLEETS, AND PERHAPS MOST DAUNTING, TWO DIFFERENT WORK FORCES. AS A RESULT OF THESE MANY COMPLEXITIES, MERGERS USUALLY FAIL IN THE AIRLINE INDUSTRY. AT THE SAME TIME, THE RESTRUCTURING OF AIR CARRIERS UNDER THE BANKRUPTCY LAWS POSES SPECIAL CHALLENGES FOR THE UNITED STATES.

AS I MENTIONED EARLIER, COMPLETING THE WORK OF DEREGULATION -- THE CENTERPIECE OF OUR POLICY -- MEANS BETTER UNDERSTANDING THE ROLE THAT OUR BANKRUPTCY AND COMPETITION LAWS HAVE PLAYED (IF ANY) IN IMPEDING CONSOLIDATION. WHILE SOME WOULD ARGUE THAT THESE LAWS ARE NO DIFFERENT FOR AIRLINES THAN FOR OTHER COMPANIES, ARGUABLY THERE ARE ELEMENTS IN THE APPLICATION OF BOTH LEGAL REGIMES THAT UNIQUELY AFFECT AVIATION. WITH RESPECT TO THE BANKRUPTCY CODE, FOR EXAMPLE, THESE INCLUDE THE SPECIAL PROVISIONS DEALING WITH AIRCRAFT LESSORS. WITH RESPECT TO THE ANTITRUST LAWS, THESE INCLUDE THE HISTORICALLY NARROW APPROACH TO MARKET DEFINITION TAKEN BY REGULATORS -- TREATING EVERY CITY-PAIR AS A RELEVANT MARKET INSTEAD OF VIEWING COMPETITION ON A NATIONAL BASIS -- WHICH HAS HAD THE EFFECT OF DISCOURAGING OR SCUTTLING MANY PROPOSALS.

SO, TO SUM UP: DO WE NEED AN INDUSTRIAL POLICY FOR AVIATION? YES, I THINK WE ALREADY HAVE ONE, WHICH IS TO COMPLETE THE WORK OF

DEREGULATION BOTH AT HOME AND ABROAD. AND DO WE PREFER CONSOLIDATION OR NEW ENTRY? BOTH ARE INEVITABLE, I THINK WE ARE AGNOSTIC ON THAT QUESTION. I BELIEVE OUR OVERRIDING PHILOSOPHY SHOULD BE TO ALLOW THE MARKETPLACE TO WORK.

I WANT TO LEAVE YOU WITH ONE OTHER THOUGHT. I THINK AN INDUSTRIAL AVIATION POLICY DEPENDS ON A STRONG CONSENSUS AMONG ALL THE AFFECTED CONSTITUENTS INCLUDING GENERAL AND BUSINESS AVIATION AS WELL AS AIRLINES AND MANY OTHERS. FROM MY VANTAGE POINT IT SEEMS THAT TODAY THE "INDUSTRY" VIEWS POLICY AS A ZERO SUM GAME. THAT NEEDS TO CHANGE.