"U.S. International Aviation Policy in 2004 and Beyond"
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It is a pleasure to be back at the International Aviation Club. Until September of last year, I had been working at the Commerce Department on broader trade issues, and had relatively little specific involvement with the aviation industry. But prior to that, I had been a proud, card-carrying member of the IAC. It's been great to get back in touch with many friends, and to participate in IAC events once again. The International Aviation Club really is an important institution – one that promotes valuable discourse on issues of importance to the aviation industry.

The State of the Industry

Having left that industry in 2001 for several years, I must tell you that I've had a bit of a Rip Van Winkle experience. For those of you who have not been so fortunate, let me remind you of the state of the aviation industry just three years ago. In 2001, the industry had just come off its seventh straight profitable year -- a record. The publicly-held major carriers had reached record market capitalizations. New low cost carriers were being financed and created, but -- with the exception of Southwest -- most were still young and they were certainly not dominating markets. And while the major airlines -- scarred by previous economic downturns -- were cognizant of the need for cost-cutting, they -- not unlike companies in other industries -- were more focused on revenue-generating mergers, alliances, and growth strategies.

As my mother would say, I leave for a few months and this is what happens?

In all seriousness, as we all know, the past several years have been brutally difficult ones for the industry, and in particular for the major network passenger carriers. And of course, these difficulties have rippled throughout the aviation community -- to affect the employees of these airlines, the airports and communities they serve, the manufacturers and service providers that supply them. The downturn that major carriers were already experiencing was compounded by September 11, by SARS, by wars, by escalating oil prices, by the continuing threat of terrorism. It is difficult to imagine any industry having to face a more challenging set of exogenous events all at once.

Through all this, I believe the U.S. Government -- in partnership with industry -- did three things right and admirably well. (And I can say this because I was not involved and deserve absolutely no credit for it.) First, in the immediate aftermath of September 11, it stepped in with a temporary program for ensuring that this huge exogenous shock did not kill the industry or force it into a period of irrational decisionmaking. I should note as an aside that the Department of Transportation did an outstanding job in getting Stabilization Act compensation payments to carriers starting less than a week after the Act was passed -- an extraordinary feat.

Second, under the President's leadership and working closely with industry, the Government undertook to address the fundamental challenge of securing the homeland. Nowhere was this need more acute than in transportation. What September 11 and its aftermath revealed was that a leg of our nation's transportation infrastructure -- security -- required improvement … both for the security of the country as a whole, but also for the vitality of our industry specifically. Through the creation of the Transportation Security Administration and the implementation of numerous security measures, this leg has been substantially strengthened.

Third, in all of this, the U.S. Government has generally resisted the temptation to get <u>more</u> involved than needed. Indeed, in areas such as federal regulation of airline distribution systems, it has actually become <u>less</u> involved. The temptation for Government to intervene when any industry is being buffeted by difficult circumstances is an alluring one -- especially when those circumstances affect the general public as directly and as visibly as the aviation industry. But the fact of the matter remains that the U.S. aviation industry is a deregulated industry and that, like any other deregulated industry, it must be left to reach its own equilibrium.

Finding that new equilibrium remains a work in progress. In a speech earlier this year, Secretary Mineta stated that the aviation industry is going through a "paradigm shift." While we can debate how long that shift will take and precisely where we will be left when it is over, there can be little question that such a fundamental shift is underway. That shift has various causes. Technology – including the far greater transparency and consumer choice afforded by the Internet – is clearly one such cause. Changes in the structure of demand – with formerly inelastic business travel becoming increasingly price sensitive – is another. The results are a highly competitive and dynamic industry that has little choice but to focus heavily on cutting costs and capturing efficiencies.

So what does all this mean for the <u>International</u> Aviation Club? With all that has gone on, it is not surprising that the aviation industry has been focused inwards over the past three years. But – I would submit – that that may be changing. One sees various signs that U.S. carriers are again focusing on international markets and international opportunities.

