U.S. Department of Transportation
Office of Public Affairs
Washington, D.C.
www.dot.gov/affairs/briefing.htm

Speech

Remarks of
JEFFREY N. SHANE
Under Secretary for Policy
U.S. Department of Transportation

Arab Air Carriers Organization
CEOs Workshop

Sharm El Sheikh, Egypt
April 25, 2004

On behalf of President George Bush and Secretary of Transportation Norman Mineta, let me thank you for inviting me to speak here today on the state of the global aviation industry and the fundamental changes currently taking place around the world. I want to convey congratulations to AACO Secretary General Abdul Wahab Teffaha for having the vision to organize this Workshop. It could not be more important or timely.

The issue I have been asked to discuss – liberalization in air services markets – is of great importance to the global aviation industry, and in particular to the carriers represented here today. Over the years, and especially during the last decade and a half, the forces of globalization and liberalization have created a vast array of exciting new opportunities, but have also required airline managers to address a vast array of daunting new competitive challenges at the same time.

Important Developments

I want to offer you some thoughts about liberalization, both as we have pursued it in other regions and its relevance to the airline business in the Middle East. Before I begin that discussion, however, I want to review a few other developments in civil aviation that have not been sufficiently noticed or discussed.

First, the global effort to ramp up the security of air travel—while still a work in progress—can be counted as a major success. It is fair to say that our creation of the Transportation Security

Administration in the U.S. and the requirements and procedures introduced by the new agency represented nothing less than a fundamental transformation of the framework within which commercial air services are conducted. It is certainly true that not every aspect of that transformation went as smoothly as we might have liked. Given the pace of those changes, that was probably predictable. But the net result has been the restoration of a system in which travelers have confidence. Whatever problems continue to compromise the industry's economic performance, fear of flying is not among them.

Second, I am pleased to report that, despite the enormous challenge of having to mount a new level of security in aviation, the Department of Transportation and its FAA have remained focused on our core responsibilities. In addition to continuing to finance new airport projects under our previous enabling legislation, the Administration worked closely with our Congress as it enacted a new four-year aviation reauthorization statute—Vision 100 – The Century of Aviation Act. It will ensure that we continue to invest in our airport and air traffic management infrastructure at the right level. We are paying particular attention, too, to the needs of smaller communities. My expectation is that your governments understand the importance of investing in aviation and are doing much the same.

In February of this year, Secretary Mineta announced an historic new initiative that will take the U.S. aviation system to an entirely new level. He understands that, no matter what the future market for air transportation looks like, we will have to handle a great many more aircraft operations than we do today. Government's job – now that we are mostly out of the business of economic regulation – is simply to ensure the safest possible operations in a system that has the wherewithal to accommodate whatever the market delivers. Secretary Mineta therefore has called for a *tripling* of system capacity over the next two decades. As part of his "Next Generation Air Transportation System Initiative," we have established a new Joint Planning and Development Office within the FAA that is staffed by representatives of a number of participating agencies, including NASA. Secretary Mineta is personally chairing a Senior Policy Committee consisting of high-level representatives of all participating agencies. It is a very serious and important initiative, and will pay off in major dividends for our economy in 15 to 20 years.

Third, some very important developments are unfolding in the international legal framework for civil aviation. Last September, the United States ratified the Montreal Convention of 1999, thereby bringing into force a long overdue modernization of the 1929 Warsaw Convention system of airline liability. Consistent in many ways with an inter-carrier agreement worked out under the auspices of IATA, the new treaty abolishes the artificial caps on damages that characterized the Warsaw System. Gone too is the need to prove "willful misconduct" by the airline in order for an accident victim to receive more than token compensation. To be sure, international airline accidents are few and far between. They do happen, however, and when they do, the international law framework now will serve the interests of passengers in a far more just and humane way than ever before. It is the responsibility of airlines – particularly those of you who agreed to waive the Warsaw limits voluntarily a number of years ago -- to encourage those governments that have not yet ratified the new treaty to do so as soon as possible, in the interest of their own citizens.

The U.S. also signed the Cape Town Convention last year, and you should urge your own governments to do the same. When it takes effect, this new treaty will make it much easier for airlines in many parts of the world to finance the acquisition of new aircraft at more affordable terms. This is particularly important in countries whose legal systems have been less than clear about whether the seller of an airplane can repossess it if the buyer stops paying for it. By setting up a new international registry for aircraft, the new treaty will overcome that uncertainty. Because the cost of financing in a country varies directly with the seller's perceived risk in that country, the advent of Cape Town will reduce the cost of financing significantly. As a result, newer, state-of-the-art airplanes will be available on more favorable terms in a great many countries, the real market for new aircraft sales will increase, and air safety will improve throughout the world. The Export-Import Bank of the United States has said that it will reduce its exposure fee by a third for purchasers in countries who have signed the Cape Town Convention. That's a measure of the importance that Exim attaches to having the new convention come into force as soon as possible.

