

# INTERNATIONAL AVIATION POLICY

Y 4. C 73/7: S. HRC. 104-274

International Aviation Policy, S.Hr...

## HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE,  
SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MAY 24, 1995

Printed for the use of the Committee on Commerce, Science, and Transportation



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# HEARING ON INTERNATIONAL AVIATION POLICY

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WEDNESDAY, MAY 24, 1995

U.S. SENATE,  
SUBCOMMITTEE ON AVIATION OF THE COMMITTEE ON  
COMMERCE, SCIENCE, AND TRANSPORTATION,  
*Washington, DC.*

The committee met, pursuant to notice, at 9:30 a.m., in room SR-253, Russell Senate Office Building, Hon. John McCain (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Michael E. Korens, staff counsel, Michael W. Reynolds, counsel; and Samuel E. Whitehorn, minority senior counsel.

## OPENING STATEMENT OF SENATOR MCCAIN

Senator MCCAIN. I would like to note that we have votes, about five or six of them, beginning in about 15 minutes or so. We will try and get at least opening statements out of the way, and then regrettably we will have to recess for about 45 minutes, until we complete those votes.

So, therefore, I will make my opening statement brief and then refer to my colleagues. And perhaps we could get the opening statement of the Secretary of Transportation, if he is here this morning. I am sure he will be here in a minute.

I would like to welcome my colleagues and the Secretary of Transportation and all of our witnesses, including representatives from the GAO and our distinguished panelists representing the U.S. commercial aviation industry and the consumer interests of various airports and communities desiring better international aviation service.

I think we are all in agreement that U.S. interests are best served by open and free trade in all sectors, including the international aviation industry. Our policies must vigorously pursue that end.

I will make my complete statement a part of the record, except to say that the reason for this hearing is to review the entire issue of international aviation, but also there has been an enormous amount of controversy generated by the proposed mini-deal involving British Air, United Airlines, and USAir.

I do not know of a recent aviation issue that has generated more controversy. And I believe that Congress does play a role in issues of this impact and import. And I am pleased that the Secretary of Transportation agreed—good morning, sir—to attend this hearing and to provide very important testimony on this issue.

Mr. Secretary, while you were arriving, I mentioned that we have votes beginning in about 15 minutes or so, and we are going to have to take a break probably for about 45 minutes, since we have about 5 or 6 votes.

I apologize for the inconvenience to you and to the other witnesses. So, therefore, I will proceed as rapidly as possible.

I would like to ask Senator Ford if he has any opening comments to make and any other of my colleagues.

[Prepared statement of Senator McCain follows:]

#### PREPARED STATEMENT OF SENATOR MCCAIN

I would like to welcome my colleagues, Secretary of Transportation Federico Peña, Ken Mead from the GAO, and our very distinguished panelists representing the U.S. commercial aviation industry and the consumer interests of various airports and communities desiring better international aviation service.

It is a pleasure to be with you today. As I look around the room it is hard to imagine a group of people more representative of the competitive and dynamic global economy that is taking shape for the 21st century.

Moreover, it would be equally hard to imagine any group of business leaders with more at stake in seeing that the national interests in U.S. international aviation are best served with the greatest opportunity for air carriers expansion and increased consumer benefits.

Because of the great interest in today's hearing, I would respectfully request that our panels and our Subcommittee Members adhere to the five minute rule as much as possible. Your complete statements will be included fully in the record. As Chairman of the Subcommittee, I will try to lead by example.

My objective for this hearing is to examine all the issues surrounding the current U.S./U.K. aviation bilateral as a case study of our International Air Transportation Policy. As most of you know, Secretary Peña released his International Air Transportation Policy Statement last month, reaffirming the major goals and principles of the previous Administration favoring an "open skies" policy. I was encouraged that Secretary Peña had crafted U.S. international strategy to meet the following important air transportation objectives:

- (1) Increase competitive pricing and consumer choice;
- (2) Enhance the access of U.S. cities to international air service;
- (3) Provide passenger and cargo carriers with unrestricted international air service;
- (4) Recognize the importance of military and civil airlift resources being able to meet defense mobilization;
- (5) Ensure that competition is fair and the playing field is level by eliminating government subsidies, restrictions on carriers' ability to conduct their own operations, and unequal access to airport facilities; and,
- (6) Promote global aviation market place or "open skies" even through enforcement of current bilateral rights through all means, including renunciation and suspension of privileges and services when violations occur.

However in an amazing shift of winds which can only be likened to wind shear, DoT's Policy Statement then describes a so-called "practical approach" to international aviation policy. This "practical approach" encompasses a different strategy for dealing with countries that are not willing to move to an unrestricted air service regime. Using this strategy, the U.S. would advance the liberalization of air service regimes only as far as our partners are willing to go. Yet, in announcing the Administration's new air transportation policy on April 25, 1995, Secretary Peña said "we will do anything and everything we can to move forward—never backwards—toward an open aviation world whose benefits, we believe, far outweigh the costs."

So, now we have an International Air Transportation Policy. But, it sounds quite different from last year when the Administration was prepared to renounce the 17-year-old U.S.-British bilateral. I submit, therefore, that this "practical approach" is not really an international air transportation policy at all, and will not serve to advance our important transportation policy objectives.

In fact, it is nothing more than mercantilism. And we all know that such protectionism reduces the flow of people, products and services. I do not believe that the U.S. should implement a strategy that does not allow us to expand trade competitively. If we do, our economy and others will greatly suffer. The expansion of the global economy depends, to a great extent on having the most efficient transportation system. There should therefore be no question that broader aviation agree-



ments are preferred mini-deals narrowly defined by special interest groups. To say this is not the purpose of the U.S./U.K. mini-deal currently on the table would be disingenuous. In fact, when I recently asked U.S. and British officials, why we were proceeding with the last U.S./U.K. bilateral round, I was told that it was because of pressure from one airline and one city. Yet, that response ignored the significant bipartisan Congressional opposition to the mini-deal.

Regrettably, it is my view that U.S. international aviation policy falls short of its intended objectives. I believe U.S. Policy should be designed to produce the maximum consumer and industry benefit. Whatever tools we employ to achieve that end—including economic analysis of agreements—should be fully examined. The U.S./U.K. bilateral is just one agreement. Negotiations of equal or greater complexity will soon be considered. For this reason, it is imperative that the U.S. has the best possible policy in place to serve its citizens.

However, the U.S. still struggles with the implementation of a coherent Policy. Although U.S. objectives are clearly stated, DoT has failed to back up its words with actions. This situation is exacerbated by the justifiable lack of faith that U.S. airlines have in the current bilateral process, which has tended to pit airline against airline, city against city and government against industry. Moreover, the archaic system of aviation bilaterals only compounds the difficulties inherent in the Administration's struggle to implement a coherent policy.

Governor Baliles recently testified before this Subcommittee on the National Airline Commission findings. Governor Baliles stated that the National Airline Commission heard from the Chief Executive Officers of every major domestic and international airline. They all felt strongly that the U.S. should move forward to expand international air service, but not until a "level playing field" had been created. In fact the Commission recommendations are clear. One such mandate: "Enforcement of current bilateral rights through all means, including renunciation and suspension of privileges and services when violations occur." The National Airline Commission also recommended that the best strategy would be for the U.S. to lead the world toward an open, comprehensive multi-national regime on as broad a geographic base as possible.

However, our current international policy effectively ignores the Commission's recommendations. Under the existing system, a single airline can use the government to pursue its own special interest at the expense of many U.S. cities that need international service. This practice results in many markets being served on a non-competitive basis, while others are not served at all. This rigid system has produced a class system for cities and airlines, which have been labeled the haves and have nots. The end result is an international policy that jeopardizes the fixture growth and profitability of the travel and tourism industry and compromises our position in the global economy. Above all, the traveling public is not well-served by this policy.

We need to return to the Airline Commission's sensible recommendations which came out two years ago today. Recognizing the importance of aviation in today's global marketplace, the Commission recommended that U.S. international aviation policy should facilitate the creation of a liberal, multilateral regime governing air transportation services. This would be achieved on as broad a geographic base as possible. The Commission also recommended that an extensive range of air service issues, not just landing rights, should be addressed by the U.S. The Commission hoped to get something started that could, in the end, bring about real change in international aviation.

I submit that special interest mini-deals do not promote that purpose. Special interest deals do not move our economy forward towards the goal of global economic expansion. Instead, such deals maintain the restrictive—and antiquated—aviation system and stunts economic growth. Sadly, the current system encourages our aviation bilateral negotiators to move backwards in time to the 1944 Chicago Convention, rather than to move forward to greater economic growth that can only be achieved under liberal aviation agreements that move the U.S. closer to "open skies."

I urge the Administration to continue to work towards establishing free trade in aviation services. I am encouraged that recent U.S. efforts to create an open, competitive international aviation environment with Canada, culminated in the signing in March of a major new aviation agreement. That agreement provides for substantial increases in air services between the U.S. and Canada and full "open skies" at the end of a transition period. We need to work for comparable liberalization of the U.S./U.K. agreement. To get such an agreement we must avoid using an incremental strategy, and instead work on fundamental change.

Mr. Secretary, the facts are the facts. I commend you for the number of aviation bilateral negotiations that you have completed, which are indeed beneficial to our

aviation industry and to U.S. citizens. This is the track that I recommend that we should continue to take—the results are indisputable.

I look forward to listening to the testimony of the distinguished witnesses that we have here before us today. And again I welcome you and thank you for coming.

### STATEMENT OF SENATOR FORD

Senator FORD. Mr. Chairman, I have a wonderful statement that would just probably appeal to everybody in the room, but since we have to go vote and will not be back for an hour, I ask unanimous consent that it be included in the record as it is given.

Senator MCCAIN. Without objection.

[The prepared statement of Senator Ford follows:]

#### PREPARED STATEMENT OF SENATOR FORD

Good morning. Mr. Chairman, I will keep my remarks brief so that we will have time to hear from all of our witnesses today. First, let me thank you for holding this hearing. I know we share a desire to see that the United States gets the best deal it can in its negotiations with the British.

As the Secretary is well aware, I have had a long-standing interest in the United States—British negotiations. We corresponded regularly last year concerning the Delta-Virgin deal, and I had an opportunity to renew our pen pal relationship recently in cosigning a letter on the prospects of a mini-deal.

It is important that we achieve a more liberal, open regime for all of our cities and carriers. Over the last several years, our share of the U.K. market has declined from 45 percent in 1992 to 42 percent this year. We must change the equation, and soon. We all know that access to Heathrow is critical, and we can not wait years for additional access.

How do we get there? The Secretary's approach is through a mini-deal that appears to provide benefits to one carrier, and in phase 2 addresses other potential needs.

The question really boils down to this: Will we be able to achieve a second phase and when? If the Secretary has faith that the British mean business this time, then the timeframe for the second phase should be relatively short. Why not, then, bundle the issues and strike a deal on all of the issues in early June? The negotiators have met 3 times recently to discuss a small package of rights. The group of rights has been subject to discussion even before that. If the Secretary believes he can scope out phase 2, and set a relatively short deadline, why not bundle the issues now. Such an approach would provide many benefits, including demonstrating that the British are serious about possible rights under phase 2.

It is clear that their are rights the British seek in the mini-deal. I have watched the British dance for many years, and they do a good job of negotiating. Given the market share statistics in their favor, what is it the British want?

- Fly America traffic—maybe. It could help address some concerns over BA's future ownership in USAir, if the national security arguments are addressed here.

- Competition for BA and American at Chicago—doubtful.

- Starburst rights out of Heathrow for U.S. carriers—unlikely.

- Service to regional airports—probably. We do know that ultimately, if British Airways decides to perfect its interest in USAir, the British will ask for a lot, including a change in U.S. law to gain a controlling interest in USAir. Only then will we be discussing an open arrangement. But that is not the only thing the British want. A 1994 report by the Transport Committee of the House of Commons suggested, among other things, that both sides consider abandoning the two U.S. carrier Heathrow limitation, that regional airports in Britain receive the benefits of liberalization, and that cargo liberalization proceed. The report makes clear that there are needs on the other side of the Atlantic, other than the BA-USAir deal.

The British and U.S. negotiators should not look only to the USAir-BA deal as the future linchpin to liberalization. There are still many paths left before BA makes that decision. Both sides must recognize that there are a host of benefits to be gained from a liberal agreement and should open up Bermuda II now, as best they can. If there truly is to be liberalization, both sides need to assure me that the steps that they appear to be pursuing are legitimate and real, and not a continuation of a long dance. There are too many cities that deserve service to Heathrow, just as there are too many cities in the U.K., including Birmingham, Britain's second largest city, that deserve service.

It is interesting that these international negotiations seem to have gotten caught up, mistakenly, in other initiatives. I hope that is not the case. There is much at stake here, and the Secretary must focus on the ultimate goal—a better and long term deal for the United States.

I look forward to listening to the witnesses today.

Senator MCCAIN. Senator Stevens.

Senator STEVENS. In the interest of time, I would like to hear the Secretary. I will just waive my opening statement.

Senator MCCAIN. Senator Inouye and Mr. Chairman.

### STATEMENT OF SENATOR PRESSLER

The CHAIRMAN. I will also waive my time, but I did want to mention I wrote the Secretary saying that international aviation agreements should be considered on cost-benefit basis.

I have been concerned that in both cargo and passenger negotiations, our carriers fight among themselves and our negotiators sometimes get undercut. This is why I am advocating a cost-benefit approach to international aviation negotiations. That is what my statement says at more length, and I will put it in the record.

[The prepared statement of Senator Pressler follows:]

#### PREPARED STATEMENT OF SENATOR PRESSLER

Thank you, Mr. Chairman. I am pleased to join in today's hearing to consider current bilateral aviation agreement negotiations between the United States and the United Kingdom. I share the Subcommittee Chairman's interest in focusing the Commerce Committee's attention on international aviation policy concerns. As the Subcommittee Chairman knows, international aviation—in the broad context—has been on my agenda for the Committee's consideration since the start of this Congress. Therefore, I want to commend Senator McCain for chairing today's hearing.

The economics of international aviation opportunities are critical to U.S. passenger and cargo carriers. For example, by 2006, international traffic is expected to account for nearly one-third of the total annual traffic of U.S. passenger carriers. The significance of this statistic speaks for itself, particularly for an industry struggling to turn the financial corner.

Although today's hearing focuses on recent negotiations between the United States and the United Kingdom, we must not lose sight of the importance of international aviation markets worldwide. In my judgment, *no* bilateral aviation negotiations, including the United States/United Kingdom talks, should be about the parochial interests of *any single* U.S. carrier. Instead, the focus of our international aviation policy must be on the *economic impact—both costs and benefits*—bilateral agreements have on our nation's economy as a whole, including the traveling consumers and the communities served. I plan to focus on these issues today.

As Secretary Peña already knows, I made this very point regarding the importance of economic cost-benefit analysis in my letter to him dated May 5th. I look forward to discussing this approach with the Secretary and the other witnesses. I should clarify, however, that when I mention cost-benefit analysis, I am *not* speaking in terms of counting how many Senators weigh in on behalf of a particular interested carrier. Indeed, I recognize the difficulties many of us impose upon the Secretary in carrying out his responsibilities in securing sound international aviation agreements.

Mr. Chairman, I read the Department of Transportation's recently published statement on International Aviation Policy with great interest. The Administration must provide the leadership necessary to carry out this policy, ensuring these words are turned into meaningful actions.

In that regard, last week I contacted President Clinton urging him to take whatever steps necessary and reasonable to ensure the government of Japan abides by the terms of the United States/Japan bilateral aviation agreement. Let there be no doubt, creating and maintaining equitable international aviation opportunities for U.S. carriers, passengers and cargo, must be a national priority.

I will be very interested in hearing from today's witnesses. Thank you.

Senator MCCAIN. Senator Hutchison.

## STATEMENT OF SENATOR HUTCHISON

Senator HUTCHISON. Thank you, Mr. Chairman. I do have an opening statement, which I will be happy to submit for the record.

But I just want to say that I come from the second largest state in America with three of the top ten cities, the second busiest airport in America, and we have no service to Heathrow.

And that is a very important issue for me, and I hope that we will be able to discuss it and see what the equities are.

Thank you, Mr. Chairman.

[The prepared statement of Senator Hutchison follows:]

### PREPARED STATEMENT OF SENATOR HUTCHISON

I am very pleased that Chairman McCain has called this hearing, and I am relieved that it comes in advance of the Department of Transportation initialing an agreement with the United Kingdom.

Accepting the agreement currently on the table would be a serious mistake and a loss for the United States. It will be a lost opportunity to achieve the objective of "open skies."

We need to pause for a review of what our goals are in the United States-United Kingdom negotiations. I recall when the Department of Transportation's goals regarding United States-United Kingdom negotiations was "open skies," then it was 15 additional United States access routes into London. Now, it appears that sights are permanently lowered on a "mini-deal" that provides one additional U.S. route to Heathrow—from a city that already has adequate Heathrow access. The DOT is responding to the misguided imperative of making a deal at any cost.

This mini-deal does not occur in a vacuum, but in the context of an already imbalanced United States-United Kingdom bilateral aviation agreement, Bermuda II. Under Bermuda II, the United States airline business has lost 25 percent of the North Atlantic traffic between the United States and the United Kingdom. In a competitive market, the split between the United States and British carriers would be 75 percent-25 percent. Under the artificial restrictions of Bermuda II, the marketshare is 50 percent-50 percent. I understand this forfeiture has cost the U.S. airline industry at least \$2.5 billion per year in 1993 dollars.

Accepting the mini-deal, and then making a leap of faith toward "limited and balanced" increased access to Heathrow makes a bad situation worse, and maybe permanent. Right now, Texas—the second largest State in America, with 3 of the 10 largest cities—has no access to Heathrow. If DOT considers U.S. leverage weak now—as it has stated—our leverage will be non-existent once this deal is made. I fear we will live with the consequences for a very long time.

I do not necessarily want to criticize the work that DOT and the Department of State have done until now. What I want to do is help refocus their attention on a broader picture of what is important. It is important that we obtain real and open access to London for more cities and carriers, and that we create a competitive environment in which consumers benefit and travel and tourism on both shores are stimulated. If these goals are not achievable in the current negotiations, then the time has come to re-evaluate our strategy.

Senator MCCAIN. Senator Gorton.

### STATEMENT OF SENATOR GORTON

Senator GORTON. Mr. Chairman, the attendance at this subcommittee hearing indicates its importance. I too will put my opening statement in the record.

But I simply want to encourage the Secretary to keep pushing as hard as he can and to take whatever steps he possibly can. Some progress is better than no progress, but his goal should be completely open skies. With that, I will put the rest of it in the record.

[The prepared statement of Senator Gorton follows:]

## PREPARED STATEMENT OF SENATOR GORTON

Mr. Chairman, I would like to take this opportunity to comment on the role of this committee, and also the role of the Secretary, in the evaluating and executing of international aviation policies. I believe that the U.S. Senate and the Secretary of Transportation must continue working toward a public policy that promotes competition, provides increased service and choice for consumers, and continues lowering the barriers that currently block expanded aviation service between the United States and the United Kingdom and other appropriate markets.

Coming from a State that relies heavily on foreign trade, sound international relations are of the utmost importance in maintaining open markets. Solid relations, however, can only be established by taking incremental steps toward a larger goal.

I would encourage the Secretary to continue shaping sound public policy in a manner that promotes both international relations and competition, while also enhancing every consumer's right to quality air service.

I welcome the opportunity to participate in a comprehensive and reasoned study of international aviation policy in the future.

## STATEMENT OF SENATOR HOLLINGS

## PREPARED STATEMENT OF SENATOR HOLLINGS

The hearing today focuses on our relationship and limitations with one of our strongest trading partners, the United Kingdom. Both sides must recognize that it is time to change the existing agreement, Bermuda II, governing the relationship.

Bermuda II, signed in 1978, and amended in 1991, has been characterized as a restrictive agreement because it limits the number of cities that can be served by U.S. and British airlines, and the number of carriers that can serve London's Heathrow Airport. With respect to the 1991 amendment, the United States and the United Kingdom agreed to change the Bermuda II agreement to allow United Airlines and American Airlines to serve Heathrow. Each of the U.S. carriers had purchased the rights held previously by Pan American Airways and TWA to serve Heathrow. As part of the right to substitute carriers, we also agreed to allow the British airlines to code-share with U.S. carriers.

I spent many months trying to convince the Department of Transportation that the British Airways-USAir code sharing agreement should be approved. Many in the industry have debated whether code sharing has had an impact on carriers other than USAir, and we will later hear testimony on this issue. However, there is no question that under the 1991 change to Bermuda II, the right of British carriers to code-share clearly exists.

We are now faced with the prospect of a mini-deal, followed by a second phase of negotiations, and possibly followed by liberalization of the market. In negotiating with the British, the U.S. delegation must remember that while the British are our allies in many respects, we are talking about dollars here. This is mercantilism, pure and simple. If the British believe it will benefit their companies, they will strike a deal. If not, we will sit here for years seeking liberalization. As a result, we must be very cautious before we give away rights, without ensuring that we will receive benefits. Tourism, which is driven in large part by the airline industry, is an enormous generator of jobs in the United States and in the world. Our two governments must not lose sight of the economic benefits of a better aviation deal.

The Secretary of Transportation has a tough job. He must not only convince the British to strike a deal, but he also must convince the U.S. carriers and Congress to support his efforts. The Secretary must be able to stand up and demonstrate that what he and his British counterpart agree to is a good deal for the United States, and not just for a small segment of the U.S. economy.

Senator MCCAIN. Perhaps in the future we should schedule votes during hearings. It certainly cuts down on opening statements.  
[Laughter.]

Senator MCCAIN. Mr. Secretary, welcome. Please proceed, and we will try and get as far as we can here before we have to go vote. And again I want to apologize for any inconvenience that it causes you. Good morning.

**STATEMENT OF HON. FEDERICO PEÑA, SECRETARY, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY: STEPHEN H. KAPLAN, GENERAL COUNSEL; PAT MURPHY, INTERNATIONAL AVIATION OFFICE, OF THE DEPARTMENT OF TRANSPORTATION**

Secretary PEÑA. Good morning, Mr. Chairman and members of the subcommittee. Let me say I fully understand the time constraints, and I am willing to be as flexible as possible.

Let me first introduce the two people who are here with me this morning, Mr. Steve Kaplan, to my right, our general counsel; Mr. Pat Murphy, from the International Aviation Office of the Department of Transportation, to my left.

Mr. Chairman and members, I appreciate the opportunity to discuss one of the most important transportation and economic issues for the United States, international commercial aviation, and recent developments with respect to our efforts toward expanding and liberalizing our aviation agreement with the United Kingdom.

I would like, with your permission, Mr. Chairman, to formally submit my complete statement, which is far lengthier than my opening statement, so I can proceed with the statement that I have before me.

And I would like, with your permission, to refer to some charts as I make my opening statement.

Senator MCCAIN. Without objection your complete statement will be made part of the record. And of course we would like you to proceed in whichever way you choose to do so.

Secretary PEÑA. Thank you, Mr. Chairman.

I welcome this opportunity because it enables us to examine where we have been, where we are today and, most critically, where we are going with respect to international aviation.

It is important that the discussion of any particular aspect of our policies or any individual negotiation be considered in the broader context of our overall goals and strategy for expanding services for the traveling public, for increasing opportunities for our aviation industry and the cities they serve, and for creating the most efficient and dynamic aviation system possible.

When I became Secretary of Transportation, the situation confronting us in international aviation was daunting. Major problems existed between foreign aviation partners and the United States, and the situation was becoming worse.

The French had renounced our bilateral aviation agreement, the Germans were threatening, and Japan was indicating that it might take steps to limit our carriers from exercising their rights.

No progress had been made despite countless rounds of talks with Canada about liberalizing air service in this, our largest international aviation and trade market. Overall, no new significant service opportunities were becoming available to our carriers.

Furthermore, the United States was operating under a 17-year-old international aviation policy.

From the airlines' perspective, our aviation industry was experiencing disastrous financial results, particularly in the international sector.

The United States had just lost two of our major airlines, including our dominant international carrier, Pan American. Three more

major airlines were in bankruptcy at the beginning of this administration.

In 1992, the U.S. aviation industry recorded its third straight year of huge losses, with an operating loss of \$2.4 billion.

The international sector, which accounted for approximately one-fourth of our airline industry's business, was registering over half of that loss, \$1.3 billion. Something had to be done, and we immediately went to work to address the problems.

In partnership with the members here today and with the Congress, we established a Commission to Ensure a Strong Competitive Airline Industry and have already acted on more than 80 percent of those recommendations.

In February, we signed a breakthrough agreement with Canada that is immediately expanding service and fare options between our countries and will result in a fully open air service regime. Estimates of the value of this agreement to our economy have been in the range of \$15 billion a year.

We have also made progress in reaching open-skies agreements with nine European countries, which will also allow our carriers unlimited access to either provide direct service on their own or under a commercial arrangement with a foreign carrier or indirect service under a code-share arrangement with carriers of third countries.

The economic recovery in the last 2 years has done more than anything else to assist the economic recovery of the U.S. airline industry. In turn, our airline industry's financial recovery has strengthened its ability to compete in the international aviation market.

And we are seeing the results. Last year more than 555 million passengers flew in the United States, up 8 percent from the year before. Revenues, traffic, load factors are all up. None of our major airlines are in bankruptcy today.

In the international sector our industry has turned the corner and reported an operating profit of \$500 million for 1994. And airline analysts project that 1995 will be a good year. Notably, the U.S. share of the growing international market is now up to 53 percent.

To anticipate the rapidly changing environment in aviation, we conducted the first comprehensive review of our international aviation policy since 1978. This culminated in the adoption of our International Air Transportation Policy Statement last November.

In developing our policy statement, we placed considerable emphasis on evaluating the economic forces in the marketplace, how those forces are shaping the evolution of the industry, and how our policies should relate to those developments to enhance the opportunities and economic prospects for our industry, for communities and for the traveling public.

In one area, code-sharing, we undertook the first comprehensive study to understand the effects of this major marketing practice and to quantify the impact on competition in the market.

Our policy contends that enhanced competition and greater service opportunities will lead to significant benefits for travelers, shippers and communities, greater general economic development and

job creation, and greater financial rewards for carriers and their employees.

Today, our airlines are doing well in terms of the share of the international aviation market.

Mr. Chairman and members, let me illustrate that by referring these charts.

To give you a sense of how our carriers are doing in the international arena, this is a map of North America. In Canada we have 67 percent of the market. In Mexico we have 58 percent of the market.

In Central and South America we have close to 60 percent of the market. In the Bahamas, 54 percent; Dominican Republic, 79 percent; Jamaica, 50 percent; Venezuela, 55 percent; Brazil, 38 percent.

We focus on those countries where we have over 1 million passengers per year. But on this continent we are doing quite well in accessing the international aviation opportunities from north to south.

Let me give you an example of what has happened in Canada just with the agreement that we signed recently. This gives you a sense of the new traffic we now have between the United States and Canada. In the few months since we have signed that agreement, our traffic has increased 25 percent. And the total economic impact of this deal is \$15 billion to our economy.

Let's turn to Europe. The three biggest markets in Europe are Germany, France and the United Kingdom. They represent 60 percent of the total international traffic between Europe and the United States.

If you look at Germany, we have 58 percent of the market. France, 64 percent of the market; the United Kingdom, 45 percent of the market. We want to do better there. But overall we are doing very well in the European market.

Senator MCCAIN. Let me just ask, Mr. Secretary, what are the trends, especially in Germany and the United Kingdom, say as opposed to five to 10 years ago?

Secretary PEÑA. As opposed to five to 10 years ago our trends in Germany have been going up, if you go back 10 years. In terms of the United Kingdom, they have been coming down.

And I am going to talk about that in a second. In terms of France, over the last 10 years the trend has been going up. So generally speaking, in Europe, our movement has been in an upward direction with the exception of the United Kingdom.

Senator MCCAIN. As far as a percentage of the marketplace?

Secretary PEÑA. In terms of percent, it has been going up.

Senator MCCAIN. Thank you.

Secretary PEÑA. Let me switch now to Asia, a booming part of the world's transportation economy. Clearly the most important market for us in Asia is Japan. It is the most valuable. We have 61 percent of the market in Japan; 57 percent in Hong Kong. You see Taiwan and Korea there.

Let me summarize—

Senator MCCAIN. Why is the U.S. marketshare so low in Taiwan and Korea?



Secretary PEÑA. In Taiwan and Korea, it is the function to some extent of the market and the extent to which our carriers want to proceed there.

Also it is a function of how well we can get our carriers to go into Japan, and then from Japan to go beyond Japan into other countries. And that is the discussion we are having with the Japanese right now.

Senator MCCAIN. So it has to do with market access.

Secretary PEÑA. Mr. Chairman, for those two countries we have open agreements, so that is not the restriction for those two countries.

To summarize, Mr. Chairman, how our carriers are doing in our six largest markets: Japan, 61 percent; Canada, 67 percent; the United Kingdom, 45; Mexico, 58; Germany, 58; France, 64.

And the last chart I want to show you is how we are doing in terms of the total international traffic for the United States.

You will see that from 1992 to 1994, total international traffic is going up from 75 to 79 to 84 million. Our percent of that is also going up, from 52.4 percent to now 53 percent of that international market.

So, Mr. Chairman, I guess the message here is that if you look at the results of our policies and the actions of our airlines, we are doing well in the international market.

Now, let me specifically address the United States-United Kingdom bilateral relationship. Despite considerable efforts, and I might add a great deal of frustration on my part, our attempts to achieve greater liberalization have not yet met with any great success.

It is widely known that ever since I became Secretary, I have not been satisfied with the air service agreement with the United Kingdom that I inherited. I have repeatedly said that it is our most restrictive air service regime with all of its restrictions on service frequencies, airports and carrier designations.

A brief review of our the history of our bilateral relationship with the United Kingdom underscores the difficulties with this relationship.

In the mid-1970's, the British renounced our aviation agreement, and the U.S. Government was confronted with reaching agreement on a new regime or facing reductions in service between our two countries.

In 1977, the U.S. Government reluctantly agreed to a restrictive and structured air service regime known as Bermuda II, which is fundamentally the regime that governs air service today.

During the 1980's, the United States was able to secure limited opportunities for a new service on a reciprocal basis, but stringent constraints remained.

This was particularly due to Annex II, which created a mechanical formula for setting frequencies that carriers are allowed to operate on each route.

Then in 1991, the United States was confronted with a need to replace our two carriers at Heathrow given the precarious financial condition of Pan American and TWA and their decision to sell their operating rights to London.

The British took this opportunity to require the United States to negotiate and pay for succession rights, an unprecedented step in bilateral history.

From these negotiations the British secured additional operating rights, including their current extensive right to code-share.

While the United States was allowed to replace our carriers at Heathrow with American and United Airlines, we did not obtain significant additional opportunities to offset the new rights obtained by the British.

In 1992, USAir and British Airways proposed a massive \$750 million investment and ownership proposal. When this administration took office, we made it clear that the original, massive investment package would not be approved because it did not comport with U.S. investment law.

British Airways and USAir broke the investment into three pieces, or tranches, in order to fall within the legal constraints, and current law gave them the right to tranche one, which we approved.

Obviously this package played a significant role in strengthening of USAir and its 40,000 employees and all the cities they serve. And it permitted British Airways to use the code-share rights they had secured long ago.

When we approved that arrangement, I indicated that I wanted to liberalize the bilateral agreement. I went to London to meet with Mr. McGregor, my counterpart at that time. We issued a joint statement committing to achieving a liberal aviation agreement within 1 year.

In early 1994, it became clear that the British would not liberalize the agreement because their desire to invest in USAir had waned in light of USAir's financial condition.

At that point, when it was clear they would not move forward, I considered renouncing our aviation agreement. But it was clear that the issue was so divisive that we could not get sufficient support from either our airlines or the cities. It was then that we began to consider incremental movements.

I continue to believe that step-by-step progress is achievable, and let me tell you why. It is very clear from the United Kingdom's perspective that they are not prepared to move toward a full open-skies agreement until the relationship between USAir and British Airways becomes stabilized.

We have two choices. One is to do nothing. The other is to attempt to make improvement incrementally, step by step, to get us to a point where we will finally achieve full liberalization or an open-skies regime.

With that background, let me review the current situation in the U.K. negotiations.

Mr. Chairman and members, as you know, the items under consideration in the package which is before the negotiators, are formalization of open rights for all U.S. and U.K. carriers between U.K. regional airports and the United States, greatly expanded code-sharing opportunities for all U.S. carriers, very limited access to U.S. government-financed traffic for the USAir-British Airways code-share alliance—and, by the way, our carriers have access to British government traffic—additional frequency authorizations for

British Airways in the Philadelphia-London market, and a Chicago-London operation for United Airlines.

Chicago is the largest U.S. gateway without authority for two U.S. carriers and is close to reaching the threshold of 600,000 annual passengers that would allow us to designate a second carrier. Clearly the elements of this deal have benefits for a number of U.S. carriers.

In addition, we have also discussed with the United Kingdom an agenda for the next round of talks and a timetable for beginning those talks.

The agenda items for that round would include the very significant items of cargo, pricing and charter liberalization, limited additional access to Heathrow and/or Gatwick for U.S. and U.K. carriers and additional access for U.S.-U.K. alliances to U.S. government-financed traffic.

While we would have preferred, and I have sought, to include some additional access to Heathrow and Gatwick in the first phase, that would have significantly imbalanced the deal in our favor, and the British could not agree.

Agreement of specific scope, limits or conditions on elements in the immediate package have not been reached, and therefore I do not want to discuss specific aspects of these elements at this time.

Rather I would like us to consider the nature of the package, how it comports with our policy as I have outlined above, and how it fits into our longer-term strategy.

First, the elements in this package are limited, particularly when compared to the overall level of service between our two countries and the revenue value of the U.S.-U.K. market, which is more than \$5 billion.

Second, the additional service and marketing opportunities will enhance competition in the marketplace and provide desired additional access to the international air transportation system for travelers and shippers.

Third, I will insist that the specific final elements provide a fair balance of benefits for the United States versus the United Kingdom.

The existing controversy surrounding the U.K. negotiations highlights a more generic problem that I want to address.

Ultimately every new agreement must be in the overall best interest of the United States, irrespective of a particular carrier. Let me repeat that. Every new agreement must be in the overall best interest of the United States irrespective of a particular carrier.

The fact that we have numerous international carriers with different service needs and different objectives makes it tougher for the U.S. Government to negotiate international air service agreements.

But we cannot allow, we cannot afford to allow the individual interests of particular carriers to obstruct meaningful progress for the United States as a whole and the benefits of expanded services for consumers and for our cities.

As long as the expansion of the marketplace represents a balanced movement forward between the United States and our bilateral partner and provides progress toward our ultimate goal of liberalization or open skies, we must be willing to move forward.

Our ultimate goal is complete liberalization of the international aviation market. Our commitment should be to the expansion of opportunities for our carriers and consumers at every opportunity as long as it is done fairly. That is the guiding principle for our negotiations, including those with the United Kingdom.

Mr. Chairman, in my opening comments with that rather long statement, I appreciate the time you have given me to present that information. I would be happy to try to answer your questions.

Senator McCAIN. Thank you very much, Mr. Secretary.

[The prepared statement of Secretary Peña follows:]

#### PREPARED STATEMENT OF FEDERICO PEÑA SECRETARY OF TRANSPORTATION

Good morning Mr. Chairman and Members of the Committee. I appreciate this opportunity to discuss one of the most important transportation and economic issues for the United States—international commercial aviation—and recent developments with respect to our efforts toward expanding and liberalizing our aviation agreement with the United Kingdom.

I welcome this opportunity because it enables us to examine where we have been, where we are today, and, most critically, where we are going with respect to international aviation. It is important that the discussion of any particular aspect of our policies or any individual negotiation be considered in the broader context of our overall goals and strategy for expanding services for the traveling public, for increasing opportunities for our aviation industry and the cities they serve, and for creating the most efficient and dynamic aviation system possible.

When I became Secretary of Transportation, the situation confronting us in international aviation was daunting. Major problems existed between foreign aviation partners and the United States, and the situation was getting worse. The French had renounced our bilateral aviation agreement, with the possibility that they could reduce services between our two countries at any time. The Germans had become exceedingly unhappy with our relationship and were threatening renunciation. Japan was indicating that it might take steps to limit our carriers from exercising their rights and to limit future growth in service.

No progress had been made despite countless rounds of talks with Canada about liberalizing air service in this, our largest international aviation and trade market. Overall, no new significant service opportunities were becoming available to our carriers. Furthermore, the United States was operating under a 17-year-old international aviation policy. We merely reacted to events out of our control.

Coupled with those problems, our aviation industry was experiencing disastrous financial results, particularly in the international sector. The United States had just lost two major airlines, including our dominant international airline—Pan American. Three more major airlines were in bankruptcy at the beginning of this administration. In 1992, the U.S. aviation industry recorded its third straight year of huge losses. In 1992, we saw an operating loss of \$2.4 billion. The international sector, which accounted for approximately one-fourth of our airline industry's business, was registering over half of this loss, \$1.3 billion. These financial results were weakening our industry and diminishing its competitive advantage in the international marketplace.

These circumstances did not bode well either in the short term or long term for U.S. international aviation interests. Something had to be done, and we immediately set to work on the problems.

Right from the beginning, this Administration worked to assist the recovery of the U.S. aviation industry. With the support of Congress, we established the Commission to Ensure a Strong and Competitive Airline Industry—almost immediately on taking office—and we have already acted on more than 80 percent of its recommendations:

The Administration took major steps to address the national deficit problem. The resulting economic recovery and period of expansion have done more than anything else to assist the economic recovery of the U.S. airline industry. In turn, our airline industry's financial recovery has strengthened its ability to compete in the international aviation market.

And we are seeing results: Last year more than 555 million passengers flew in the United States, up 8 percent from the year before. Revenues, traffic and load factors are all up. None of our major airlines is in bankruptcy. Most importantly, in the international sector, our industry has turned the corner and reported an operating profit of \$500 million for 1994, and the profit picture is improving further. Air-

line analysts project that 1995 will be a good year. Also, the U.S. share of the growing international market is up to 53 percent.

To anticipate the rapidly changing environment in aviation, we conducted the first comprehensive review of our international aviation policy since 1978. This culminated in the adoption of our International Air Transportation Policy Statement last November. In developing our policy statement, we placed considerable emphasis on evaluating the economic forces in the marketplace, how those forces are shaping the evolution of the industry, and how our policies should relate to those developments to enhance the opportunities and economic prospects for our industry, communities and the traveling public.

In one area—code-sharing—we undertook the first comprehensive study to understand the effects of this major marketing practice and to quantify the impact on competition in the market.

In our policy statement, we laid out our broad and fundamental policy goals and objectives. We announced initiatives that we would pursue to achieve those goals. And we indicated how we would respond to countries with differing levels of interest in liberalization and opening up market opportunities.

Our goal is to encourage the expansion of service in light of market demand and the development of the most efficient and competitive international airline operations. Enhanced competition and greater service opportunities will lead to significant benefits for travelers, shippers and communities, greater general economic development, and greater financial rewards for carriers and their employees.

We outlined more specific objectives designed to meet this goal and to serve as the basis for developing our positions for international negotiations. They include the following:

- Increase the variety of price and service options available to consumers;
- Enhance access of U.S. cities to the international air transportation system;
- Provide carriers with unrestricted opportunities to develop types of service and systems based on their assessment of marketplace demand;
- Ensure that competition is fair and playing field is level by eliminating marketplace distortions such as state subsidies;
- Encourage the development of the most cost-efficient and productive air transportation system that will be best equipped to compete in the global market at all levels and with all types of service.

Our stated commitment to these goals and objectives has provided the basis for us to pursue a number of initiatives that are already demonstrating the validity of our policy and bringing enormous benefits to the United States.

Today, our airlines are doing well in terms of share of the international aviation market. Regional maps showing our carriers market share in the largest country markets demonstrate this point. In the Western Hemisphere, our carriers have a strong position, particularly in the two largest markets—Canada and Mexico—which together account for half of the total traffic in this region. Our carriers have 67 percent of the Canadian market and 58 percent of the Mexican market. To Central and South America, our carriers have 60 percent of the traffic. In Europe, in the three largest markets—the United Kingdom, Germany and France—which account for two-thirds of all traffic between the United States and Europe, our carriers have almost 52 percent of the total traffic, with 45 percent of the British market, 58 percent of the German market and 64 percent of the French market. In Asia and the South Pacific, U.S. carriers have 61 percent of U.S.-Japan traffic, and this single market accounts for over half of the traffic from the Far East and South Pacific.

In February, we signed a breakthrough agreement with Canada that is immediately expanding service and fare options between our countries and will result in a fully open air service regime. Scores of new services have already begun. Every one of our major carriers has new services between the two countries. In short, there will be more service, greater efficiency and better fares. Consumers, cities, airlines and both nations all gain. Estimates of the value of this agreement to our economy have been in the range of \$15 billion per year.

We have also made progress in reaching open-skies agreements with nine European countries which will also allow our carriers unlimited access to provide direct service, either on their own or under a commercial arrangement with the foreign carrier, or indirect service under a code-sharing arrangement with carriers of third countries.