- One sees carriers – where permitted by bilateral agreements – launching new services to new international destinations. I should note that this includes both traditional network carriers as well as some of our newer low cost carriers.

- One sees carrier revenues and yields improving in certain key international markets, including the transatlantic and transpacific markets.

- One sees continued expansion by air cargo carriers, as they prepare for what appears to be renewed growth in cargo traffic.

- One sees new interest on the part of carriers in new international partnerships.

- One sees carriers and communities increasingly interested in gaining access to international markets that are now restricted.

Recognizing that international air services markets remain critically important – not just to our carriers, communities and consumers but to the broader global economy – let me turn then, to the subject of the Department's international agenda.

The Administration's International Transportation Agenda

Before I discuss the Administration's agenda in the specific area of international aviation, I'd like to place it in the broader context of the agenda for international transportation writ large.

Consistent with his record in Congress over the past three decades, Secretary Mineta has laid out an active internationalist vision for the Department. The Secretary has made clear that the Department must be actively involved internationally and must be a "good neighbor" to its transportation partners and allies, if the United States is to maintain its position as a global leader in transportation. Under Secretary Mineta's direction, the facilitation of "global connectivity" has been introduced as a strategic objective for the Department for the next five years. His top management team -- including the Department's Acting Deputy Secretary, Chief of Staff, Under Secretary for Policy, and modal administrators -- is focused on and engaged in the Department's international role and activities. And – having accompanied the Secretary on first a grueling five-day trip to Kabul, Baghdad, Kuwait and Jordan; then a trip to Brussels, Paris and the Hague for bilateral negotiations; and, both before and after, innumerable bilateral meetings here in Washington – I can attest that the Secretary has been willing to put his time and energy where his mouth is. He has devoted substantial amounts of his time to raising the United States' and the Department's profile in international fora, pursuing international initiatives, and interacting with his foreign government counterparts.

This is more, however, to be done.

First, we are seeking to do a better job within the Department coordinating our international activities and initiatives. Some of our modes have been very successful in their international initiatives. Our Federal Aviation and Maritime Administrations have, for example, reached important bilateral agreements with foreign partners and have achieved new levels of international cooperation to the benefit of industry and consumers. Our National Highway Traffic Safety Administration has been very active in promoting global awareness of the problems of road traffic safety. But historically those discrete modal initiatives have often not been particularly well coordinated or leveraged at the Departmental level. Stovepiping is always a danger in an agency as large and diverse as DOT, but it is a particular danger in the international arena where, to be effective, we must speak with one, coordinated voice.

Second, we are looking to work more closely with industry in our international activities. Having worked both in government, at the Department of Commerce, and in the private sector, I know how important and how challenging this is. By nature, industry and government look at each other with a degree of suspicion. And while a dose of suspicion may be healthy in certain areas, I firmly believe that an effective international transportation policy depends on close communication between government and industry. Deregulation cannot mean that government and industry don't communicate effectively and work closely together, especially in the international environment.

Third, the Department needs to be more active and more engaged in the interagency process shaping U.S. international policy. There is no question that transportation affects and is affected by broader USG policies – economic policies, security policies, diplomatic policies. It is important that the views of the Department and its stakeholders get reflected in that policymaking process and that transportation initiatives get championed and reinforced by other agencies. To that end, we have made – and will continue to make – a point of trying to reach out to colleagues at the White House, State, Commerce, Department of Homeland Security, Office of the U.S. Trade Representative, and other agencies to ensure that the DOT's perspectives are brought to bear on policies that affect transportation.

Fourth, for us to lead internationally, we must be actively engaged internationally, but with clear goals and a focus on tangible results. The Department and its modes have a history of internationalism that we can be proud of. They have been and remain actively involved in fostering strong relations with foreign counterparts – working bilaterally, regionally and multilaterally. Those relationships have paid off immensely – often in ways that many people never see – in working through problems that we confront. The challenge we face going forward is marrying that internationalism with vigor, creativity and a results-focused bottom line – what are we <u>actually</u> achieving for industry, for communities, and above all for transportation consumers.