Pursuing Liberalization

Let me now return to the topic I was asked to discuss: liberalization. Where liberalization has occurred – for example in the over 60 markets in which the United States now has signed Open Skies agreements – airlines have been given the flexibility to serve their customers in ways barely contemplated just two decades ago. Study after study has shown that Open Skies helps to expand the overall market for aviation and produces enormous benefits for millions of passengers. Our department has carefully studied the impact that the Open Skies agreements we have signed with major European trading partners like France, Germany and Italy have had on fares and service availability. We found that these agreements helped fuel a significant increase in traffic – about 30 percent – between the U.S. and Europe in the late 1990's. This increase was driven at least in part by a substantial reduction in average fares. Those fares decreased by twice as much in Open Skies transatlantic markets during this timeframe – 20 percent -- as they did in non-Open Skies markets – 10 percent.

It should come as no surprise, therefore, that we continue to pursue liberalization on a host of important fronts. I was in China earlier this month. A broad cross-section of representatives from the U.S. and China gathered in Beijing representing airlines, airports and aircraft manufacturers. They were there to talk about the importance of aviation to the broader China-U.S. relationship. The two sides are looking for ways to strengthen cooperation in this critical sector.

While in Beijing I discussed with senior Chinese officials ways we might make further progress towards the conclusion of an agreement that would substantially liberalize air services between our two nations. We need a framework for air services more in keeping with the large and growing China-U.S. economic relationship than the agreement we have today. I am optimistic that a new agreement may be within reach, and that it will be one that serves the interests of airlines and their customers on both sides of the Pacific in a fair and mutually beneficial way.

Also in Asia, we recently secured new agreements with Vietnam and Hong Kong that are already expanding our air service relationships in those markets in ways that will deliver substantial new benefits to U.S. and foreign carriers, as well as the passengers, shippers and others that rely on air transportation.

A New Opportunity

These efforts to liberalize air services have gone hand-in-hand with what the United States and other countries have done to liberalize international trade over the last decade and a half. Through the creation of the World Trade Organization and its accompanying agreements, trade restrictions have been reduced substantially, increasing demand for international travel as businesses seek to exploit the economic opportunity created by the newly globalized marketplace. Building on that worldwide success, the U.S. has worked hard to encourage more interaction between our economies in an effort to improve our bilateral trade relationships, while enhancing economic freedom for peoples across the globe.

In the Middle East, for example, we have signed an historic free trade agreement with Jordan eliminating barriers on virtually all goods and services traded between our two nations. In addition, just last month Morocco became the second Muslim nation to sign a free trade agreement with the U.S., and earlier this year we launched negotiations with Bahrain. The most prominent and far reaching initiative in this area, of course, was the announcement by President Bush last May of our desire to achieve a comprehensive U.S.-Middle East Free Trade Agreement within the next decade.

All of this supports the Middle East Partnership Initiative that President Bush announced last November. That initiative is intended to support economic, political and educational reform efforts in the Middle East and to champion opportunity for all people throughout the region. It strives to link businesses, non-governmental organizations, civil society elements and governments from Arab nations, the U.S. and elsewhere together in the pursuit of innovative policies and reforms that will advance the cause of freedom throughout the Middle East.

Because of the enormous trade and financial changes that are inexorably working their way through the global economy, we need to explore ways of modernizing the rules governing aviation more ambitiously. If we fail to meet this challenge, the air transport sector will fall short of the growth and increased profitability it might otherwise realize. We will have placed aviation in the "back seat" of the global economy. To fully respond to the opportunity now in front of us, we need to take several important steps.

First, we need to seek to work *multilaterally* to the extent possible to expand the benefits of liberalization. In that regard, let me refer to a multinational Open Skies treaty known as the MALIAT – the Multilateral Agreement for the Liberalization of International Air Transport. Currently, there are only six signatories to this multilateral open skies agreement, but it is my hope that – as countries increasingly move to liberalize their own international aviation regimes – many more will join the MALIAT. Simply stated, MALIAT permits the benefits of bilateral Open Skies to be multiplied geometrically, because each new signatory automatically enters into

Open Skies relationships with all other signatories. The MALIAT also provides new opportunities for investing in the airlines participating in the regime by eliminating many of the standard bilateral restrictions on foreign ownership.