These steps have resulted in new opportunities for our airline industry. They will bring greater operating efficiencies for our carriers and enable them to maintain their competitive edge in the international marketplace.

Building on this progress, we have indicated our willingness and determination to pursue open skies and liberalization with other countries. As part of our 1994 agreement with Germany, we are committed to working toward an open skies agree-

ment with that major trading partner. We recently held talks with Poland. While no agreement was reached, significant progress was made and I remain optimistic about the liberalization of that market in the near future. And we continue to seek expanded service opportunities and reliance on market forces in developing regimes with the new governments in eastern Europe.

In Latin America our position has improved dramatically as that market has grown rapidly and our carriers have strengthened their position. We have just concluded an agreement with Peru which will allow for a substantial expansion of service between the two countries.

At the same time, despite enormous efforts, and I might add a great deal of frustration for me, some of our attempts to achieve greater liberalization of our international aviation markets have not yet met with any success. At the top of this list is the United Kingdom.

I believe that it is widely known that ever since I became Secretary I have not been satisfied with the existing air service agreement with the United Kingdom that this administration inherited. I have repeatedly said that it is our most restrictive air service regime, with all of its restrictions on service frequencies, airports and carrier designations.

A brief review of the history of our bilateral relationship with the U.K. underscores the difficulties with this relationship. In the mid-1970's the British renounced our aviation agreement and the U.S. Government was confronted with reaching agreement on a new regime or facing reductions in service between the two countries. In 1977, the U.S. Government reluctantly agreed to a restrictive and structured air service regime known as Bermuda II, which is fundamentally the regime that governs air service today. During the 1980's, the United States was able to secure limited opportunities for new service on a reciprocal basis, but the stringent structural constraints of the agreement continued to hamper the development of market-oriented service. This is particularly due to Annex II, which created a mechanical formula for setting frequencies that carriers are allowed to operate on each route. Then in 1991, the United States was confronted with the need to replace our two carriers at Heathrow given the precarious financial condition of Pan American and TWA and their decision to sell their operating rights to London. The British took this opportunity to require us to negotiate and pay for succession rights, an unprecedented step in bilateral history. From these negotiations, the British secured additional operating rights, including their current extensive right to code share. While the United States was allowed to replace our carriers at Heathrow with American and United, we did not obtain significant additional opportunities to offset the new rights obtained by the British.

In 1992, USAir and British Airways proposed a massive \$750 million investment and ownership proposal. When this administration took office, we made it clear that the original, massive investment package would not be approved because it did not comport with U.S. investment law. British Airways and USAir broke the investment into three tranches in order to fall within the legal constraints and we had no choice but to approve it. Obviously, this package played a significant role in the strengthening of USAir and its 40,000 employees and permitted British Airways to use code-share rights. When we approved the arrangement, I indicated that I wanted to liberalize the bilateral agreement and I went to London to meet with Mr. McGregor. We issued a joint statement committing to achieving a liberal aviation agreement within 1 year. In early 1994, it became clear the British would not liberalize the agreement because their desire to invest in USAir had waned in light of USAir's financial condition. At that point, when it was clear they would not move forward, I considered renouncing our aviation agreement. But it was clear that the issue was so divisive that I could not get sufficient support from our airlines and cities. It was then that we began to consider incremental deals.

The recent negotiations reflect our policy statement's recognition that there are countries like the United Kingdom that are unwilling to take major steps to open up our air service market. Our policy statement indicated that we would consider transitional agreements with a phased removal of restrictions and liberalization of the air service market or sectoral agreements, such as cargo or charter services. Both of these approaches are attempts to achieve some progress rather than allowing a service regime to stall and remain static.

We also recognized that we would have to address limited, ad hoc proposals for specific new services. These could be in the form of extra-bilateral authority or, as we are having to deal with pertaining to the United Kingdom, in the form of amendments to the existing bilateral agreement. In either case, our willingness to agree to such a proposal should be determined on the basis of the standards outlined in our Policy Statement. The applicable standards are:

- Whether approval will increase the variety of pricing and service options available to consumers;
- Whether approval will improve the access of cities, shippers and travelers to the international air transportation system;
- The effect of the proposed transaction on the U.S. airline industry and its employees; and
- Whether the transaction will advance our goals of eliminating operating and market restrictions and achieving liberalization.

With this background, I would like to review the situation with the U.K. negotiations. There are two aspects of this I would like to address. First is the appropriateness of the elements under consideration in the immediate package. Second is the effect of reaching agreement regarding a limited package of rights on the feasibility and timing of achieving our long-term objective of complete liberalization of the market.

The items under consideration in the immediate package are formalization of open rights for all U.S. and U.K. carriers between U.K. regional airports and the United States, greatly expanded code-sharing opportunities for all U.S. carriers, very limited access to U.S. government-financed traffic for the USAir-British Airways code-share alliance (U.S. carriers already enjoy access to British government traffic), additional frequency authorizations for British Airways in the Philadelphia-London market, and a Chicago-London operation for a second U.S. airline. Chicago is the largest U.S. gateway without authority for two U.S. carriers and is close to reaching the threshold of 600,000 annual passengers that would allow us to designate a second carrier. Thus, the elements of the deal have benefits for a number of U.S. carriers.

In addition, we have also discussed with the United Kingdom an agenda for the next round of talks and a timetable for beginning such talks. The agenda items for that round would include the very significant items of cargo, pricing and charter liberalization, limited additional access to Heathrow and/or Gatwick for U.S. and U.K. carriers and additional access for U.S.-U.K. alliances to U.S. government-financed traffic. While we would have preferred to include some additional access to Heathrow and Gatwick in the first phase, that would have significantly imbalanced the deal in our favor and the British would not agree.

Agreement on specific scope, limits or conditions on elements in the immediate package have not been reached, and therefore I do not want to discuss specific aspects of these elements at this time. Rather I would like to consider the nature of the package, how it comports with our policy as I outlined above, and how it fits into our longer-term strategy.

First, the elements in this package are limited, particularly when compared to the overall level of service between the two countries and the revenue value of the U.S.-U.K. market, which is more than \$5 billion. Second, the additional service and marketing opportunities will enhance competition in the marketplace and provide desired additional access to the international air transportation system for travelers and shippers. Third, I will insist that the specific final elements provide a fair balance of benefits for the United States versus the United Kingdom.

That leaves the issue of how agreeing to a short-term package affects our ability to achieve our longer term liberalization objectives. The British position is that they are unwilling to move forward to talks on other areas until the short-term package is agreed. Our position has been that, even if agreement on the immediate package elements is reached, we will not accept the deal unless there is commitment by the British on the agenda and dates for the next round of talks. The British have generally agreed to the agenda items and indicated a willingness to agree to dates for starting second-round talks.

The existing controversy surrounding the U.K. negotiations highlights a more general problem that I would like to address.

Ultimately, every new agreement must be in the overall best interest of the United States, irrespective of a particular carrier. The fact that we have numerous international carriers with different service needs and objectives makes it tougher for the U.S. government to negotiate international air service agreements. The process naturally is more contentious. But we cannot afford to allow the individual interests of one particular carrier to obstruct meaningful progress for the United States as a whole and the benefits of expanded services for consumers and cities. As long as the expansion of the marketplace represents a balanced movement forward between the United States and our bilateral partner and it provides progress toward our ultimate goal of liberalization or open skies, we must be willing to move forward.

Our ultimate goal is complete liberalization of the international aviation market. As we stated in our International Air Transportation Policy Statement attempts to slow down or resist the movement toward the development of aviation systems and

markets driven by economic factors in order to enhance or protect the competitive position of individual carriers will not succeed. Countries that are not willing to move forward and expand opportunities for their carriers are going to be left in the dust. In the long run, those countries that do not seize opportunities to expand operations for their carriers will weaken the competitive position of their carriers. Our commitment should be to the expansion of opportunities for our carriers and consumers at every opportunity as long as it is done fairly. That is the guiding principle for our negotiations, including those with the United Kingdom.

Senator MCCAIN. Senator Ford.

Senator FORD. Are you going to let me go first?

Senator MCCAIN. In deference to your age and experience and knowledge. [Laughter.]

Senator FORD. Well, you left out one thing, money, and you have all that. [Laughter.]

Senator FORD. Mr. Secretary, after your discussions with the British that have now gone on for a number of years—they are pretty good dancers, otherwise negotiators. We have had a long dance.

And there has been a little movement forward. What really do you expect to achieve in phase two? How much additional access to Heathrow and service to others can we anticipate?

Secretary PEÑA. Senator, what has been discussed is some more access to Heathrow and/or Gatwick. We have not yet determined, because we have not had the negotiation, how much access.

It will not be the full liberal access that we would ultimately like to achieve with the United Kingdom. But it will be some access.

Senator FORD. By concluding the so-called open-skies arrangement with one of our largest aviation partners, Canada, you were able to succeed where others before you had failed.

And in concluding that agreement the United States established a specific, clearly defined timeframe for moving to a total liberalization of air service.

Yet with the United Kingdom the United States seems to be prepared to agree to incremental deals without a specific well-defined plan to move toward open skies.

Now, why has the United States allowed this to happen and when do you plan to establish a timetable with United Kingdom similar to the one concluded with Canada?

Secretary PEÑA. Well, Senator, it has been one of my most vexing problems. As you will recall, very early in our discussions with the United Kingdom we did set a timetable. We said publicly that we would attempt to reach an open-skies agreement, or a liberal agreement, within a year.

Unfortunately, what happened in those discussions was the development of a somewhat difficult financial situation for USAir, and that then discouraged the British, and very specifically British Airways, from having any continued interest in making additional investments in USAir.

That had been the impetus, frankly, for the United Kingdom for moving forward somewhat aggressively on the bilateral.

As I said in my opening statement, because British Airways is now taking a wait-and-see attitude for the financial condition of USAir to become more stable, the British Government has correspondingly backed off a very aggressive timetable for full liberalization.



Obviously we want to continue to press them to agree to a very specific timetable on full liberalization, but it is clear that they are going to continue to observe the situation between USAir and British Airways.

So in the meantime we are going to continue to press these additional steps, but obviously get there as quickly as possible.

Senator FORD. Are you telling this committee then that the problems with British Airways and USAir—what are they pressing for, more than the 25 percent? Do they want to go beyond the law and take over USAir? Why is it they are so adamant about everything else based on this one investment?

Secretary PEÑA. Senator, they have made a \$300 million, and that was leveraged up to a \$400 million investment in USAir. This is British Airways. You may have read very recently where British Airways had to write off that investment because of that relationship.

Obviously they are being very thoughtful about making any more investments in USAir until that stabilized. But that has been the major motivation for the United Kingdom in agreeing to movement.

Ultimately, British Air would like to move forward with tranches two and three, which we denied over a year ago, which would allow them to make additional investment in USAir. And, yes, they would want the law on ownership changed to allow for up to a 49-percent ownership of a U.S. carrier.

That cannot happen until the Congress amends the current law which limits ownership to 25 percent.

Senator FORD. Let me try to get around to a point here. Recent studies conducted by your department and GAO indicate that the major reason for the success of the KLM-Northwest alliance lies in the ability of four carriers to coordinate their efforts without the threat of prosecution under U.S. antitrust laws.

Is it the department prepared to grant other pro-competitive international airline alliances the same antitrust immunity currently enjoyed by KLM and Northwest?

Secretary PENA. Senator, the provision of antitrust immunity is obviously a very complicated and controversial aspect of U.S. law. However, we are thoroughly evaluating that provision with the Justice Department.

We hope to complete our analysis in the near future. We have not yet formally received an application by any of our U.S. carriers to grant antitrust immunity as was the case with Northwest and KLM.

So at this point we do not have a position one way or another, but we are evaluating that provision and trying to determine how best we can use it as a strategic hook in encouraging countries to open up their markets to an open-skies agreement.

Senator FORD. Mr. Secretary, as the chairman has said, Senator McCain, that in this area our passenger load has declined and continues to decline. Where the passengers are increasing our percentage is declining. And I think the share of the U.K. market has declined from 49 percent to 46 percent last year, dropped 3 percent.

We all know that access to Heathrow is critical, and we cannot wait years, in my opinion, for additional access. And what disturbs this senator is that access for other countries to Heathrow appears

obtainable. Twenty-two countries have gained access to Heathrow since 1992.

Why not grant the U.S. rights to Heathrow? Why not? Twenty-two other countries can do it. We sit here and it seems to be that we want to have the long dance instead of putting it all together.

I am concerned about these mini-steps, however you want to—the short steps and the long dance. Why can we not put all the package together and say here it is and lay it out on the table—they are coming back in June—and see why we cannot get after them.

It seems to me that we just keep nibbling, and it is clear there are rights that the British seek in the mini-deal.

I have watched the British for a good many years, and I have been trying to keep up with this. You and I carried on a long correspondence last year. I see your legal counsel shaking his head.

And we have already signed letters and I have returned to my pen-pal relationship with you, Mr. Secretary. I hope you read the letters, and sometimes between the lines.

Given the market share statistics in the favor of the British, what is it the British want? I could ask a lot of questions, fly American traffic, maybe.

Competition for British Airways in America to Chicago, doubtful. Philadelphia—London, oh, yes. Starburst rights out of Heathrow for U.S. carriers, unlikely.

What is it they really want? Is it just their financial interest in USAir that seems to be clogging up the whole operation?

It bothers me considerably that an investment by the British in an airline in our country stymies the negotiation between two countries. They made a bad deal. So what. That should not regulate all of the negotiations you have.

I do not have any more questions, Mr. Chairman. I want to listen to the airline executives that are coming in here after that, and I have some questions for them that might relate to it.

Mr. Secretary, you meet June 1 and 2?

Secretary PEÑA. That is the tentative schedule.

Senator FORD. What are your prospects then, just to continue where you are and not—

Secretary PEÑA. No—

Senator FORD. To mini-deal and—

Secretary PEÑA. Let me answer the last question, Senator and then I would like to come back to the first point that you made.

Senator FORD. You can do anything you want to.

Secretary PEÑA. I would like to respond to both points. Our general understanding in our discussions is that we would agree on completion of the first phase of these negotiations. But before they would become final we would have to agree on the agenda for the second phase of the discussion.

Senator FORD. And a timetable.

Secretary PEÑA. And a timetable for those. So that is part of the discussion. We have not yet gotten to that point yet.

But let me answer your first question, Senator, because I think you have really asked the most important question. And it is the same question that I have been asking myself now for 2 years.

What is it that the British want. Frankly, they do not need anything.

Let me emphasize that. If you take the current aviation agreement that was signed years ago and we do nothing, I predict they will continue to gain a larger and larger percent of our international aviation traffic.

So there is not any impetus. There is not any pressure on the British to do much. They are in a wonderful position right now because of an agreement that was signed years ago.

So we have tried to find a way to work with them in a constructive fashion to try to at least rebalance the agreement step by step. That is what we have attempted to do.

It is interesting that a year ago when we took the position that we should try to have a much broader agreement as you have suggested, combine the first agreement and the second, the first negotiation and the second negotiation into a very large agreement, we encountered a problem.

A number of our airlines, and I have a letter here which I will not read, I will give you copies, from six of our airlines saying: don't do that. Don't try to do the entire deal. Do it step by step.

Now, after having spent some time with the British, understanding their motivation, and I talked about the problem with USAir, I have become convinced that the only way we are going to make any progress is a methodical step-by-step process, to continue to move us forward and to begin to generally rebalance the agreement which now is in imbalance.

That is my judgment after having spent a lot of time on this. And at this point, after all the other approaches we have taken, we think this is the one that has the most promise.

Senator FORD. Is it true that 40 percent of the tourists that fly to Europe or Great Britain and so forth return on another airline, a foreign airline?

Secretary PEÑA. Senator, we would be happy to answer that question specifically—

Senator FORD. Well, I think I am approximately right. And one of the reasons is the similarity in safety—that word “similar”—and the foreign carriers do not go through all the things that we require our American airlines to do.

And I think something has to be done for safety if nothing else, because it is costing our carriers tens of millions of dollars annually to put in the same safety functions we require here, we do not require of the foreign air carriers.

And where their time is short, our time is long. There are a lot of things that bring 40 percent of those that fly to Europe or Great Britain or wherever, that 40 percent of those fly back on a foreign air carrier and not with the American carrier.

And just little things that you do. And if you need to change the word, I will be more than happy to try to work with folks up here to change the word.

Thank you, Mr. Chairman.

Senator MCCAIN. Thank you. Mr. Secretary, I just want to ask one question before turning to Senator Stevens.

The real question here is, and it will be raised by the other witnesses, you are about to make a “mini-deal,” which in the view of

most observers is an advantage to British Air and Virgin Atlantic, since they are achieving most of the goals that they seek by this first mini-deal.

What will be the incentive, therefore, for the British to make future concessions and enable us to achieve the goals that we seek if you, in the description of some, basically give away to the British what they seek in the first round?

What assurance and what confidence do you have that if you make this agreement that the British might say, "Yes, we will be glad to talk to you," but because there is no incentive for the British to make further concessions to us to open their skies to American airlines?

Secretary PEÑA. Senator, let me respectfully disagree with the characterizations that others have made about the phase one negotiations. We do economic analysis of these agreements, and we very strongly believe—

Senator MCCAIN. Can you provide those economic analyses to the committee, please?

Secretary PEÑA. Mr. Chairman, we would be pleased to provide the analysis in confidence. I know the chairman will assure that. Obviously we are in the middle of negotiations, we would not want those analyses to be made public.

But our economic analysis indicates that the agreement that we have on the table with the British would be in our interest. It is balanced, but it is in our interest. I would never agree to any proposal that is not in our best interest.

We think that movement on the second agreement, at least as it is currently described, would also be in our best interest.

And that is what I have said in my statement and in our international aviation policy, that the decisions we will make must be in the overall best interests of the country and move the effort to fully liberalize the agreement forward.

Senator MCCAIN. Thank you, Mr. Secretary, but that is going to be the crux of the argument that a number of witnesses are going to make today.

Senator STEVENS.

Senator STEVENS. Thank you very much, Mr. Chairman. You are very kind to move on fast, and we are lucky that this vote has been delayed.

Mr. Secretary, if you had those charts up here 10 years ago Alaska would have had a spot on your chart. Because of the change in the traffic over the Soviet Union we have sort of dropped off the charts, and that bothers us considerably.

Our Alaska airports have wanted to encourage foreign carriers to hub cargo in Alaska. And, as a matter of fact, in 1990, your department wrote our former Governor and indicated a willingness to support that concept of cargo hubbing. It really was a specific authority to have inbound in-transit cargo transfers at Anchorage and Fairbanks.

Since we have been very hard hit in this situation because of the opening of Russian air space and also the 747-400's fly from Chicago directly into the Orient now, we are very interested in whether your department would support a concept of allowing the devel-

opment of that kind of hubbing in a cargo area. Have you looked at that?

Secretary PEÑA. Senator, we have. And let me have Mr. Murphy go into more detail. But let me first address the concern about Alaska.

We have been very concerned about Alaska, and as you know we recently reestablished the agreement with the Russians, that they will land in Alaska and not forego Alaska as they had been suggesting otherwise.

As respects cargo, let me have Mr. Murphy address that question.

Mr. MURPHY. Well, I would also like to point out, Senator that several years ago the department began a policy of offering to our foreign partners, whenever we meet them, the opportunity to land or operate to Alaska.

So we are making that offer available to any foreign government who would like to operate there.

With regard to cargo hubs, we would be happy to work with the Alaskan authorities. We are working with some other authorities around the country to see whether we can develop inter-modal or air cargo hubs.

Senator STEVENS. I think it would be very important to us if that could happen. Because of our geographic location the cargo operation seems to be our future, because passenger operation is entirely different economics.

Let me switch to another thing, Mr. Secretary. I know of my own knowledge of a group of my friends who were going to go to London and then to Paris, and they have had a rather sweetheart deal offered to them by the Concorde group, the British, to fly into Paris, and they threw in a round trip over to London and back.

I want to mention that in connection with these statistics that we have received. The Civil Aviation Authority in London showed that for the full calendar year in 1993, the Chicago-London non-stop passengers exceeded the 600,000 mark that is in the agreement. But as soon as that happened for a year, it has been totally down now for a year.

Does that drop-off not give you pause to believe that there is sort of a manipulation of the traffic in and out of London so in fact the agreement that we have had under Bermuda II is not triggered to give us the extra airline access into that route from Chicago to London?

Secretary PEÑA. Well, Senator, I want to be very thoughtful in answering your question because certainly I do not want to make any allegations about the conduct of others. But let me say that generally speaking I think those of us in the U.S. Government and those in the United Kingdom Government have observed that trend that you describe.

And I think it is because of that concern that the United Kingdom has been willing to, in a sense, accelerate that provision in the agreement that says that if you reach 600,000 2 years in a row another airline can fly out of Chicago.

The United Kingdom is basically saying: let's deem it having reached the 600,000 mark. And that is why they have offered to include it in the first round of these discussions.

So there is a sense that perhaps it is now time for Chicago to have two airlines.

Senator STEVENS. My point is that if we had had the statistics any 1 month, as I understand it, in 1994, over 600,000, we would have had another free access and you would be negotiating for a second one now.

Now you are negotiating for the first one which we would have had if any 1 month had continued the trend of 1993.

Then we would have had two consecutive calendar years in which we had exceeded the 600,000 and, therefore, there would have been an additional route into this market.

Now, I join you, I am not going to make allegations about a conspiracy or anything, but it does seem sort of strange that the Chicagoans reduced their enthusiasm to travel to London, but they increased their enthusiasm to travel to France during 1994.

And I believe we have lost the concept of having an additional route because of that change in the traffic pattern.

But I do not know whether you have studied what happened to the Chicago-France, Chicago-other portions of Europe traffic during the period that it dropped off on the London route. Did you do that?

Secretary PEÑA. Senator, we are very much aware of the traffic because we obviously were hopeful the 600,000 figure could be reached.

And there is a discussion here between Pat Murphy and me about whether it is for 24 months or 12 months and a month.

And you are going to have a panel which will be discussing this in a while, and I would be curious to see what their interpretation is of that traffic change.

Senator STEVENS. The vote is on, so I better just quit.

But let me just read—I am just reading that portion of the Bermuda II agreement “Provided the total on-board passenger traffic carried by the designated airlines of both contracting parties in scheduled air service on a gateway route segment exceeds 600,000 one-way revenue passengers in each of two consecutive 12-month periods.”

It did not have to be total for two 12-month periods, having exceeded it for 1 year, all it took was 1 month and we would have had a second route, as I understand it. That sort of disturbs me as I looked at this. I just hope you will continue to deal with open skies.

Open skies has left our state sort of a by-way with two massive international airports that were there because the air space across the Soviet Union. Then for a while, Russia was closed.

Now that it is open, the Asian traffic is going obviously on the shortest route, and we are back now searching for a future as far as aviation is concerned.

I appreciate your cooperation, and we do appreciate the fact that the Russian landing agreement has been renewed. I think that is very important for our relationships with Eastern Russia and Alaska, and we are grateful to you for that.

Thank you very much, Mr. Chairman.

Senator MCCAIN. Thank you.

Dan, could I ask your indulgence? Senator Hutchison has a burning comment that she would like to make.

Please, go ahead just before we have to take a recess.

Senator HUTCHISON. I did not mean that I wanted to go out of order.

Well, I am concerned about your statement, Secretary Peña, and I want to thank you for the access that you have given the senators on this issue and for delaying your meeting last week so that we could have some input. I really do appreciate that.

But I was concerned about your statement that the British do not really want anything and if we just do nothing that they have an advantage. It seems to me that at one point Fly America was on the table with increased access to Heathrow.

And now we seem to have a two-phase step and Fly America is really the biggest thing that the British want. I am told that it is worth about \$134 million.

And while they do allow access of our government employees on British Air, nevertheless, that is not half what they would get by having Fly America.

So it seems to me that there is something that they want, but if we do not have parity of issues, increased access to Heathrow with Fly America, we really will lose our leverage. Could you comment on that?

Secretary PEÑA. Senator, I will. Let me restate what I said earlier. Remember the significant increase in the market that the British, in particular British Airways, have achieved without any difference or amendment in the agreement. They now are up to 55 percent of the market, and over time they will even get more of that market.

That is what I mean about the lack of real pressure or motivation for the United Kingdom to change its relationship. They are doing very well under this old agreement.

Now, would they like to have additional things? Yes. Our view is, to the extent they would like to have additional things, we need to rebalance this agreement in the process by putting on the table things that we think are very important from an economic impact analysis, and that is what we do.

Originally, they had suggested a Fly America provision where British Airways alone would be able to bid for the Fly America traffic. We have denied that.

We have said they must use the same relationship that United-Lufthansa, KLM-Northwest uses, that any other U.S. carrier that has a code-sharing relationship must use.

So USAir must be the bidder, and the ticket must be on a USAir ticket. In that very limited Fly America provision they can bid, and not necessarily win, just simply have a right to bid for the Fly America traffic as do those other code-sharing companies that are now bidding for that traffic.

Senator HUTCHISON. Well, I would just say that I think that USAir ticket is a distinction without a difference. We are talking about giving them the one thing that will really enhance their ability to have access in America.

They are going to fly American government employees, which is worth about \$134 million by our calculation, and it is the one thing that we have as leverage.

On the other hand, I think everyone by any standard believes that we are being docked of access to Heathrow from many cities in America.

As I said earlier, there are three of the top ten cities in America in my State, one of whom has the second busiest airport in America, that does not have—we have no access for my constituents to Heathrow and, therefore a gateway into other places.

So I do believe that there is one point of leverage, and if we give it away without demanding that we have sort of parity into Heathrow, we really will be at a severe disadvantage.

Secretary PEÑA. Senator, I agree, if that were the case. But that is not the case. First of all, let me say that we have a much different analysis of the value of the limited Fly America provision that we have put on the table for the first phase of the negotiation.

We have, as you know, said that in the second phase of the negotiations we would be willing to consider some expanded Fly America provisions, again within the context of the code-share relationship.

But at that time the access to Heathrow and Gatwick has to be on the table. So we think that we are approaching this in a methodical fashion, again making sure that the economic equivalency is positive in our favor every step of the way.

Senator MCCAIN. Mr. Secretary, can I ask if you would come back in 45 minutes?

Secretary Peña. I can do that, I think, Senator. Let me just check my schedule, but I will do my very best.

Senator ROCKEFELLER. Mr. Chairman, we are having a welfare reform markup in finance. I am unable to come back, but I have questions for three of the witnesses.

Can I submit those for the record?

Senator MCCAIN. Without objection.

Secretary PEÑA. Mr. Chairman, if for some reason I cannot come back, because I have not checked my schedule, obviously Mr. Kaplan and Mr. Murphy will be here. They know all about this issue and would be happy to answer any questions.

Senator MCCAIN. Dan, did you have questions for the Secretary?

Senator INOUYE. If I may, may I summarize what I think you have said. That the issue before us is do we proceed with the phased mini-deal approach or a maxi-deal approach.

Your conclusion is that, from your background and experience and history, with the mini-deal there is a potential for success, with a maxi-deal it is a stalemate.

That being the case, there are some who support the mini-deal, others do not, because the ones who do not support the mini-deal may benefit from a stalemate. Is that a proper conclusion?

Secretary PEÑA. Senator, you have been very perceptive. [Laughter.]

Senator INOUYE. Second, I believe there is an issue involved here that no one has mentioned. There are some who are suggesting that the negotiations should be taken out of DOD and the State



Department and placed in the U.S. Trade Representative What are your thoughts on that?

Secretary PEÑA. The administration is opposed to that, Senator and I have given you a presentation this morning that demonstrates what we have been able to accomplish just in 2 years.

I think it is a remarkable record. The best evidence of that is our market share of North America, Europe, and Asia. We have some problem areas we have to work on, one is the United Kingdom, and we are doing our very best to advance our interests in that market.

Senator INOUE. And finally, if I may make an observation, I believe the sudden rise in the French traffic was Normandy.

Senator MCCAIN. Mr. Secretary, I would like to exercise the prerogatives of the chair and say that you do not have to come back. I do not want to put this kind of imposition on your time. The taxpayers, I think, make too big an investment in you.

I have a number of additional questions. I am deeply concerned, obviously, as are other members of this committee, but I think that what you provided the committee is sufficient testimony. And I appreciate your being here.

When we come back we will proceed with the next panel of witnesses.

Thank you very much, Mr. Secretary.

Secretary PEÑA. Thank you very much, Mr. Chairman.

[Recess.]

Senator MCCAIN. Mr. Mead.

**STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE**

Mr. MEAD. Our code-sharing report illustrates how the United States in 1991 granted British carriers extensive access to the United States via code-sharing.

At the time, there was little economic analysis of the value of code-sharing. British Air has greatly increased its access to the U.S. market and improved its competitive position as a result.

Mr. Chairman, I think you have a chart in front of you.

Senator MCCAIN. Yes.

Mr. MEAD. Page one of the chart shows the "before" the code-share alliance, and page two shows the "after". And as they say, a picture is worth a thousand words. And this is a case in point.

I think you will recall, Mr. Chairman, that we cited a similar lack of analysis in DOT's approach to approving domestic mergers in the mid-80's. To its credit, over the last several months, DOT has heightened the emphasis that it places on economic analysis. But several problems persist that will handicap that new office. By placing a proper emphasis on economic valuation, DOT will be on a better footing with its foreign counterparts than it was in 1991.

I was going to spend some time on illustrating the importance of international operations to U.S. carriers, but the attendance today explains why that will not be necessary. But it is within a framework of increasing dependence on international revenues that the so-called mini-deal with the United Kingdom is being negotiated. This occurred subsequent to our study. We have been briefed on

this deal by the DOT, but we have not seen the underlying analysis of the agreement or the data on which it relies. So we are not in a position to comment on whether the overall package produces a net benefit for U.S. airlines and consumers.

But our code-sharing and other work does bear on most elements of that deal. And if I might, I will quickly overview each of the five principal elements of it.

The first element is the extension of the British Airways–USAir code-share agreement. We found in 1994 that the USAir–British Airways code-share produced over \$100 million in revenue for British Airways and \$20 million for USAIR. The gains accruing to the British came largely at the expense of other U.S. airlines. Those gains, we believe, are likely to grow.

British Air currently has authority to code-share in 68 U.S. cities. The deal would add 72 cities to that list. The U.S. market share on U.S.–U.K. routes has fallen from 50 percent in 1992 to about 45 percent in early 1995 in part due to the success of this alliance.

It ought to be emphasized that the right to unlimited code-sharing within the U.S. was given to the British in 1991. Thus, rejection of the code-sharing arrangement that is now being proposed as part of this mini-deal would almost certainly be viewed by the British as inconsistent with the bilateral.

The *second element* of the mini-deal is the Chicago–Heathrow authority for United. The last chart in this package illustrates the importance of Heathrow Airport. I believe what is interesting about this particular graphic is that it shows that Heathrow handles more international traffic than any other airport in the world. Forty-four million of the 51 million passengers at Heathrow are international. Roughly 6 million of Chicago O'Hare's 66 million are international.

Moreover, most lucrative customers for airlines, the business travelers, prefer Heathrow over London's other airport, Gatwick, by a factor of seven.

The benefits accruing to United from this provision of the proposal will largely be diverted from two airlines, and they are American and British Air. But the introduction of a third carrier in that market would in fact increase competition and thereby benefit consumers through lower fares and increased service.

A key question remains though—I think this was raised by Senator Stevens earlier, and that is, is the United States trading for a right that it is going to get eventually anyway? The bilateral calls for new entry when traffic in a specific city-pair market exceeds a certain threshold—that is the 600,000 passenger number you heard earlier. In the Chicago–London market, we have been close to that threshold for some time now. And if exceeded, United would be allowed to enter that market without the proposed mini-deal.

*Element three* is added Philadelphia–Heathrow authority for British Airways. This is important because most USAir–British Air code-share traffic connects through Philadelphia. That provision can be expected to take traffic away from U.S. carriers that serve London from the New York–Philadelphia area, particularly Continental. Continental is, in some ways, out in the cold here; that is because Continental is the only carrier that serves London from

the New York-Philadelphia region that cannot serve Heathrow. Continental must go to Gatwick.

The *fourth element* is unlimited code-sharing rights beyond each country. The correct valuation of this provision, commonly referred to as the "starburst" provision, is the crux of the current debate.

Although it is potentially the most valuable provision for the U.S. airlines, the benefits are not nearly as immediate nor as certain as those for British Air at Philly or the negative impact on American at O'Hare.

That so-called starburst provision essentially gives U.S. airlines unlimited rights to code-share beyond Heathrow. Our analysis of the current code-share alliances indicates that the potential competitive impact of this could be substantial. That is because nearly one-third of the traffic at Heathrow is destined for some other place.

The ability to utilize these new rights, though, will depend on whether third countries will say OK, and whether additional code-sharing alliances between United States and other carriers will be created.

I am sure the airline panel will be much more eloquent than I can be on this, as there may not be too many other code-share partners left.

And finally, the *fifth element*, the Fly America rights. This is probably the most uncertain part of the deal, as we understand it. But in terms of traffic diversion to foreign airlines, the economic impacts of that provision would likely be small in relation to other elements of the package. British Airways will basically be allowed to bid on the right to carry U.S. workers between two U.S. gateways and London.

I would like to say a few words about the data limitations we found. First, code-share traffic on U.S. airlines are not identified in DOT's data base. Second, traffic is not always reported accurately with respect to the carrier that even operated the flight. And third, no data are collected on code-share traffic traveling to and from the United States exclusively on foreign carriers.

These limitations, Mr. Chairman, also prevent DOT from determining the impact of code-sharing on fares.

Three of the five provisions in this package involve code-sharing: (1) Automatic extension and expansion of the code-share alliance; (2) increasing British Airways' presence at its main code-share connect point; and (3) the starburst provision.

I should also point out, as we noted in our report, that antitrust immunity has become a most important ingredient of the success of the KLM-Northwest arrangement. Such immunity is now being requested by other Nations. Perhaps the Secretary does not have formal applications for immunity yet, but they may be on their way. And the value of antitrust immunity will need to be carefully and accurately assessed before we agree to extend it to other nations or renew it, in the case of Northwest-KLM.

And a final and most important issue when considering this current proposal is to ascertain what incentives the British will be left with to provide opportunities for other U.S. airlines to serve Heathrow. That concludes my summation, Mr. Chairman.

Senator MCCAIN. Thank you very much, Mr. Mead.

United States General Accounting Office

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**GAO**

**Testimony**

Before the Subcommittee on Aviation,  
Committee on Commerce, Science,  
and Transportation  
United States Senate

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**INTERNATIONAL  
AVIATION**

**Better Data on Code-Sharing  
Needed by DOT for  
Monitoring and  
Decisionmaking**

Statement of Kenneth M. Mead,  
Director, Transportation Issues,  
Resources, Community, and Economic  
Development Division



Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on international aviation issues. International operations are increasingly important to U.S. airlines, representing 27 percent of their traffic today compared with 21 percent in 1980. Over the last few years, we have reported on a range of issues affecting international aviation, including our recent report on code-sharing alliances between U.S. and foreign airlines, restrictions on foreign investment in U.S. airlines, problems that U.S. airlines encounter in doing business at airports overseas, and efforts by the European Union (EU) to deregulate air travel between member nations.<sup>1</sup> Many of these issues coalesce in the United States' relationships with its major aviation trading partners, particularly the United Kingdom, and have contributed to the difficulty in achieving more liberal agreements with those countries. Our testimony is drawn from our body of work in this area, in particular our findings concerning code-sharing's competitive impacts.<sup>2</sup> In summary,

-- Bilateral agreements between the United States and 72 nations often greatly restrict an airline's ability to serve foreign markets. In large part, airlines of one nation investing in other countries' airlines during the late 1980s and early

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<sup>1</sup>International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain (GAO/RCED-95-99, Apr. 6, 1995), Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines (GAO/RCED-93-7, Dec. 9, 1992), International Aviation: DOT Needs More Information to Address U.S. Airlines' Problems in Doing-Business Abroad (GAO/RCED-95-24, Nov. 29, 1994), and International Aviation: Measures by European Community Could Limit U.S. Airlines' Ability to Compete Abroad (GAO/RCED-93-64, Apr. 26, 1993).

<sup>2</sup>Code-sharing is the practice whereby one airline lists another airline's flights as its own in computer reservation systems, which are used by travel agents to book flights.

1990s and the tripling of code-sharing alliances since 1992 are efforts to secure indirectly what airlines are having difficulty getting directly--greater access to international markets. The U.S. accord with the United Kingdom, for example, allows only American and United to serve London's Heathrow Airport--the largest gateway to Europe, Africa, and the Middle East. As a result, Delta pursued the next best alternative and recently began code-sharing on Virgin Atlantic flights to and from Heathrow.

- We found that code-sharing is an effective strategy for airlines to access traffic to and from cities that they did not previously serve because of (1) bilateral restrictions or (2) the economics of serving those cities with their own aircraft. The alliance between Northwest and KLM, for example, has increased their combined annual traffic by about 350,000 passengers and produced about one-third and one-fifth of their transatlantic passenger revenues respectively in 1994--gains largely achieved at the expense of other U.S. and foreign airlines. However, code-sharing has potential downsides. The increasing success of several alliances may allow them to preclude other airlines from entering markets--even though those airlines have the bilateral right to serve those routes. Likewise, code-sharing may frustrate DOT's efforts to achieve "open skies" if airlines increasingly use it as a substitute for direct access to cities to which they would like to fly. This would reduce the pressure on foreign nations to increase direct access for U.S. flights.
  
- Given its effectiveness, code-sharing will play a prominent role in bilateral negotiations for the foreseeable future and any increased rights of direct access or relaxation of foreign investment limits will likely be linked to the value that governments and airlines place on code-sharing. We found, however, that DOT's capabilities to quantify and assess such

issues as code-sharing were often greatly limited compared to its foreign counterparts. To address this, DOT created a new economic unit in November 1994. However, the new unit will be hindered by data limitations, such as a lack of detailed data on foreign carriers' code-share traffic traveling to and from the United States. As we reported, DOT could remedy this by, among other things, requiring that (1) U.S. airlines, as part of their regular reporting of traffic data to DOT, identify which passengers traveled on code-share flights and (2) foreign airlines involved in such alliances with U.S. airlines report data on their code-share traffic to DOT.

- Data problems handicap DOT's efforts to place a value upon the access rights to the U.S. market that it relinquishes to foreign governments in exchange for improved access or code-sharing rights in foreign markets. Thus, the agency is limited in its ability to ensure the (1) protection of consumers' interests, (2) equitable treatment of competing U.S. airlines in negotiating for and awarding limited access rights, and (3) most effective use of its negotiating leverage--accommodating foreign airlines' desire to serve the U.S. market. Likewise, it is hindered in its ability to place a value on other factors that may be negotiated during bilateral talks. For example, DOT granted Northwest and KLM immunity from U.S. antitrust laws in conjunction with the 1992 "open skies" accord with the Netherlands.<sup>3</sup> Immunity allows Northwest and KLM to jointly develop fares and integrate operations without fear of legal challenge. However, DOT has not assessed the value of immunity to foreign carriers or determined whether it should be available to other alliances

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<sup>3</sup>The antitrust laws prohibit contracts and agreements that restrain trade. This would include agreements between competitors to set prices.

when the other nation allows for significantly increased access to its aviation markets.

In the past few months, DOT has made some progress in opening foreign markets, such as reaching an agreement with the Canada that greatly increases U.S. airlines' access to the Canadian market. Nevertheless, DOT continues to face several fundamental challenges, such as negotiating for increased access to restricted markets with nations that are often protecting one or two national carriers. By improving its ability to quantify the value of direct access and code-sharing rights and to analyze emerging trends, DOT will be better positioned to negotiate with its foreign counterparts, such as the British, and reach agreements that yield maximum benefits for consumers.

#### BACKGROUND

In contrast with the relatively mature domestic market, international service has been a key growth area for U.S. airlines. Between 1987 and 1994, the number of passengers flying on U.S. airlines internationally increased by 53 percent while domestic traffic increased by only 15 percent. The airlines' ability to further tap this potential is restricted by most of the 72 bilateral agreements between the United States and other countries--a situation unlike the domestic market where airlines' decisions concerning routes, flight frequencies, and fares are deregulated.

DOT has attempted to "export" our deregulated environment by working with foreign nations to eliminate bilateral restrictions. It has achieved mixed results, concluding agreements with Canada and several smaller countries that substantially reduce or eliminate restrictions. However, most major U.S. aviation trading partners, including the United Kingdom and Japan, have maintained--and in some cases added--extensive limitations on U.S. airlines' access to and beyond their markets. Others, such as France and



Thailand, have renounced their accords with the United States because their flag carriers were continuing to lose market share to U.S. airlines. DOT has also had mixed results in eliminating U.S. airlines' problems in doing business at overseas airports.

In its efforts to open foreign markets, DOT faces several challenges. It generally must negotiate with nations that are often protecting national flag carriers that usually have much higher costs than U.S. airlines. A study by the EU, for example, found that the operating costs of major European airlines were about 50 percent higher than the costs of major U.S. airlines in 1992. DOT must also balance the competing and often conflicting interests of U.S. airlines--nearly all of which want to serve Heathrow from various points in the United States--while protecting consumers' interests.