International Air Services Negotiations

Let me now turn to the specific subject of U.S. agenda in international air services. And let me approach that subject from two perspectives. First, what is our agenda <u>substantively</u> – what do we currently seek from international air service negotiations. And secondly, what is our agenda <u>geographically and temporally</u> – which countries and regions are we focused on, where do those initiatives stand, and what is at stake.

Substantively, the United States remains firmly committed to serving the public interest – both in the United States and abroad – through the elimination of governmental barriers to entry and regulations that distort international commercial aviation markets. We believe strongly that the Open Skies template constitutes the most effective international legal vehicle to that end, and stand ready to negotiate such agreements with any trading partner.

I believe that the evidence is unequivocal that Open Skies has been to the benefit of U.S. and foreign consumers alike. It has exposed U.S. and foreign airlines to rigorous competition – it has forced them to rationalize their international operations and has resulted in lower prices, and new and better service options.

The problem – the most significant problem that consumers of international air transportation face today is the fact that still too many of our international markets – and, in particular, too many of our largest international aviation markets – remain distorted by governmental regulation. Notwithstanding the achievement of negotiating more than 60 Open Skies agreements, we continue to lack liberalized aviation regimes with some of our most important trading partners.

And so, under Secretary Mineta's leadership and in partnership with our colleagues at the State Department and in industry, we are working to change that. If I may make a fairly bold declarative statement – the United States is currently engaged in the most ambitious agenda of bilateral aviation negotiations of the past decade. In the past six months, we have launched bilateral negotiations with China, India, Japan, and the newly-expanded European Union with its 25 member states. In sum, through these negotiations, we are seeking further liberalization – further opportunities for carriers, communities, and consumers – with a third of our fifty largest trading partners. Together, they represent over 50 percent of the world's population and over 60 percent of the global economy. The conclusion of any of these negotiations – and let me be clear and cautious, there remain significant issues to be worked out in all of them – would yield enormous economic dividends and be a significant diplomatic achievement with an important global partner.

Nor do we intend to stop there. We will also seek to engage our significant trading partners in North America, Latin America and the Middle East. In all these negotiations we are seeking to liberalize the bilateral aviation relationships. Where our foreign partner is willing, we seek Open Skies. Where it is not willing, we will consider pursuing incremental or phased-in liberalization. The goal is to keep our air services relationships moving forward to keep pace with – or preferably to outpace – the trade relationships that aviation should facilitate and foster.

While I would be happy to talk about any of the ongoing negotiations, there is one set of negotiations in particular that I would like to address in some detail – those with the European Union. As I commented during my confirmation hearing last September, the negotiations with the EU – launched by Presidents Bush, Prodi and Simitis last June – are exciting because they potentially promise the removal of governmental constraints on one of the most important international markets and because they may create a new template for international air services.

As many of you know, the fifth round of negotiations is ongoing in Washington, D.C. this week, with the negotiators from both sides working very hard to try to bring to closure a first phase agreement. I remain no less enthusiastic than I was last September about what could potentially result from such an agreement.

An agreement along the lines that the United States has offered would promise substantial, tangible benefits to both sides.

- First, it would create the conditions for transatlantic open skies with all 25 EU member states. In so doing, it would afford carriers and communities direct access between the United States and the 10 European countries that are currently constrained by bilateral legal restrictions. These countries, I might add, represent over a third of the total EU-U.S cargo market, and 47% of the total passenger market.

- Second, it would solidify and strengthen our relationships with the 15 European countries with which we currently have signed Open Skies agreements

- Third, it would – in many cases, for the first time – include provisions that address a series of issues that often have significant effects on commercial aviation operations, including provisions governing the foreign ownership of carrier voting stock, providing for consultation on competition matters, and addressing environmental issues. Increasing certainty, predictability and coordination on such topics is unquestionably to the benefit of both sides.