Second, we need to work to expand the *scope* of our aviation agreements – to seek to overcome barriers to trade that, to date, have not been part of our aviation agenda. In that regard, the ground-breaking aviation negotiations that we are currently conducting with the European Union – commenced at the direction last June of President Bush, EC President Prodi, and EU Chairman Simitis – have raised areas for discussion and potential inclusion in an air services negotiations that have heretofore never been included. For example, we are discussing environmental regulation, competition law, and foreign investment. We are also re-examining the requirement that designated air carriers be owned and controlled by citizens of the designating country. I should note that the Bush Administration supports a plan that would raise the permissible ceiling on foreign ownership of voting stock in U.S. airlines to 49 percent from its current level of 25 percent.

Third and finally – as much has been done in the broader trade sphere – we should embrace new regional approaches to the liberalization of international aviation markets. The U.S.-EU effort and the MALIAT are two examples of this approach.

I know that there has been some discussion to date of a regional initiative here in the Middle East. As many of you know, Secretary Mineta recently traveled to the region, and while much of that trip focused on reconstruction in Iraq and Afghanistan, he also took the opportunity to encourage all parties to think seriously about such a regional initiative. We strongly urge the members of AACO to consider how the Organization might facilitate such regional liberalization and ensure that your governments are fully aware of your position on these issues. Represented here today are carriers with state-of-the art fleets, highly sophisticated management, and truly visionary plans for the future. It is therefore only right that AACO should be at the vanguard of deregulation and liberalization of aviation markets.

Unfortunately, despite our tremendous success in securing Open Skies agreements since 1992, the U.S. still has outdated bilateral agreements with a number of countries in the Middle East. Currently, only six nations whose airlines are members of AACO – Jordan, Bahrain, Morocco, Oman, Qatar, and the United Arab Emirates – have signed Open Skies agreements with the U.S.

If there is reluctance on the part of some to enter into a liberalized agreement, it may be attributable to a fear of the unknown. Competing in an open marketplace is always challenging. The U.S. experience makes clear, however, that liberalization carries with it tremendous benefits, both for carriers and for their customers. Air services liberalization has had enormous positive consequences for U.S. communities and for our national economy, without weakening U.S. or foreign carriers serving our marketplace. To be sure, some adjustments have been made in facing this new reality, mostly in the form of new route structures, business plans, and changing international alliances. But the net result has been positive all around. U.S. carriers today would refuse to turn back the clock if given the chance.

Some skeptics believe that the U.S. motivation for pursuing air services liberalization is to establish a more dominant position for American carriers – to enable them to run smaller carriers out of business. The fact is that while U.S. international carriers remain strong players in delivering global air services, they have been among the hardest hit in recent years due to the downward trend in traffic after September 11th and the tough new competition they are facing in our domestic market from low-cost carriers. They are not running anyone out of business. They certainly would not do so in the Middle East; under the Open Skies agreements currently in place with governments in the region, it is the AACO members who provide virtually all of the direct service – not their U.S. competitors.

The international debate about whether liberalization is the right approach ended some time ago. At a worldwide ICAO Air Transport Conference last year in Montreal there was clear consensus among the member states that liberalization was not only the right policy but inevitable in today's globalized economy. In fact, widespread acceptance of Open Skies is placing increasing pressure on those markets that have yet to be liberalized as governments find themselves in competition with one another to attract major international hubs for both passengers and cargo. The economic benefits derived from liberalization and the ability to attract international hubs are clear – lower costs for air travel, cheaper imports, more competitive exports, tourism, job creation and, ultimately, higher economic growth.

The question, therefore, is no longer "whether" but "when." The challenge before all of us is to determine how best to accelerate the process of removing the market barriers that are preventing this industry from exploiting new economic opportunities more effectively, thereby connecting businesses, markets, and people around the world.

Conclusion

The bottom line is that the liberalized aviation relationships that are already in place throughout much of the world have not only been a laudable success in their own right, but they are now beginning to put pressure on markets still governed by outdated regulatory restrictions. The United States will continue to pursue liberalization wherever we can find it, and we encourage others to do the same. It would be a great step forward for us to work with AACO's members and your governments to conclude a precedent-setting, robust, multilateral air services agreement in this region. The U.S. will be ready when you are.

Thank you for allowing me to share these thoughts with you today.

# # #