CODE-SHARING ALLIANCES ARE THE LATEST EFFORT OF AIRLINES  
TO OVERCOME A RESTRICTIVE GLOBAL AIR TRANSPORT ENVIRONMENT

While DOT has tried to negotiate with other nations to eliminate bilateral restrictions, U.S. and foreign airlines have pursued various strategies in their attempts to overcome bilateral restrictions and economic constraints that limit their international growth. In the late 1980s and early 1990s, some airlines invested in airlines from other nations to gain increased access to foreign markets. For example, British Airways acquired 24.6 percent of USAir and pushed for relaxing the 25 percent limit on foreign investment in U.S. airlines. Current legislative proposals would raise the limit to 49 percent. In 1992, we reported that raising the limit could give U.S. airlines, particularly those in financial difficulty, greater access to needed capital, thus enhancing their domestic competitive position. However, we noted that if it chose to relax the limit, the Congress might consider limiting eligibility for greater investment to

investors from nations willing to exchange improved access to their markets for greater opportunities to invest in U.S. airlines.

Recently, airlines have pursued code-sharing alliances, which require DOT's approval and reapproval on a periodic basis, as the preferred vehicle for gaining access to another nation's market. From January 1992 through December 1994, the number of alliances between U.S. and foreign airlines increased from 19 to 61. Code-sharing occurs when an airline, by agreement, uses its two-character designator code (e.g., "NW" for Northwest) to market flights operated by another airline as its own in computer reservation systems (CRS). Code sharing is most often used to show connecting flights as occurring on one airline, allowing airlines to "feed" their flights to and from gateway cities with passengers traveling to and from nongateway foreign cities that they do not serve with their own aircraft. (See figs. 1 and 2.) The airlines do not fly to these cities because of bilateral restrictions or the cost of providing direct service is too high relative to passenger demand. In general, foreign governments have been more willing to grant U.S. airlines authority for code-sharing than to remove limits on U.S. airlines' ability to directly serve their markets.

Figure 1: British Airways' Access to the U.S. Market Prior to Code-Sharing Alliance With USAir

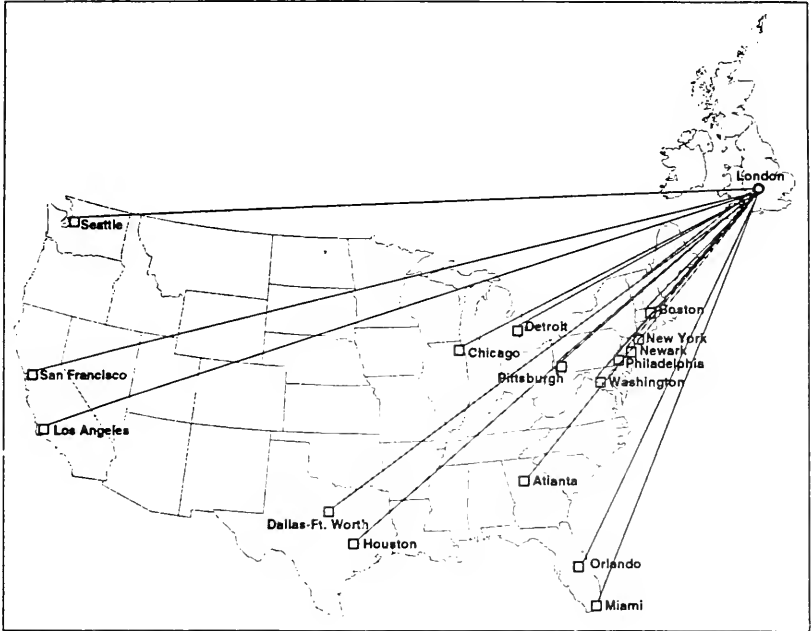
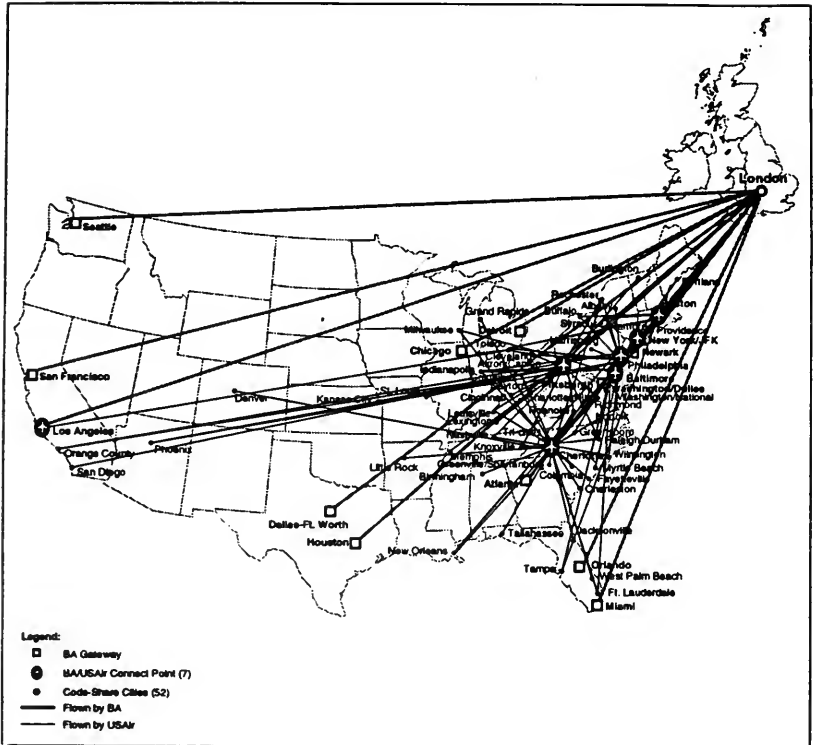


Figure 2: British Airways' Access to the U.S. Market After Implementing Code-Sharing Alliance With USAir



We found that code-sharing often produces substantial added traffic and revenues for partners. Most importantly, strategic alliances, those that involve code-sharing on a large number of routes and thereby link airlines' route networks, are producing substantial traffic gains for partners. Three of the alliances

entered into to date can be considered strategic--Northwest/KLM, USAir/British Airways, and United/Lufthansa. These have generated large increases in passenger traffic for the partners because their alliances involve (1) code-sharing on numerous routes covering a wide geographical area and (2) a great degree of operating and marketing integration. Northwest and KLM data show, for example, that their annual traffic has increased by about 350,000 as a result of their alliance, producing an increase in their combined transatlantic market share from 7 percent in 1991 to 11.5 percent in 1994 and yielding between \$125 million and \$175 million for Northwest (about one-third of its transatlantic passenger revenues) and \$100 million for KLM (18 percent of its transatlantic passenger revenues) in 1994. Alliances that involve code-sharing on a more limited number of routes have also resulted in increased traffic for partners, though at much lower levels than strategic alliances. Although most gains come at the expense of other airlines, some come from new traffic stimulated by competition among alliances and between alliances and other airlines.

Code-sharing, however, has several potential downsides. First, we found that CRSs often list the same code-share flight option multiple times. Three listings of the same code-share flight can push a competing flight option--which often has the same fare and a similar elapsed time from departure to arrival--to the second CRS display screen. (See attachment I.) We found such crowding out in nearly 20 percent of the cases we reviewed. This limits competition because travel agents--who book 80 percent of all flights--book options that are listed on the first CRS screen 90 percent of the time. To address this, the EU in 1993 limited to two the number of times a code-share flight can be listed in European CRSs. We have recommended that DOT follow the EU's lead.

Second, in its November 1994 policy statement on international issues--in which it supported code-sharing--DOT cautioned that the increasing success of several broad alliances may give those

alliances sufficient competitive muscle to preclude other U.S. airlines from entering markets where a successful code-share arrangement is in place. As a result, code-sharing's long-run impact on competition, and thus fares, is uncertain. Third, it is unclear whether foreign governments whose airlines are already benefiting from a strategic alliance will allow nonaligned U.S. airlines increased access to their market in the future. Similarly, code-sharing may work to frustrate DOT's efforts to achieve "open skies" if airlines increasingly use it as a substitute for direct access to cities to which they would like to fly, thereby reducing the pressure on foreign governments to remove bilateral restrictions. The U.S. accord with the United Kingdom, for example, allows for only American and United to serve London's Heathrow Airport. DOT's negotiators have been unsuccessful at opening up access to Heathrow for other U.S. airlines. As a result, Delta pursued the next best alternative and now code-shares on Virgin Atlantic flights to and from Heathrow. According to many airline representatives, DOT's recent approval of the Delta/Virgin alliance reduced the pressure on the United Kingdom to increase U.S. access to Heathrow and has made it more difficult to negotiate a deal that accommodates the desires of several U.S. airlines to serve Heathrow.

DESPITE EFFECTIVENESS OF CODE-SHARING, SIGNIFICANT BARRIERS REMAIN THAT INHIBIT U.S. AIRLINES' INTERNATIONAL GROWTH

Although all seven of the major U.S. airlines that fly internationally have entered code-sharing alliances, significant barriers remain that limit their ability to serve key foreign destinations with their own aircraft. In Europe, U.S. airlines' routes and number of flights to, from, and beyond such major aviation trading partners as Germany and the United Kingdom are limited by accords. Besides limiting the number of U.S. airlines that can serve Heathrow, for example, the U.S.-U.K. accord does not allow American and United to serve Heathrow from their main hubs

(Dallas and Chicago, respectively). In 1993, we reported that liberalization efforts by the EU could limit U.S. airlines' ability to compete in the EU. The EU's measures, for example, prohibit non-EU airlines from introducing fares lower than existing ones on routes within the EU. U.S. airlines also face restrictions in the Pacific Rim. Delta, for example, must rope-off sections of seats on flights to and from Thailand and fly them empty to avoid exceeding capacity limits.

Furthermore, we reported in 1994 that U.S. airlines serving key overseas airports also face problems in doing business that foreign airlines operating in the United States do not experience or experience to a much lesser extent. In general, we found that these problems affect all airlines--U.S. and non-U.S. alike--except the national flag carrier, creating a home-country advantage for that carrier. Many European airports, for example, prohibit U.S. and other airlines from conducting their own ground handling services, such as checking in passengers and baggage handling. Instead, only the airport authority and/or the national carrier can provide these services, at a cost greater than if U.S. airlines performed these services for themselves.

LIMITED DATA ON CODE-SHARING UNDERCUTS DOT'S  
ABILITY TO BUILD UPON RECENT BREAKTHROUGHS

In the past 6 months, DOT has been successful in liberalizing accords with several nations and taken several other positive steps to improve U.S. airlines' ability to compete abroad. In November 1994, for example, DOT initiated negotiations with Canada and nine smaller European nations. These efforts resulted in the February 1995 accord with Canada that expanded opportunities for U.S. airlines to Canada and increased competition and lowered fares in such markets as Washington, D.C.-Montreal. Likewise, they yielded agreements with the nine nations that all bilateral restrictions

will be removed.<sup>4</sup> In November 1994, DOT also issued the first U.S. policy statement on international aviation since 1978 and has moved out quickly to act on our recommendation that it collect and analyze information on U.S. airlines' doing-business problems to better monitor and address them.

Despite the positive trends, DOT is not well positioned to deal with the more difficult and complex aviation negotiations with Germany, Japan, and the United Kingdom. This is because DOT's capabilities to analyze such trends as code-sharing are often limited compared with those of its foreign counterparts, who have access to their own carriers' data as well as much of DOT's data.<sup>5</sup> In 1991, for example, DOT gave British carriers extensive access to the U.S. market through code-sharing in exchange for substituting American and United for TWA and Pan Am as the two U.S. carriers allowed to serve Heathrow. Many U.S. airline representatives have criticized the deal because they believe the value of extensive code-sharing rights granted to British carriers (1) outweighs the value of allowing two U.S. airlines to serve Heathrow in place of two other U.S. airlines and (2) contrasts greatly with the severe restrictions on U.S. airlines' access to Heathrow. DOT conducted little analysis of the value of code-sharing prior to concluding this deal, while we found that the British were analyzing the potential benefit of code-sharing as early as March 1989.

Acknowledging that it needed to greatly improve its analytical capabilities and better prepare U.S. negotiators, DOT created the Office of Aviation and International Economics in November 1994. However, the new office's ability to carry out its mission will be greatly hindered because of data limitations. For example, the

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<sup>4</sup>The nine smaller European nations are Austria, Belgium, Denmark, Finland, Iceland, Luxembourg, Norway, Sweden, and Switzerland.

<sup>5</sup>Some data collected by DOT are confidential and not publicly available for 3 years.



data reported by U.S. airlines to DOT from a sample of their tickets do not identify passengers who traveled on code-share flights and, in some cases, which airline actually operated a code-share flight. Likewise, the office will be handicapped because DOT does not collect detailed data from foreign airlines' tickets on flights between the United States and foreign countries. In its review of the Northwest/KLM and USAir/British Airways alliances for DOT, a consultant noted that such shortcomings in DOT's data greatly limited its ability to analyze code-sharing and stated that "if DOT wants to monitor the effects of international code-sharing on airlines and consumers, it should consider expanding the reporting requirements for code-sharing operations, particularly those of foreign carriers."

As a result of these weaknesses, DOT's new office will be limited in the extent to which it can accurately value access rights that DOT relinquishes to foreign governments in exchange for improved access or code-sharing rights in foreign markets and fully analyze emerging trends in this increasingly global industry. In light of these limitations and the potential downsides to code-sharing, we recommended in the report being released today that DOT (1) require that U.S. airlines, as part of their regular reporting of traffic data to DOT, identify which passengers traveled on code-share flights and that they take steps to ensure that they report which airlines actually operated those flights, (2) require foreign airlines involved in such alliances with U.S. airlines to report data on their code-share traffic to DOT, and (3) direct the new office to analyze DOT's existing data and the detailed data mentioned above to determine if the U.S. airline industry or consumers have been negatively affected before reapproving the broader alliances and any other alliance that the agency deems significant.

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<sup>9</sup>A Study of International Airline Code-Sharing, Gellman Research Associates, Inc., Dec. 1994.

These data problems also hinder DOT's ability to place a value on other considerations involving access to markets. For example, the agency has yet to determine, in light of the Northwest/KLM experience, the value of antitrust immunity or whether immunity should be potentially available for other alliances in markets that allow for significantly increased access for U.S. airlines. Immunity allows Northwest and KLM to jointly develop fares. As a result, they can quickly enact fare reductions to attract traffic. DOT granted Northwest and KLM immunity in 1992 in conjunction with the "open skies" accord with the Netherlands and in the hopes that the major European aviation trading partners would follow suit in seeking open skies. They did not. Many representatives of U.S. and foreign airlines and foreign government officials have expressed concern about the competitive impacts of allowing only one alliance to have antitrust immunity, which allows partners to, among other things, jointly set fares without fear of legal reprisal. They also expressed interest in obtaining immunity for their alliance. Noting these sentiments, several U.S. airline representatives maintained that the success of the Northwest/KLM alliance presented DOT with a new "carrot" in its efforts to obtain open skies. Nevertheless, others objected to such an approach, stating that U.S. antitrust laws protect consumers and prevent anticompetitive behavior; therefore, they continued, it does not make sense to remove these protections in the hopes of increasing competition.

#### CONCLUSIONS

DOT's recent successes have created momentum and spawned renewed hope that U.S. airlines' will have improved access to key foreign markets in the future. However, the challenges facing DOT are stiff as foreign governments are often unwilling to permit increased competition between their national airlines and lower cost U.S. airlines, while U.S. airlines often disagree as to what DOT's strategy should be. The international environment has also

become increasingly dynamic with airlines forming a growing number of alliances to create global and regional route networks. Given the success of such alliances, it is likely that code-sharing will continue to play a prominent role in bilateral negotiations and any increased rights of direct access or relaxation of foreign investment limits will be linked to the value that governments and airlines place on code-sharing. As a result, it is important that DOT be on an equal footing with its foreign counterparts and build on the lessons learned from the 1991 negotiations with the British. Without addressing its data problems, however, DOT will be limited in its ability to effectively negotiate for increased U.S. access to foreign markets and in its ability to keep abreast of the increasingly global industry, monitor code-sharing's impact on competition and fares, and equitably accommodate the competing desires of U.S. airlines.

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Mr. Chairman, this concludes our prepared statement. We would be glad to respond to any questions that you or any member of the Subcommittee may have.

CROWDING OUT OF FLIGHT OPTION FROM THE FIRST CRS SCREEN  
AS A RESULT OF SEVERAL LISTINGS OF THE SAME FLIGHT OPTION

CRS Screen-Worldspan:								
(Screen One)								
	Airline	Number	Origin	Destination	Leaving	Arriving		
Flight option involving code-sharing	1	LH	2423	TXL	FRA	1125A	1235P	
	2	LH	6430	FRA	ORD	130P	420P	
Same option using code-sharing to list a different way	3	LH	6430	UNITED AIRLINES				Actual operator of LH6430
	4	UA	3647	TXL	FRA	1125A	1235P	
Same option listed a third time (as interline connection)	4	UA	941	FRA	ORD	130P	420P	Actual operator of UA3647
		UA	3647	DLH LUFTHANSA				
	5	DI	7045	TXL	DUS	1135A	1240P	
	6	AA	157	DUS	ORD	130P	405P	
	7	LH	2423	TXL	FRA	1125A	1235P	
	8	UA	941	FRA	ORD	130P	420P	
(Screen Two)								
	Airline	Number	Origin	Destination	Leaving	Arriving		
Competing flight option "crowded out" to second screen	1	LH	2628	TXL	DUS	1115A	1220P	
	2	AA	157	DUS	ORD	130P	405P	
	3	UA	3645	TXL	FRA	1025A	1130A	
	4	UA	941	FRA	ORD	130P	420P	
		UA	3645	DLH LUFTHANSA				
	5	LH	2419	TXL	FRA	1025P	1130A	
	6	LH	6430	FRA	ORD	130P	420P	
		LH	6430	UNITED AIRLINES				
	7	KL	144	TXL	AMS	1150A	110P	
8	KL	815	AMS	DTW	240P	515P		
9	KL	8175	DTW	ORD	655P	717P		
	KL	8175	NORTHWEST AIR					

TXL: Berlin  
 FRA: Frankfurt  
 DUS: Dusseldorf  
 ORD: Chicago

Note: Request was for travel from Berlin to Chicago departing around noon on Saturday, December 10, 1994.

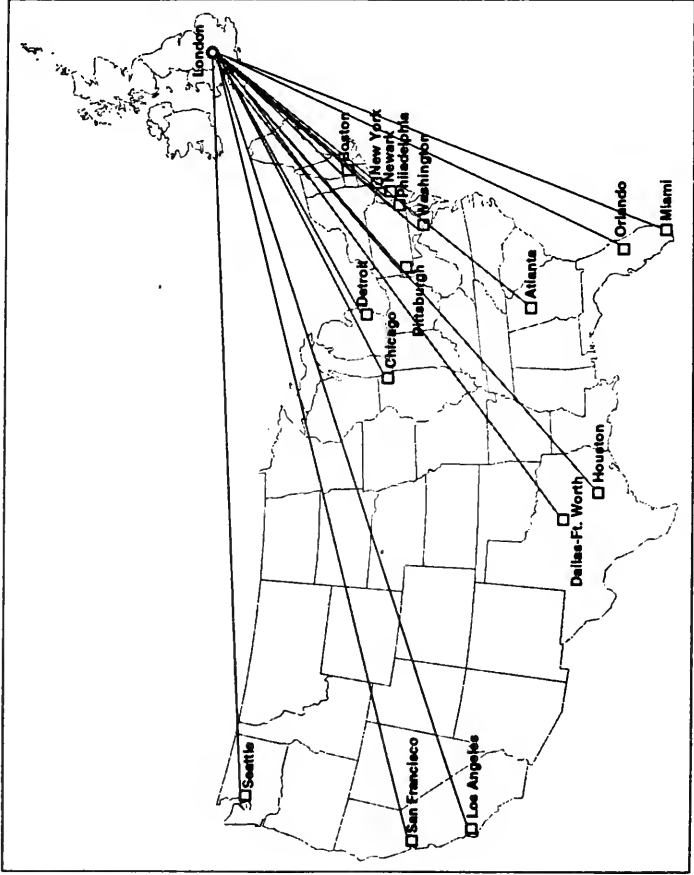
**U.S. General Accounting Office**

**Charts to Accompany the Statement of 47**

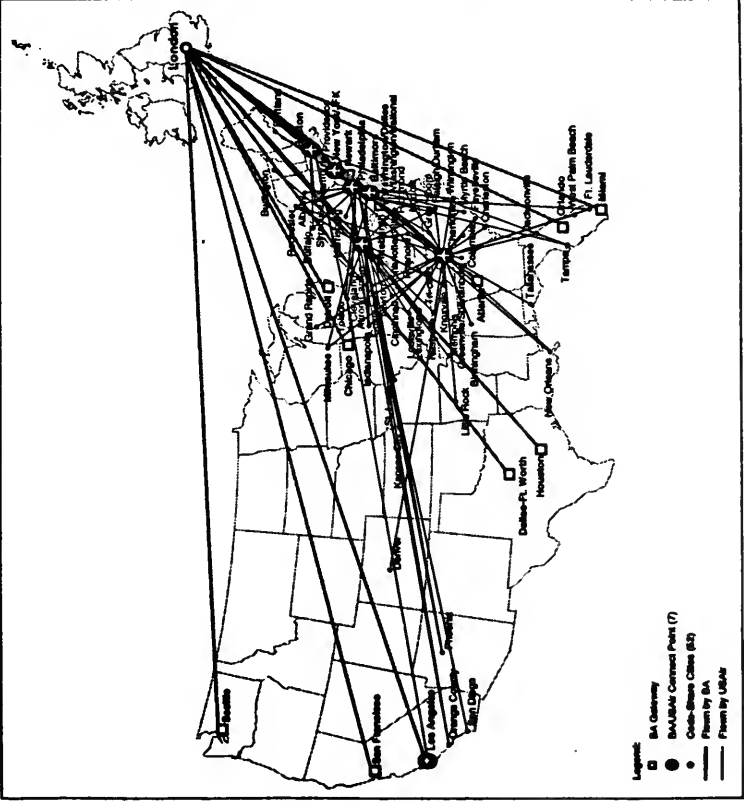
**Mr. Kenneth M. Mead**

**Director, Transportation Issues**

# Chart 1: British Airways' U.S. Access Before Code-Sharing Alliance with USAir



# Chart 2: British Airways' U.S. Access After Code-Sharing Alliance with USAir

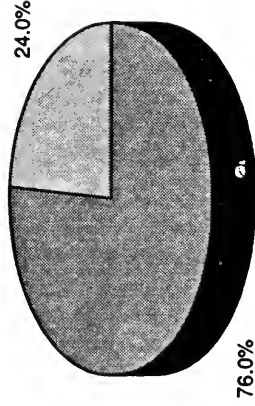
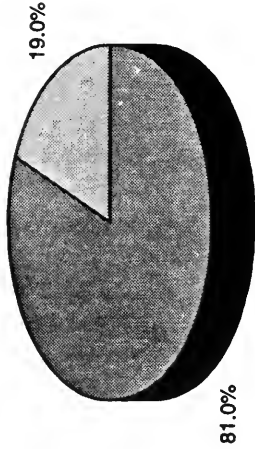


# Chart 3: International Share of U.S. Operating Revenues Increased

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1980: \$6.5 Billion

1994: \$17 Billion



□ International ■ Domestic



**Chart 4: Selected Scheduled U.S. Airline's Operating Profit from International Passenger and Cargo Services, 1993-4**

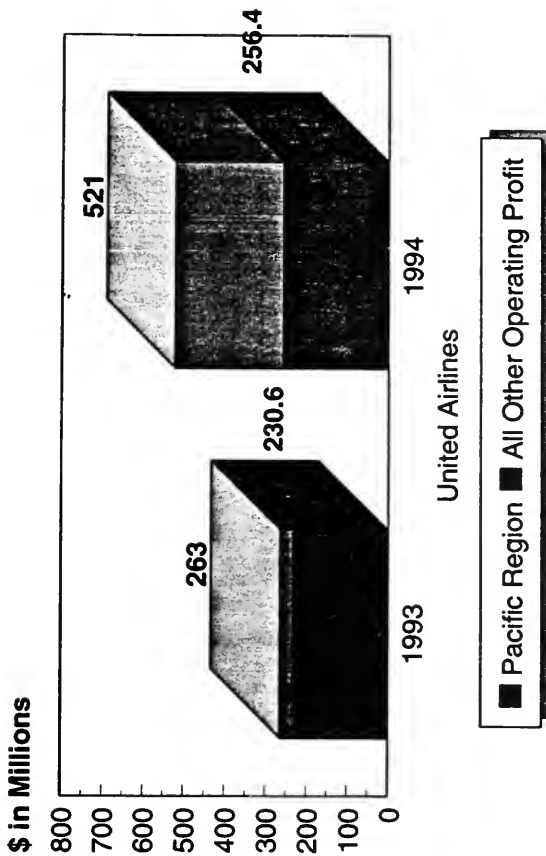
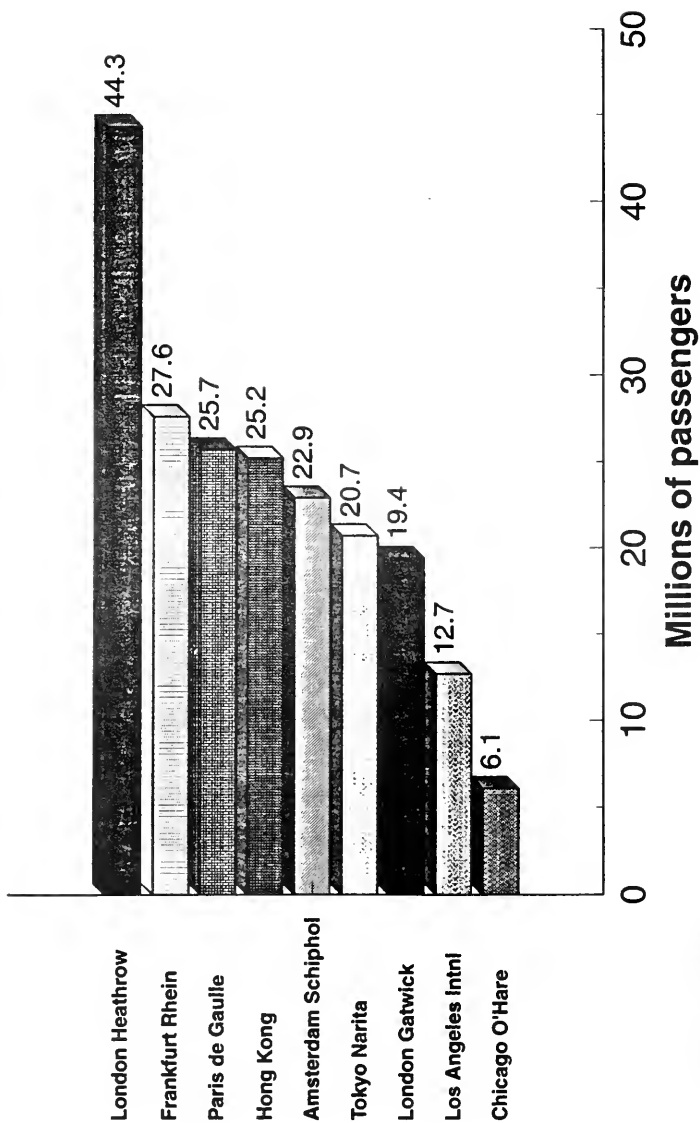


Chart 5: International Passengers Carried at Selected International Airports, 1994\*



\* Preliminary data

Senator MCCAIN. Senator Inouye?

Senator INOUE. Mr. Chairman, I was not here earlier, but in looking over the approach taken by the Department of Transportation, would you say that it has potential for success?

Mr. MEAD. We have not seen the underlying analysis for their proposal and thus are not in a position to conclude that it would have net benefits. I can say, Senator, that in our discussions with most of the airlines that overall the United States probably would end up with more benefits from this deal than they currently have. But the key question is whether the door will then be closed for future access to Heathrow.

An example would be Atlanta. Delta probably would like to fly to Heathrow direct from Atlanta. American would probably like to fly to Heathrow direct from DFW. Neither of those contingencies are in the mini-deal, as we understand that package.

Senator INOUE. What percentage of British Airways is owned by the British government?

Mr. MULVEY. I do not have that right now. We can get that for the record, Senator.

Senator INOUE. It is certainly more than a majority.

Mr. MULVEY. They are in the process of privatizing it.

Senator HUTCHISON. I think it was privatized.

Mr. MULVEY. It was privatized.

Mr. VEAL. It was privatized in 1987 and a small percentage of the shares may still be held by the British government. I believe it is completely privately owned.

Senator INOUE. What do you think would be the outcome if the DOT's proposed phased type of negotiation was changed to one mega negotiation?

Mr. MEAD. I think it is a judgment call. I do not have the background and experience of the Secretary in these negotiations. I am not sure I could make that call.

I would say that once this arrangement is concluded, that the things left on the table, what is left that the British might want, would be, (1) further investment in USAir and a relaxation of the foreign investment limits; (2) antitrust immunity; and (3) possible cabotage, although if British Air owned USAir that almost certainly would not be necessary.

Beyond these items, I have some difficulty understanding what additional rights in the United States the British would want.

Senator INOUE. Thank you very much, sir.

Thank you.

Senator MCCAIN. Senator Pressler.

The CHAIRMAN. Let me ask you a general question about our international goals here. Could you suggest alternative negotiating procedures or structures with regard to the U.S.-U.K. negotiations or as to international aviation bilaterals generally?

It occurs to me that both in cargo and passenger negotiations we have our Secretary of Transportation or the State Department who are responsible for negotiating international aviation agreements, but that domestically we tend to quarrel among ourselves and that this sometimes undercuts our negotiators. Would that be a fair assessment?

Mr. MEAD. Yes, it would be. In our work on code-sharing, Mr. Chairman, we found that some of the carriers (as you will hear later) will say, "Well, here is one set of numbers. This is how much something is worth or not worth." And two other carriers will say, "Well, we see it much differently." So it is important for the U.S. Government to be in a position to properly perform a cost and benefit valuation of these packages.

The CHAIRMAN. Now, does the GAO have an opinion as to whether renunciation of Bermuda II would be an effective strategy in dealing with the British? What might be the consequences of renunciation?

Mr. MEAD. We do not have an opinion on that.

The CHAIRMAN. OK. Now what type of data and analysis does the DOT need in order to properly assess the value of items over which it is bargaining in international aviation negotiations? And does DOT have the capability for generating that type of information?

Mr. MEAD. A general answer, and then I will have Mr. Hannegan amplify, because he did the work on this.

Implicit in our recommendations to the Department would be a requirement that additional reporting be required of the airlines, particularly foreign airlines, presumably as a condition of code-sharing. If you want to continue code-sharing, you would have to meet these reporting requirements.

But Mr. Hannegan can outline a couple of the data shortfalls that we felt were significant.

Mr. HANNEGAN. Yes, Senator. I think the primary weakness that DOT has is the lack of foreign carrier data, especially on several of these blocked-space arrangements where the foreign airline exclusively does the flying.

Currently, we get no data on that. That is a big weakness as far as many of these deals because code-sharing is often the central element in the bilateral talks, as far as the rights that are exchanged.

Several other elements deal with accuracy, as far as who is actually operating the flight. It is very difficult to gauge how much a foreign carrier will benefit if you are not exactly sure which carrier is actually operating the flight.

Another problem is the lack of identification in the data base as far as code-sharing is concerned. It is very difficult to analyze what you cannot identify.

So those are fundamental problems that pertain to code-sharing. But code-sharing in all of these, even in this deal, becomes the central element. And if you have those limitations, it undercuts your ability to put an accurate value as to the benefits that will accrue to the foreign side.

The CHAIRMAN. Mr. Chairman, I will put the rest of my questions into the record.

Senator MCCAIN. Thank you very much, Mr. Chairman.

Senator MCCAIN. Senator Hutchison.

Senator HUTCHISON. Mr. Chairman, I just have one question that I wanted to clarify on the point that I brought up with Secretary Peña.

It was estimated by GSA that the government passengers on the potential routes in Fly America could number up to 18,250 per

month at an average fare of \$615. The amount of revenue at stake in London was estimated to be as high \$134 million per year.

Now obviously, that depends on what the arrangement is and how much access there. Do you, Mr. Mulvey, have a view on the value that should be put on Fly America or what cities? Obviously, if it is the biggest gateways, the four biggest, San Francisco, Dulles, BWI and New York, we have offered two of those.

Do you have any further information that would clarify?

Mr. MULVEY. We spoke about this and other elements of DOT's economic analysis with DOT analysts, and they shared with us what they thought these things might be worth. They have agreed to supply their estimates to the committee, and you will see those numbers. It is substantially less than \$134 million.

We have not had an opportunity to review the GSA numbers. It is our assumption that that probably deals with all of the traffic over the Atlantic that is under Fly America, not just what is at stake here.

But I do know that the numbers that we have seen, the estimates that we have seen, show that the Fly America provisions of this deal to be much, much less than \$134 million.

Mr. MEAD. Yes. Vastly less. So perhaps over the next couple of days we could have some discussions with your office to clear that up.

Also, the information we were given at a debriefing, if I am not mistaken, was that there were only two gateways involved. And that is why in my summation I was saying that this seems to be the fuzziest or the most unsettled part of the entire arrangement.

Senator HUTCHISON. Would you just say, though, that Fly America is an important part from the British side of the negotiation, and if we have any important point for them, it would be that?

Mr. MEAD. I would say that it is one among several. From a financial point of view, we were advised by one airline, for example, that the Chicago—actually, I believe this was United—that the Chicago—London frequency, in comparison to the value of Fly America, that Fly America was worth one-fiftieth of the value of flying from Chicago to London.

Mr. HANNEGAN. Senator, I would like to just add one thing. That we are negotiating Fly America rights shows just what little leverage we have left. Regardless of the value we place on Fly America, the British got almost everything they wanted through the deal that was structured in 1991.

That is why we are now talking about Fly America and the leverage that gives us. That just shows you where we stand in these negotiations as far as leverage.

Senator HUTCHISON. Well, I would just say that I do think it is important that as we are looking at whether we put everything on the table together or whether we do a phase one and a phase two, that we look at the important points that we do have as leverage, and perhaps we would be better off having one phase with the important things on both sides at issue.

Thank you.

Senator MCCAIN. Thank you, Senator Hutchison.

Mr. Mead, I received today a report from a Professor Jenkins at George Washington University, and he alleges that the United

Kingdom's flag carriers would only have 25 percent of the traffic to and from the United States instead of the current 50 percent in a fully competitive environment, without the artificial divisions that exist.

Would you have any comment as to the accuracy of such a study? Would that make sense?

Mr. MULVEY. Given the relative competitive position of U.S. carriers and the fact that our carriers are amongst the world's most efficient, one would assume that in a fully competitive market, they would do better than they would in a restricted market.

So I think that without having seen Professor Jenkins's paper, it makes economic sense.

Senator MCCAIN. Thank you. From your written and your verbal testimony, I get out of this that you are concerned that there is no real economic analysis associated with this decision, at least that you have been able to see.

Mr. MEAD. We have not seen their economic analysis Mr. Chairman. We understand they have made an effort at it.

They did brief us. That is certainly different from in the past. But I cannot comment on the quality of that analysis.

Senator MCCAIN. But your overall message is that the Department of Transportation has not been well positioned to value rights that are on the negotiating table, according to your testimony.

Mr. MEAD. In the past, that is correct.

Senator MCCAIN. You also state that as a result of code-sharing, there has been for British Airways approximately \$100 million increase in revenue—\$100 million revenues for British Air and \$20 million for USAir.

Mr. MEAD. That is correct.

Senator MCCAIN. You also state, perhaps most importantly, the final question, when considering this deal, is whether the British will be left with any incentive to conclude broader agreements in the future that contain opportunities for other U.S. airlines to serve Heathrow. That is exactly the same question I asked the Secretary of Transportation this morning.

Do you see any incentive if this mini-deal is made? Do you see any incentives for the British to conclude further agreements that might contain additional opportunities for U.S. airlines to serve Heathrow?

Mr. MEAD. I am concerned that what is left is a relaxation of the foreign investment rules, Fly America, antitrust immunity and cabotage. Those are all very serious items. But I do not see what additional traffic rights the British could possibly want to the United States in contrast to the access rights or traffic rights U.S. carriers want to Heathrow and Great Britain. The latter do not involve antitrust immunity, or cabotage.

Senator MCCAIN. Thank you very much. I want to thank you and your colleagues for providing this very important testimony, as always. Thank you very much.

Mr. MEAD. Thank you, sir.

Senator MCCAIN. Our next panel would be Mr. Ronald Allen, who is the Chairman, President and CEO of Delta Air Lines; Mr. Gerald Greenwald, who is the Chairman and CEO of United Airlines; Mr. Jeffrey Erickson, who is the President and CEO of Trans

World Airlines; and Mr. Robert Crandall, who is Chairman, President and CEO of AMR Corporation.

Senator HUTCHISON. Mr. Chairman, as we are switching, could I ask unanimous consent to submit for the record a letter from the Houston mayor, a letter from the Dallas mayor, testimony from the Executive Director of the DFW Airport, and testimony from the Director of the city of Houston Department of Aviation?

Senator MCCAIN. Without objection, we would be more than happy to hear those totally objective reviews of the situation.

[The information referred to follows:]



# CITY OF HOUSTON

Post Office Box 1562 Houston, Texas 77251 713/247-2200

OFFICE OF THE MAYOR

Bob Lanier, Mayor

March 21, 1995

The Honorable Federico F. Peña  
Secretary  
U.S. Department of Transportation  
400 Seventh Street, N.W.  
Washington, D.C. 20590

Reference: March 22-24 U.S. - U.K. Bilateral Negotiations

Dear Mr. Secretary:

As you know, talks have been scheduled this week in London with the U.K. Government to discuss the so-called "mini-deal". I'm writing this letter to urge that the U.S. proposal currently on the table not be signed unless it is amended to include a comprehensive plan for allowing access to Heathrow for cities such as Houston which currently are denied such access.

In essence, the agreement proposed would expedite access for a second carrier to a Heathrow market that is already competitive (Chicago-Heathrow), while impairing the valid claims of other U.S. cities for their first Heathrow service. Under the existing U.S.-U.K. agreement the U.S. will shortly be able to designate a second carrier in that market even without the "minimum." Thus if the proposed agreement is finalized, it will further imbalance existing U.S. service to Heathrow by providing redundant rights for a carrier and city already well endowed with such rights, while continuing to deprive cities such as Houston of service they desperately need, and seriously handicapping the ability of carriers such as Continental, which have no Heathrow access at all, to compete with United and American.

As a former Mayor, I know that you are acutely aware of the importance to a major city of ensuring the community's access to critical air transportation markets. For Houston, London is the largest and most important European gateway, and service to Heathrow is the top priority for the city's international business community. Yet for many years Houston has been denied access to this market. Indeed, Houston is the third largest U.S. city without Heathrow service, based on both population and London traffic. Yet other, much smaller U.S. cities, such as Charlotte and Pittsburgh, already have the ability to market and develop their international business by means of their Heathrow access, while Houston cannot. This lack of access to Heathrow is damaging to the City's international business development efforts.



The Honorable Federico F. Peña  
U.S. Department of Transportation

-2-

March 21, 1995

I realize that in any new international agreement there are many competing considerations, and that the desires of every U.S. city and carrier cannot be taken care of instantly. However, access to Heathrow continues to be the major obstacle to U.S.-U.K. liberalization, and it is only fair and reasonable to insist that any new agreement with the U.K. include a comprehensive plan and timetable for Heathrow access for those who do not already enjoy it.

I respectfully urge your assistance in ensuring that the Department's top priority in these negotiations be to address the inequities of Heathrow access before providing expanded, and in effect, redundant rights for Heathrow incumbent carriers and markets.

Thank you very much for your consideration. I very much appreciate your service to our country.

Sincerely,



Bob Lanier  
Mayor

BL:g:cw

cc: The Honorable Patrick V. Murphy



## Dallas/Fort Worth International Airport Board

BOARD MEMBERS

David R. Braden, Chairman  
 Mayor Kay Granger, Vice Chairman  
 Al Gonzalez, Secretary  
 Mayor Steve Bartlett  
 Adelle B. Childs  
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 Betty J. Culbreth  
 Robert L. Fernandez  
 Robert E. Kellum  
 William McInnes, Jr.  
 Bert C. Williams

Jeffrey P. Rojas  
 Executive Director

March 14, 1995

VIA FAX (202) 366-7200  
AND REGULAR MAIL

Honorable Federico F. Peña  
 Secretary of the Department  
 of Transportation  
 400 Seventh Street, S.W.  
 Washington, D.C. 20590

Dear Secretary Peña:

As the Mayor of the City of Dallas, the Mayor of the City of Fort Worth, and as the Chairman of DFW International Airport Board, we want to urge you to include routes from Dallas/Fort Worth International Airport to Heathrow Airport in any bilateral discussions with the U.K. government. As I am sure you are well aware, business and communities leaders in the Dallas/Fort Worth area have long-sought authority to fly directly from DFW to Heathrow Airport. Such service would ensure that passengers from the area, the State of Texas, and those simply travelling through DFW could gain access to significant markets through Heathrow.