- Fourth, the agreement would establish the concept of the "European carrier." This would, for the first time, legally abolish the traditional bilateral notion that a European carrier must be owned and controlled by citizens of the country from which it is designated. It would afford European carriers the flexibility that they need to restructure their industry.

- Fifth, and perhaps most importantly, the agreement would be a building block – a first step to creating, in subsequent negotiations, a broader and deeper aviation relationship with a critically important trading partner. And – after 50 years of bilateralism – this agreement would create a new, multilateral, regional model for organizing international aviation services. It is in part for this reason that our efforts are being so closely watched by our trading partners around the world.

Would the agreement that we have proffered address all the concerns of both sides? No. There would unquestionably remain unresolved issues for both sides. For the United States, we would seek in subsequent rounds to address, for example, the issue of access at congested European airports. For its part, the European Union has made clear that it wants to discuss access to domestic direct air transportation markets. These are complex issues that have heretofore not been part of bilateral landscape. They cannot be resolved in the near future – the remainder of this year – and I fear that those who insist that a first phase agreement must await resolution of these issues are making a serious miscalculation. We – the responsible authorities on both sides of the Atlantic – cannot be so implacable as to reject any agreement until the "perfect" agreement is reached. Significant change in the aviation industry – including the deregulation of our own domestic aviation market and the European aviation market – has almost always come incrementally.

"So what?" you may ask? Does it really matter if there is no such agreement? After all, these negotiations – seeking to create a new template for international air services – have been only underway for eight months. What difference does it make if it takes a few more years?

I would submit that it could make a great deal of difference. As I've just described, a near term agreement that achieves the benefits that I've just described could help spur international carrier activity at a critically important period in the industry's development. It could help to broaden and deepen international carrier alliances at a time when those alliances themselves are going through substantial change. And it would strengthen and reinforce the United States' broader economic relationship with our European partners.

These benefits would, at best, be postponed, if the two sides are unable to conclude a near-term agreement. We would fail to capture the excellent progress made to date by the negotiators, and inevitably some "well-trodden" ground would need to be re-trod, as a new European Commission is installed, a U.S. presidential election occurs, and the actors and context change. Moreover, the failure to conclude a near-term agreement, could open the door to new tensions. For example, there has been unfortunate speculation about the vitality of the existing Open Skies agreements between the United States and member states, and even about a further European lawsuit that would seek effectively to force the renunciation of those agreements. Even if ultimately unmeritorious, such a suit would be highly regrettable as it would inevitably cast a cloud on the productive open skies relationships that we enjoy with many key European trading partners and the many rights and immunities which are premised on those agreements. And in so doing, it would introduce an unhelpful element of uncertainty at precisely the moment when carriers – on both sides of the Atlantic – least need it.

If this is the end result, both sides will have lost an important opportunity and we will be left with a situation that will not be in the best interests of either U.S. or European carriers or consumers. We urge all stakeholders in this negotiation to appreciate and seize the historic opportunity that now presents itself, thereby not only moving the industry towards a brighter future but also avoiding the more difficult and painful choices that could result from failure. And I should add -- based on the results of the productive discussions that we have had with our counterparts with the European Commission thus far this week (including a meeting between Secretary Mineta and Commissioner de Palacio yesterday) that I am heartened that both sides appear to be committed to moving the relationship forward in a productive spirit.

Conclusion. Let me conclude my remarks by returning to the beginning. I began my remarks by recounting the series of events that have contributed to the industry's fragile state during the past three years. Some of those conditions persist today, and to be sure, there may be difficult and dynamic times facing some carriers ahead. But there are also unmistakable signs that, after a period of introspection, carriers are again looking to expand internationally and, indeed, seeking to define new international roles for themselves. To facilitate this process we -- all of us here today -- have to capitalize on the opportunities before us to eliminate barriers to competition, to liberalize markets, and to create new options for travelers and shippers the world over. That is the path to real, durable progress in this industry – and the way to foster the growth in global trade and connectedness that we all seek.

Thank you for your attention.