Under the existing bilateral agreement, DFW Airport can only serve Gatwick Airport. This leaves the DFW area at a severe disadvantage to other regions of the country, such as New York and Chicago, which already have access into Heathrow Airport. As the second busiest airport in the world serving over 52 million passengers annually, we urge you to include in any discussions with the U.K. government, DFW's access into Heathrow Airport. We thank you in advance for your consideration of this matter.

Sincerely,

*Kay Granger*  
 Mayor Kay Granger  
 City of Fort Worth

*David R. Braden*  
 David R. Braden  
 Chairman of the Board  
 DFW International Airport

*Steve Bartlett*  
 Mayor Steve Bartlett  
 City of Dallas

cc: Ed Faber  
 Terry Parent

Senator MCCAIN. We appreciate very much their writing to the committee and their input. I thank you, Senator Hutchison. Gentlemen, before we begin, and I do not want to take any more time, I do want to apologize to you profusely. Mr. Bismarck's adage about laws and sausages was affirmed today, and I apologize for the delay.

The members of this committee and I are keenly aware of the value of your time and of your being here, and I am deeply apologetic for the delay.

I also know that you appreciate, as much as I do, how important this issue is to the future of aviation in America and the world, and I thank you very much for your patience.

#### **STATEMENT OF RONALD ALLEN, CHAIRMAN, PRESIDENT, AND CEO, DELTA AIR LINES**

Mr. ALLEN. Thank you, Mr. Chairman, members of the committee, on behalf of Delta Air Lines, I appreciate this opportunity to appear before you today to provide our perspective on the U.S.-U.K. relationship and related international aviation policy issues.

We have submitted a more detailed statement to the subcommittee, and I will summarize the positions contained in that statement. We ask that it be made a part of this subcommittee's record.

Senator MCCAIN. Without objection, so ordered.

Mr. ALLEN. Thank you, sir. Mr. Chairman, the U.S.-U.K. market is the No. 1 transatlantic air travel market, almost twice the size of the next closest market. Any airline that wishes to be a major competitor on the North Atlantic must have a significant presence in the U.S.-U.K. market.

It is also imperative that a carrier have access to London's premiere airport, Heathrow. Heathrow is the No. 1 international airport in the world, and its preference by travelers, especially business travelers, requires that a carrier must have rights to Heathrow in order to effectively compete in the U.S.-U.K. marketplace.

Unfortunately, as you know, access to London and Heathrow are severely restricted under the Bermuda II agreement. As a monument to managed trade, it prescribes limits for the number of carriers and cities that receive service. It governs access to Heathrow, and it allows the British government to regulate both capacity and pricing.

Our primary concern with the U.S. Government approach to the liberalization of this agreement is its failure to address the fundamental and most egregious restrictions contained in Bermuda II, specifically government regulation of capacity and market access.

The current controversy about the U.S. Government approach to liberalization is directly traceable to actions taken by this administration in 1993 and 1994. During this time period, the administration approved the British Airways-USAir investment and code share partnership, thereby solidifying and enhancing British Airways' dominant position in the marketplace.

Despite five rounds of negotiations, the two governments simply could not agree on the terms or timing for liberalization of Bermuda II.

It then became clear to Delta that true liberalization would not occur in the near future. We responded by signing a blocked-space/code share agreement with Virgin Atlantic in April 1994.

This arrangement enables Delta to purchase Virgin seats between London and seven cities in the United States, and it gives us rights to sell these Virgin seats to Heathrow from four U.S. cities.

I can assure you Delta prefers to operate its own aircraft, but the Virgin Atlantic alliance at least helps us fill a major void in our transatlantic operations.

We feel strongly that the U.S. should adopt a broader comprehensive strategy for liberalization. The current negotiations with U.K. on a new limited exchange of benefits, or mini-deal, do not provide any real benefits to Delta.

We are told that this package is a first step in a broader process to liberalize the U.S.-U.K. agreement, and that a subsequent round to liberalize cargo, pricing, and charter provisions, and some as yet undefined new access for U.S. carriers, to serve Heathrow and Gatwick will be forthcoming.

Our objection to the current process approach is its failure to provide any assurances or guarantees that a successful conclusion of either round will lead to broader liberalization.

This administration's promise sounds much like the promise made in 1993 and 1994, and these were not kept.

Rather than an incremental approach, we encourage the administration to challenge the British to sit down and devise a real framework to liberalize all aspects of Bermuda II.

If the British are truly interested in open skies, then we should be willing to respond to their requests for changes in U.S. law relative to investment, ownership, Fly America rights, and even cabotage.

If not, the administration should seriously consider termination of Bermuda II as an option for eliminating excessive government regulation of the market.

One of the elements of the proposed mini-deal that has been discussed to compensate the British is a limited grant of access for British Airways to carry U.S. Government traffic, so-called Fly America rights.

Delta strongly opposes this grant. We believe that statutory changes to the Fly America Act are needed to protect and strengthen this program.

Even though Delta has more code sharing relationships than any other U.S. airline, we strongly object to the current GAO policy that allows U.S. Government traffic to be carried by a foreign flag carrier using U.S. airline codes.

We believe the intent of Congress was grossly circumvented when Lufthansa, for example, by virtue of its code share relationship with United, can become the GSA contract carrier between our headquarters, Atlanta, and Frankfurt, Germany.

Foreign airline use of the Fly America Act is also inconsistent with the objectives of the U.S. Civil Reserve Air Fleet program.

In order for us to qualify as a bidder for carriage of official government traffic, we must participate in the CRAF program. U.S. tax dollars should not be spent on transporting government pas-

sengers on foreign airlines, when U.S. airlines serve the same route.

We feel it is time for Congress to make clear to GAO that its current ruling on code share operations is contrary to the purpose of the Fly America Act.

Now, despite our opposition to foreign carrier excess to U.S. Government travel on code sharing operations, Delta is a strong proponent of code sharing.

We agree with the conclusions reached by the Department of Transportation and the GAO in their recent analysis of the benefits associated with code sharing for both U.S. carriers and consumers, Delta has derived significant benefit from our code share relationships.

However, we cannot take full advantage of the efficiencies without an ability to operate under a grant of antitrust immunity.

Delta strongly supports a grant of antitrust immunity for any pro-competitive airline alliance involving countries that have concluded open skies agreements with the U.S.

GAO's recently released report confirmed that the Northwest-KLM alliance has gained enormous efficiencies through the integration of their pricing, scheduling, marketing, and advertising activities.

The administration's Open Skies initiatives with nine European countries provides an opportunity to inject new competition into the relevant markets and to facilitate the formation of stronger alliances that will put pressure on those protectionist countries, for example, France and the United Kingdom, that refuse to open their markets.

We strongly endorse this initiative, and believe it is a bold strategic approach that will serve as a catalyst for broader liberalization throughout Europe.

However, the success of this initiative, in bringing greater consumer benefits and opening up competition, depend on the formation of alliances that operate with the same degree of efficiency as Northwest and KLM.

In concluding, we say that recent successes with Canada and the European Open Skies initiative reflect the benefits of a sound strategy that concentrates on eliminating government regulations, and replacing them with the disciplines of the market.

We do not believe we should continue our incremental approach with the British, unless a well-defined and unmistakable commitment to both the substance and timing of liberalization is clear.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today and would be happy to answer any questions.

Senator MCCAIN. Thank you, Mr. Allen.

[The prepared statement of Mr. Allen follows:]

PREPARED STATEMENT OF RONALD W. ALLEN, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER

#### INTRODUCTION

Thank you Mr. Chairman. I appreciate this opportunity to appear before the Subcommittee to provide Delta's views on the U.S.-U.K. relationship and related international issues. Our access to international markets remains wholly dependent upon government agreements and regulators. Nowhere is this more evident than in seek-

ing access to the U.K. market. We therefore welcome this timely review of this relationship.

**THE U.S.-U.K. MARKET IS THE LARGEST AND MOST IMPORTANT TRANSATLANTIC MARKET**

Mr. Chairman, the U.S.-U.K. market is the No. 1 transatlantic air travel market—almost twice the size of the next closest transatlantic market (Germany). Demand for U.S.-U.K. air travel remains strong and vibrant. The United Kingdom is the linchpin to transatlantic business. As we have learned, any U.S. airline that wants to be a major competitor on the North Atlantic must have a significant presence in the U.S.-U.K. market. Our customers demand that presence. Just as important, travel agency networks and corporate accounts through which our services are sold, will demand such a presence in this market. In short, the United Kingdom is a pivotal market for U.S. international aviation interests.

The real benefits of this vast market are enjoyed by a chosen few. A carrier's competitive position is based upon one threshold criterion: its ability to serve London's premiere airport, Heathrow. Heathrow is the No. 1 international airport in the world. Its proximity to London and its size and service options make it the airport of choice for travelers—especially business passengers—to and from London and for passengers connecting to points beyond London. Market research shows that travelers will pay a premium to use Heathrow.

Unfortunately, the U.S.-U.K. Aviation agreement, Bermuda II, only allows two U.S. carriers—American and United—to operate their aircraft to Heathrow. This antiquated bilateral also regulates the specific U.S. cities that can receive service to Heathrow. While Delta's experience in serving London's other major airport, Gatwick, has been positive, we will never be a major player in the United States-London market until we can compete with the favored Heathrow operators.

Not surprisingly, the Heathrow carriers—British Airways, Virgin Atlantic, American and United—also have exclusive rights that enable them to serve more gateways with more capacity than other competitors in the market. By far, the most dominant carrier and the biggest "have" in the U.S.-U.K. market is British Airways. According to schedules filed with the U.S. Government representing services for the 1995 summer season, British Airways will operate 7,050 frequencies between five U.K. gateways and 19 U.S. cities. Almost 4,900 of those frequencies will operate to the United States from London Heathrow. American Airlines will operate 5,310 frequencies between three U.K. gateways and nine U.S. cities. 3,436 of these flights will operate to Heathrow. United Airlines will operate 2,812 frequencies between London and five U.S. cities, all of which will operate to and from London Heathrow. In sharp contrast, Delta, the next largest U.S. carrier in the market, will operate 1,070 of its own flights to two U.K. cities from three U.S. gateways. Again, none of these services will operate to Heathrow.

Holding this lower rank in the market and lacking our own presence at Heathrow does not come from a lack of commercial determination on Delta's part or an inability to sell our transatlantic services effectively. Rather, our status is exclusively a function of government imposed restrictions on competition.

The Bermuda II agreement is a monument to managed trade. The concepts contained in Bermuda II are antiquated and invalid in today's market-oriented aviation world. It contains outdated provisions that limit the number of carriers and cities that receive service. It also allows the British Government to regulate capacity and pricing. Quite simply, it is an agreement designed to restrict and regulate trade and protect competitors from meaningful market competition. The restrictions within the agreement facilitates mercantilist behavior by the British Government and perpetuates the dominant position of its leading carrier.

Mr. Chairman, let me share with you one example of how Bermuda II regulates supply and demand. Delta sought last winter to increase from 10 to 14 weekly flights between Atlanta and London. The British Government challenged this increase as not consistent with the capacity principles contained in Bermuda II. The market could clearly bear such an increase. Delta experienced a load factor above 70 percent on its Atlanta-London service the previous winter. Also, Atlanta is the home of Delta and is the second largest airport in the United States. Our request was denied for one simple reason—the British Government used the Bermuda agreement to protect the interest of British Airways which chose to operate only 7 weekly flights during the same period. This is not an isolated occurrence. It takes place each season and affects most U.S. competitors in the market.

This illustration dramatizes the reason for our complaint about the recent U.S. approach to liberalization of this agreement. The U.S. Government concentrates on solving immediate commercial needs of individual carriers rather than addressing the fundamental infirmities of our most restrictive, anti-competitive and anti-

consumer bilateral agreement. Instead of arguing whether a market should get a certain number of frequencies we should be devising and pursuing a strategy that prohibits government regulation of capacity and market access.

#### RECENT EFFORTS AT LIBERALIZATION HAVE RUN INTO BRITISH INTRANSIGENCE

To its credit, the Clinton Administration has attempted to open the skies between the United States and the United Kingdom but its efforts have met a series of formidable obstacles. Also, the situation it inherited from the previous administration was less than ideal. As you know, in 1991 in order to simply allow American and United airlines to replace TWA and Pan Am as the two U.S. flag carriers allowed to serve Heathrow, the United States paid, and please excuse the metaphor, "a Queen's ransom" allowing British Airways virtually unfettered access to the United States through the use of code sharing. Similar rights were not granted for U.S. carriers to serve points into and beyond the United Kingdom.

Delta, American, United, Federal Express, and other U.S. interests subsequently challenged British Airways attempt to gain an enormous advantage through its investment and code share relationship with USAir. We urged President Clinton and Secretary Peña to defer a grant of such extraordinary rights until a new agreement could be reached that balanced the competitive landscape.

Secretary Peña approved the sweeping British Airways/USAir partnership in March 1993, promising at the time that unless the United Kingdom liberalized its relationship within 1 year, the Department would deny further approval of its code sharing authority. Five rounds of negotiations during the next 8 months failed to produce any progress toward meaningful liberalization.

Despite our willingness to support U.S. steps to terminate the agreement to prevent British Airways from gaining a permanent advantage in the market, the Administration renewed approval of the British Airways-USAir code sharing in March 1994. At that point, it became clear to us that any prospect for true liberalization would not occur.

In response to the regulatory situation at the time, Delta signed an agreement to enter into a blocked space code share arrangement with Virgin Atlantic in April 1994. This agreement enabled Delta to purchase seats between London and seven cities in the United States. It also gave us first time access, albeit through a code-share partner, to London's Heathrow airport. Delta's decision was a commercial response to an untenable regulatory situation. Despite our position as the largest transatlantic operator, our inability to serve London Heathrow from major U.S. gateways was an enormous competitive void that weakened our overall position on the North Atlantic.

Delta applied for code sharing authority with Virgin Atlantic to DOT in April 1994 and asked for approval outside the negotiating process. We sought this approval on a "stand alone" basis because the British made it clear that U.K. approval would be immediate and without "payment" or negotiated concessions. It is important to differentiate this deal from the British Airways/USAir code share alliance and the current discussions on a so called "mini deal" package. Virgin gained no new access to the United States and does not use its code on Delta's extensive domestic network to feed its U.K. services. Delta immediately gained the ability to buy seats on Virgin Atlantic on seven U.S.-U.K. city pair markets and then offer them for sale to the public as Delta seats.

The Delta-Virgin Atlantic blocked space code share application was finally approved by DOT on February 2, 1995—nearly 10 months after it was submitted. The delay was attributable to DOT's mistaken belief that this arrangement provided leverage that could be packaged with other changes to the U.S.-U.K. agreement. We were finally successful in convincing Secretary Peña that the benefits to consumers and competition necessitated approval on a stand alone basis and that a negotiated approach was unnecessary. Again, unlike the current mini deal proposal, Delta obtained valuable new U.K. access without any U.S. Government payment to the British.

#### THE U.S. SHOULD ADOPT A BROADER, COMPREHENSIVE STRATEGY FOR LIBERALIZATION

The current negotiations with the United Kingdom on a new limited exchange of benefits or mini deal do not provide any real commercial benefits to Delta. As currently agreed to by Secretary Peña and U.K. Secretary Mawhinney, the two governments are expected to conclude next week an agreement involving the following elements:

1. Authority for the United States to designate a second carrier on the Chicago-London route.

2. Authority for British Airways to offer twice daily flights in the London-Philadelphia market.

3. Unlimited access for all carriers between the United States and non-London airports.

4. Authority for all carriers to conduct extensive code sharing operations into and beyond gateway cities in both countries.

5. "Fly America" rights for British Airways from a yet undetermined number of U.S. gateway cities to London.

We are told that this package is the first step in a broader process to liberalize the U.S.-U.K. agreement. A subsequent round of talks will be convened to discuss another agreed upon agenda that includes cargo, pricing and charter liberalization and some, as yet undefined, new access for U.S. carriers to serve London's Heathrow and Gatwick airports.

Our objections to the current mini deal relate to its failure to provide any assurances or guarantees that real liberalization will occur. We are not aware of any agreement that links rights and benefits in the mini package to the successful conclusion of arrangements that will liberalize the designation, gateway and capacity restrictions in Bermuda II. Additionally, the U.S. proposal for new access to Heathrow and Gatwick in phase two does not address the underlying designation and gateway limitation but merely allows some flexibility in using rights already contained in the agreement.

History has shown that an incremental approach with the British will not accomplish our overall goals. Our past experience makes us very skeptical and very suspicious whenever our government starts talking about "a process" for liberalization. In our view, the conclusion of any so called mini deal must be linked to a well-defined and specific agreement that establishes both the terms and the timetable for liberalization of all aspects of Bermuda II. For the United States to do otherwise would be—as we say down south—"buying a pig in a poke."

It is time to abandon incremental approaches and instead challenge the British to sit down and devise a short term framework for real liberalization. Secretary Peña was successful with this type approach with Canada. If the British truly do favor liberalization then we should insist that they commit to total elimination of the antiquated, hyper-regulatory arrangement that has governed our relationship since Bermuda II was concluded in 1978. Delta is willing to support changes in U.S. laws regarding investment, ownership, "Fly America" and cabotage to meet British objectives if they will commit to open skies between our two countries.

If an agreement cannot be reached on these terms, the United States must once again consider termination of Bermuda II.

#### "FLY AMERICA" RIGHTS SHOULD BE PRESERVED

One of the options being considered to compensate the British in the current exchange is a limited grant of access for British Airways to carry U.S. Government traffic—so called "Fly America" traffic. This traffic is funded by U.S. taxpayers and the Federal Aviation Act requires that U.S. Government employees travel on U.S. airlines for official business. As one of the largest providers of government financed transportation on the North Atlantic, Delta supports this law and believes that statutory changes are needed to protect and strengthen this program. There must also be new, clear guidelines for the Secretary of Transportation in exercising authority to negotiate rights for foreign flag carriers to carry this traffic.

Consistent with the position expressed previously, U.S. Government travel should be available, when appropriate, to open skies partners. However, the United States should never grant such rights to countries that insist on maintaining restrictive agreements. We should use this valuable authority as leverage to liberalize agreements. Section 1117 (c) of the Federal Aviation Act stipulates that foreign carriers can only receive "Fly America" rights if their governments conclude agreements consistent with the policy goals contained in the Act. The British do not now qualify because the Bermuda II Agreement is totally contrary to the goals and policies set forth in the Act and as established in the Secretary's new International Air Transport Policy Statement. We urge the Committee to reexamine its intent under the Fly America Act and to provide new guidelines for restricting DOT's discretion to trade away "Fly America" rights.

In addition to new statutory guidelines, the Subcommittee should recognize that code sharing operations have totally circumvented the original intent of the Fly America Act. With the proliferation of code sharing alliances, there has been a corresponding increase in U.S. Government traffic carried by foreign flag operators using U.S. airline codes. Even though Delta has more code share relationships than



any other U.S. airline, we strongly object to the current GAO policy that allows this situation to occur.

Do you realize that Lufthansa—by virtue of its code share relationship with United—is the GSA contract carrier between Atlanta and Frankfurt, Germany? This means that the bulk of U.S. military traffic and Federal employees traveling between Georgia and Frankfurt are traveling on Lufthansa when there are two daily flights offered by Delta in the same market. Delta loses over \$2 million in this market and nearly \$10 million annually in other markets where U.S. carriers operate but foreign operators are allowed to carry U.S. Government traffic through a code share relationship. In addition, international mail carriage is also affected by the new Fly America Act interpretation. For example, Delta traditionally carried 100 percent of the U.S. mail carriage from Atlanta to Frankfurt. As a result of the current interpretation, Delta now must share with Lufthansa the U.S. mail delivery to and from Frankfurt—Atlanta.

A primary reason for our current frustration on this issue is the obligations that are imposed on U.S. carriers seeking to carry government travelers on official business. In order to qualify as a bidder for carriage of official government travel, U.S. carriers must be participants in the Civil Reserve Air Fleet (CRAF) program. Participation in the CRAF program requires carriers to commit a minimum of 30 percent of their long haul passenger aircraft to the Department of Defense for use in time of military emergency in order to facilitate large scale troop and equipment movement.

The relevant issue involved is whether the carrier actually transporting the passenger on the long haul segment is a CRAF participant. If the carrier transporting the "Fly America" passenger is not a CRAF participant, it should be prohibited from carrying that passenger if there is an alternative service by a U.S. long-haul operator. Fairness dictates adoption of this policy. Carriers involved with the CRAF program have an obligation to maintain a fleet of aircraft that can be used in time of emergency by the U.S. Government. In return, the U.S. Government should support the commercial operations of that fleet.

U.S. tax dollars should not be spent on transporting government passengers on foreign carriers when U.S. airlines serve the same route. According to the General Accounting Office, the purpose of the Fly America Act is to "help improve the economic and competitive position of the U.S. flag carriers against foreign carriers." It is time for Congress to make it clear to GAO that its current ruling on code share operations is damaging U.S. airlines.

#### CODE SHARING/ANTITRUST IMMUNITY

Despite our opposition to foreign carrier access to U.S. Government travel on code sharing operations, Delta is a strong proponent of code sharing. We agree with many of the conclusions reached by Department of Transportation and the GAO in their recent analyses of the code sharing phenomenon. Both GAO and DOT asserted that code sharing alliance can provide significant benefits to consumers and participating carriers. I can speak firsthand of some of these benefits as Delta has an extensive global code sharing network with carriers like Swissair, Singapore, Virgin Atlantic, Sabena, Austrian, Malev, TAP, Aeromexico, Varig and Aeroflot.

While we have realized a number of benefits from these relationships, the ability of Delta and other carriers to gain full advantage of its alliances can only occur under a grant of antitrust immunity. GAO pointed out in its recently released report, that the alliance formed by Northwest and KLM has benefited greatly from its ability to effectively operate as a single airline. These two airlines have gained enormous efficiencies through the integration of their pricing, scheduling, marketing and common branding activities. Notably, DOT reached the same conclusion in its recent study of code sharing practices. Without question, the ability of Northwest and KLM to operate as a merged airline has made this alliance highly successful and Delta seeks to achieve the same efficiencies with its code sharing partners.

The Administration's open skies initiative with nine European countries provides an opportunity to inject new competition in the relevant markets and to facilitate the formation of stronger alliances that will put pressure on those protectionist countries that refuse to open their markets. While Delta has been a critic of the Administration's policies in dealing with Europe, we strongly support and endorse this initiative. Secretary Peña has advanced a bold strategic approach that will serve as a catalyst for broader liberalization throughout Europe.

The success of this initiative in bringing greater consumer benefits and opening up European marketplace to more competition will depend upon formation of strong alliances that can operate with the same efficiency as KLM/Northwest. If the nine countries are willing to open their skies to the United States, then their carriers

should enjoy the same opportunities as the Dutch. Secretary Peña must permit carriers to operate under a grant of antitrust immunity in these circumstances in order to prevent competitive disadvantage.

The recent successes with Canada and the European nine country initiative reflect the benefits of a sound policy and strategy that concentrated on eliminating government regulation and replacing it with the disciplines of the market. Rather than accepting incremental changes, these efforts sought to reward countries that shared our goal of liberalization. Until the British embrace these principles, we should not conclude any agreement with the United Kingdom that merely perpetuates restrictions and protects incumbency status. We recognize that an incremental or a transitional approach is often necessary to achieve open skies. But, there must be a clear, well defined and unmistakable commitment to both the substance and the timing of liberalization in order to justify continued managed trade.

The current U.S.-U.K. negotiation does not offer any such long term guarantees. It is time for a new, bolder, more dramatic strategy. We hope that the Subcommittee's oversight will lead to such a result.

Mr. Chairman, Members of the Subcommittee, I appreciate you taking the time to hear my concerns and I look forward to answering any questions you might have.

Senator McCAIN. Mr. Greenwald.

**STATEMENT OF GERALD GREENWALD, CHAIRMAN AND CEO,  
UNITED AIRLINES, INC.**

Mr. GREENWALD. Thank you.

Chairman Pressler and Chairman McCain, I am finding more and more that the U.S. airlines are finding common ground to work on matters in the interest of the industry and our nation as a whole. I should start my comments by saying this is not one of those days.

Thank you for providing me this opportunity to appear here today. The U.S. Government is negotiating with the U.K. for the right to designate a second U.S. carrier between its busiest hub airport, Chicago O'Hare, and Heathrow, London,

England.

That right is guaranteed by the U.S.-U.K. bilateral, but only after the market passes a 600,000 passenger threshold for two consecutive 12-month periods.

Eighteen years ago, both the Congress and the Civil Aeronautics Board recognized that the flaw in Bermuda II was that it actually encouraged an incumbent carrier to keep service low and prices high. It was an incentive to maintain traffic just below the level that would trigger new competition.

That is precisely what has been occurring in the Chicago-London market. The incumbent carrier, American, has manipulated schedules and capacity to force London traffic that would naturally use Chicago to move via another gateway. When traffic growth reached levels that began to exceed the 600,000 annual figure, capacity was suddenly removed from the market.

As you can see in the chart nearest to me, while overall U.S.-U.K. traffic continues to grow substantially, somehow Chicago-London traffic has been stagnant. Eighteen years after this issue was first aired, the U.S. and the U.K. are trying to negotiate a second designation to meet demand in this under-served market.

That brings us to the central question in this hearing. What is the appropriate negotiating objective in the U.S.-U.K. talks, a complete agreement, an omnibus agreement, resolving all issues at once, or an incremental approach that nails down agreements as the opportunities arise?

I do not want to sound obtuse or academic, but the way we answer this question has immediate practical impact on the service United can provide. And the next chart illustrates how badly underserved the Chicago-London market is.

More importantly, how we answer this question also has a practical impact on the pocketbooks of U.S. passengers and shippers we serve. As the last chart illustrates, passengers traveling between Chicago and London pay substantially more than at virtually every other city of destination, for destination to London.

In my view, the direction of U.S. policy is already clear. The incremental approach builds confidence, delivers benefits, and moves us closer to our overall objective. The question today is whether we will heed the counsel of certain companies who suddenly want to abandon this approach, but only after taking advantage of its benefits.

Just last week, British Foreign Secretary Douglas Hurd praised the agreement opening new services for American Airlines to Birmingham, from Chicago. Bob, I think you were there.

Now, the reason American Airlines was able to add that flight, its sixth daily frequency between O'Hare and points in the U.K., was because the U.S. was willing to take an incremental step early this year to liberalize access when the opportunity presented itself.

That progress, those public benefits were not put on hold until we could conclude an Open Skies agreement, nor, in my opinion, should they have been. Again, earlier this year, the U.S. and U.K. agreed to allow Delta to ally with Virgin Atlantic.

Ron, as I recall, your company was quite enthusiastic about the benefits to the public and to Delta that would flow from that approval. No one, let me underline this point, no one said that the Delta Virgin deal should be postponed until the governments negotiated a comprehensive agreement.

In both cases, in my opinion, the U.S. made the right decision. Measured steps toward liberalized air access does have public benefits on both sides of the Atlantic.

Now, the current negotiations have produced a general accord on the shape of the next step forward. For the U.S., that includes long-awaited U.S. carrier competition on the Chicago-London route, formalization of open access by U.S. carriers to U.K. regional airports, and enhanced code share rights beyond London for U.S. carriers, in my view, a major potential.

In return, British Airways will be allowed to add flights into Philadelphia, a market to London that was recently abandoned by American Airlines.

British Airways will also be allowed a limited ability to participate, and I underscore the word limited, in Fly America contracts from several specified gateway cities, specific cities, by virtue of their code share agreements with USAir, a participation more limited and of lesser value than any other code share alliance the U.S. has approved.

The key is, in our view, competition. Allowing United, one of America's premier air carriers, to fly from the world's busiest airport, to the world's largest international hub, will provide U.S. consumers better service, more choices, and lower fares.

In addition to those clear benefits, there is something more, an opportunity to advance the overall U.S.—U.K. talks.

We have a commitment, I am told, from the U.K. Secretary of Transportation, that provided we finalize this package by June 2nd, the U.K. government will move directly to the next phase of liberalization.

With all of that to be gained, why then has this agreement become so politicized? We all know U.S. negotiators can expect hard bargaining from their foreign counterparts, but what they do not need is a chorus of critics back here at home, dissatisfied U.S. airlines, who have suddenly developed an allergy to the kind of incremental advances they have favored when the deal was their own.

Let me add, in asking for fairness, we, United, are quite willing to live by that standard ourselves. I will publicly and persistently applaud agreements that produce U.S.-national public benefits, even if it is other airlines and not United that share in those benefits.

My position is and will remain, all of us in this industry ought to support the principle of access, open new markets, and we will all have plenty of opportunities to compete for the new business. And the U.S. consumer will benefit.

I believe there are two actions that this government can do to further the success of this industry and the benefits it brings to our nation. First, we need to do something about the tax burden on this industry and the risk of an even heavier burden this fall with the potential imposition of a fuel tax.

Second, we need to stop making the perfect the enemy of the good. If our approach on GATT as nation had been solely free trade or no trade, we would still be negotiating for the next 15 years.

Similarly, in aviation, we cannot proceed on the basis that we must have it all or we will take nothing. We have already tried that approach with the British, and it has failed. We cannot expect to dictate to a trading partner, a friendly one, at that.

Mr. Chairman, I am here today, because U.S. and U.K. negotiators are on the verge, at long last, of providing relief for consumers who have paid too much for too long, because there was too little competition on the London route.

We still have time, but the clock is ticking. We would like to start flying in the peak summer season, and the summer is coming on quick.

I urge the members of this committee to stand behind the approach that has served our industry and the U.S. consumer so well, and to conclude this deal as quickly as possible.

Thank you for allowing me to comment this morning. When the time comes, I would be happy to answer any questions you have.

Senator MCCAIN. Thank you, Mr. Greenwald.

[The prepared statement of Mr. Greenwald follows:]

#### PREPARED STATEMENT OF GERALD GREENWALD

Mr. Chairman, Senator Ford, Members of the Subcommittee, thank you for the opportunity to appear before you today.

United's interest in the U.S.—U.K. aviation negotiations is well known. For us it represents a long-awaited opportunity to secure a non-stop route from our home city and principal hub—Chicago—to London, England, the primary overseas destination for American passengers. For the citizens of the Chicago area and for the hundreds

of thousands of U.S.-U.K. passengers for whom Chicago would be the most convenient and logical gateway to London, it represents an opportunity to end years of being underserved and overcharged. On the other hand, for those who profit from constrained service and inflated prices, these negotiations pose an economic threat.

The recent history of the Chicago-London market has been one of activities that frustrated the right of the U.S. to designate a second carrier on the route. The so-called Bermuda 2 agreement permits a second U.S. competitor to enter the market automatically once there are 600,000 one-way passengers traveling on the route during each of two consecutive twelve-month periods.

The ink was hardly dry on that Agreement before Congress and the CAB pointed out the fundamental problem with relying upon that provision to ensure needed competition.

"There may be markets in which traffic would stagnate at a level below 600,000 passengers a year because of poor service and marketing." (Congressman Glenn Anderson, Chairman, House Subcommittee on Aviation, Hearings on U.S. International Aviation, September 29, 1977.)

"Until you introduce low fares, you may always be at 599,999." (Alfred Kahn, Chairman, Civil Aeronautics Board, House Subcommittee on Aviation, Hearings on International Aviation, September 29, 1977.)

The situation that Chairman Anderson and Chairman Kahn foresaw in 1977, has existed in the Chicago-London market for several years. While the 600,000 bilateral threshold has been surpassed on other gateway route segments from far less important transportation hubs than Chicago, the incumbent on this route has taken direct actions to prevent the threshold from being crossed on the Chicago-London route for the required 2-year period. (See Chart A.) It has manipulated schedules and capacity to force both local Chicago and behind gateway connecting passengers to travel via other less convenient gateways.

In defending his negotiating of Bermuda 2 at the 1977 hearings, Ambassador Boyd implied that in the case of deliberate stagnation, the 600,000 passenger threshold would not be required before a second carrier could be added. Both sides could simply recognize that a new carrier was needed and could agree to its designation. It is just such an agreement that the United States and Great Britain have been pursuing and that American has been seeking to prevent. Its efforts here are yet another aspect of its strategy to hold onto the U.S.-flag monopoly it enjoys over this key route.

Apart from American, a number of U.S. carriers are seeking to strengthen their competitive presence in the U.S.-U.K. market. Each offers earnest and compelling arguments as to why its proposal would be beneficial from the public's standpoint. As in many other negotiations, these parties ardently oppose the finalization of any agreement that does not address their interests.

Short of "open skies," where a free market determines how the public interest is best served, the Government still negotiates in an environment in which it must first pick and choose from among the opportunities demanded by its carriers and then must bargain to secure those opportunities.

In making its choices, the United States should be guided by one overriding principle: what alternative offers the greatest benefits to the largest number of consumers—passengers and shippers. Where it is apparent that an existing situation has been seriously disadvantaging a major segment of transportation users, priority should be given to correcting the situation.

Both the identification of negotiating objectives and the question of what constitutes a fair bargain to secure those objectives requires the type of economic analysis to which Secretary Peña referred in DOT's recent Statement of U.S. International Aviation Policy. Factual review, more than anything else, allows the Government to navigate through the fog of rhetoric and conflicting demands on a course that is truly responsive to the *public* interest.

That process can be and has been followed in the current discussions with the United Kingdom.

Objectively, it is difficult to dispute that, from the users' standpoint, the most pressing need in the U.S.-U.K. aviation structure is for competitive U.S.-flag carrier service from Chicago to London. This is evident from separate studies commissioned by the city of Chicago and by United Airlines. Those studies have graphically demonstrated:

- Passengers between Chicago and London are disadvantaged in terms of price.

The average Chicago-London fare is higher than the average fare to London from other gateway cities. For example, if the Chicago-London average fare were constructed at the same rate per mile as the Los Angeles-London fare, the

price charged to the Chicago passenger would be a third less than it is. (See Charts 1, 2, 3 of the attached study.)

- Relative to its population, Chicago has the poorest level of service of any U.S. city with two or more non-stop carriers to London.

Chicago has less non-stop competition to London than do other cities much smaller in size. For example, Chicago has one non-stop carrier for every 3.84 million people; Newark has one for every 481,000. (See Charts 4, 5, 6 of the attached study.)

- Although virtually every other international market from Chicago is growing substantially, the Chicago-London market has been declining.

This was during a period when the total U.S.-London market was increasing at a 5.6 percent annual rate, and traffic between Chicago and major international markets was growing at 5.8 percent annual rate. See attached study and Chart 7 thereof.)

- The percentage of passengers from Chicago's "catchment area" that use O'Hare as a gateway to London is significantly less than the percentage using it as a gateway to other European points.

Chart B lists the states and major cities for which Chicago serves as a logical gateway to London and Europe. As can be seen, in every instance, the percentage of travellers to and from those U.S. points using Chicago as the gateway for their journey to England is substantially lower than passengers from those same points traveling to Europe. From points in Arizona and New Mexico, for example, the percentage using O'Hare as a gateway to London is slightly more than half of the percentage using O'Hare as a gateway to Europe. This difference reflects the limited price and service options available to these passengers on the Chicago-London route.

As I mentioned, there are many other international aviation issues of significant concern to the United States, but in terms of economic and competitive importance to the U.S. traveling public, no single route opportunity comes close to matching in value a second Chicago-London/Heathrow designation. This Administration recognizes the penalty that this situation imposes on hundreds of thousands of consumers each year and is actively seeking to rectify it.

We agree that it would be advantageous if all of the outstanding issues between the United States and United Kingdom could be immediately resolved in favor of the United States. Unfortunately, we have learned from experience with the British that they are not willing, either from a political or economic standpoint, to make these changes in a single agreement. U.S. attempts to secure such an all-encompassing agreement with them have produced only stalemate.

In this regard it should be kept in mind that while the United States is running an international trade deficit in the range of \$9 billion per month, trade in air transportation services and in aircraft and engines has represented a major plus. In these areas, we compete effectively and extensively around the world. A key to maintaining that position lies in continuing to expand access to foreign markets whenever expansion is possible. We simply cannot afford to politicize the process in efforts to meet the demands of one producer or another. This course will only lead to paralysis.

The current U.S.-U.K. negotiations are an example of how the process now defeats progress. We have had four rounds of talks on a straight forward mini-deal. A *fifth* round is scheduled for June 2.

We are approaching gridlock on this relatively simple agreement because one or another carrier does not believe the progress toward liberalization sufficiently benefits its particular interests. If we had followed this "all or nothing" approach in negotiating the GATT, we'd be negotiating still.

We cannot dictate to our negotiating partners. We cannot force them to accept open skies any more than we could compel them to accept free trade. What we can do, and what we should be doing with the British, is to take advantage immediately of opportunities to expand U.S. carrier access; to move the relationship in the right direction.

The British are prepared to make meaningful and steady incremental progress toward liberalization. They signaled this last fall, when their Secretary of Transport, without bargaining for anything in return, offered to grant the U.S. open access to U.K. regional airports, to approve the alliance between Delta and Virgin Atlantic under which Delta can now sell seats to London/Heathrow, and to expand U.S. Opportunities to code share in the U.K. market.

Once the United States accepted this break-through offer, immediate positive results occurred. American Airlines seized the opportunity to increase its already dominant position in the United Kingdom by expanding in regional markets, and Delta finalized its extensive commercial alliance with Virgin Atlantic, allowing it to put Heathrow on its route map.

The most important result, however, was that the United States and United Kingdom agreed to resume formal negotiations. Those formal negotiations have produced an initial package which will expand long-deferred opportunities for Chicago and the region it serves, will rectify the imbalance in code-share opportunities which now favors British Airways, and will formalize a *de facto* open skies arrangement to most of the United Kingdom through its regional airports.

The opportunities that the U.K. is seeking in return are modest. British Airways would be allowed to add capacity to its existing gateway at Philadelphia, compensating the consumers in that city for seats that were lost when American abandoned the market. In addition, British Airways, through its code-share relationship with USAir, would gain limited rights to transport "Fly America" traffic. Although this access would be similar to that now granted to other foreign carriers as a result of their alliances with U.S. carriers, it would be substantially more limited in scope.

The carriage of U.S. Government traffic on foreign carriers through code-share alliances is entirely consistent with U.S. policy as articulated by the DOT, the Department of State and the GAO, and is supported by the Department of Defense as an important adjunct to the Civil Reserve Airfleet (CRAF) program. Numerous U.S. carriers currently are eligible to benefit from this program: Delta with its codeshare partner Virgin Atlantic; American with South Africa Airways and QANTAS; Continental with SAS and Alitalia; and United with its partner Lufthansa. In BA's case, however, those opportunities would be limited to only a few of its gateways. To put the value of the Fly America opportunity at issue here in perspective, United calculates that the annual revenues British Airways would gain from "Fly America" traffic would be approximately equal to *one week's* revenue from the new U.S.-flag carrier operation over the Chicago-London/Heathrow route.

In short, the negotiating package now under consideration is a fair one for the U.S.; fair in terms of the potential revenue balance, fair in terms of the competition it will provide for bids for contracts to carry U.S. Government traffic, and fair because the British are opening up rights for U.S. carriers to carry British Government traffic, even its military passengers.

The deal, like most, does not have something for every carrier. Those not included in this initial package are, of course, dissatisfied. But most of those not benefited here will receive new opportunities in the second round of talks, for which dates and a negotiating agenda have been set.

Nonetheless, it is understandable for those carriers that are not benefited from the initial phase to urge its deferral and argue for a merging of phases 1 and 2 of the negotiations. But there are several reasons why that should not be done. First, our negotiating partner has previously rejected this type of approach. The United Kingdom is prepared to deal, in seriatim, with a number of important issues. Trying to compel the British to fold all of the issues into one set of negotiations, however, is a prescription for delay and probable failure. Second, further delay, even a minimal one, will mean that no new U.S. carrier services could be added to the market during the critical summer season. This would benefit incumbent carriers, but would be demonstrably unfair to passengers in markets such as Chicago-London who have been poorly served and overcharged on that route for years. Finally, deferral portends a process without end. If stages 1 and 2 of the negotiations should be merged, then why not stages 1, 2 and 3? The process will end where it began, in stalemate.

There are, of course, those for whom status quo is the actual objective. With a flourish of rhetoric, they will urge a course they know full well cannot succeed. They have achieved significant benefits from recent mini-deals with the U.K. Now, it appears, they want to shut the door behind them. They see these hearings as a chance to protect themselves from competition by politicizing the negotiating process to the point that it becomes wholly ineffective. I hope that you will recognize their claims, assertions and protestations for precisely what they are.

Earlier in this testimony I spoke of the benefits that the U.S. international air transportation industry provides to our citizens, our communities, and our economy. It can be accomplished much, much more if the U.S. Government seizes negotiating opportunities and quickly capitalizes on them and, as I have said often in recent months, the United States does not continue taxing our industry to the point that its efficiency is lost. Over the next few weeks the Administration can finally secure important new access to London from Chicago; it should do so. Over the next few

weeks Congress can extend air carriers' exemption from the transportation fuel tax; it should do so as well.

Again, thank you for the opportunity to present our views.

## CHART A

CHICAGO-LONDON NONSTOP PASSENGERS  
(January 1991 - December 1994)

	<u>MONTHLY</u>	<u>12 MONTH MOVING TOTAL</u>
Jan-91	21,600	N/A
Feb-91	10,534	N/A
Mar-91	19,930	N/A
Apr-91	19,684	N/A
May-91	28,155	N/A
Jun-91	40,473	N/A
Jul-91	50,560	N/A
Aug-91	53,275	N/A
Sep-91	48,197	N/A
Oct-91	44,732	N/A
Nov-91	30,016	N/A
Dec-91	30,762	397,918
Jan-92	30,165	406,483
Feb-92	25,958	421,907
Mar-92	40,599	442,576
Apr-92	37,151	460,043
May-92	55,022	486,910
Jun-92	62,300	508,737
Jul-92	69,521	527,698
Aug-92	68,892	543,315
Sep-92	59,781	554,899
Oct-92	61,980	572,147
Nov-92	40,152	582,283
Dec-92	43,777	595,298
Jan-93	42,029	607,162
Feb-93	30,092	611,296
Mar-93	47,010	617,707
Apr-93	46,512	627,068
May-93	54,467	626,513
Jun-93	63,751	627,964
Jul-93	66,546	624,989
Aug-93	67,041	623,138
Sep-93	60,796	624,153
Oct-93	56,274	618,447
Nov-93	36,185	614,480
Dec-93	31,139	601,842
Jan-94	30,624	590,437
Feb-94	22,409	582,754
Mar-94	33,382	569,126
Apr-94	43,495	566,109
May-94	53,114	564,756
Jun-94	66,589	567,594
Jul-94	67,208	568,256
Aug-94	65,842	567,057
Sep-94	60,015	566,276
Oct-94	54,140	564,142
Nov-94	31,679	559,636
Dec-94	35,122	563,619

Source: Civil Aviation Authority, London -- UK Airports Monthly Statements of Movements, Passenger and Cargo



CATCHMENT AREA ANALYSIS  
UNITED STATES-EUROPE/LONDON

	<u>LONDON</u>	<u>EUROPE</u>	<u>CHICAGO SHARE OF TOTAL</u>	
	<u>Pax/Year</u>	<u>Pax/Year</u>	<u>London</u>	<u>Europe</u>
Alaska/Hawaii/PR	5,635	17,465	1.6%	12.2%
Chicago	11,660	43,301	67.9%	77.9%
Illinois/Indiana	2,408	8,403	33.3%	46.4%
Michigan/Ohio	2,500	8,517	22.2%	29.9%
Wisconsin/Minnesota/Iowa	2,915	8,047	33.9%	49.0%
Minneapolis	6,582	17,637	8.7%	18.4%
Alabama/Miss./Tennessee	5,719	15,745	10.8%	19.1%
Dakotas	542	1,361	8.3%	14.1%
Missouri/Arkansas	7,256	20,406	10.5%	21.8%
Kentucky/West Virginia	1,080	3,275	9.6%	10.4%
Nebraska/Kansas	1,343	3,683	28.7%	35.3%
Louisiana	3,548	13,111	7.1%	18.8%
Texas	5,421	17,079	16.1%	26.0%
Dallas/Fort Worth	7,900	21,033	6.4%	19.3%
Houston	7,522	14,859	2.8%	9.5%
Arizona/New Mexico	5,924	15,911	14.1%	26.9%
Colorado/Wyoming	14,795	34,752	8.1%	21.7%
Montana/Idaho	783	2,137	1.9%	6.0%
Las Vegas	2,984	9,828	10.8%	28.0%
Other Nevada	498	1,040	1.4%	7.2%
Southern California	1,323	3,807	17.7%	38.0%
Los Angeles	28,020	64,416	1.3%	10.3%
Central/N. California	1,474	3,875	11.4%	30.5%
San Francisco	24,888	67,057	3.2%	11.9%
San Diego	4,128	12,572	7.8%	24.3%
Oregon	2,527	7,500	21.5%	37.9%
State of Washington	7,887	10,815	4.7%	19.0%

**ANALYSIS OF PRICE AND  
SERVICE COMPETITION IN THE  
CHICAGO - LONDON AIR TRANSPORTATION MARKET**

**Prepared For:**



**UNITED AIRLINES**

**Prepared By:**

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**December, 1994**

## ANALYSIS OF PRICE AND SERVICE COMPETITION IN THE CHICAGO-LONDON AIR TRANSPORTATION MARKET

### OVERVIEW

The Campbell Aviation Group, Inc. has been asked by United Airlines to conduct an analysis of the price and quality of nonstop air transportation between Chicago and London, England. Our research shows that the lack of a third or fourth carrier in the Chicago-London market has resulted in a significantly higher level of price and an inferior level of service options than the levels which prevail at the more competitive gateways, including cities smaller in population than Chicago. These results are discussed below.

### FARE STRUCTURE

When we examined fares, we found that passengers in the Chicago-London market are disadvantaged in terms of price when compared to other gateways at which there is multiple U.S. carrier competition. The Chicago-London average fare, constructed at the same rate per mile as the average paid in the Los Angeles London market, would be 33.0 percent lower than it is. There are five non-stop competitors in the Los Angeles-London market, but only two between Chicago and London.

This discrepancy is illustrated in Chart 1 which shows that the Chicago-London average fare on a per mile basis is higher than seven other major U.S.-London markets. When the Los Angeles-London market is indexed at 100, as shown on our Charts 2 and 3, the relative differentials become quite vivid.

### SERVICE OPTIONS

In examining the London service levels available at Chicago we found that in terms of its local population, Chicago had the poorest levels of service of any U.S. city with two or more nonstop air carriers in the market. It has, by a significant margin, fewer non-stop carriers in relation to local metropolitan population than any of the ten other gateways examined. As illustrated in Chart 4, the comparison is dramatic. Chicago has one non-stop carrier per 3.84 million people; Newark has one nonstop carrier for every 481,00 residents. A similar ratio is found in the number of weekly seats offered per million residents. The comparisons made in Chart 5 show that Chicago has only 687 weekly non-stop seats to London per million population; San Francisco has 4,499 per million, or roughly 6.5 times as many seats as Chicago in terms of relative local metropolitan population. That same chart illustrates that in terms of total non-stop seats, Boston and Miami, with local populations that are less than half of those of Chicago, have substantially more weekly non-stop seats available to their passengers.

We also established that demand for international travel from Chicago is sufficient to sustain at least three non-stop competitors in the market. Our analysis showed that comparable foreign markets from Chicago, with significantly less total traffic demand, today support three carrier competition. Chart 6 shows that Chicago-Tokyo, -Frankfurt, -Mexico City and -Paris all sustain vigorous three carrier competition with substantially less total traffic than the Chicago-London market.

Not surprisingly in these circumstances, we found that while Chicago's international traffic has been growing at a healthy pace, the lack of adequate competition in the Chicago-London market has produced a traffic decline. Those figures are presented in Chart 7. They show a 2.7 percent annual decline in Chicago-London traffic at a time when virtually all other international markets from Chicago were growing substantially, and when the U.S.-London market itself was increasing by a 5.6 percent annual rate according to the United States INS statistics.

Finally, we examined the effects of Chicago's London service disparity on the flow of merchandise exports from the Illinois, Indiana and Wisconsin areas. We found that well over a third of bound air-cargo from this region was moving over other gateways (Chart 8). Given the levels of service and lack of U.S. carrier competition from Chicago to London, this "leakage?" of traffic to other gateways reflects insufficient cargo lift or non-competitive cargo rates at Chicago.

### CONCLUSION

After examining these data, we conclude the multiple carrier competition in the Chicago-London market would result in lower fares, commensurate with other multiple designation markets, as well as provide increased service options to passengers and shippers between these two important international commercial centers. Relative to other major U.S. cities, Chicago is significantly underserved to London.

**THE AVERAGE CHICAGO-LONDON FARE IS UNREASONABLY HIGH  
IN RELATION TO MARKETS WITH GREATER COMPETITION**

Year-Ended March 31, 1994

	<u>Constructed Chicago-London Fare</u> <sup>1/</sup>	<u>Percent Chicago Fare Higher Than Others</u>	<u>Number of Non-Stop Carriers</u>
<b>Chicago - London Actual</b>	100.0	—	2
<u>Reference Market</u>			
Washington, DC - London	92.3	8.4%	2
New York / Newark - London	89.8	11.4%	8
Dallas - London	83.9	19.2%	2
Boston - London	81.3	23.0%	4
Miami - London	75.8	32.0%	3
San Francisco - London	74.8	33.7%	3
Los Angeles - London	67.0	49.4%	5

Note

<sup>1/</sup> Chicago - London fare derived using the fare per mile paid by passengers in the U.S. - London reference markets. Due to confidentiality restrictions, actual fares were indexed with Chicago = 100.0. Includes data from fared passengers only.

**PASSENGERS BETWEEN CHICAGO AND LONDON PAY MORE  
THAN PASSENGERS FROM MOST OTHER MAJOR GATEWAYS**

Year-Ended March 31, 1994

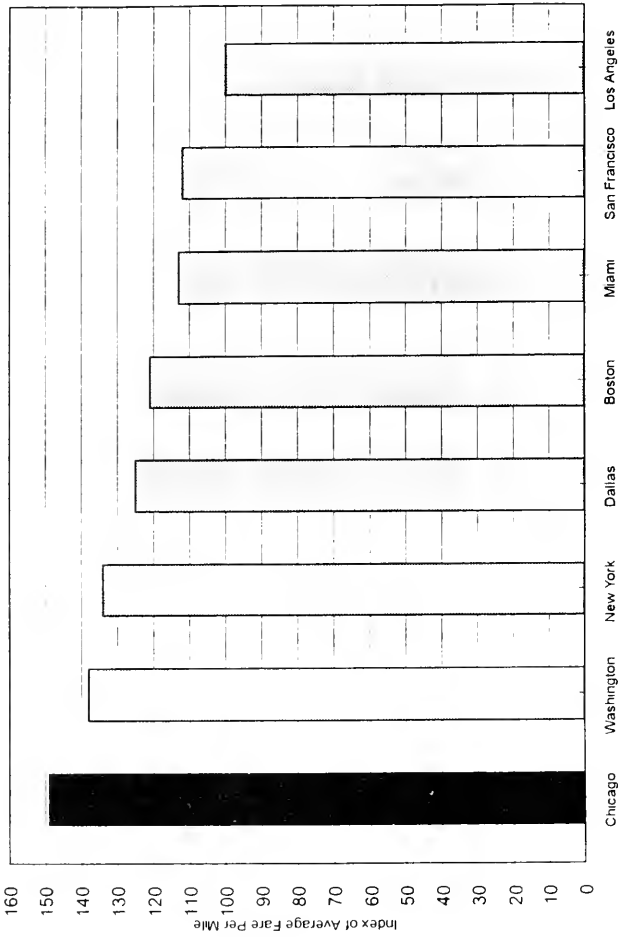
<u>London Market</u>	<u>Average Fare Per Mile</u> <sup>1/</sup>
Chicago	149
Washington, DC	138
New York / Newark	134
Dallas	125
Boston	121
Miami	113
San Francisco	112
Los Angeles	100

Note

<sup>1/</sup> Due to confidentiality restrictions, actual fares were indexed at Los Angeles = 100  
Includes data from fare-paying passengers only

**PASSENGERS BETWEEN CHICAGO AND LONDON PAY MORE THAN PASSENGERS FROM MOST OTHER MAJOR GATEWAYS**

Year-Ended March 31, 1994



Note: Due to confidentiality restrictions, actual fares were indexed at Los Angeles = 100. Includes data from failed passengers only.

Source: U.S. Department of Transportation, Origin-Destination Survey, accessed through Database Products

**CHICAGO HAS LESS NON-STOP COMPETITION TO LONDON THAN CITIES THAT ARE MUCH SMALLER IN POPULATION**

<u>To London:</u>	<u>Number of Non-Stop Carriers</u>	<u>Population <sup>1/</sup> (000's)</u>	<u>Population Per Non-Stop Carrier (000's)</u>
Chicago	2	7,671.6	3,835.8
Washington, DC	2	4,467.9	2,234.0
Los Angeles	5	9,193.1	1,838.6
Houston	2	3,601.4	1,800.7
Atlanta	2	3,302.6	1,651.3
Dallas	2	2,914.5	1,457.3
New York	6	8,627.1	1,437.9
Boston	4	3,777.7	944.4
Miami	3	2,001.7	667.2
San Francisco	3	1,659.6	553.2
Newark	4	1,925.3	481.3

Note

<sup>1/</sup> Population of each city's Metropolitan Statistical Area as defined by the Office of Management and Budget

Source: Sales and Marketing Management Survey of Buying Power, 1994 and The Official Airline Guide accessed via TRIP Information Services.

## CHICAGO HAS FAR FEWER WEEKLY NON-STOP SEATS TO LONDON PER MILLION RESIDENTS THAN MOST OTHER MAJOR GATEWAYS

Week Ending November 7, 1994

To London:	Number of Non-Stop Carriers	Non-Stop Seats (Each Direction)	Population <sup>1/</sup> ('000's)	Weekly Non-Stop Seats Per Million Residents
Chicago	2	5,274	7,671.6	687
Dallas	2	3,360	2,914.5	1,153
Houston	2	4,347	3,601.4	1,207
Los Angeles	5	12,210	9,193.1	1,328
Washington, DC	2	6,457	4,467.9	1,445
Atlanta	2	4,837	3,302.6	1,465
Boston	4	8,666	3,777.7	2,294
Miami	3	6,960	2,001.7	3,477
New York	6	33,898	8,627.1	3,929
Newark	4	8,232	1,925.3	4,276
San Francisco	3	7,467	1,659.6	4,499

Note:

<sup>1/</sup> Population of each city's Metropolitan Statistical Area as defined by the Office of Management and Budget



**OF THE PRINCIPAL FOREIGN DESTINATIONS SERVED NON-STOP  
FROM CHICAGO, THE LONDON MARKET HAS THE MOST DEMAND  
AND THE FEWEST COMPETITORS**

<u>Chicago Market</u>	<u>Number of Non-Stop Carriers</u>	<u>INS Survey Passengers</u> <sup>1/</sup>	<u>Annual Flow Passengers Per Carrier</u>
London	2	569,054	284,527
Tokyo	3	458,888	152,963
Frankfurt	3	426,822	142,274
Mexico City	3	313,067	104,356
Pans	3	302,628	100,876

**Note**

<sup>1/</sup> INS traffic data for the period of March 1, 1993 through February 28, 1994

## CHICAGO INTERNATIONAL MARKET GROWTH

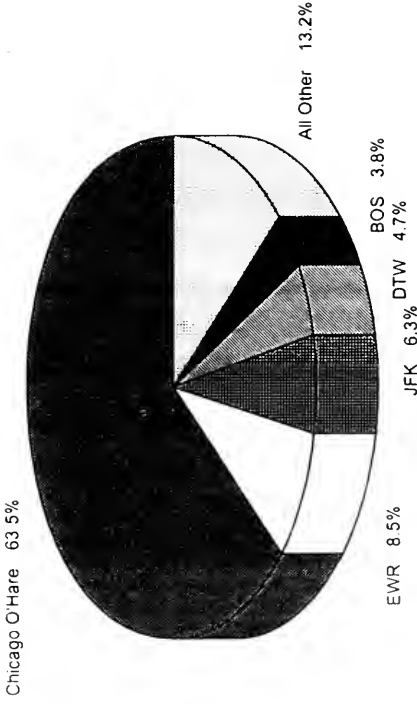
(1992 - 1994)

<u>Chicago To</u>	<u>1992 International Passengers</u>	<u>1994 International Passengers<sup>1</sup></u>	<u>Annual Growth</u>
Belgium	135,742	143,714	2.9%
Czechoslovakia	5,526	15,277	66.5
Denmark	44,704	54,061	10.0
France	309,593	307,960	-0.3
Germany	589,201	642,836	4.5
Ireland	11,867	28,284	54.3
Italy	194,989	213,090	4.5
Jamaica	46,010	57,533	11.8
Japan	423,445	470,969	5.5
Korea	29,326	135,109	114.6
Mexico	638,270	745,458	8.1
Netherlands	170,770	196,399	7.8
Poland	66,328	83,082	11.9
Sweden	95,781	99,717	2.0
Switzerland	202,921	203,149	0.1
United Kingdom	832,285	810,525	-1.3%
.. London	290,230	274,769	-2.7
Total Chicago	3,909,884	4,373,859	5.8%

<sup>1</sup> January through June, 1994 are actual passengers and July through December 1994 were estimated in conjunction with United Airlines.

Source: U.S. Department of Transportation, International Air Travel Statistics

WITHOUT COMPETITIVE U.S. NON-STOP SERVICE TO LONDON,  
OVER 35% OF THE CHICAGO REGION'S AIR EXPORTS TO THE UK ARE SHIPPED  
THROUGH OTHER GATEWAYS



Notes

Region = Illinois, Indiana and Wisconsin  
All other includes Memphis, St. Louis, Minneapolis-St. Paul, Baltimore, Orlando, Atlanta, Pittsburgh and Washington Dulles

Source: U.S. Bureau of Census, U.S. Exports of Domestic and Foreign Merchandise by Port.

Senator MCCAIN. Mr. Erickson.

**STATEMENT OF JEFFREY ERICKSON, PRESIDENT AND CEO,  
TRANSWORLD AIRLINES**

Mr. ERICKSON. Thank you, Mr. Chairman, members of the subcommittee.

I appreciate very much the invitation, and I am honored to appear here before you on behalf of our 23,000 employee owners at Trans World Airlines.

I would like to summarize my remarks, but would ask that my full statement be included in the record of this proceeding.

Senator MCCAIN. Without objection.

Mr. ERICKSON. Thank you.

Mr. Chairman, these are exciting times at TWA. Over the past year, we have embarked upon an ambitious attempt to cut costs, restructure, and become more competitive.

The fruits of our labor are beginning to show, and just 9 days ago, we announced the last phase of our recapitalization, a final agreement with our creditors to restructure TWA's finances.

This will enable TWA to write off its books approximately \$500 million in debt. Our restructuring will be completed by the end of this summer, either out of court or through a prepackaged bankruptcy filing, which would enjoy the full support of our creditors.

This is the first time that this will have been accomplished by any major carrier.

Mr. Chairman, we are embarking on a new era at TWA. A new management team is in place. New labor contracts, without wage snap-backs are in force. Our service is second to none.

TWA is hungry to compete, and our cost structure makes us competitive. But Mr. Chairman, we are an international carrier that cannot access London, the gateway to Europe, from our New York-JFK hub.

We can fly to Paris. We can fly to Frankfurt. We can fly to Rome. But we cannot fly to London. It is very difficult to develop the allegiance of the international business travel when British Airways, Virgin-Delta, American, and United can fly from New York-JFK to London Heathrow, but TWA cannot.

The U.S.-U.K. bilateral was negotiated in 1977. It is widely acknowledged to be the most restrictive and anti-competitive aviation bilateral to which the United States is still a party.

The United States government has vowed repeatedly to take a tough stance with the British, to engage them in general negotiations, aimed at broad liberalization. But to date, it has not happened.

Eighteen years ago only two U.S. carriers were given access to Heathrow. Only two U.S. carriers can access Heathrow today with their own aircraft. The U.S. government's failure to achieve any meaningful new access to London's Heathrow Airport is, in my view, appalling.

After all, U.S. negotiators sit in a position of strength. The U.S. domestic aviation market is the largest, most lucrative aviation market in the world. Access to our market, which alone comprises about 30 percent of the world's aviation market, is critical to British carriers.

But recent U.S. negotiations with the British have been characterized by limited gains for U.S. carriers and broad new authority for U.K. carriers.

Two years have passed since U.S.—DOT approved broad new access for British Airways to the U.S. domestic market, through a temporarily authorized code share arrangement with U.S. Air.

There still has been no liberalization. And on February 10, of this year, the competitive landscape fundamentally changed when the Department approved the extra bilateral request of Virgin Atlantic and Delta to engage in a blocked-space/code share arrangement over seven U.S. points, including between London Heathrow, and New York's JFK.

TWA has consistently sought access to London Heathrow.

Given the Virgin/Delta code sharing arrangement, that access has now become critical to the competitive balance in international aviation.

We have been working with Senator Ashcroft, Senator Bond, Senate Majority Leader Dole, House Minority Leader Gephardt, and the rest of the Missouri Congressional delegation, the Governor of our State, and the mayor of St. Louis to impress upon the Department the importance of our being able to access London from New York.

Mr. Chairman, I regret to tell you that we, in my view, are about to be had, the United States is about to be had, as we are again about to be out-maneuvered by the British. The Department of Transportation lumped our request into the so-called second phase of the negotiations, the agreement to negotiate in the future.

In its most recent proposal to the British, the United States did not insist on any new access to any London airport for TWA. To say we were disappointed would be an understatement.

Senator Ashcroft and Senator Bond expressed their views as outraged.

In a letter to the President of the United States they said that "The failure of the administration to even so much as ask for London authority for TWA suggests a callous indifference for the sacrifices made by TWA's employee owners, and indicates a disregard for the economic interests of the State of Missouri."

Mr. Chairman, we agree.

TWA's message today is simply this: There should be no more U.S. capitulation. The time has come to draw the line.

The current round of negotiations with the British should not be concluded until the United States has obtained meaningful new access to London/Heathrow.

TWA's hub operation in New York—JFK is larger than that of any other carrier. It is in the best interest of the United States and the flying public that it be allowed to compete with British Airways, Virgin Delta, United, and American in the JFK—Heathrow market.

We have come to the conclusion that we must seek access to Heathrow, and we must seek it now. No more talk of first phase and second phase.

Two years ago, when the original British Airways/U.S. Air code share agreement was approved, there was a commitment on the

part of both the U.S. and U.K. governments to liberalize the current bilateral.

The two governments set a 1-year deadline for themselves. The time has come for the U.S. to stand firm, to negotiate with resolve.

Earlier this month, Secretary Peña introduced a new statement of the United States International Air Transportation Policy, the first new policy in 17 years. It says that the goal of the United States is achievement of an unrestricted international air service regime.

The policy affirmatively states that the consequences for countries unwilling to work toward liberalization will involve the withholding of benefits from those countries. The current round of negotiations with the British is the first test of the Department's new policy.

Mr. Chairman, thank you again for inviting me to appear before the subcommittee today. I would be happy to answer questions at the appropriate time.

Senator McCAIN. Thank you, Mr. Erickson.

[The prepared statement of Mr. Erickson follows:]

#### TESTIMONY OF JEFFREY H. ERICKSON

Chairman McCain, Members of the Senate Aviation Subcommittee, I am honored to appear before you today on behalf of the 23,000 employee owners of Trans World Airlines.

Mr. Chairman, these are exciting times at TWA. Over the past year, we have embarked upon an ambitious attempt to cut costs, restructure, and become more competitive. The fruits of our labor are beginning to show. Just 9 days ago, we announced a final recapitalization agreement with our creditors to restructure TWA's finances. This will enable TWA to write off its books approximately half a billion dollars of debt. Our restructuring will be completed by the end of this summer, either out-of-court, or through a prepackaged bankruptcy filing, which would enjoy the full support of our creditors.

TWA is bullish on the future. To quote from our advertising campaign, "We are up to something good." Consider the following:

- TWA has introduced a new premier service for international business travelers: Trans World One. Trans World One offers luxury First Class appointments and gourmet meals at business class prices. It is meeting with praise from our customers, and is sure to set a new industry standard.
- TWA's employee-owners demonstrate an enthusiasm for their jobs, a commitment to service, and a sense of "team" that is unique in commercial aviation. The service provided by our flight attendants, and the customer-focused approach of our reservations staff have received industry recognition for excellence in the past year.
- The U.S. Department of Defense recently awarded a multi-year heavy maintenance contract for Navy and Air Force Aircraft to TWA. This work, worth at least \$38.4 million per year, will be performed by skilled TWA mechanics at our Kansas City overhaul base.

Mr. Chairman, we are embarking on a new era at TWA. A new management team is in place. New labor contracts without wage snapback provisions are in place. Our service is second to none. TWA's cost structure makes us competitive. But, Mr. Chairman, we are an international carrier that cannot access London—the gateway to Europe—from our New York/JFK hub. We can fly to Paris. We can fly to Frankfurt. We can fly to Rome. But we cannot fly to London. It is very difficult to develop the allegiance of the international business traveler when British Airways, Virgin Atlantic/Delta, American, and United Airlines can fly from New York/JFK to London/Heathrow, but TWA cannot.

The U.S.—U.K. bilateral was negotiated in 1977. It is widely acknowledged to be the most restrictive and anti-competitive aviation bilateral to which the United States is still a party. The United States government has vowed repeatedly to take a tough stance with the British, to engage them in general negotiations aimed at broad liberalization. But, to date, it has not happened. Eighteen years ago only two

U.S. carriers were given access to Heathrow. Only two U.S. carriers can access Heathrow today with their own aircraft.

The U.S. government's failure to achieve any meaningful new access to London's Heathrow Airport is, in my view, appalling. After all, U.S. negotiators sit in a position of strength. The U.S. domestic aviation market is the largest, most lucrative aviation market in the world. Access to our market, which alone comprises about 30 percent of the world's aviation market, is critical to British carriers. But recent U.S. negotiations with the British have been characterized by limited gains for U.S. carriers and broad new authority for U.K. carriers. The following summary illustrates this point.

Two years ago, on March 10, 1993, the U.S. Department of Transportation approved broad new access for British Airways to the U.S. domestic market through a code-share arrangement with USAir. The arrangement provided for service to 38 U.S. cities beyond Baltimore, Philadelphia and Pittsburgh. At the time, Transportation Secretary Federico Peña said, "let me emphasize to all that the approvals granted to BA and USAir are faced at 1 year," during which "the Administration will pursue a new agreement . . . that incorporates 'open skies' provisions." In reference to Bermuda II, the Secretary said, "the current agreement is unacceptable."

Eight months later, on November 12, 1993, the Department approved a British Airways/USAir request to serve an additional 66 U.S. cities on a code-share basis for 60 days. This new approval expressly stated that DOT would monitor the progress toward a liberalized aviation regime. When this new application was filed, Secretary Peña said that "this new code-share request strains our relationship as we enter the most sensitive phase of our renegotiation."

A month later, on December 22, 1993, DOT extended the November codeshare until March 17, 1994—the date for expiration of the original code-share request.

Three months later, on March 17, 1994, the Department extended the code-share arrangement for an additional year, even though it noted that it was "extremely dissatisfied with our existing relationship" with the United Kingdom.

Now another year has passed. There still has been no liberalization, although another British carrier has obtained expanded access to the U.S. domestic aviation market through code sharing. On February 10 of this year, the Department approved the extra-bilateral request of Virgin Atlantic and Delta to engage in a blocked-space/code share arrangement over seven U.S. points, including between London/Heathrow and New York/JFK. DOT said that securing "the benefits of this new service outweigh any contrary bilateral considerations."

Mr. Chairman, that takes us to today. British Airways/USAir now seek the reauthorization of their code sharing arrangement. But this year, the Department of Transportation does not even pretend to be seeking broad liberalization in return for continued code sharing authorization. Instead, the most recent proposal forwarded by the United States offers the United Kingdom reauthorization of the British Airways code sharing arrangement, a new flight for British Airways from London/Heathrow to Philadelphia, and an opportunity to carry U.S. Government "Fly America" traffic on certain code sharing flights. In return, the United States seeks only to obtain early authorization for United Airlines to fly from Chicago to London—authority that United will automatically obtain soon anyway, an opportunity for U.S. carriers to fly to United Kingdom destinations other than London, and a commitment from the British to talk later about cargo, pricing, charters, and access to London Heathrow and/or Gatwick. In other words, Mr. Chairman, all of the real U.S. negotiating objectives are, once again, to be put off for another day.

TWA has consistently sought access to London Heathrow. We have, however, learned that we should not expect too much from our negotiators. Thus, when it became clear that the United States would not be seeking authority for any new carriers to serve Heathrow in the current round of negotiations, TWA asked that the Department simply seek authority for us to serve London/Gatwick. It is, and always has been, our intention to serve this route on an interim basis until new Heathrow authority becomes available. For us, seeking access to Gatwick is a fall-back position. It is a significant concession. We thought we were making a reasonable request of the Department, that we were one carrier that was being realistic, that the Department would be pleased that TWA was scaling back its expectations for the current round to what would be "achievable." Working with Senator Ashcroft, Senator Bond, Senate Majority Leader Dole, House Minority Leader Gephardt, the rest of the Missouri Congressional delegation, the Governor of Missouri and the Mayor of St. Louis, TWA impressed upon the Department the critical importance of our being able to access London from New York, even if that access were limited to Gatwick until Heathrow opened up. Some access is better than no access.

Mr. Chairman, I regret to tell you that the United States is about "to be had" and out-manuevered by the British. The Department of Transportation lumped our

request into the so-called "second phase" of the negotiations—the agreement to negotiate in the future. In its most recent proposal to the British the United States did not insist on *any* new access to *any* London airport for TWA. To say we were disappointed would be an understatement. Senator Ashcroft and Senator Bond expressed their view as "outraged." In a letter to the President of the United States, they said that the failure of the Administration "to even so much as ask" for London authority for TWA "suggests a callous indifference for the sacrifices made by TWA's employee owners, and indicates a disregard for the economic interests of Missouri." Mr. Chairman, we agree.

Mr. Chairman, TWA's message today is simply this: There should be no more U.S. capitulation. The time has come to draw the line. The current round of negotiations with the British should not be concluded until the United States has obtained meaningful new access to London/Heathrow. TWA's hub operation is larger than that of any other carrier at JFK. It is in the best interests of the United States and the flying public that it be allowed to compete with British Airways, Virgin Atlantic/Delta, United and American in the JFK Heathrow market. We have come to the conclusion that we must seek access to Heathrow and we must seek it *now*. When we fell back to Gatwick, Gatwick fell back to the second phase. It displaced access to Heathrow as a negotiating objective for the second phase. No more talk of first phase and second phase.

Two years ago, when the original British Airways/USAir code share agreement was approved there was a commitment on the part of both the U.S. and U.K. governments to liberalize the current bilateral. The two governments set a 1-year deadline for themselves. Two years have gone by. The time has come for the United States to stand firm, to negotiate with resolve.

Earlier this month, Secretary Peña issued a new Statement of United States International Air Transportation Policy—the first new policy in 17 years. It says that the goal of the United States is achievement of an unrestricted international air service regime. The Policy affirmatively states that the consequences for countries unwilling to work toward liberalization will involve the withholding of "benefits from those countries." The current round of negotiations with the British is the first "test" of the Department's new policy. The world is watching.

Mr. Chairman, again, thank you for inviting me to appear before the Subcommittee today. I would be happy to answer any questions that you or the Members of the Subcommittee might have.

Senator MCCAIN. Mr. Crandall.

**STATEMENT OF ROBERT L. CRANDALL, CHAIRMAN AND CEO,  
AMERICAN AIRLINES, INC.**

Mr. CRANDALL. Thank you, Mr. Chairman.

As with my colleagues, I shall summarize my remarks, and ask that my full statement be entered in the committee's proceedings.

Senator MCCAIN. Without objection.

Mr. CRANDALL. Thank you. With regard to the United Kingdom, Mr. Chairman, American's objective is very clear. We seek an opportunity to compete on an equal footing with the airlines of the United Kingdom.

Unfortunately, the opportunities we have today, in markets between the United States and United Kingdom, are anything but equal to those of our U.K. competitors.

Senator Ford observed earlier that the British are quite excellent dancers. And back in 1991, they did quite an outstanding dance, after American and United paid hundreds of millions of dollars to replace TWA and Pan American as operators at London's Heathrow airport.

The British, at that time, would not permit American and United to replace TWA and Pan American until the United States agreed to a modification of the U.S.-U.K. bilateral, which, as you know, is generally referred to as Bermuda II, which took the form of granting the U.K.'s airlines, mainly British Airways, tremendously increased access to the United States, and imposing new restric-



tions on both United and American. And as a result, the already bad bilateral became even worse.

Today, American and other U.S. airlines are very seriously disadvantaged by the many anti-competitive restrictions in Bermuda II, which limits airport access, and routes, and capacity, and pricing, and particularly, by the fact that British Airways has far broader access to U.S.—U.K. passengers than any U.S. carrier.

Today, by virtue of its code sharing with USAir in the United States, and its own domination of Heathrow, British Airways effectively has hubs on both sides of the Atlantic, a tremendous advantage, and it is that fact, Mr. Chairman, that addresses the question you raised earlier, as to whether British Airways, in an unrestricted environment, would have a smaller share—they would have a dramatically smaller share, without the advantage of hubs on both sides of the Atlantic.

Senator MCCAIN. Do you agree that it would be in the area of 25 percent—

Mr. CRANDALL. Or less.

Senator MCCAIN [continuing]. As opposed to 50 percent?

Mr. CRANDALL. The aviation relationship between the United States and the United Kingdom is shaped by a number of factors which, together with Bermuda II, favor the United Kingdom's airlines.

First, it is very important to understand that the U.S. aviation market is eight times larger than the U.K. market, thus access to the internal markets of the two countries offer nothing like comparable opportunities.

Second, and much more important, a very large percentage of the passengers flying between the United States and the United Kingdom are going to or coming from third countries that are not parties to Bermuda II.

That traffic is reserved for British Airways, since U.S. airlines have very limited rights to serve routes beyond the United Kingdom.

The chart that my colleague is now displaying shows that by combining its access to the United States, which it gets by means of code sharing with U.S. Air, and its unique rights beyond the United Kingdom, British Airways can now offer customers nearly six times as many on-line city pairs as can American.

Very simply put, British Airlines has six times as many products for sale on each of its transatlantic flights as we have on ours. And the result, of course, is that British Airways carries more passengers at higher prices.

Now, it is our view that the United States must rebalance the competitive playing field with all of its aviation trading partners, and specifically must do so with the United Kingdom.

Recently, as we have heard today, the U.S. and the U.K. resumed aviation consultations, but rather than seeking a comprehensive revision of the bilateral, the U.S. agreed to negotiate an entirely inappropriate mini-deal, which, if consummated, will increase British Airways' advantage even further in exchange for special treatment of one U.S. airline—United.

The United Kingdom has included in its mini-deal proposal a provision that would permit its airlines to carry U.S. Federal em-

ployees, as we have heard, under the provisions of Fly America legislation.

U.S. and U.K. negotiators have agreed to relegate, for no apparent reason, additional rights for U.S. airlines, other than United, to a second phase of mini-deal negotiations. And if our experience with the U.K. holds true, we think it unlikely that that second phase will ever come to fruition.

Senator as you heard various testimony about whether this deal is or is not balanced, let me paraphrase it for you in simple terms.

British Airways gets the right to carry Fly America traffic on its existing flights, and every dollar of Fly America revenue amounts, as a practical matter, to something like 85 cents worth of operating profit, since it moves on existing airplanes.

Second, the U.S. Government has conferred on British Airways a perpetual monopoly between Philadelphia and London.

By permitting British Airways to have a code shared hub in Philadelphia, and a dominant hub in Heathrow, it has created a circumstance where no U.S. airline can or will operate between Philadelphia and London, despite the fact that the Bermuda II agreement gives a U.S. airline that right.

I am not surprised to hear that Mr. Greenwald would applaud this deal, but I am delighted to hear, Gerry, that you will henceforth favor incremental gains in every market. I hope we can count on that in Japan.

Rather than negotiating a mini-deal that will only worsen a badly flawed agreement, the United States ought to be seeking to level the playing field, something it simply must do, if it wants U.S. carriers to be competitively successful in markets to, from, and beyond the United Kingdom.

At a minimum, the following changes should be included in any revision to the agreement. First, U.S. carriers need more opportunities to fly to and from Heathrow, which would thus save a good deal of money by those who must split their operations between Gatwick and Heathrow, and allow U.S. carriers to compete for the vast percentage of London-bound passengers, who prefer Heathrow.

Second, we need an opportunity to serve, either with our own aircraft, or by code sharing the many destinations that British Airways now serves beyond Heathrow. As my full testimony explains, recent actions by U.S. negotiators have dramatically reduced the value of such beyond rights.

Nonetheless, if we had them, we would have some chance to offer our customers at least some of the many city-pairs in which British Airways now has an advantage.

Third, the United States should insist on eliminating Annex Two of Bermuda II, a provision which allows the United Kingdom to exercise unilateral capacity control. And finally, the United States should insist on eliminating the pricing restrictions in Bermuda II.

Today, those rules allow British Airways and other U.K. airlines to offer low fares through private distributors, but prevent American from offering the same fares directly to U.K. travelers.

Mr. Chairman, time constraints and the focus of your interests today have caused me to confine these remarks very largely to the subject of the U.S.-U.K. bilateral agreement. Nonetheless, I should like to make one closing comment.

With respect to the generally pernicious effects which U.S.—European code sharing agreements have had on the ability of U.S. carriers to succeed in Transatlantic markets, the charts that my colleague is now putting up illustrate that the transatlantic code sharing agreements done to date have served to increase the proportion of transatlantic flying done by foreign airlines, which benefits primarily those foreign carriers, and which creates few, if any, U.S. jobs.

In my judgment, the long-term effect of this policy position will be to continuously reduce the U.S. carrier share of transatlantic flying by way of validation of that rather pessimistic forecast.

In April 1995, the capacity of Northwest, United, TWA, and Delta are all down year over year on the transatlantic. Only American seeks to compete on its own and has added additional capacity.

I think it is time for Congress to tell the administration that it should support the interest of both U.S. consumers and U.S. airlines.

Since domestic airline deregulation occurred 17 years ago, American has been a successful competitor. But we cannot compete effectively in markets where our competitors are granted unique advantages.

In our view, many U.S. international aviation relationships, and specifically our agreement with the United Kingdom, are sharply skewed in favor of our fine competitors.

While we seek no special favors, we do think that U.S. carriers generally, and American Airlines in particular, are entitled to an opportunity to compete for each and every passenger, and each and every pound of cargo destined to or originating within the United States of America.

Thank you very much.

Senator MCCAIN. Thank you, Mr. Crandall.

[The prepared statement of Mr. Crandall follows:]

#### TESTIMONY OF ROBERT L. CRANDALL

Mr. Chairman, Senator Ford, Senator Hutchison, distinguished members of the subcommittee, ladies and gentlemen: good morning and thank you for the opportunity to present the views of American Airlines on aviation relations between the United States and the United Kingdom.

No issue is more important for American Airlines, and for our employees, than being able to compete successfully in the international aviation marketplace. Given opportunities equal to those of our competitors, we and other U.S. airlines can and will compete successfully, and by doing so, will benefit U.S. manufacturers and suppliers, the cities we serve, and the many U.S. citizens who are our shareholders.

Let me clearly state our objective with regard to the U.K.: we seek an opportunity to compete on an equal footing with U.K. airlines. Unfortunately, our opportunities in the U.S.—U.K. market are anything but equal to those of our U.K. competitors.

One of our predecessor companies, American Overseas Airlines, operated the first land-to-land commercial airline service between the United States and the United Kingdom, 50 years ago this October. However, American's recent history in the U.K. market dates from 1982, when we began service between Dallas/Fort Worth and London's Gatwick Airport. For 9 years between 1982 and 1991, we did our best to secure rights to London from other U.S. cities, but were thwarted by Bermuda 2, the very restrictive air transport agreement that governs air services between our two countries.

In 1991, we gave up on gaining more access to London on our own, and paid TWA \$360 million for the right to operate to London's Heathrow Airport from four U.S. cities—New York, Boston, Chicago, and Los Angeles. Also in 1991, United purchased Pan Am's authority to serve London/Heathrow.

Despite the huge sums we and United paid, British officials would not permit American and United to replace TWA and Pan Am until the United States agreed to an additional payment, which took the form of granting U.K. airlines—mainly British Airways—increased access to the United States, and imposing new restrictions on the United States airlines serving the United Kingdom. Our government agreed to these additional conditions, and as a result, a bad agreement was made even worse. American and other U.S. airlines are seriously disadvantaged by the burdensome, anticompetitive restrictions in Bermuda 2 that affect airport access, routes, capacity, and pricing, and by the fact that British Airways has far broader access to U.S.—U.K. passengers than any U.S. carrier.

Notwithstanding these limitations, our transatlantic routes to and from London have become an important part of the American Airlines system. However, they would be far more rewarding if the United States and the United Kingdom would liberalize Bermuda 2. Given the fact that the transatlantic routes between the United States and United Kingdom are, collectively, the largest long-distance aviation market in the world, and in light of the very close economic, political, and cultural relationships between the two countries, the rigidities and limitations of Bermuda 2 are particularly inappropriate.

In our view, the United States must re-balance the competitive playing field with all of our major aviation trading partners, but particularly with the United Kingdom. In the remainder of my testimony, I would like to elaborate on these views.

#### "MINI-DEALS" CANNOT RECTIFY THE IMBALANCE

Recently, the United States and the United Kingdom resumed aviation consultations. However, rather than turning their attention to the task of overhauling the entire aviation relationship, the two sides agreed to negotiate an entirely inappropriate "mini-deal", which—if consummated—would increase British Airways' advantage and provide special treatment for one U.S. airline. Neither State nor DOT has performed any analysis of the economic impact of the deal on U.S. airlines, and they have proceeded without any substantive consultation with U.S. airlines other than United—the putative beneficiary!

The United Kingdom has included in the mini-deal proposal a provision that would permit its airlines to carry U.S. Federal employees traveling on government business, in essence suspending application of the "Fly America" legislation.

Even worse, it has apparently been agreed that this mini-deal will be negotiated in two phases. Phase one is to comprise most of what British Airways wants and specific route rights for one U.S. airline. Additional Heathrow access—an element originally linked to the U.K. desire for access to Fly America traffic—has now been deferred to phase two, which may never be concluded. American has urged that the United States either marry the two phases, or make implementation of phase one conditional upon agreement on all of the specific issues to be included in phase two. U.S. negotiators have declined to insist upon either type of linkage.

Without the intervention of this Committee, the two governments would already have reached agreement on phase one, and we thank you for your active role. We do not place much stock in the vague commitment to negotiate phase two at a later date. On several occasions in the past, United Kingdom promises for subsequent negotiation have evaporated once it has secured what it seeks. For example, in 1993, after DOT approved the initial round of the British Airways/USAir combination, the United Kingdom promised to begin negotiation on a wholesale liberalization of Bermuda 2—a promise subsequently proved totally empty.

The Administration seems to want the mini-deal, so that it can trumpet another alleged accomplishment. In our view, such deals only worsen an already flawed relationship. In our view, the recently concluded United States-Canada aviation agreement is an example of the right way to proceed. The United States refused to negotiate mini-deals, and eventually persuaded Canada that a broad, open arrangement was best for consumers, airlines, communities, and employees. It took several years, but the result was worth it.

#### THE STRUCTURAL IMBALANCE OF BERMUDA 2 FAVORS U.K. AIRLINES

The foundation of this structural imbalance—and of many disparities in U.S. bilateral aviation relationships—are two basic geographical facts. First, the United States is much larger in area, population, and discretionary income than the United Kingdom or any other single aviation market. In fact, the U.S. market is eight times larger than the U.K. market; thus, the internal markets of the two countries offer nothing like comparable opportunities.

Second, a substantial amount of traffic that flows across the Atlantic on the airlines of the two countries also travels beyond the United Kingdom to third countries that are not parties to the U.S.-U.K. agreement.

By combining its broad rights to serve points beyond the United Kingdom with the U.S. codesharing rights it obtained in 1991 and has exercised by its combination with USAir, British Airways has created a powerful route system with hubs on both sides of the Atlantic. Effectively, British Airways has the ability to provide single-network service between any U.S. point served by either it or USAir and any point in the United States or countries beyond the United Kingdom served by British Airways. As a consequence, British Airways is now able to offer transatlantic customers nearly six times as many city-pair markets (often called "O&D" or "Origin and Destination" markets) as can be sold by any U.S. carrier—including American—which elects to operate its own aircraft between the United States and the United Kingdom. Exhibit 1, which is attached to this testimony and is being displayed now, illustrates the British Airways advantage. In fact, when fully developed throughout the United States, the British Airways/USAir combination could sell over 12 times as many city pair markets as American.

By contrast, Bermuda 2 limits American to just 17 codeshared flights per day beyond London. We are permitted to operate only one codeshared flight beyond the U.K. for each transatlantic flight into that country and are forbidden to carry local passengers on those flights; British Airways offers nearly 10 times as many flights beyond Heathrow as it operates to the United States and has full local traffic rights on all of them.

The impact of these disadvantages is substantial. In December 1994, the DOT released a study of international airline codesharing which estimates that the British Airways/USAir combination will reduce the revenues of American and other U.S. airlines by \$41.7 million per year. Earlier last year, British Airways forecast its current-year benefits from the USAir alliance to be approximately \$110 million in 1994 alone, more than twice the DOT estimate. The erosion of traffic we have noticed suggests that even the British Airways estimate is too low.

#### BERMUDA 2 CONTAINS RESTRICTIONS THAT SEVERELY DISADVANTAGE U.S. AIRLINES

The most pernicious of these restrictions are those that limit U.S. carrier access to Heathrow.

Heathrow is so important that in 1991, American paid TWA \$360 million to acquire rights to operate between that airport and Chicago, Boston, New York, and Los Angeles. Access to Heathrow is absolutely essential—I emphasize essential—for any carrier that wishes to compete on transatlantic routes to London. London-bound passengers prefer Heathrow because it is closer to Central London, while passengers traveling beyond London prefer it because it is the only London airport with significant connections to cities beyond London.

The magnitude of the Heathrow advantage is statistically overwhelming. In 1994, London Heathrow was the world's fourth busiest airport, with 51.7 million passengers, more than twice as large as London Gatwick, which ranked 28th, with 21.2 million passengers. And the gap is widening: In 1994, Heathrow grew by 8 percent while Gatwick grew by just 5 percent.

Despite the huge amount we paid for the right to serve Heathrow, we must still operate some of our U.S. flights at Gatwick. These services include our flights from Dallas/Fort Worth—our largest hub—as well as those from Nashville and Raleigh/Durham. This inefficient split operation penalizes those U.S. cities we must serve via Gatwick, and costs American several million dollars annually in incremental expenses for duplicate staff and facilities. Even more important, American loses large amounts of revenue because passengers in many U.S. cities choose to fly with British Airways in order to arrive and depart at Heathrow.

Bermuda 2 also imposes restrictions on our right to carry passengers between London and cities in Continental Europe, the Middle East, Africa, Asia, and the Far East. Such rights, which are known in aviation parlance as "fifth freedom" traffic rights, enable an airline to carry passengers between two non-homeland countries as, for example, between London and Paris. An airline can exercise such rights either by operating its own aircraft or by codesharing, and if American or any other U.S. carrier hopes to compete effectively with British Airways, we must have such rights. If we do not get them, people wishing to go from the United States to a point beyond London, or to travel from a point beyond London to a point in the United States, and who prefer to travel for the entire distance on a single actual or simulated network, will inevitably choose British Airways for their flight across the Atlantic!

Our need for rights beyond Heathrow has grown much more acute since the U.S. government's decision to permit British Airways to codeshare with USAir in the United States. Prior to that agreement, U.S. carriers had the unique ability to offer beyond-gateway U.S. consumers on-network services that could not be offered by British Airways. Now that British Airways has broad codesharing rights within the United States, the United States simply must secure for its own carriers equivalently valuable rights beyond London, if it hopes to have any U.S. carriers competing on transatlantic services between the United Kingdom and the United States.

In addition to beyond-gateway codesharing rights within the United States, the U.K.'s airlines have broad fifth freedom rights beyond the United States to Latin America, the Caribbean, and the Far East. This means that British Airways can fly or codeshare to all those places with unrestricted rights to carry local traffic between the United States and countries beyond. Bermuda 2 also gives the U.K.'s airlines intermediate rights to the United States by way of points in Canada, France, Germany, and other countries, as well as rights which allow the U.K.'s airlines to operate non-stop flights between non-United Kingdom points in Europe and the United States.

It is important for the Committee to know, Mr. Chairman, that even if the United States were to secure the unrestricted "beyond Heathrow" fifth freedom rights we seek, we would not automatically be able to compete against British Airways' extensive route system to Europe, the Middle East, Africa, Asia, and the Far East. To make such rights usable, the United States must also secure approvals from the third countries involved. The DOT noted this problem in its recent International Air Transportation Policy document, which reads:

"(Substantial international) access is not readily available in today's bilateral system of negotiating air rights, since governments can only exchange access rights to their own countries and cannot, between themselves, deliver access to third countries, thus requiring piecemeal negotiating efforts to build the necessary package of rights."

Moreover, the value of rights beyond the United Kingdom has diminished significantly in recent years, because of (1) bilateral and other restrictions on codesharing into these countries, (2) French renunciation of its aviation agreement with the U.S., and (3) the fact that most European carriers have already entered into combinations that prevent them from an alliance with American or any other carrier. Exhibit 2 attached to this testimony shows that there are few markets of significant economic value that would permit a codesharing arrangement beyond the United Kingdom. Furthermore, in the most recent round of negotiations, the United Kingdom sought to pull back their earlier offer of unlimited codesharing beyond the United Kingdom, by including only countries in Western Europe.

A third restrictive element of Bermuda 2 imposes artificial capacity restraints that have allowed the United Kingdom to exercise unilateral, *a priori* control of how many flights can be offered between any two points. An instrument known as Annex 2 of the Agreement limits U.S. airline flights on each route segment between the two countries to no more than 150 percent of U.K. carrier flights. Since the United States almost never seeks to limit U.K. airline capacity, the U.K. government—not the free market—determines how much capacity will be offered to consumers.

Fourth, the pricing provisions of Bermuda 2 permit U.K. regulators to disapprove low fares that American would like to offer to British consumers. At the same time, the U.K.'s air transport regulations permit BA to offer the same fares by means of "wholesalers," or more colloquially, "bucket shops." Since U.K. wholesalers are very much captive of British Airways, American's inability to offer low prices directly to consumers is a competitive problem for us and a deprivation for U.K. consumers.

#### RECOMMENDATIONS

We do not believe that the mini-deal currently being negotiated is a substitute for wholesale liberalization of a massively imbalanced U.S.-U.K. aviation relationship. As I noted earlier, the U.S. has not analyzed the possible economic impact of the deal on U.S. airlines. Certainly the mini-deal will not reduce British Airways' huge advantage, and may very well increase it.

Rather than a mini-deal that will only worsen a flawed agreement, the United States must level the overall playing field with the United Kingdom if it wants its carriers to be competitively successful. The United States should insist that the United Kingdom agree to the following:

First, U.S. carriers need more opportunities to fly to and from Heathrow. Having the ability to operate all our U.S. services to Heathrow will eliminate the substantial cost of splitting our U.K. operations between Gatwick and Heathrow, will allow

American to compete for the large percentage of London passengers who prefer Heathrow, and, not at all incidentally, give London services from cities such as Raleigh/Durham and Nashville at least a fighting chance to succeed.

Second, give American the opportunity to sell the same city-pairs BA now offers to transatlantic passengers, by allowing unlimited fifth freedom traffic rights beyond U.K. gateways, exercisable by either codesharing or actually flying one's own aircraft. Although the value of these rights beyond the U.K. has diminished in recent years because of United States and foreign government decisions, we still must have these rights if we are to be able to compete with British Airways.

Third, eliminate Annex 2 of Bermuda 2, which has allowed the United Kingdom to exercise unilateral, *a priori* capacity controls.

Fourth, eliminate the pricing restrictions in Bermuda 2 that prevent American from offering U.K. travelers competitive fares to and from U.S. cities.

#### CODESHARING IS NOT A SOLUTION

Mr. Chairman, time constraints and the focus of your interest today have caused me to confine these remarks largely to the subject of U.S.-U.K. civil aviation relations. Nonetheless, I should like to end my testimony with comments on the pernicious effects of international codesharing. It is no secret that American believes that most international codesharing agreements have benefited primarily our foreign competitors and that we have vigorously opposed such arrangements. Exhibit 3 attached to this testimony, which is being displayed now, demonstrates how the benefits of codesharing on the North Atlantic have had the practical effect of encouraging the operation of aircraft by foreign flag rather than U.S. carriers.

As you know, for over a decade, American's emphasis has been on vigorous expansion with our own aircraft, which creates U.S. jobs and economic opportunity. Codesharing creates artificial, virtual networks that require no capital investment, and which are, as a practical matter, nothing but officially approved collusion. We are profoundly disappointed that our government has been indifferent to this argument, and has made decisions that disadvantage firms like American that are willing to invest in the growth of America.

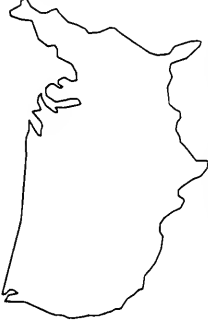
Despite our opposition, the DOT has approved most of the codesharing proposals presented to it. Thus, our efforts to overcome the huge advantages that Bermuda 2 confers on British Airways have been compounded by the competitive disadvantages imposed by the British Airways/USAir codesharing combination, and, more recently, by the Virgin/Delta arrangement. Despite assurances from Administration officials that we would be given offsetting opportunities to be fully competitive in the U.K. market, no new, comparably rewarding service rights have been obtained. In effect—and let me emphasize this point—our government has told us to stop buying airplanes and make a deal to partner with a foreign airline.

#### CONCLUSION

Mr. Chairman, it is time for the U.S. Congress to make clear to the Administration that you expect it to support both U.S. consumers and U.S. airlines. American has done quite nicely in the 17 years since airline deregulation within the United States, and we believe we can give a good accounting of ourselves in any competitive marketplace. However, we cannot and will not do well in any market where competitors are permitted advantages of frequency or destination, and we do not believe it is sound policy to grant foreign airlines unique advantages solely for the purpose of creating additional competition.

We do not fear competition, but we believe that our shareholders and our employees deserve an opportunity to compete in a marketplace which is not deliberately skewed in favor of our competitors. Today's U.K.-U.S. aviation market is severely tilted in favor of the U.K.'s airlines, an advantage which accrues primarily to the benefit of British Airways. While BA is a stalwart competitor, and a first-rate company, we do not believe there is any reason why it should be permitted to offer customers in the U.S., the U.K., or other countries services which American Airlines is forbidden to provide. We seek no special quarter, but we do seek equal opportunity—and I hope the Committee will see fit to support our quest.

**Exhibit 1: The British Airways City Pair Advantage**



81 U.S. points (BA gateways and codeshare points with USAir)

**British Airways/USAir**



138 points in the United Kingdom and beyond to Europe, Africa, and Asia

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$$81 \times 138 = 11,178 \text{ City Pairs}$$



177 U.S. points

**American Airlines**



11 points in the United Kingdom and beyond

$$177 \times 11 = 1,947 \text{ City Pairs}$$



# Beyond U.K. Code-sharing Restrictions – Western Europe

- Only major carrier in country already has code-share agreement with another U.S. carrier
- Third country code-share prohibited
- Third country code-share restricted by bilateral
- Renounced air transport agreement
- Shannon stop requirement
- Limited economic value

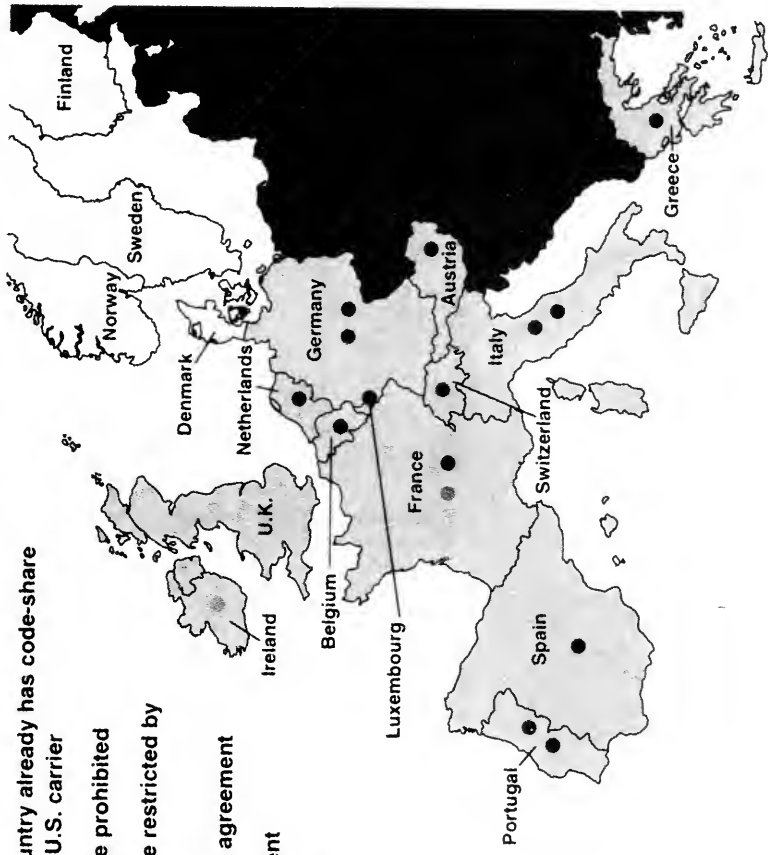


Exhibit 2

## Exhibit 3

## Foreign Airlines Perform Most Transatlantic Codesharing Operations

**Bold type** indicates airline operating the service.  
*Italics* indicate airline placing its code on the operating flight.

Route	Foreign Airline Operates; U.S. Airline Codeshares	Competing U.S. Airline Without Foreign Support
Charlotte - London	<b>British Airways</b> 1/	
New York - London	<b>British Airways</b> 1/	American, Continental, United
Philadelphia - London	<b>British Airways</b> 1/	
Pittsburgh - London	<b>British Airways</b> 1/	
Detroit - Amsterdam	KLM <i>Northwest</i>	
Minneapolis/St. Paul - Amsterdam	KLM <i>Northwest</i>	
Chicago - Amsterdam	KLM <i>Northwest</i>	
Houston - Amsterdam	KLM <i>Northwest</i>	
Los Angeles - Amsterdam	KLM <i>Northwest</i>	
New York - Amsterdam	KLM <i>Northwest</i>	Delta, Tower
San Francisco - Amsterdam	KLM <i>Northwest</i>	
Washington - Amsterdam	KLM <i>Northwest</i>	United
Chicago - Frankfurt	Lufthansa <i>United</i>	American
Washington - Frankfurt	Lufthansa <i>United</i>	Delta
Atlanta - Frankfurt	Lufthansa <i>United</i>	Delta
Boston - Frankfurt	Lufthansa <i>United</i>	
Dallas/Ft. Worth - Frankfurt	Lufthansa <i>United</i>	American, Delta
Los Angeles - Frankfurt	Lufthansa <i>United</i>	Delta
Miami - Frankfurt	Lufthansa <i>United</i>	American
New York - Frankfurt	Lufthansa <i>United</i>	Continental, Delta, TWA
San Francisco - Frankfurt	Lufthansa <i>United</i>	
New York - Oslo	SAS <i>Continental</i>	
New York - Stockholm	SAS <i>Continental</i>	
New York - Vienna	<b>Austrian</b> <i>Delta</i>	
Washington - Geneva - Vienna	<b>Austrian</b> <i>Delta</i> 2/	
New York - Brussels	<b>Sabena</b> <i>Delta</i>	American
Atlanta - Zurich	<b>Swissair</b> <i>Delta</i>	
New York - Geneva	<b>Swissair</b> <i>Delta</i>	
New York - Zurich	<b>Swissair</b> <i>Delta</i>	American
<b>Total Routes =</b>	<b>29</b>	

1/ British Airways receives feed traffic at U.S. gateway by placing its code on USAir domestic services  
 2/ Swissair also places its code on this service

Source: Published airline schedules, effective May 1995.

## Exhibit 3

Route	U.S. Airline Operates; Foreign Airline Codeshares		Competing U.S. Airline Without Foreign Support
Cincinnati - Zurich	Delta	<i>Swissair</i>	
New York - Lisbon 1/	Delta	<i>TAP</i>	TWA
Boston - Amsterdam	Northwest	<i>KLM</i>	
Detroit - Amsterdam	Northwest	<i>KLM</i>	
Minneapolis/St. Paul - Amsterdam	Northwest	<i>KLM</i>	
Chicago - Frankfurt	United	<i>Lufthansa</i>	American
Washington - Frankfurt	United	<i>Lufthansa</i>	Delta
<b>Total Routes =</b>	<b>7</b>		

1/ TAP Air Portugal still operates non-codeshared daily Newark-Lisbon service

Senator MCCAIN. Senator Pressler.

The CHAIRMAN. Thank you very much.

Mr. Erickson, I am sympathetic to what you are saying. There is a question, however, as I understand it, did not TWA have access to London Heathrow and sell those authorities? Was a substantial gain realized from that sale?

Why should the U.S. Government now be asked to help TWA remedy what might have been a regrettable business decision?

Mr. ERICKSON. Senator, let me make three observations with regard to that. Now, first, when Carl Icahn sought to purchase TWA in 1985, this committee was so concerned about the possibility that he would sell TWA's international routes, that it held hearings and reported legislation that provided that under certain circumstances, these international route authorities would revert to the Federal Government in the event of an attempted sale.

This legislation was never enacted, but the committee was very aware of the potential.

Second, at that time, TWA employees fought very hard against that sale, and, in fact, the former chairman of this committee, Senator Danforth, really led that effort.

And third, as I mentioned in my testimony, the competitive landscape has fundamentally changed in recent months with the approval of the code share arrangement between Virgin and Delta.

It is essential that we be able to compete. If the mini-deal is approved, we will be the only carrier with a major hub on the eastern half of the United States that does not have service to London.

The CHAIRMAN. I am very sympathetic and I certainly think that should be worked out.

Mr. Greenwald, you stated that the Chicago market is substantially under served. If that is true, why is it that the 600,000 threshold has not been reached?

Mr. GREENWALD. Mr. Chairman, the view that we have, having gathered statistical data, is that simply stated when bad incentives are put in front of red-blooded American businessmen, they will follow them.

There is, unfortunately, an incentive for American Airlines to do what they need to do to keep flying out of O'Hare to Heathrow below the threshold.

I do not think it is coincidence that British Air flies 747s from O'Hare to Heathrow, substantially more capacity than the 767s or MD-11s that American flies.

When we talk about wanting to be competitive with the British, we do have existing capacity that we are not using. Certainly, one of those examples is O'Hare-Heathrow. I want to give you another example, Dulles.

This threshold system does not apply uniquely to O'Hare-Heathrow. It also applies to Dulles-Heathrow. There are two authorized, or there were two authorized carriers, British Air and United, flying Dulles-Heathrow.

That threshold has been exceeded. That market is available for another U.S. carrier to go in. And we welcome them.

The CHAIRMAN. Now, Mr. Allen, as I understand it, Delta is opposed to the proposed deal because it is a mini-deal, and you believe an incremental negotiating strategy is unwise.

However, was not approval of the Delta Air lines/Virgin Atlantic code-sharing agreement in February of this year essentially a mini-deal that, in terms of U.S. carriers, benefited only your airline?

Mr. ALLEN. Senator Pressler, I appreciate the opportunity to discuss that, particularly since it has been mentioned two or three times, and clarify the difference. While this could be classified as a mini-deal, it was a stand-alone deal, in that the British received, in effect, nothing in return.

This is a case where Delta, after the USAir-British Airways approval of the second year of that agreement in March 1994, recognized that the only way we could get into the market was in some relationship such as we struck with Virgin.

This relationship, as I said, stands alone. The British did not achieve new route authority as a result of the fact that Delta is now buying seats on Virgin Atlantic.

That is what this amounts to, the blocked-seat agreement, where Delta Air Lines goes in and buys seats from the seven gateways, into London, and those seats are on Virgin.

We did that in a competitive response, as a result of our government's approval of the British Airways-USAir deal, but the British received nothing else in return.

The CHAIRMAN. Mr. Crandall, according to a recent Business Week article dated May 15, 1995, an American Airlines official is quoted as saying American Airlines is "counting more on scotching United's plans than getting their own new route."

This statement suggests American's opposition to the current round of U.S.-U.K. negotiations is based on parochial interests rather than the concerns you have expressed today.

Is this statement by your official accurate, as reported?

Mr. CRANDALL. Mr. Pressler, I am certainly not going to deny parochial concerns. It is my duty to manage the company for the welfare of our shareholders, and I do the best I can to do that.

The fact is we are operating three flights a day from Chicago O'Hare. That is the maximum number of flights we are permitted to operate. We are also flying, as Mr. Greenwald was kind enough to point out, between Chicago and Birmingham, a route United elected not to apply for.

The fact of the matter is that United, Northwest, and others have successfully prevented us from serving Chicago-Tokyo, and I am not anxious to have another U.S. competitor between Chicago and Heathrow.

Nonetheless, we are operating all the flights that the bilateral permits us to operate, and we will continue to do our best to compete to out carry British Airways.

I might make the point, British Airways—again, I made the point that the agreement should be altered to prevent the British from unilaterally controlling capacity. Our ability to operate to Chicago is measured as a percentage of the frequencies operated by British Airways.

So the gauging item is really how much British Airways flies, and not how much we fly. The gauge or the size of the particular airplanes that we use are those that we use typically in international markets.

The CHAIRMAN. My final question, and if I may submit the rest of my questions for the record, for anyone, do you have an opinion as to whether renunciation of Bermuda II would be an effective strategy in dealing with the British? What might be the full consequences of renunciation?

Mr. GREENWALD. I would like to try to answer that. I think that some of this discussion strikes me as what I call warming up in the locker room. The real game is out there.

It is between the DOT, on our side, and their counterparts in the U.K. They are two teams, and they negotiate positions from where they both stand.

I have heard others say, well, darn it, we do not have a balance, and if we cannot get a balance, let us renunciate the bilaterals. Well, let us look at what happens when there is a renunciation.

At very best, it simply confirms the status quo. That is what has gone when France did this to the United States. The status quo exists between France and the U.S., and there are no talks going on.

Now, a more drastic version of renunciation is that we refuse to allow the foreign carrier of country "X" to fly into the United States. Now, of course, what do they do?

They refuse to allow our carriers to fly across to their country. I do not think there are enough fax machines in Washington that could take the outcry that would occur if an event like that occurred.

Mr. CRANDALL. I, too, have an opinion. It is my judgment that renunciation would be an effective strategy because access to the United States is vastly more important to British Airways than is access to the United Kingdom to any single United States carrier or United States carriers collectively.

Mr. Greenwald outlines various unpleasant possibilities. The result of renunciation would be unpleasant; nonetheless, the existing situation is equally so, and in my judgment, unacceptable.

British Airways, as you have seen from the Secretary's statistics, carries a disproportionate share of the traffic between our two countries. I think it is wonderful that British Airways has set up a business transiting people to and from the United States across the United Kingdom.

I do not believe that they should have as large a piece of that action as they have, and I think U.S. carriers can get it back only with the aggressive support of the U.S. Government.

Mr. ALLEN. I would like to respond to that, also, and say that, obviously, we have been out negotiated by the British. We are to a point where we do not really have much leverage left.

You have been asking that question before, and we are down to a point of very little leverage. We lost most of this when our government approved the USAir-British Airways deal for the second time.

Our government had stood pretty firm. We stood behind our government, including saying we should renounce if the British government is not willing to open its skies to get this deal, and unfortunately, our government, we made the wrong decision, extending this without getting anything in return for that.

We lost our leverage. And without renunciation, we really do not have any leverage. So I would also favor renunciation.

Mr. ERICKSON. Senator, I do as well concur with that view.

The CHAIRMAN. May I submit the rest of my questions for the record, Mr. Chairman?

Senator MCCAIN. Without objection.

Mr. Allen, I think you answered the question that Mr. Greenwald raised about Delta having a deal.

Mr. Crandall, Mr. Greenwald also mentioned that you also had a deal—

Mr. CRANDALL. Not—Mr. Greenwald, I think—

Senator MCCAIN. Would you like to respond to that?

Mr. CRANDALL. I think Mr. Greenwald misspoke. The opening of the regional airports was not a by-product of negotiations between the United States and the United Kingdom. It was a unilateral offer by the British Transport secretary, simply making the offer that if U.S. carriers wished to serve the regional airports, they could do so.

And I think he made it in response to very strong pressures that were brought on the Secretary, on the Minister, by representatives of the city of Birmingham.

We subsequently applied. United could have applied, had it wished to apply. In that case, the U.S. Government would have had a route proceeding to decide which of us might be permitted to fly, and, in fact, might have permitted both of us to do so. But it was not part of the negotiations, and it was not part of any mini-deal.

Senator MCCAIN. Mr. Crandall, Mr. Greenwald also said that British Air flies 747s out of Chicago, you fly 767s, and you are, at least, in effect, keeping the number of passengers down. Is that so?

Mr. CRANDALL. Well, I guess I would simply have to take—I would simply have to disagree. As Mr. Greenwald perfectly well knows, we do not have 747s in our fleet. We do not have 747s, because we do not have a large route structure to that part of the world, where very large airplanes, very long-range airplanes are needed.

That is the Pacific. United Airlines and Northwest and others have actively sought to prevent us from participating in that part of the world. So I will make an offer.

Whenever we get Chicago-Tokyo access, we will buy larger airplanes, either 777s or 747s, and we will be happy to use some on London, but in the meantime, the aircraft we use are those best suited to our system.

Mr. GREENWALD. I would like to add a comment. I believe that American is using approximately 65 to 70 percent of the available seat capacity from Chicago to Heathrow today.

The remedies are: (a) I will introduce you to Mr. Schrontz, you can buy some airplanes from Boeing, they are laying off 12,000 people today, or (b) put a competitor in, and we will fly 777s out of O'Hare to Heathrow.

Senator MCCAIN. Thank you, Mr. Greenwald. Mr. Greenwald, there is a copy of Aviation Daily, Wednesday, May 24, and it is entitled, "United Says Chicago-Heathrow Service Is Constrained To Keep Out Competition." It says, "According to Chairman and CEO Gerald Greenwald, Bermuda II specifies that when the authorized carriers, American and British Airways, exceed in carrying thresholds of 600,000"—it goes on.

At the end it says, "Greenwald said the airline has been able to put together a 'strong political base' that he noted was 'unfortunately necessary' to make its case."

What is your strong political base, Mr. Greenwald?

Mr. GREENWALD. I did make that statement. I made it primarily, because I wanted to highlight the unfortunate politicizing of what should be primarily an economic matter, a negotiated matter between the DOT and their counterparts in the U.K.

Now, I am not going to embarrass anybody, but it is now only about five or 6 weeks ago when I received a call from someone who ought to know, and who said your case on the threshold is sound, the economic analysis that justifies that this is good for the United States proves the whole point, but the other guys have 20 Congressmen who are writing letters, and you need 25.

And I think that says a lot of bad things about the process. We created 25 letters.

Senator MCCAIN. So you put together a strong political base. That does not mean that you put together a strong political base within the administration.

Mr. GREENWALD. That does not mean that we—you are absolutely right. I do not remember the count, but it was, if anything, more balanced on the other side of the floor.

Senator MCCAIN. There are allegations that you were intimately involved in these negotiations with the British on this proposed agreement, mini-agreement.

Mr. GREENWALD. I am sorry, but do you have a question, sir.

Senator MCCAIN. Is that true?

Mr. GREENWALD. That we were involved in the negotiations?

Senator MCCAIN. Yes.

Mr. GREENWALD. No. That is against the law.

Senator MCCAIN. Pardon me?

Mr. GREENWALD. No. That is not true, and that is against the United States law.

Senator MCCAIN. You stated—I did not read it in your statement, but you stated you believe in open markets, equal access for everyone, fair competition, et cetera.

How does that coincide with your total and complete opposition and assembling of a strong political base in opposition to lifting the perimeter rule that prevents anybody flying more than 1,250 miles from National Airport, Mr. Greenwald?

Mr. GREENWALD. I believe no economic analysis was done to measure that proposal by anyone in Washington. We have done—

Senator MCCAIN. Economic analysis on lifting the perimeter rule?

Mr. GREENWALD. Yes. I think the outcome of such an analysis would demonstrate that there would be relatively little flying from National, short-haul flying, because it would be more profitable for the airlines, with limited slots, to fly long range. And that second, it would undermine the Dulles Airport.

Senator MCCAIN. Well, that flies in the face of the facts. What you have decided is that you are going to support an artificial barrier to people flying long distances from National Airport, because you got a better deal at Dulles Airport.



That contradicts many of your statements, Mr. Greenwald, that you are somehow for free, open markets and competition.

And congratulations on your assembling of a strong political base, as you said, so that the perimeter rule will probably be kept in effect, thereby maintaining an artificial barrier to competition, and an artificial barrier to American citizens from being able to fly from one place to another.

Mr. GREENWALD. Mr. Chairman, if an economic analysis were done by a third party of the U.S. Government that demonstrated that lifting the periphery rule would be beneficial to the United States, we would stand aside.

Senator MCCAIN. Mr. Greenwald, no artificial barrier to markets make economic sense. If you believe in deregulation in international routes, sir, you should believe in deregulation and removal of artificial barriers to markets domestically.

Senator HUTCHISON.

Senator HUTCHISON. Thank you, Mr. Chairman.

There has been a proposal put on the table that would allow the four dormant authorities that now exist for access to Heathrow to be switched to cities that would like to use them. Philadelphia, St. Paul, Detroit, and Seattle are the dormant ones, and I would like to ask any of you who would like to comment on whether you think that would be a fair proposal, and one that should be pursued by the United States?

Mr. CRANDALL. I think, Senator, that if, in fact, the United States has a right that it cannot now use, and it can put that right in a different place and use it, it would be better off. It ought not to be, however, something that we have to buy incrementally.

If the United States is authorized to have "X" cities and we only have "Y" cities serving Heathrow, it seems to me that the United States ought to be free to move those around. I do not think we ought to have to pay extra for that, but it is a way to get at the question of Heathrow access.

Senator HUTCHISON. Mr. Greenwald.

Mr. GREENWALD. I believe a practical answer is that it is unlikely the U.K. will simply say do what you want.

Senator HUTCHISON. Well, I think it is unlikely that the U.K. is going to deal with us as long as everyone considers that we have no leverage, and we do not do the things that would create leverage.

So in trying to fashion something that would open some competition, it seems to me that this would be a potential for United also to have the access to O'Hare, and also allow other carriers to use these dormant routes from other cities.

It would seem to me that that might be something on which we could have a united front, and ask the Department of Transportation to take up. Is that a fair statement?

Mr. GREENWALD. Senator, I fully agree with you. I do not know that they are here. My understanding is that that is a subject they intend to take up in the next phase.

Senator HUTCHISON. Phase two?

Mr. GREENWALD. Yes.

Senator HUTCHISON. Well, let me just ask you this. Do you feel that it is—well, I heard all of your opinions on renouncing Ber-

muda II as one of our ways to create leverage. I think that certainly is a way to create leverage.

If the Department of Transportation chose not to do that, would a fallback position be that these issues, which we have discussed, all occur in phase one, so that there is not a future for the few things that are on the table that everyone seems to want, which is Fly America and increased access to Heathrow, and with perhaps the use of the dormant routes? Could we all agree that putting that into phase one might create whatever bit of leverage we might have?

Mr. ERICKSON. Senator, that is certainly my view, that we ought to get all of the options, many of which you have mentioned, on the table, get a comprehensive deal right now, and that we get away from this phase one, phase two business, and be stuck with a phase two that is unlikely to achieve any success.

Mr. CRANDALL. Senator, I want to come back to a point that I think the Chairman raised, and that perhaps you have commented on.

I sincerely hope that this committee and the Congress will make a serious demand on the Department of Transportation for a serious analysis of the economic implications of these transactions, and of all international aviation transactions.

In my judgment, even a combined phase one and phase two will be dramatically favorable for the British.

I mean I do not think we have to argue a whole lot about this. The data shows that British Airways has a vastly disproportionate share of traffic. They have that traffic, because they have a whole plethora of rights and authorities that U.S. carriers do not have.

Now, rolling phases one and two of this so-called mini-deal together would be better than splitting phase one and phase two, but even phase one and phase two together will, in my judgment, further worsen the relationship, the balance of trade, if you will, in aviation, between the United States and the United Kingdom.

Senator HUTCHISON. Mr. Greenwald.

Mr. GREENWALD. I would like to make clear that we at United are quite prepared to stand behind an economic analysis of phase one. And if the answer states that it is net good for the United States, not United, go forward. And if it says it is not, stop.

Now, I am told, and I have never seen this, that the DOT has conducted such an analysis. We alone have tried to do our own, and we think that there is a very strong answer.

But I think they are now going to provide that information to the committee, and you-all will have a chance to judge it for yourself.

I think all future bilateral negotiations should be judged on the economic analysis of each deal, and that the airlines ought to get out of the way. And if it is right for the United States, we ought to do it. And if it is not, we should not.

And finally, it is unfortunate that there is an unbalanced relationship that goes to history between the U.S. and the U.K., but I submit to you that if it were on the other—if it were turned upside down, would the United States volunteer to redress the balance?

I doubt it very much, and I know of some other markets where it is reversed, and we are not volunteering, and I would say—and we should not.

Mr. CRANDALL. I wonder if I could comment. In fact, the United States probably would. [Laughter.]

Mr. CRANDALL. If you look at the history of international aviation since World War II, and if you look explicitly at the U.S.—U.K. bilateral, the United Kingdom renounced the agreement.

Secretary Peña said this morning that the United States reluctantly agreed to a new restrictive agreement. It did not need to.

The United States prior to that revision of the first Bermuda agreement had a very favorable balance, a very favorable agreement with the United Kingdom. The fact is we simply have not used our leverage, Senators, and we should.

Mr. ALLEN. May I add that we feel we have done the same thing, Senator, in the agreement between the United States and Germany. We had an open sky agreement.

That agreement is now closed for the next few years, with a hope and a promise that the German government will come forward and talk about open skies at the end of the 4-year deal. There is no guarantee of that.

We did that, because, as I understand it, the German government came to us and said Lufthansa needs some help. They struck a commercial relationship with United, which is fine, but in doing so, we feel that our government should not have closed the skies, in effect, in what was a liberal agreement.

May I add one thing to what you said? I think certainly combining phase one and phase two is helpful, but I would agree it is a very small step, in light of the lack of balance we have in the U.S.—U.K. bilateral today.

As you can see from the discussion on this panel, I think British Airways and the British government has done a very good job of dividing and conquering the United States aviation interests, and it is time that our government stood back from a reactionary mode, and studied what is in our best long-term interest in dealings with the British government, and go to the British government with those kinds of demands, including renunciation, if necessary.

Senator MCCAIN. Including using other leverage in other markets and other industries, if necessary, I would suggest, since there is such enormous imbalance at this time, as far as strictly aviation is concerned.

Senator HUTCHISON. Mr. Chairman, I would like to ask, and I will submit this for the record, but I think it is important, when we hear from the Department of Transportation about the benefit to the United States, the economic analysis, that we also look for the alternative cities, as if we took, say, the four dormant routes, and gave those to the cities that want access, and would use routes.

I think we need an alternative economic analysis of the benefit of that approach, as well as the economic benefit analysis of just increasing the share of cities that already are served between America and Heathrow on American carriers.

Senator MCCAIN. I agree.

Senator HUTCHISON. So I would submit that and would like to have that done by the Department of Transportation.

Senator MCCAIN. I also wonder, in the context of what we were just saying, if the U.S. Trade Representative should perhaps be the person or office conducting these negotiations, giving that office a broader scope of responsibility. I think that is something that we ought to look at in the long term.

Thank you, Senator Hutchison.

Just finally, I would like to ask all four panelists that if this deal, the so-called mini-deal, is agreed to by the administration, what remaining leverage does the United States have, within the airline industry and within airline issues, to try to achieve the goals that we seek to balance the playing field?

Mr. ALLEN.

Mr. ALLEN. Mr. Chairman, I really think we have very little left. I would say the No. 1 interest on the part of British Airways would be further ownership rights under U.S. Air, but beyond that, I do not see much.

Senator MCCAIN. Mr. Greenwald.

Mr. GREENWALD. I believe there are four, three of which were mentioned by the panel before us, which I will repeat and add one. There is going to come a time, my guess is it will be longer than sooner, when BA and U.S. Air are ready to propose a further involvement by BA in U.S. Air.

I say longer, only because I have lived through the time it takes, it took 8 years in our case to arrive at employee ownership, and that is part of what U.S. Air is doing in the meantime.

Second, certainly, they would like the opportunity to waive anti-trust rules, so their new relationship could be tighter and more advantageous. Third, cabotage is something that is out there.

I mean the clearest way I can say it is, the U.S. market is no longer regulated, this goes back to the seventies, but the international markets, and flying in and out of other countries certainly is still regulated. Cabotage is an issue.

And fourth, I would submit that Fly America is one other one that is of interest to British Airways, because I believe what is going on here is the potential for them to bid is a great big bucket.

I do not know if it is \$134 million a year. What is in phase one is a couple of drops out of that bucket, and there is a lot more there. And I think, therefore, there are these four issues.

Senator MCCAIN. Thank you.

Mr. ERICKSON.

Mr. ERICKSON. Well, Senator, I would just say that none of those issues is of sufficient magnitude, I think, to have any meaningful liberalization of Heathrow access in phase two, and I am very concerned about that, which is why I am pushing for a comprehensive approach.

Senator MCCAIN. Mr. Crandall.

Mr. CRANDALL. I think we have little, if anything, left, Mr. Chairman. I do not believe British Airways wants any further ownership of USAir. They certainly do not need it to get the traffic benefits, which flow from the code share, not from ownership.

Waiving antitrust rules would be valuable for any combination, but we have had some very clear indications that the government is not prepared to do that beyond Northwest/KLM.

We hope the Northwest/KLM grant will be carefully examined. Cabotage is less valuable than code sharing, so I cannot imagine why anybody would want to substitute cabotage for code sharing.

And finally, I agree with Mr. Greenwald, in a sense, that the Fly America pot is a big pot, and any revenue that BA manages to get will be very profitable revenue, because they will put it on existing airplanes, and simply raise their yield.

But even the \$135 million magnitude of it does not approach the value of preserving fortress Heathrow.

If I could just offer a very brief comment with respect to something Senator Pressler said, you had asked about process, Senator.

One of the important points, and I think this is one area where my colleagues and I agree, when two teams of negotiators go to the table for an international aviation negotiation, they are not equal. The British side brings British Airways with them. Our side leaves us home.

We have long felt, and this is one of the great difficulties of the United States, is that we have a huge economy and competitive airlines, so we do not always agree. Nonetheless, we are excluded from those negotiations.

As you can tell from the intensity of our testimony this morning, we are intimately and very deeply involved in them. We would like to be on the team, and we think it is time and past time that was done.

Senator HUTCHISON. Has that always been the case?

Mr. CRANDALL. Senator, I am not enough of a historian to say, but I believe the answer is yes.

Senator HUTCHISON. Since your time—

Mr. CRANDALL. In my time, in my years in the airline, the U.S. airlines have been excluded from the negotiating teams.

Mr. GREENWALD. I would just like to—I frankly think that sending all of us to join a U.S. delegation, negotiating with another country, it would be a mistake, unless the process changes. I mean to me it is the equivalent of why parents do not bring their kids on vacation, if they are too unruly.

We have to find a means by which the government can freely make its decisions in the best interests of the Nation. And I, again, submit that the answer to that is an economic analysis each and every time.

And each of us potentially, if there is way to share it confidentially, should have a chance to critique that analysis, and then it gets done, and we get out of the way.

Senator MCCAIN. Thank you.

Are there any closing comments, Mr. Allen or Mr. Erickson?

Mr. ALLEN. If I may just address that last point, our experience has been one of concern, based on what I feel is a lack of expertise and experience on the part of some of our U.S. negotiators.

They are good people, but they do not have the same level of expertise and understanding as the British or the Germans, and we have lost ground in every one of these negotiations probably because of that fact.

Senator MCCAIN. Let me just comment, I think the record is clear that the recent negotiations that were just concluded were not in the interest of the country, so I think certainly the historical record will bolster your argument.

Mr. Erickson, do you have any final comments?

Mr. ERICKSON. Well, I agree. Certainly, we would like the opportunity to participate in some stage of the negotiations.

Economic analysis is very important, and certainly our situation is different from the United Kingdom, where you have a dominant carrier. I kind of like our system better.

Senator MCCAIN. Well, I do not want to waste time either, but also the reality is, especially when you are dealing with countries like Japan and other European countries, they have career bureaucrats and career professionals who engage in these negotiations, and we have this turnover that does not give us perhaps the same kind of benefits at the negotiating table that others have.

I thank you all very much, and I appreciate your being here, and most of all, I want to apologize again for the delay in your testimony. Thank you.

Senator MCCAIN. My apologies to you that I extended to the previous panel. It is just one of those days when we are besieged with a large number of votes.

I am not expecting sympathy, but I was just informed we are going to have about 20 votes beginning around 1:45 to 2:00. So I am looking forward to that.

Perhaps, Mr. Weidemeyer, you would begin with your testimony.

#### STATEMENT OF THOMAS H. WEIDEMEYER, PRESIDENT AND CEO, UNITED PARCEL SERVICE CO.

Mr. WEIDEMEYER. Thank you, Mr. Chairman and distinguished members of this subcommittee. My name is Tom Weidemeyer, and I am the President and Chief Operating Officer of UPS Airlines, which is the airline subsidiary of United Parcel Service of America Inc., the largest package transportation company not only in the United States but throughout the world.

I am grateful for the opportunity on behalf of UPS to appear before you today. I would also like to take the opportunity to thank Senator Ford, even though he is absent at this point, from the great State of Kentucky, the home state of the UPS Airline—we are headquartered in Louisville—and thank him for his ongoing support of U.S. aviation interests throughout the years.

And as prior folks have done, I would request that my previously submitted full statement be made part of the record.

Senator MCCAIN. Without objection, Mr. Weidemeyer.

Mr. WEIDEMEYER. Thank you.

I have an interesting comment to make to open my remarks, and perhaps it will set the tone for what I am about to say as I paraphrase my written statement. As I look around me, I recognize that going last has benefits and detriments.

Certainly, going last, you get to have the opportunity to have the last word. And when we have distinguished panelists like we had on the prior panel, it is tough to get the last word if you are with them.

On the downside, however, is the audience disappears. And what you have to say does not necessarily get the attention it should.

And my concern with that is that I think that this, unfortunately, is a significant event that shows that the secondary status that express and cargo interests have been afforded, not only today in the typical, bilateral negotiation process that takes place.

The world is rapidly changing. Orders, both political and economic, are coming down. The rate of global change is increasing at a blistering pace. Individuals and businesses involved in this change know it and live it every day.

Information and financial resources already flow freely around the world, while the movement of people and goods that support them are too often restricted by archaic and protectionistic rules and regulations.

Globalization is inevitable, and nationalistic constraints will not be able to stop it. We must accept this fact and seek new ways to benefit from this new environment. Agreements, such as GATT and NAFTA, recognize this change.

My statement amplifies our concerns and recommendations, but I would like to digress to tell a story, one that is relevant to discussions you have had here today. It is a story of change, rather than status quo. It is also a story of success and growth, rather than protectionism.

The air express/air cargo industry as it has evolved is one of the real success stories in the annals of American business. Cargo deregulation a mere short 17 years ago in the United States led to the development of a new and vibrant industry.

In our business, we consider each package a guest of honor. That being understood, we impact more individuals and businesses on a daily basis than anybody realizes. For, you see, a wide body cargo aircraft may contain as many as 1,500 packages, substantially more guests than on any passenger aircraft.

What impact has this deregulation had on the U.S. economy? On a daily basis, approaching four million letters, documents, packages and air freight shipments move in the systems of the major express carriers each and every day, traffic that is both domestic and international.

In regards to UPS, we are an airline that came into existence just a short 7 years ago. And in that time, because of the ability to compete unfettered but in a fair way, we have been able to develop into an airline that operates 176 jet aircraft and now employs in excess of 13,000 people in Louisville, Kentucky, the headquarters of our airline.

Similar stories exist with the other express carriers. Our experience with the expanded opportunities to Germany have reinforced our belief that open skies with regard to all cargo rights should be our ultimate goal.

We know we can flourish in an environment of fair and unfettered competition. Our ability to obtain rights to fly to Asia has led to the development of a substantial UPS cargo hub in Anchorage, Alaska.

In a new world where information exchange is virtually seamless, a worldwide bilateral aviation system comprised of 1,200 sepa-

rate agreements cannot possibly cope with the economic realities of today.

For years, UPS has supported, and continues to support, the concept of open skies and the attempted liberalization of cargo rights through expanded bilateral or multilateral agreements with members of the European Union, including the United Kingdom. In addition, the President's National Airline Commission supported this position.

Last year, the U.K. House of Commons Transport Committee made the following recommendation for the resumption of talks with the United States, and I quote, "Our principal recommendation is that the United Kingdom government should offer an immediate, deal with no strings attached, involving total liberalization of access to United Kingdom regional airports and, in respect to freight-only services, the removal of all restrictions on fifth freedom rights."

This seemed to be a common sense approach. Do not let the easier issues bog down the discussion of the difficult ones.

What a surprise to us when we were informed that cargo was not part of the mini-deal that we have talked about today. One wonders the relative importance that cargo plays in our negotiating strategy, despite the impact it has on our economy, as I stated earlier, even in the situation where a U.K. Parliament panel had recommended that cargo be liberalized completely before talks began on the rest of the issues.

I think that I can safely predict that if your subcommittee were to make significant recommendation that supported a U.K. priority, the U.K. negotiators would have it on their short list. Clearly, the voice of cargo has not been heard.

So what would we at UPS like to see? First, since liberalization of all cargo rights appears to be common ground for agreement with the United Kingdom, we would recommend that a prompt closure of this issue be pursued.

With that accomplished, the negotiations can focus on the real issues where agreement, even in principle, has apparently not been reached.

Second, UPS will continue to firmly support our government's effort to negotiate a liberal, open skies agreement with our like-minded international aviation partners.

Given the experience of cargo deregulation here in the United States and recent agreements with countries such as Germany, it is being shown that all cargo industry can effectively deal with the challenges of fair and unfettered competition.

Indeed, I would not be sitting here before you today representing a UPS airline but for the deregulation that took place in all cargo 17 years-ago.

In closing, it is important to recognize what we in the private industry have come to realize over the past decade, the world is shrinking. A global economy is replacing local and regional economies as a driving force. And with these changes, the customer reigns supreme.

So in this arena, what does the customer ultimately want? A question that we have not asked today. The customer, whether a passenger or a shipper of goods, wants and expects unrestricted op-



tions with the quality service and cost benefits inherent in any competitive environment.

To give them less stifles the ability of the economies of both parties to a bilateral agreement, to grow and prosper globally. More importantly, to give them less clearly does not serve the public benefit.

Thank you, and I am available for questions at the appropriate time.

Senator MCCAIN. Thank you, Mr. Weidemeyer. Your testimony is that your business has been given second tier priority throughout your experience.

Mr. WEIDEMEYER. Yes, sir.

[The prepared statement of Mr. Weidemeyer follows:]

#### TESTIMONY OF THOMAS H. WEIDEMEYER

Good morning, Mr. Chairman and distinguished members of this Subcommittee. My name is Thomas H. Weidemeyer and I am the President and Chief Operating Officer of United Parcel Service Co., the airline subsidiary of UPS. I am grateful for this opportunity to appear before you to talk about our government's international aviation policy, how it is developed and whether it sufficiently prepares us for the future.

The world is rapidly changing. Borders—both political and economic—are coming down. The rate of global change is increasing at a blistering pace. The individuals and businesses involved in this change know it and live it every day.

It is time for governments to recognize this and react in a way that helps, rather than hinders, global development. Information and financial resources already flow freely around the world, while the movement of people and goods that support them are too often restricted by archaic and protectionist rules and regulations. Globalization is inevitable and nationalistic constraints will not be able to stop it. We must accept this fact and seek new ways to benefit from this new environment.

Once you understand these changes, there seems to be a disconnect between the nations of this world wanting free trade on the one hand, as evidenced by GATT and NAFTA, and, on the other hand, wanting to continue to restrict perhaps the most important means of facilitating free trade—namely, air transportation. In less than 10 years, UPS has gone from a domestic U.S. carrier to one that now serves more than 200 countries and territories for the delivery of documents, small packages and traditional air cargo.

International air transportation is the primary reason for this because it allows businesses around the world to participate in the global economy faster and more efficiently through carriers such as UPS. From a startup airline in 1987, UPS now operates 176 jet aircraft to 11 different countries. In addition, other carriers operate our aircraft to three countries where we do not have the necessary bilateral rights to operate. UPS is now one of the largest airlines in the world. This rapid growth is all the more amazing considering the amount of regulatory hurdles that are in the way.

Although our current operations are running smoothly in the U.K., it has not always been that way, due in large part to the bilateral relationship between the United States and the United Kingdom. You may notice that I did not refer to the bilateral agreement, but rather the bilateral relationship. I did this to point out the fact that it is the bilateral system, not necessarily the aviation agreements themselves, that are the problem. Let me give you an example to illustrate. Two years ago, UPS decided to move its United Kingdom operations from the Stansted airport north of London (where very few airlines want to operate) to the East Midlands airport about 150 miles northwest of London (which very few people have ever heard of).

Under the U.S.-U.K. aviation agreement, known as Bermuda II, UPS is one of only three U.S. carriers designated to serve the United Kingdom with fifth freedom beyond rights. This is very important to UPS because our U.K. flight moves beyond to our primary European air hub in Cologne, Germany. In 1980, Bermuda II was liberalized by what is known as Annex 5, which basically allowed more than three carriers to be designated for service to the U.K. (although only the first three could utilize fifth freedom rights) and did away with the specific point for services requirements under Bermuda II. In essence, a U.S. or U.K. cargo operator was not limited to the four or five cities specified under Bermuda II.

This designation was integral to our decision to move to East Midlands. However, when we approached the U.K. DOT, they informed us that we would have to be re-designated by the United States under provisions of the agreement and that would cause us to lose our fifth freedom rights to Germany. They said that East Midlands was not one of the points designated for those services under Bermuda II, although Annex 5 did away with that requirement.

We approached our own U.S. DOT to help us solve this misinterpretation of the agreement and were told the United Kingdom was right. This was how the agreement was interpreted and they would be happy to redesignate us as directed by the U.K. DOT. Imagine our surprise to have two English speaking government agencies unable to read what was, in our opinion, very plain English. As it turned out, using the East Midlands airport director and some back-home Member of Parliament contacts, we were able to convince the U.K. DOT that our interpretation was correct and we were finally allowed to move our operations with no restrictions.

This example underscores the fact that it is often the relationship, not just the agreement, that causes the problems. The U.S.-U.K. relationship is an old one, with a well-defined choreography. The parties to this bilateral dance seem to be very comfortable with the music being played and very familiar with the steps being taken by the other partner. And that's the problem. We would not have a NAFTA or GATT if we were following the same old dance steps. Why, then, do we allow this to continue for international air transportation? In order to make a significant change, it will take higher level policy changes than those outlined by the DOT in the recently released International Policy Statement. In a new world where information exchange is virtually seamless, a worldwide bilateral aviation system comprised of 1200 separate agreements cannot possibly cope with the economic realities of today.

For years, UPS has supported and continues to support the concept of open skies and the attempted liberalization of cargo rights through expanded bilateral or multi-lateral agreements with members of the European Union, including the United Kingdom. In addition, the President's National Airline Commission supported this position.

In the current rounds of bilateral negotiations with the United Kingdom, the United States government has developed a strategy that separates a potential agreement into short-term priorities and medium and long-term issues to take up once the short-term priorities are resolved. Last year, the U.K. House of Commons Transport Committee made the following recommendation for resumption of talks with the United States:

*"Our principal recommendation is that the U.K. Government should offer an immediate deal, with no strings attached, involving total liberalization of access to U.K. regional airports and, in respect of freight-only services, the removal of all restrictions on fifth freedom rights, so that both sides can reap the benefits these measures would produce; these proposals would be decoupled from the main negotiations and should be considered on their own merits, irrespective of the prospects for agreement on the remaining issues."*

This seemed to be a common-sense approach: don't let the easier issues get bogged down in the discussion of the difficult ones.

What a surprise to us when we were informed that cargo was not on the short-term list of priorities for the U.S.-U.K. talks, although regional airport liberalization was. We were reassured at a February meeting where this strategy was first unveiled that a final decision had not been made. However, with regards to cargo, it apparently had been made because we are still on the second list. Now, one might say, "at least you are on the second list, so you should not complain." When you are consistently on the second list negotiation after negotiation, one wonders the relative importance that cargo plays in our negotiating strategy—even in a situation where a U.K. Parliament panel had recommended that cargo be liberalized completely before talks begin on the rest of the issues.

I think that I can safely predict that if your Subcommittee were to make a significant recommendation that supported a U.K. priority, the U.K. negotiators would have that on *their* short list. There clearly needs to be better coordination and consultation with the all-cargo industry before strategies are developed. Despite several attempts in the past, the scheduled all-cargo industry's major voice, the Air Freight Association, has never been allowed to participate as part of the U.S. delegation to negotiations, even after repeated attempts by its President to become involved. Individual carriers may now participate as part of the delegation and this is a positive step and is welcomed. On the other hand, having the input from an industry voice as well would be beneficial to our negotiators.

With respect to some of the other issues involved in these talks, let me briefly summarize our thoughts. First, with regards to the Fly America Act, UPS believes that, as a general rule, the customer should be allowed to decide who they use. Artificial constraints in the form of protectionist laws hurt the customer, and in the end, hurt the carrier because a foreign country is more apt to institute similar or more stringent protections for its carriers. The marketplace should decide. There are many ways to incent a CRAF program or give CRAF participants priority. With regards to beyond rights for cargo, we are currently limited to just four points (Belgium, Netherlands, Germany, and Turkey). This does not give us the flexibility we need to meet customer demand and make changes in our current operating pattern.

All of this is not to say that the recent DOT policy initiatives will not get us closer to where we need to be. As exemplified by the recent open skies initiatives with the nine target countries in Europe, headway can be made with like-minded trading partners. But what the policy cannot do is guarantee that we can change the way we are doing business with those who are not like-minded. That is what has to happen for us to be successful in a competitive global economy. If we continue to speak about the future in today's vocabulary—or continue to negotiate in the same old fashion with certain trading partners, we will never reach a truly free trade environment.

So, what would we at UPS like to see? First, since liberalization of all-cargo rights appears to be common ground for agreement with the United Kingdom, we would recommend that a prompt closure of this issue be pursued. With that accomplished, the negotiations can focus on the real issues where agreement, even in principle, has not been reached. Second, we at UPS will continue to firmly support our government's effort to negotiate a liberal open skies agreements with our like-minded international aviation partners.

However, other creative attempts to deal with a changing world, such as the pursuit of multilateral agreements, must be vigorously pushed forward. Initial efforts should still focus on an agreement with the EU on all-cargo. The majority of agreements with EU Member States have liberal cargo provisions so the finish line on such a deal is much closer and attainable.

Given the experience of cargo deregulation here in the United States and recent agreements with countries such as Germany, it is being shown that the all-cargo industry can effectively deal with the challenges of fair and unfettered competition. Indeed, I would not be here before you today representing the UPS Airline but for the deregulation of the all-cargo industry 17 years ago.

In closing, it is important to recognize what we in the private industry have come to realize over the past decade. The world is shrinking. A global economy is replacing local and regional economies as a driving force. And with these changes, the customer reigns supreme. So, in this arena, what does the customer ultimately want? The customer, whether a passenger or a shipper of goods, wants and expects unrestricted options with the quality, service and cost benefits inherent in any competitive environment. To give them less stifles the ability of the economies of both parties to a bilateral agreement to grow and prosper globally. More importantly, to give them less clearly does not serve the public benefit.

Thank you.

Senator MCCAIN. Mr. Doughty, welcome.

#### **STATEMENT OF GEORGE F. DOUGHTY, EXECUTIVE DIRECTOR, LEHIGH-NORTHHAMPTON AIRPORT AUTHORITY**

Mr. DOUGHTY. Mr. Chairman, members of the committee, my name is George Doughty, Executive Director of the Lehigh-Northampton Airport Authority. And I appreciate the opportunity to be here today to provide the views of airports and communities.

You have received our written comments, which I hope will be provided for the record.

Senator MCCAIN. Without objection.

Mr. DOUGHTY. I want to point out that those comments are endorsed by the following airports and communities: Houston, Memphis, Phoenix, Kansas City, Las Vegas, Portland, Dallas-Fort Worth, and Minneapolis-St. Paul.

They likely are supported by others, but in the time of getting them, two people for comment and endorsement, not all are included.

I do, however, want to point out that neither the written comments or my remarks this morning are the policy of USA-BIAS or ACI-North America or any other organization.

In the written testimony, we have made the following key points, and I will be very brief.

One, we favor liberalized open skies regimes in all international markets. We believe this brings competition and service advantages to the greatest number of U.S. cities and regions and their citizens.

Second, we believe that the government in the last 2 years has made great strides toward this goal with the Canadian agreement and with the nine-country European initiative. Clearly, these are remarkable achievements.

Third, we believe the economic benefits of improved international air service to communities should be given priority over short-term benefits for particular airline companies.

While incremental negotiations may be necessary and appropriate at times, we raise two questions with regard to the proposed mini-deal with the United Kingdom. First, are there significant benefits to U.S. consumers and communities? And second, does this agreement lead us toward our goal of open skies with the United Kingdom?

If the answer to each of these questions is no, and we suggest it might be, then in the proposed agreements we would urge changes to assure that these criteria are met.

In the interest of time, Mr. Chairman, I will conclude my remarks at this point and be happy to respond to any questions.

Senator MCCAIN. Thank you.

[The prepared statement of Mr. Doughty follows:]

#### PREPARED STATEMENT OF GEORGE F. DOUGHTY

Mr. Chairman and members of the subcommittee, my name is George Doughty, Executive Director, Lehigh-Northampton Airport Authority, and I appreciate the opportunity to appear here today before the Senate Commerce Committee, Subcommittee on Aviation.

As an airport director, I have been involved in the international aviation bilateral negotiations process for many years, including as part of my current duties. I have also participated in the process in previously held positions as Director of Aviation for the Cities of Denver and Cleveland. I am also a past Chairman of Airports Council International-North America and an active participant in its U.S. International Air Service Program. In addition, I was a founding member of the United States Airports for Better International Air Services, more commonly referred to as USA-BIAS. This loosely knit and somewhat informal group of approximately 30 cities has been at the forefront of initiatives supporting liberalization of air services between the United States and its trading partners.

I am here today again representing community interests, and while I do not represent the views of either organization, my testimony is supported by many of the members of both ACI-NA and USA-BIAS. I can assure you that the bilateral air service agreement negotiating process and our participation in it is very important to us.

Today, I want to express our views on very specific areas of your investigation.

First, the policy and process issues, and the importance of broad liberal air service agreements,

Second, mini-deals in general, and the inherent dangers of such deals, particularly with large and sophisticated trading partners such as the British; and

Third, the current U.S.-U.K. mini-deal.

### *1. The Policy and Process Issue*

International aviation is a critical engine in the economies of U.S. communities. It has been estimated by the GATT and the World Tourism Organization that trade in services now amounts to in excess of 10 trillion annually, while travel and tourism generates 3.5 trillion dollars, or 10 percent of the annual world output of goods and services. Additionally, travel and tourism now accounts for 1 in 9 jobs worldwide.

From a travel and tourism perspective, it should be noted that the United States accounts for 40 percent of world travel. Consequently, we are dealing with very large economic impacts. In terms of the typical community, it has been estimated that, depending on the size of aircraft serving a city pair market, a new international transatlantic service can have a first year economic impact on a U.S. city of between \$270 and \$400 million (direct and indirect). Therefore, airports, as economic engines for the communities of our countries, are fiercely interested in bringing new international airline services into our cities.

Historically, however, this substantial economic impact has gone largely ignored and the government has focused on assuring that no new service is provided unless U.S. carriers provide most of it. New service to a new U.S. gateway will have the economic impact in the hundreds of millions of dollars, regardless of the nationality of the carrier. The additional direct economic benefit, however, to the U.S. economy should it be flown by a U.S. rather than a foreign carrier is arguably less than ten million dollars (primarily the value of flight crew labor).

It is for that very reason that USA-BIAS was founded, and has worked hard to focus attention on the real benefits of the liberalization of air services between the United States and various of its trading partners. We feel we have been somewhat successful in our efforts, and the Department of Transportation should be commended for their continuing long-term strategies that have resulted in the new Canadian Bilateral and U.S.-Group of 9 European Countries "open skies" agreements. These agreements, I believe, provide primary benefits to the users of air service and will substantially stimulate the economies of all of the nations involved. In the case of Canada, this was done despite the fact that U.S. carriers will not—the full benefit of the agreement until later. Correctly, the balance of benefits concept was set aside in favor of broader public goals.

### *2. Mini-deals in General*

Because of the importance of true liberalization, airports and their communities have tended to shy away from mini-deals, notwithstanding our recognition that, under certain circumstances, they are "the only game in town."

But, having said that, I believe that the U.S. must be extremely cautious when considering these deals, particularly in Europe now that there are "open skies" agreements with the Netherlands, and similar agreements soon to be signed with the G-9. We should not want to reduce the pressure on other European countries such as Germany, France, and the United Kingdom. They are the largest and among the most restrictive European traffic markets.

In general, when mini-deals are to be negotiated, that negotiation should be characterized by the following principles if possible:

a. They should be negotiated in public, and under the direction of the U.S. Government.

b. The negotiation should be for rights for cities and carriers, with the stipulation that the city(s) and carrier(s) will be selected at a later date, based on the best community/carrier service proposals. Again, a good example of this was the recent U.S.-Canada transition agreement wherein the U.S. gained limited rights, and allowed carriers and cities to bid on those rights.

c. Mini-deals should not be undertaken with major trading partners at the expense of negotiating leverage that the U.S. will need later in order to satisfy a broader public interest. In other words, mini-deals should enhance our ability to achieve liberalized agreements not inhibit it.

### *3. The U.S.-U.K. Mini-deal*

Let me start by stating that obviously the current U.S.-U.K. mini-deal does not meet the above criteria. The question then is, is it in the public interest and will it help or hurt our efforts to achieve a liberal regime? Frankly, except for the unlimited access to the regional U.K. airports, the benefits are minimal, but I should acknowledge that if I were representing Chicago, Washington or Philadelphia I would suggest to you that they were just fine.

The North Atlantic aviation market is comprised of 34 million passengers per annum, and fully a third of North Atlantic passengers, 12 million travel between the United States and the United Kingdom. Thus, it is the single most important North Atlantic market for U.S. aviation, tourism, and community interests.

However, for many years, the aviation relationship between the United States and the United Kingdom has been fraught with conflict and controversy. That situation has not inured to the benefit of U.S. cities, in general. Rather, it has allowed the marketplace to be limited in terms of both access and pricing, and thus the traveling public has paid dearly while the carriers have generated significant, and for the most sustained profits. Parenthetically, we want our carriers to be profitable, but we would prefer that such profitability take place in an expanding, efficient, and competitive marketplace.

The United States has not, over the years, been the beneficiary of what most of us would characterize as balanced or favorable agreements with the United Kingdom. Rather, we have, more often than not, been outmaneuvered by the British. Let me cite some examples, since they are relevant in the context of this mini-deal. If we characterize the modern day relationship as that extant during the years since Bermuda II was signed in 1978, we begin with a situation wherein the United States carriers had significant interests on the table, including broader liberalization with fifth freedom rights beyond the United Kingdom. Ultimately, the U.S. acceded to most U.K. demands, including that which virtually eliminated fifth freedom rights for U.S. carriers beyond the United Kingdom to Europe.

During the 1980's there were numerous additional mini-deals, but in no sense has real liberalization been advanced. The U.S., to its credit, did secure added services for a number of U.S. cities that previously had none. Then, in 1991, the United States government was put in the position where it had to replace Pan American and TWA at Heathrow. Since the U.S. needed something badly, the British secured virtually everything they could ever want, plus more, at no cost. This, of course, has been a trademark of U.S.-U.K. aviation relations. That is, the British wait until the U.S. has to have something, and then it extracts a large bounty.

It is now time for the U.S. to reverse this pattern of history. We know from experience that the U.S. only gains when the British have to have something and at the present moment, they appear to have some important items on their agenda. Thus, if a mini-deal is to be done it should be modified to the extent possible to include the following:

1. The public benefit needs to be expanded. For example, we should get more route authorities for the U.S. side, particularly with respect to Heathrow even if such access is in specified future years. Without broader liberalization we should not relinquish "Fly America." While "Fly America" may be an anachronism in the 1990's world of free trade, it has value to the other side.
2. We would prefer to see an agreement accomplished in one single package. However, if that is not possible, then a firm commitment to a timetable and conclusion of a Phase II would be acceptable.

If this mini-deal is completed as structured I am concerned as to whether we can expect to see the British at the negotiating table again for a considerable time. One only need ask the question, "What would they really need?"

In summary, the United States aviation negotiation policy has evolved in a very positive fashion during the past five to 10 years in no small part because of the growing role of communities in the negotiating process. A year and a half ago, in a speech before the International Air Transport Association Annual General Meeting in Dallas, Texas, Secretary Peña established a framework for what would become U.S. international aviation policy when he stated,

"We must re-affirm who our constituents are: the traveling public; shippers of goods and services; the airlines and aircraft manufacturers and also those cities that desire air service to revitalize their economies."

Weighing the interests of all of these parties may be challenging. But I believe that we must try, not by using precise mathematical formulae, but by applying good judgment and fairness in advancing the national interest."

We should continue to adhere to that policy. There is a real question as to whether this deal is consistent with that policy and whether it will aid us in achieving the eventual goal of an "open skies" agreement with the U.K.

I thank you for your time and attention, and I am prepared to answer any questions you may have.

Senator MCCAIN. Mr. Doughty, one of the problems that has been raised, one of the issues, is why Chicago should get additional air service and not one of those airports that you listed that are in support of your testimony? Do you have any comment on that?

Mr. DOUGHTY. Not particularly, other than to say that obviously, if any of those were there in place of Chicago or in addition to Chicago, I am sure they would flip in their position on this matter.

But I really cannot comment as to why it is Chicago, other than maybe greater effort on their part to be considered.

Senator MCCAIN. One of your recommendations is that, if a mini-deal II has to take place, there be a date certain for completion. Do you think that is doable?

Mr. DOUGHTY. Again, I think that is a judgment call, and it would be difficult to say. Obviously, when you are in a situation where you have an agreement and then you have another agreement to agree without any deadlines, it makes that second agreement pretty tentative.

Senator MCCAIN. Mr. Weidemyer, in your written testimony, you state that you need significantly more access in Europe in order to get the kind of market penetration and service that you need. What are we talking about?

Mr. WEIDEMEYER. Sir, we are now not only a U.S. company, but we serve virtually every point in the world. And one of the emerging markets for us, because of our customer base in the U.S., are the many countries in Europe, both the established western countries, as well as the eastern bloc countries.

We currently fly large jet aircraft into East Midlands and the U.K., as well as two more into Cologne. From there, we have smaller aircraft that fly routes between points in Europe.

Because of the limited access we have to some of those markets, those aircraft are flown by European companies that have operating rights that we do not possess. And that is service that we think we could provide more effectively, more efficiently and more responsibly for our customers, if we were able to do it ourselves.

Senator MCCAIN. What percentage of your business now is in Europe?

Mr. WEIDEMEYER. The percentage of business as a total of UPS business is still not large, but it is one of our fastest growing markets. And indeed, it continues to grow in excess of 30 percent a year.

Senator MCCAIN. And you expect that to continue, or do you expect that to bump into a ceiling because of your lack of access to certain areas?

Mr. WEIDEMEYER. I believe that at this point in time, our lack of access is capping our growth. I think we have unlimited potential.

As I said in my remarks, we are becoming a global economy, and governments are about the only people that have not realized that. Information moves instantaneously. What does not move are the people and the goods to support the information. So I think imminently that is going to happen, yes.

Senator MCCAIN. Mr. Doughty, if this mini-deal goes through, who gets hurt?

Mr. DOUGHTY. Well, I think that depends upon what happens afterward. If there is a—

Senator MCCAIN. Let's suppose that the United States has very little, if any, leverage, and it is an extended period of time before further agreements are made.

Mr. DOUGHTY. Well, obviously, if you assume that you have more leverage now than you will have later and that there is more that can be extracted at this time or with continued negotiations, then obviously a number of communities who very definitely need additional service to London and a few communities, and not very many, that can support additional service via Heathrow and are very interested in the Heathrow service because of the connections beyond definitely would get hurt.

The question, of course—and it is a judgment call again—is that achievable anyway and is it risked if you do the mini-deal.

Senator MCCAIN. Would you like to add anything, Mr. Weidemeyer?

Mr. WEIDEMEYER. Yes sir. I would just like to make a couple brief comments on the issue of the mini-deal. As I said previously, the issue of air cargo really is not in dispute other than that it has been relegated to the second round of negotiations.

I would heartily recommend, since it is an area where there seems to be agreement not only from the consumer and the carriers, as well as both governments, that we take the opportunity to show a success and get that out of the way right up front.

In addition to that, the mini-agreement, although it involves issues that are not totally involved with the UPS, since we are a cargo carrier, I would recommend that to the extent we have a concern of the future prospects of completing negotiations, that some sort of temporary or contingent grants of the authorities under the bilateral agreement be made contingent on a successful completion of the next phase, whenever that may be.

Senator MCCAIN. That is a good point. Do you have a comment on my observations that perhaps these negotiations should be put in the hands of the U.S. Trade Representative?

Mr. WEIDEMEYER. No comment on that issue.

Senator MCCAIN. Well, my point is that if they have these almost in-concrete advantages, and if we are going to deal with them, then maybe we should include a wider range of issues to regain some of that leverage.

There must be some aspects of our relationships that would give us some better way of influencing the process. Because right now, I am afraid, because of past history, we are in a situation of serious disadvantage.

Any closing comments, Mr. Doughty?

Mr. DOUGHTY. Only, Mr. Chairman, that I would—there was a lot of discussion earlier about the economic analysis that everyone, I think, agrees needs to be done, or maybe not everyone, but most agree needs to be done and needs to be done well.

I think in the past there has been, and there continues to be, a very strong emphasis on the revenue that accrues to a U.S. airline company. I hope the economic analysis will be done in a manner that shows where that revenue needs to be spent in order to support the flight.



And the vast majority of that revenue is locationally dictated. You cannot have a TWA worker at Kennedy Airport doing ground handling on the other end of the London flight. That has to be expended in London.

So the real benefit of the route accrues to the users and the communities that receive the service and not to as great an extent as has been characterized to the airline companies.

Senator MCCAIN. Thank you.

Mr. Weidemeyer, I apologize again for the delay to both of you. I would point out that my wife is a frequent user of your services, so I am grateful. And I would like some of my money back when you have—

Mr. WEIDEMEYER. And, Senator, I would like to express our appreciation to her for the business.

Senator MCCAIN. Thank you. There are several items that have been submitted for the record, including statements by Senator Brown; Senator Mosely-Braun; Paul Gaines, Director of Aviation, city of Houston; David Mosena, Commissioner, city of Chicago Department of Aviation; Patricia Friend, National President, Association of Flight Attendants; Vicki Frankovich, who is the President, Independent Federation of Flight Attendants.

[The information referred to follows:]

#### STATEMENT OF SENATOR HANK BROWN

Mr. Chairman, members of the Committee. I appreciate your courtesy in extending me the opportunity to appear before you today to speak on aviation relations with the United Kingdom.

Colorado is the home of the first new international airport to be built in this nation in more than as years. DIA has had many well publicized problems. That is why I asked the General Accounting Office to study the Denver Airport to detail the concerns raised by the dozens of Federal and state investigations and press reports.

Despite its problems, this is a spectacular facility. The airport's five runways can handle as many as 1,750 take-offs and landings every day. It is the first airport in the world that can regularly land "triples"—three aircraft at one time on parallel runways. Planes can taxi from the runway to their gates without crossing another runway, saving the expense and time of waiting as planes taxi in from the runway to the gate. The airport's \$20 million traffic management system will keep the airport open during all kinds of weather. The FAA predicts that this will reduce national delay by at least 5 percent. With all of these advancements and improvements, Denver International can be the safest airport in the world.

The new airport makes Denver and the Rocky Mountain region an ideal gateway for a major expansion of international air service. That is why I support Phase I of the arrangement with the United Kingdom which is the subject of this hearing.

I am a strong supporter of bilateral agreements which expand U.S. carrier opportunities. We have on the table an arrangement which provides the U.S. significant immediate benefits, phased opportunities for new expansion of U.S. services over time, and the reality of incremental progress in a relationship that has too long been stalemated. To fail to move ahead would be a mistake. To compete fairly, we must have equal access.

Denver would benefit immediately from Phase I through improved services to London and Europe via United's new services between Chicago and London. Denver also has an opportunity to benefit even more directly from Phase II, when service to London Heathrow from Denver International becomes a possibility.

Secretary Peña's new *International Aviation Policy Statement* recognizes the benefits to a city like Denver that come from expansion of international services. DIA is the major air transport hub in the Rocky Mountains. The *Policy Statement* recognizes the benefits that come from linking a U.S. hub like Denver with a foreign hub like London Heathrow. Yet, without improvements in the aviation agreement with the United Kingdom, like the one that we hope to obtain in Phase II, Denver will continue to lack the nonstop linkage to London Heathrow that it needs.

Some other airlines who also seek access to Heathrow from other airports are demanding that the Phase I deal be rejected. This all-or-nothing position, urged by carriers like American, will assure that there will be no progress. That may suit American just fine but will cheat communities like Denver and even Dallas/Ft. Worth out of the benefits that can come from incremental improvements in our relationship with the British. American has been cited in Business Week magazine as being more interested in "scotching United's plans than getting their own new route." The U.S. negotiators should not be influenced by a carrier with this type of self-serving attitude.

I recall that shortly after Secretary Peña took over at the Department of Transportation, DOT laid down a marker for the British when it approved the British Airways/USAir alliance. That arrangement was approved for only 1 year during which the Secretary told the British that they must enter into a deal that would "eliminate restrictions that undermine competition and which limit U.S. carrier access to the British markets." (Peña Statement dated March 15, 1993) This "open skies" deal had to be achieved within 1 year or the British were threatened with dire consequences. That all-or-nothing approach did not work then and it won't work now.

The British are now prepared to enter into a deal that represents real progress toward improving the U.S. carriers' position in the U.K. market. They are also willing to accept an agenda and schedule toward Phase II which will include still more benefits. The United States should accept the deal that has been negotiated and go back to the table to discuss Phase II. Cities like Denver have invested in the future with the new DIA facility. The future will never come, however, if we continue to take an all-or-nothing approach in seeking expanded opportunities with our trading partners like the British.

I encourage the committee to give a favorable report on the incremental deal being discussed before you today. We must be able to continue to make progress in this type of trade relationship, for the benefit of all of our constituents.

I would also like to submit statements for the record of my colleagues listed below who share my support for the incremental access to the United Kingdom that Secretary Peña is achieving for our U.S. passengers: Senators Boxer, Robb, Simon, and Moseley-Braun and Congressman Phil Crane, Chairman of the Subcommittee on Trade of the House Ways and Means Committee.

I thank you for your time and attention and I will be happy to answer any questions you may have for me.

MAY 23, 1995.

The Hon. HANK BROWN,  
*United States Senator,*  
*SH-716 Hart Senate Office Building,*  
*Washington, DC.*

DEAR SENATOR BROWN: On April 5, 1995 I wrote to Transportation Secretary Federico Peña urging that the United States move forward "as quickly as possible to conclude" an air service agreement with the United Kingdom I. In that letter I urged that the United States move forward "by taking stall steps." The city of Denver is clearly on record as supporting the incremental negotiating approach. I am writing now to also indicate my support for the substance of the mini-deal which is on the table.

From Colorado's perspective the primary benefit of the mini-deal should lead to additional agreements providing improved access Heathrow Airport from other United States cities. It must be stated that currently Denver and the metropolitan area represent the largest community in the United States without non-stop service to either of London's airports. Therefore, Denver and United Airlines will be aggressively pursuing authority into Heathrow Airport during the next phase of bilateral negotiations.

I understand that the mini-deal does not serve every city's total interest immediately but I believe that the best way to achieve everyone's interest is to conclude the mini-deal as an indication of our good faith and resolve to work with the UK towards greater liberalization.

Yours truly,

WELLINGTON E. WEBB,  
*Mayor.*

## STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Chairman McCain, Senator Ford, Members of the Subcommittee, I would like to thank you for the opportunity to offer this testimony in support of an immediate agreement between the United States and the United Kingdom that will allow competitive service from Chicago to London this summer. As the Senator from Illinois, I believe that additional Chicago-London service is the single most important international air transportation opportunity for the economy of my state and my region.

Expanded Chicago-London air service, however, is not just an Illinois issue, and it is not just a Midwest issue. Because of Chicago's central location and the role of O'Hare International Airport as the largest airport in the United States and the most important connecting point for air passengers throughout the United States, the addition of another U.S. carrier on the Chicago-London route is probably the most significant single international air transportation opportunity before our country today. Given its importance, it makes no sense to leave this crucial opportunity on the bargaining table—and at risk—when it can be secured now, at the start of the peak summer traffic season for travel between the United States and Europe.

Mr. Chairman, O'Hare International Airport is truly the aviation crossroads of the United States, providing superb connections and comprehensive services not only for domestic travelers, but also for those making transatlantic trips from points in Central and Western United States. Unfortunately, our ability to increase competition in the Chicago-London market has been limited by the restrictions contained in the current bilateral aviation agreement between the United States and the United Kingdom.

Mr. Chairman, the existing constraints on the Chicago-London market not only affect Chicago residents; they also distort the entire structure of the market for traffic between much of the United States and Europe's most important destination, Heathrow Airport. This impact can only be expected to grow unless we seize the unique opportunity before us to increase competition in the Chicago-London market.

In conclusion, therefore, I do not believe that we should sacrifice this opportunity to achieve additional service and additional competition in the Chicago-London market. On the contrary, I believe that a failure to seize this opportunity, would constitute a serious strategic error in our aviation relationship with the United Kingdom.

Thank you, Mr. Chairman.

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 STATEMENT OF SENATOR ROBB

Mr. Chairman, Senator Ford, and Members of the Committee, I want to thank you for the opportunity to be on record in support of the Administration's efforts to negotiate a more expansive and liberalized aviation agreement with the United Kingdom.

A less rigid agreement between the United States and the United Kingdom would enhance U.S. competitiveness, increase the economic viability of our U.S. carriers, and maximize U.S. carrier resources as the demand for international air travel increases. For example, U.S. airline services from Virginia to London have operated at full capacity for several years, often making it difficult for local passengers to obtain seats on these nonstop flights. A more liberalized bilateral agreement would allow United Airlines, which services the route from this area to London, to add flights from Chicago to London, thereby increasing U.S. competitiveness and increasing available seats for passengers from this area to London.

The Administration has negotiated an agreement which would allow some additional international flights from the United States to London. Some groups, however, oppose this incremental agreement in favor of instantaneous approval of widespread increases in flights for U.S. carriers to London. The British, however, have been resistant to such substantial increases in flight frequencies from the United States to London. While this "open skies" scenario is the goal for which we should strive, we should not ignore the benefits achieved through an incremental approach. Therefore, I would strongly urge the Committee to support the Administration's efforts to achieve substantive gains through the current proposal scheduled to be negotiated in June and thereby pave the way to create more liberal air agreements between the United States and United Kingdom.

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 STATEMENT OF SENATOR PAUL SIMON

Chairman McCain, Senator Ford, and Members of the Committee, I appreciate this opportunity to share my concerns about the important relationship between the

United States and our friends in the United Kingdom. Both countries' aviation interests are at a critical juncture. Do we settle for the status quo or do we urge progress toward a more open and competitive aviation environment for both nations?

The State of Illinois, and in particular the city of Chicago, have much at stake in efforts to reach a limited agreement with the United Kingdom in this matter. O'Hare Airport, the nation's busiest, has only one U.S. carrier flying directly to Heathrow. As a result, fares charged to passengers traveling to the United Kingdom from or through Chicago are needlessly higher than in comparable markets with more competitive service. The city of Chicago is a logical gateway to London, and the entire Midwest region will reap the economic benefits if international traffic is allowed to grow out of O'Hare.

We now have an opportunity to fix this long-standing problem. Secretary Peña's decision to proceed with incremental moves toward liberalizing air traffic restrictions between the U.S. and the U.K. are commendable, and they are needed.

I can understand the arguments of those who say we should hold out for an "open skies" agreement between the U.S. and the U.K. of course, that would be optimal. But, can the U.S. aviation industry afford to wait for "open skies" to become a reality? The clear answer is that it cannot. U.S. aviation would immediately benefit from this bilateral agreement. Let's not wait for a perfect solution that may be years away.

Acceptance of an incremental step allowing a second U.S. carrier direct access from Chicago O'Hare to London Heathrow will afford substantial economic and trade benefits to the U.S. traveling public, to our business community, and to the U.S. economy.

In return, the British would be allowed a limited opportunity for USAir to bid on government traffic that would be transported on British Airways through their code-sharing agreement with the U.S. carrier.

These tradeoffs provide both countries balanced economic gains, as well as establishing a phased approach to continued negotiations to benefit U.S. interests.

If we choose to reject this package, we step back into the unacceptable status quo, in which most U.S. carriers lose opportunities in the global marketplace.

I realize the pressure this committee is receiving from both sides on this issue, and the intensely competitive nature of the aviation industry. This Administration is obliged to ensure that what is left of the U.S. aviation industry be allowed to prosper. We cannot allow the narrow concerns of the few to determine this decision.

I encourage this Committee to report favorably on the "mini-deal" presented by our negotiating team during the last round of talks. We must act affirmatively and decisively to take advantage of this economic opportunity.

I thank you for convening this hearing, and for giving me this opportunity to contribute my observations and suggestions.

---

[Ltr to Sen. McCain from Senator Paul Sarbanes.]

PAUL S. SARBANES  
MARYLAND

308 HART SENATE OFFICE BUILDING  
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202-224-4524

**United States Senate**  
WASHINGTON, DC 20510-2002

June 1, 1995

Honorable John McCain  
Chairman  
Subcommittee on Aviation  
Committee on Commerce, Science and Transportation  
U.S. Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

I regret that I was not able to participate in your May 24, 1995 hearing on the conduct of the bilateral civil aviation negotiations between the United States and the United Kingdom. However, I wanted take this opportunity to underscore my own strong support for the on-going negotiations and Secretary Pena's efforts to secure a more open aviation regime and more rights for U.S. airlines and cities in the discussions.

In my view, the so-called "mini-deal" now under negotiation represents a significant step toward achieving the goal which I believe we all share of an "open-skies" agreement with the U.K. The two-pronged, incremental approach currently being pursued by the U.S. negotiators -- a successfully concluded "mini-deal coupled with an agenda and timetable for a second phase of negotiations -- strikes me as a prudent strategy to achieve this goal. It is only by actively engaging the U.K. in discussions which produce meaningful results such as the interim arrangements that we can establish a dialogue which leads to an even greater expansion of commercial opportunities for our carriers and additional, much needed, air service opportunities for U.S. communities.

It has been suggested that one of the proposals on the table -- allowing British Airways to participate in the "Fly America" traffic through its code-sharing arrangements with USAir -- is somehow at odds with the intent of the Act and current U.S. aviation policy. Frankly, I regard it to be a perverse interpretation of the Fly America Act when foreign carriers including South African Airways, QUANTAS, KLM, Asiana, Varig, Swissair and Lufthansa are eligible to carry "Fly America" traffic while British Airways -- which uses USAir planes and crews -- is precluded from doing so. The carriage of U.S. Government traffic on code-share flights is a widely-accepted practice in the aviation community and consistent with current U.S. policy. Allowing British Airways similar eligibility is not only the fair thing to do, but the right thing.

Honorable John McCain  
Page 2  
June 1, 1995

I appreciate your attention to this important issue and ask that my letter be made part of the hearing record.

With best regards,

Sincerely,

A handwritten signature in black ink that reads "Paul Sarbanes". The signature is written in a cursive style with a long horizontal stroke at the end.

Paul S. Sarbanes  
United States Senator

PSS/cas

## TESTIMONY OF PAUL B. GAINES

I appreciate this opportunity to submit to the Committee these views on behalf of Houston, Texas and the Greater Houston Partnership. The Partnership is an association of the Chamber of Commerce, World Trade and Economic Development Organizations, all of which have a keen interest in our air service. Good international air service is, of course, essential to economic development, especially for a city such as Houston with so many worldwide international business interests. Because of its size—the 4th largest U.S. city—and unique multicultural character, Houston also has a need for good air transportation to all corners of the globe to satisfy the personal travel needs of our citizens.

I understand that this hearing has been convened to consider U.S. international aviation policies and negotiations, with particular attention to the so called “mini-deal” now being negotiated with the United Kingdom. Houston has taken a position in opposition to such a deal in letters we have addressed to the Departments of State and Transportation.

This is an unusual position for us. Typically, we favor any agreement which will increase opportunities for international air transportation by Americans. While our primary goal is to obtain the best possible service for Houston residents and those in the large catchment area it serves in the West and Midwest, we think that by and large any move toward liberalization tends to be beneficial in that it adds to the momentum for opening up international air service generally. The sooner the world as a whole moves toward free and open skies, the better served we in Houston, and Americans everywhere, will be.

Obviously not all countries or airlines share our hope for full deregulation of international air transportation. Some, including some airlines, give lip service to liberalization but seek it only where it seems to offer a competitive advantage. However, I believe our government is genuinely interested in obtaining as liberal air transport arrangements as possible with other countries.

Nevertheless, I part company with our government to the extent it seems to regard the proposed mini-deal as a step toward liberalization. The problem is that, while the agreement would allow increased service at some new markets, it avoids addressing fundamental imbalances in our aviation agreement with the United Kingdom. Worse yet, it makes it more likely that those imbalances will not soon be addressed satisfactorily.

The central problem with our agreement is the British “crown jewel”—Heathrow Airport. Not only is Heathrow a very convenient London airport in terms of access to the city, it is especially valuable for connecting services beyond. For these reasons, Heathrow is highly favored by passengers, especially higher fare business travellers. Airlines without Heathrow access have an extremely difficult time competing with those that serve Heathrow, in terms of both the number of passengers they can attract and their profitability.

Exhibit A shows the very significant edge enjoyed by U.K. airlines in Heathrow-U.S. services. The British carriers serve more United States-Heathrow gateways than U.S. carriers; they operate more weekly frequencies by a significant margin (180 vs. 147) and they offer 133 percent more seat capacity. The disparity is aggravated by the fact that, as a carryover from an earlier agreement with the British, the United States is limited to only two airlines eligible for Heathrow service. Those two airlines, United and American, have every incentive to seek liberalization” for themselves. But they also have every incentive not to encourage an agreement which allows other U.S. carriers access to Heathrow. In that sense they share the same incentive to limit liberalization as the major British carrier.

The proposed mini-deal is a serious mistake because it is built on the foundation, which it helps to perpetuate, of Heathrow being closed to all but two U.S. airlines. U.S. airline service to Heathrow will continue to be confined to what those two airlines choose to provide to the American public in terms of the cities to be served, and the capacity and service quality to be offered. These are decisions that should rightfully be made by a truly competitive marketplace. Lacking that marketplace, these choices should be made after comparative consideration by DOT of competing public interest proposals by different carriers and cities. The last and worst alternative is that the choices are made solely by a government sanctioned airline duopoly.

Much of the controversy about the proposed mini-deal is between the two U.S. carriers that hold the Heathrow rights. Their controversy is about who gets what share of the U.S. Heathrow duopoly created by the U.K. agreement. The issue that deserves Congressional attention however is: what does this mini-deal do to *end the duopoly*? In our judgment, by offering the United States a limited amount of additional capacity in one market, Chicago-Heathrow, the United Kingdom is laying the

basis for perpetuating its current Heathrow advantage. Promises to talk about further "limited" access to Heathrow for U.S. carriers commit the United Kingdom to nothing except endless discussions during which they continue to retain the advantageous *status quo*.

The *status quo* is of course a major problem for Houston. Houston is the third largest U.S. metropolitan area that lacks service to Heathrow. (Exhibit B) Houston's Heathrow "problem" is that its hub carrier happens not to be one of the designated two. Other large U.S. cities face the same problem: they are not served as a hub or major point by one of the two U.S. airlines that have Heathrow rights. We fail to see why, in this monopolistic environment, the choice of which U.S. cities get Heathrow service should be made on the basis of the competitive motives of the two designated airlines, without any assurance that larger national interests about how Heathrow services should be apportioned among U.S. cities and airlines are being considered.

The problem the United States has created for itself by accepting a limit of two named airlines at Heathrow goes well beyond its exclusionary effect on competition among U.S. carriers. It creates a whole set of twisted incentives, and these are all visible in the proposed mini-deal. First, because Heathrow rights can go only to American or United Airlines, we are quick to grasp at offers which satisfy one of those carriers, regardless of whether it adds to the overall balance of Heathrow services among U.S. cities. United badly wants rights from Chicago, its major hub, to Heathrow. In that market it would be the third nonstop carrier. But it has just abandoned the Seattle-Heathrow nonstop market, leaving it unserved by any U.S. airline; and there are other U.S. cities that are now entitled to Heathrow service but are not receiving it because they are hubs for a U.S. carrier which has not been designated for Heathrow service.

Second, the mini-deal would pay additional value to the British for rights—a second United States airline between Chicago and Heathrow—which would automatically fall to the United States under the current agreement once the market reaches a size of 600,000 passengers per year. That size might well have been achieved already but for the limited capacity offered by the two incumbent airlines. Under the current agreement it is plainly not in the interests of either American Airlines or British Airways to have the Chicago—Heathrow traffic exceed the 600,000 passenger trigger point which would allow the U.S. to designate a second carrier under the current agreement. Exhibits C and D show that Chicago—Heathrow capacity has actually declined significantly in the last year. Exhibit E shows that this is not typical for major U.S.-Heathrow markets. These capacity reductions may be an explanation of why the U.S. has not already obtained Chicago-Heathrow rights for two U.S. airlines, instead of having to pay a second time through the mini-deal.

My purpose in submitting this testimony is not to critique each and every aspect of the proposed mini-deal in terms of the balance of benefits to both sides. I readily acknowledge that it would provide a limited amount of liberalization over the present agreement for both sides. But in Houston's view, whatever these other features, they are not worth it if there is not also a commitment by the United Kingdom that the United States may designate any airlines it wishes to provide service to Heathrow, and that additional slots will be made available for service by U.S. carriers.

I am not suggesting that the agreement must provide immediate and unlimited access for every U.S. carrier or city. I realize that Heathrow is to some extent capacity restricted, although by no means to a point that, given a British willingness to cooperate, would prevent most U.S. cities which now have service at another London airport from obtaining service at Heathrow. I *am* suggesting that the United States, before making any more mini-deals, must establish and negotiate a plan which assures that all U.S. airlines and cities will have an opportunity to obtain Heathrow service over a reasonable period of time. I am also suggesting that, if we accept this Chicago Heathrow "bird in the hand", it will, in the long run, be far more expensive to U.S. interests in breaking the two airline monopoly than a negotiation which addresses that fundamental problem right now.

There are those who will say that, in these circumstances, it is always better to take what you can get when you can get it while continuing to press for further liberalization. Let's face the facts, however. The United States made a major mistake when, in its eagerness to allow American and United to buy out the U.K. authority of Pan American and TWA, it agreed to continued restriction on its freedom to designate Heathrow carriers and services in a way that would maximize competition and consumer benefits for Americans. It was another case, of which there have been too many, when our international air transport negotiators were more focused on the concerns of carriers than consumers. The result has been a steady erosion of the U.S. carrier share of the U.S.—U.K. market.



There is no reason to think the United Kingdom will ever give up the Heathrow advantage which has made this possible. The proposed mini-deal is nothing more than a bone aimed at keeping the United States at bay. United Kingdom promises to talk about further liberalization in some unspecified way at some indefinite period in the future are another bone, to buy still more time. Now, today, is the time to get to the meat of our differences with the United Kingdom—Heathrow access. The process may be long and difficult, but it must go forward promptly. One way or the other, it must end with nothing less than fairly apportioned, fully competitive access to Heathrow for the consumers, cities and airlines of the United States.

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**Weekly Nonstop Departures and Seats to London Heathrow Airport  
By U.S. Gateway and Airline  
May 1995**

City	Airport Code	Airline	Nonstop Departures	Nonstop Seats
<u>U.S. Flag Airlines</u>				
Boston	BOS	AA	14	2,828
Chicago	ORD	AA	21	4,361
Los Angeles	LAX	AA	7	1,505
Los Angeles	LAX	UA	7	1,456
Miami	MIA	AA	7	1,715
New York	JFK	AA	42	9,296
New York	JFK	UA	21	4,312
Newark	EWR	UA	7	1,428
San Francisco	SFO	UA	7	2,219
Washington	IAD	UA	14	5,656
Subtotal U.S.			147	34,776
<u>U.K. Flag Airlines</u>				
Boston	BOS	BA	14	5,261
Chicago	ORD	BA	14	5,222
Los Angeles	LAX	BA	14	5,404
Los Angeles	LAX	VS	7	2,800
Miami	MIA	BA	7	2,702
New York	JFK	BA	42	11,935
New York	JFK	VS	13	3,949
Newark	EWR	BA	7	2,611
Newark	EWR	VS	7	2,800
Philadelphia	PHL	BA	14	4,340
San Francisco	SFO	BA	14	5,222
San Francisco	SFO	VS	6	1,968
Seattle	SEA	BA	7	2,511
Washington	IAD	BA	14	4,340
Subtotal U.K.			180	61,165
Total U.S. & U.K. Flag			327	95,941

Source: OAG Schedule Tape, processed by SH&E

Houston is the 3rd Largest U.S. Gateway  
Without Service to London's Heathrow Airport  
Based on Population and London Traffic

INS Traffic to London  
12 Months Ended October 31, 1994

Market 1/	Psg Rank	INS Scheduled Passengers			1993 Population (000)	Population Rank
		Total	US Flag	Non-US Flag		
Orlando	1	432,378	404	431,974	1,354.3	11
Atlanta	2	349,930	238,273	111,657	3,302.6	4
Houston	3	307,434	176,480	130,954	4,037.9	3
Dallas/Ft. Worth	4	293,671	181,480	112,191	4,403.4	1
Minneapolis	5	181,832	181,832	0	2,695.3	5
Cincinnati	6	138,900	138,900	0	1,578.3	10
Detroit	7	120,639	78,901	41,738	4,313.9	2
Charlotte	8	111,461	23,715	87,746	1,255.0	12
St. Louis	9	98,828	98,828	0	2,555.3	6
Pittsburgh	10	97,186	249	96,937	2,388.0	8
Baltimore	11	95,320	542	94,778	2,458.5	7
Denver	12	89,699	89,699	0	1,925.3	9
Raleigh/Durham	13	45,917	45,917	0	934.0	14
Nashville	14	43,751	43,751	0	1,055.0	13

1/ Includes the 14 U.S. Gateways that had nonstop service to London exclusively through Gatwick in Summer 1994

Source: US DOT, INS Database, and SMM, Survey of Buying Power, Aug. 1994.

Scheduled Monthly Nonstop Seats From Chicago O'Hare to London Heathrow  
Monthly 1993 and 1994

	American		British Airways		Combined		
	1993	1994 % Change	1993	1994 % Change	1993	1994 % Change	
January	13,733	-38.8%	28,493	20,209	42,226	28,610	-32.2%
February	9,632	-21.2%	22,916	17,920	32,548	25,508	-21.6%
March	15,010	-36.9%	29,401	21,900	44,411	31,376	-29.4%
April	14,580	0.0%	30,816	31,560	45,396	46,140	1.6%
May	15,066	0.0%	33,147	37,772	48,213	52,838	9.6%
June	16,260	-10.3%	38,400	36,720	54,660	51,300	-6.1%
July	16,802	-10.3%	39,680	37,944	56,482	53,010	-6.1%
August	16,802	-10.3%	39,680	37,944	56,482	53,010	-6.1%
September	16,260	-10.3%	38,400	36,720	54,660	51,300	-6.1%
October	16,802	-10.3%	36,728	37,206	53,530	52,272	-2.4%
November	15,989	-30.9%	27,059	22,124	43,048	33,178	-22.9%
December	16,531	-27.3%	27,601	23,083	44,132	35,096	-20.5%
Total	183,467	-16.9%	392,321	361,102	575,788	513,638	-10.8%

Source: Official Airline Guide Schedule Tapes

**Chicago O'Hare - London Heathrow  
Scheduled Monthly Seats  
January 1993 - December 1994**

Month	American Airlines				British Airways			Total Market
	767	763	M11	Total	747	767	Total	
Jan 1993	5,332	0	8,401	13,733	14,760	0	14,760	28,493
Feb	9,632	0	0	9,632	13,284	0	13,284	22,916
Mar	0	6,880	8,130	15,010	14,391	0	14,391	29,401
Apr	0	6,450	8,130	14,580	16,236	0	16,236	30,816
May	0	6,665	8,401	15,066	18,081	0	18,081	33,147
Jun	0	0	16,260	16,260	22,140	0	22,140	38,400
Jul	0	0	16,802	16,802	22,878	0	22,878	39,680
Aug	0	0	16,802	16,802	22,878	0	22,878	39,680
Sep	0	0	16,260	16,260	22,140	0	22,140	38,400
Oct	0	0	16,802	16,802	19,926	0	19,926	36,728
Nov	0	0	15,989	15,989	11,070	0	11,070	27,059
Dec	0	0	16,531	16,531	11,070	0	11,070	27,601
CY 1993	14,964	19,995	148,508	183,467	208,854	0	208,854	392,321
Jan 1994	0	0	8,401	8,401	11,808	0	11,808	20,209
Feb	0	0	7,588	7,588	10,332	0	10,332	17,920
Mar	0	1,075	8,401	9,476	11,439	985	12,424	21,900
Apr	0	6,450	8,130	14,580	11,070	5,910	16,980	31,560
May	0	6,665	8,401	15,066	22,509	197	22,706	37,772
Jun	0	6,450	8,130	14,580	22,140	0	22,140	36,720
Jul	0	6,665	8,401	15,066	22,878	0	22,878	37,944
Aug	0	6,665	8,401	15,066	22,878	0	22,878	37,944
Sep	0	6,450	8,130	14,580	22,140	0	22,140	36,720
Oct	0	6,665	8,401	15,066	22,140	0	22,140	37,206
Nov	2,924	0	8,130	11,054	11,070	0	11,070	22,124
Dec	3,612	0	8,401	12,013	11,070	0	11,070	23,083
CY 1994	6,536	47,085	98,915	152,536	201,474	7,092	208,566	361,102

Source: Official Airline Guide Schedule Tapes.

Chicago O'Hare - London Heathrow  
Scheduled Monthly Departures

January 1993 - December 1994

Month	American Airlines				British Airways			Total Market
	767	763	M11	Total	747	767	Total	
Jan 1993	31	0	31	62	40	0	40	102
Feb	56	0	0	56	36	0	36	92
Mar	0	32	30	62	39	0	39	101
Apr	0	30	30	60	44	0	44	104
May	0	31	31	62	49	0	49	111
Jun	0	0	60	60	60	0	60	120
Jul	0	0	62	62	62	0	62	124
Aug	0	0	62	62	62	0	62	124
Sep	0	0	60	60	60	0	60	120
Oct	0	0	62	62	54	0	54	116
Nov	0	0	59	59	30	0	30	89
Dec	0	0	61	61	30	0	30	91
CY 1993	87	93	548	728	566	0	566	1,294
Jan 1994	0	0	31	31	32	0	32	63
Feb	0	0	28	28	28	0	28	56
Mar	0	5	31	36	31	5	36	72
Apr	0	30	30	60	30	30	60	120
May	0	31	31	62	61	1	62	124
Jun	0	30	30	60	60	0	60	120
Jul	0	31	31	62	62	0	62	124
Aug	0	31	31	62	62	0	62	124
Sep	0	30	30	60	60	0	60	120
Oct	0	31	31	62	60	0	60	122
Nov	17	0	30	47	30	0	30	77
Dec	21	0	31	52	30	0	30	82
CY 1994	38	219	365	622	546	36	582	1,204

Source: Official Airline Guide Schedule Tapes.

**Scheduled Monthly Nonstop Seats  
From Selected U.S. Gateways to London Heathrow**

Month	Boston			Los Angeles			Miami			Newark		
	1993	1994	% Change	1993	1994	% Change	1993	1994	% Change	1993	1994	% Change
Jan	17,267	18,011	4.3%	48,211	48,639	0.9%	26,271	23,645	-10.0%	13,423	25,017	86.4%
Feb	15,596	16,268	4.3%	41,100	41,370	0.7%	25,488	20,660	-18.9%	12,124	22,786	87.9%
Mar	18,011	19,121	6.2%	48,034	48,755	1.5%	29,708	30,317	2.0%	13,999	25,942	85.3%
Apr	17,430	24,090	38.2%	48,930	47,840	-2.0%	34,860	35,034	0.5%	27,624	29,719	7.6%
May	21,341	24,893	16.6%	50,991	49,538	-2.8%	36,022	24,827	-31.1%	29,729	29,481	-0.8%
Jun	24,080	24,090	0.0%	60,022	52,793	-12.0%	34,860	24,090	-30.9%	29,496	28,530	-3.3%
Jul	24,893	24,893	0.0%	63,767	56,079	-12.1%	36,022	24,893	-30.9%	30,752	29,481	-4.1%
Aug	24,893	24,893	0.0%	63,767	56,079	-12.1%	36,022	24,893	-30.9%	30,752	29,481	-4.1%
Sept	19,872	26,826	35.0%	56,144	53,004	-5.6%	34,860	24,090	-30.9%	29,562	28,530	-3.5%
Oct	18,011	28,625	58.9%	50,267	49,764	-1.0%	34,558	24,815	-28.2%	28,602	28,419	-0.6%
Nov	17,215	17,215	0.0%	47,070	48,330	2.7%	28,272	21,822	-22.8%	23,828	27,105	13.8%
Dec	17,430	17,430	0.0%	47,294	48,541	2.6%	22,907	22,769	-0.6%	23,649	27,308	15.5%
Total	236,049	266,355	12.8%	625,597	600,832	-4.0%	379,850	301,855	-20.5%	293,540	332,799	13.4%

Source: OAG Schedule Tapes

**Scheduled Monthly Nonstop Seats  
From Selected U.S. Gateways to London Heathrow**

Month	New York, J.F. Kennedy		San Francisco		Washington Dulles		Subtotal	
	1993	% Change 1994	1993	% Change 1994	1993	% Change 1994	1993	% Change 1994
Jan	81,611	15.5%	24,373	28,653	24,729	25,048	209,614	14.3%
Feb	74,276	12.7%	22,096	25,739	22,452	23,264	187,644	3.6%
Mar	89,105	93,268	24,373	30,628	26,529	27,969	245,683	11.6%
Apr	89,532	96,386	31,188	36,572	36,820	36,720	251,524	-0.3%
May	94,922	108,193	32,679	43,403	38,252	38,352	271,427	7.9%
Jun	101,468	123,612	39,118	52,114	41,064	41,146	293,860	9.7%
Jul	112,753	132,580	42,439	54,281	43,894	43,994	322,285	9.2%
Aug	110,438	126,975	42,439	54,281	43,894	43,894	318,498	7.2%
Sept	108,624	124,533	39,606	51,277	42,420	42,520	316,283	6.1%
Oct	106,756	124,449	32,923	47,673	41,432	42,482	296,228	10.3%
Nov	100,106	119,416	27,650	32,320	24,782	27,557	277,991	2.5%
Dec	89,153	117,821	28,287	33,079	24,675	26,961	240,651	11.2%
Total	1,158,744	1,345,140	387,171	490,020	411,043	419,907	3,112,144	2.2%
							230,488	9.3%
							3,455,053	11.0%

Source: OAG Schedule Tapes

SEATSUM.WK4

EXHIBIT E  
Page 2



## STATEMENT OF DAVID R. MOSENA

As owner and operator of the world's busiest airport—O'Hare International Airport—and the centerpiece of any U.S.—U.K. interim agreement, which is the primary focus of today's hearing, the city of Chicago is pleased to present this written statement to the Committee. I would ask that my written testimony be considered and accepted for the record.

While we commend the Committee for holding hearings on the important issues affecting international aviation, we are concerned about both the balance and timing of today's hearing.

First, despite the requests of Chicago and many other communities, the Committee has not allowed any major airport to testify, even while it allows five major air carrier CEO's to do so. This imbalance underscores one of our fundamental points—in assessing the impact of bilateral air transport negotiations, the Administration and Congress must weigh equally the views of air carriers and communities. For so long as international aviation is viewed merely as a political contest among airlines with "winners" and "losers," no real progress can be made. We respectfully submit that the Committee and others would benefit from a more balanced discussion, which would include providing the opportunity for a few airports with direct interests in the outcome of the U.S.—U.K. talks to express their divergent views.

Second, today's hearing comes in the midst of an ongoing, ambitious schedule of international aviation talks with the United Kingdom, Japan, China, and South Africa—to name a few. Without question, the Congress can and should play a major role in international aviation. At the same time, we are concerned about disrupting the ongoing negotiations and forcing the same people at the Departments of Transportation and State who are in the middle of negotiations to spend their scarce time preparing themselves and others to respond comprehensively and accurately to the Senate's first international aviation oversight hearing in over 4 years. Timing can also unduly "politicize" particular negotiating positions. Rather than becoming embroiled in airline disputes over negotiating strategy on the eve of later rounds of protracted negotiations, we respectfully suggest that Congress could play a more useful role by expressing its broad policy views well in advance of major negotiations.

## THE ADMINISTRATION'S OUTSTANDING RECORD JUSTIFIES DEFERENCE

Secretary Peña, as well as the political and professional staffs at DOT and State, have done an outstanding job in the international aviation arena under very difficult circumstances. We do not envy their jobs. They must make tough decisions in every negotiation that are bound not to please everyone. Given their successful track record, they are deserving of greater leeway to reach an agreement.

Around the globe, we are facing bilateral retrenchment. Our aviation partners are striving to ward off competition from U.S. airlines that bear no resemblance to their international predecessors. With pared costs, sophisticated yield management systems, extensive frequent flyer programs, and formidable feeder networks, carriers like United and American out of O'Hare represent powerful competitors. Despite protectionism in the form of state aid, threatened renunciation, and "doing business" problems, the Clinton Administration has managed to make enormous progress in international aviation.

First, the Administration reached an agreement with our fifth largest aviation partner, Germany, which avoided renunciation, preserved rights, authorized three U.S. transnational alliances, and paved the way for open skies in the near future. Already, consumers are benefiting from the seamless network being provided out of Chicago by the United/Lufthansa alliance; consumers also are enjoying new non-stop service to/from Munich by Lufthansa.

Second, the Administration put an end to over 15 years of stalled negotiations by reaching a landmark agreement with our largest aviation partner, Canada. This agreement, which will go down in history as one of the most significant advances in air service since the Chicago Convention in 1944, will unleash over \$15.0 billion in new economic activity, with growth expected from 13.0 million annual passengers today to 20.0 million in the next few years. Chicago already has seen a huge jump in Canadian service, with new American service to Winnipeg, Ottawa, and Calgary, new Canadian Airlines International service from Toronto and Vancouver, newly proposed Air Canada service from Ottawa, and more on the way.

Third, the Administration issued the first formal statement of international air transportation policy in 17 years. The policy statement directly responds to criticism from the Congress and industry that DOT has resorted to *ad hoc* approaches and crisis management in international aviation, instead of an articulated vision. For the first time, the Federal policy expressly recognizes the need to "enhance the ac-

cess of U.S. cities to the international transportation system"—a goal too often overlooked.

Fourth, the Administration recently concluded initialing "open skies" agreements with nine European countries in the face of formidable opposition from the European Commission. This diplomatic coup, achieved in just 6 months, holds the promise of bringing extraordinary consumer benefits in terms of increased service, lower fares, and more jobs. Perhaps more importantly, it increases pressure on two of our largest aviation partners, France and the United Kingdom, to liberalize their restrictive bilateral agreements with the United States while encouraging liberalization in Southern Europe.

Thus, while it is often easy to criticize our government, we submit that the current team has done more to advance U.S. international aviation than has been done in the previous decade. They should be given substantial deference to reach agreements that they believe are in the public interest.

#### THE U.S.—U.K. INTERIM DEAL BENEFITS THE U.S.

The current form of the U.S.—U.K. interim agreement—a second U.S. carrier (United) for Chicago-London (Heathrow); double-daily service (British Airways) for Philadelphia-London (Heathrow); liberal regional U.K. service; renewal of the USAir/British Airways code share; limited "Fly America" benefits; "starburst" code-sharing; and limited and balanced additional opportunities in the near term—is unquestionably balanced in favor of the United States. The only remaining question is: could the United States hold out for more? The resounding answer from both sides of the Atlantic is no.

Chicago shares the desires of other airlines and airports for an "open skies" regime with our second largest aviation partner, the United Kingdom. We abhor the Bermuda II restrictions on routes and capacity that were agreed to after the United Kingdom threatened renunciation in 1976. As in our discussions with Germany and Canada, however, there comes a time when the ideal of immediate open skies must give way to pragmatism and moving forward, not backward.

Now is such a time. As Mayor Richard M. Daley stated in a letter to President Clinton: "It is becoming increasingly difficult, if not impossible, to understand why the world's largest airline, United, cannot fly from the world's largest airport, O'Hare, to the world's largest international connecting hub, Heathrow." The United States has within its grasp the ability to (i) correct an historical anomaly, (ii) add service to a route that has the largest unmet demand, (iii) bring added competition to the world's largest international air corridor, and (iv) exploit the competitive advantages of another U.S. hub carrier at Heathrow.

In addition, adding a second U.S. carrier on the Chicago-Heathrow route would remove any incentive that may exist to divert traffic or undersell the current Chicago-Heathrow service to avoid triggering the 600,000 passenger threshold for adding a second carrier. To grasp this point, one must enter the Byzantine world of the Bermuda II air transport agreement between the United States and United Kingdom. The agreement allows only one airline from each nation to serve any city-pair, except two U.S. carriers are allowed to serve London from five named U.S. points, which does not include Chicago. The agreement allows, however, "double-tracking" on any market whose total traffic exceeds 600,000 passengers for two consecutive years.

After 7 years of strong growth, where traffic levels jumped from 250,000 in 1986 to over 578,000 in 1993, traffic levels on the Chicago-London route have strangely fallen off in the past 2 years, with only a 1.52 percent increase in 1994. Unfortunately, the incumbent carriers have decided not to add frequencies or increase the size of the aircraft on the route, despite demonstrable unmet demand. As a result, the threshold is not triggered. United is shut out of the market. Chicago suffers from an artificial constraint on growth on the world's largest traffic corridor. And consumers from Chicago and the beyond-gateway points in the Midwest and West do not enjoy the benefits of increased service and competition.

Even beyond this artificial constraint, Chicago suffers from archaic and inequitable designations under the Agreement that fail to recognize the importance of O'Hare in the post-deregulation world. O'Hare is the largest airport in the world in terms of passenger volume, aircraft operations, and number of non-stop destinations served, with over 66.4 million passengers and 883,022 operations in 1994. Chicago is the second most important gateway to Europe, but is only the seventh most important gateway to London. In terms of non-stop seats, Boston and Miami, with local populations that are less than half those of Chicago, have substantially more non-stop London seats available to their passengers. Two U.S. carriers are allowed to operate to London from JFK, Newark, Miami, Boston, and LAX, but somehow not

from the world's busiest airport. United's Chicago operation is by far the largest hub without services to London. Just as it no longer makes sense after deregulation to place our weakest carriers on international routes, it makes no sense whatsoever to not exploit fully the vast connecting opportunities at the world's largest airport.

Because of O'Hare's unsurpassed domestic feeder system (with non-stop service to 135 cities in the U.S.), the benefits from a second U.S. carrier to Heathrow are not limited to the Chicago, Illinois, or even Midwest areas. Our studies indicate that substantial beneficiaries of the interim deal include over 700,000 passengers from throughout the Middle and Western States, like Arizona, Arkansas, California, Colorado, Kansas, Kentucky, Nevada, Oregon, Utah and Washington, many of whom are forced today to pay higher prices, face limited carrier choice, and navigate circuitous routes to connect through other, less convenient hubs. No other hub or airline combination could serve more beyond-gateway passengers than United through O'Hare.

With regard to other aspects of the deal, suffice it to note that (1) the added Philadelphia service by British Airways would be beneficial for that city, although the benefit to BA does not approach that for United in the Chicago-Heathrow market; (2) the regional U.K. service is helpful to the United States; (3) renewal of the British Airways/USAir code share would probably be necessary without an interim deal; (4) the United States has allowed "Fly America" traffic to go on numerous foreign air carriers, including Lufthansa, KLM, Varig, Swissair, Sabena, and Saudia; the United Kingdom allows U.S. carriers to bid on its governmental traffic; and the Baltimore/Washington areas would benefit by limited Fly America opportunities; (5) "starburst" code-sharing is of equal benefit to all carriers; and (6) setting an aggressive agenda and timetable for further liberalization talks can only be viewed as positive.

At bottom, the benefits of the draft interim agreement between the United States and United Kingdom are substantial, broad, and weighed heavily in favor of the United States. The United States should seize this historic opportunity and climb the first rung of a stepladder that will lead to complete liberalization.

#### THE U.S. NEEDS TO SCHEDULE FORMAL NEGOTIATIONS WITH JAPAN

A decade ago, almost half of U.S. carriers' international revenues were earned over the Atlantic. Now, the Asia Pacific region generates over 45 percent of U.S. international revenues; the Atlantic, just over 37 percent. Unfortunately, while the United States has a liberal bilateral with our third largest aviation partner, Japan, this agreement has not been adhered to and is the subject of much discontent.

Under existing agreements, differences exist in the rights held by three U.S. carriers with long-term service to Japan (United, which purchased Pan Am's routes, Northwest, and FedEx), and the carriers designated under various memoranda of understanding (American, Delta, Continental, and UPS). Japan has taken the position that only long-term carriers have Fifth freedom rights to operate beyond Japan, and even those carriers are subject prior approval for capacity increases. This interpretation has caused numerous disputes with U.S. carriers.

Regarding Japan, Chicago finds itself in a roughly comparable situation as in the U.K. talks, only this time the hubbing carrier at O'Hare shut out of the lucrative route—here Chicago-Tokyo—is American. Meanwhile, even though United's Chicago-Tokyo route is the single highest demand segment in its system, United remains limited to six flights a week, and encounters disputes over their fifth freedom operations. Northwest has daily service from Chicago to Tokyo, but very limited domestic connections. No carriers serve the new Kansai airport near Osaka from Chicago, nor is there any service to Nagoya. Under any new agreement, this disservice to the traveling public must end. American should be given comparable Chicago-Tokyo authority; United should be allowed greater frequencies and fifth freedom flexibility; and all carriers should have liberal access to Kansai.

Having said this, Chicago recognizes that numerous other factors must be taken into account in our sensitive aviation relations with Japan. First, unlike auto parts, aviation is one of the few trade sectors where the United States does very well. We would appear to have 66 percent of the United States-Japan aviation market, and U.S. carriers have fully 35 percent of all operations at Tokyo's Narita airport. Second, Japan has a very limited capability to enter into an open skies agreement, as its infrastructure is severely constrained. Unlike O'Hare, which has six commercial runways, Narita only has one runway. Finally, because of current economic conditions in Japan and at its major airlines, little demand would appear to exist to increase service to the United States. As a result, Japan has neither the incentive nor the capability to permit liberal access for all U.S. airlines.

These competing tensions must be discussed and resolved. We are encouraged by reports that the parties are engaging in informal discussions. Given the enormous

size of the markets, the interpretive restrictions that impede growth for both the long-term and MOU carriers, and the continuing and increasing nature of disputes over beyond rights, we believe that talks should begin formally and seriously to repair the poor state of aviation relations between the United States and Japan.

#### CODE-SHARING AGREEMENTS MUST BE REVIEWED CAREFULLY AND CONSISTENTLY

Chicago recognizes that code-sharing is widespread, and it does not wish to stand in the way of cooperative operating, marketing, or service agreements between airlines of different countries, especially where the agreement stands to benefit consumers by providing "seamless" travel. Chicago will, however, insist on its rights as landlord. Moreover, we are increasingly concerned that the DOT is engaging in a haphazard approach to code-sharing, where a flight operated by one airline is listed twice in computer reservation systems; once as a flight of the operating airline and separately as a flight of the code-sharing airline.

Other than a loosely structured process to request a "statement of authorization" (set up originally for wet lease arrangements), no formal process or factors appear to exist to evaluate code-sharing applications. More troubling is the increasing tendency of U.S. carriers to object at the DOT to the initiation or renewal of foreign airline service to various cities or other alliances whenever the host country of the foreign carrier objects to third-country code-sharing.

Two examples of this disturbing trend are the applications of Air India to initiate service to Chicago and the American/LOT Polish agreement. Air India, the international nag carrier of the second largest country in the world, would like to serve Chicago with local traffic rights from Frankfurt or London. United and Northwest, however, have objected to the service, because their code-sharing partners, Lufthansa and KLM, are having problems in India gaining approval of this third-country code-sharing. While local rights from the restrictive London market might be difficult to grant in light of the pendency of the U.K. talks, no justifiable reason exists to withhold this new service, and the attendant trade and tourism benefits, from Chicago and India.

Similarly, the DOT has delayed action on the code-sharing application of American and LOT Polish for over 7 months while it has tried to force the Polish government to accede to the demands of United and Northwest for third-country codesharing. While Chicago generally supports on economic grounds and competitive necessity DOT authorization of international code-sharing agreements, we do object when disputes over code-sharing are given greater precedence over more direct international route opportunities for U.S. cities, or consummation of an alliance like American/LOT Polish that can provide consumer benefits and competitive parity for certain carriers. Reasonable minds can and do differ on the relative merits of code-sharing; we would only encourage the DOT to be careful and consistent and not prioritize third-country code-sharing over direct service between the two countries.

#### THE FUTURE OF LIBERALIZATION LIES IN MEASURED STEPS

Given the current competitive position of U.S. carriers in international markets, Chicago believes that the Federal Government needs to be firm on insisting upon its hard-fought rights, but sensitive to the unique situation of each bilateral negotiation. Many foreign air carriers are undergoing drastic restructuring or privatization. Airport and airways infrastructure has failed to keep pace with the burgeoning demand for air travel. Following the successful models of Germany and Canada, we should recognize that open competition sometimes is only possible after a transitional period of incremental benefit.

While pursuing multilateral accords, we support efforts to be pragmatic and reach bilateral agreements that stimulate more air travel, increase competition, create jobs, and pave the way for broader liberalization, like the interim agreement between the U.S. and the U.K. We support the formation of a global coalition of like-minded, free market-oriented nations to significantly advance liberalization. As history has shown, bombastic rhetoric and renunciation is counter-productive and unnecessarily harms cities, consumers, and all air carriers. Quiet diplomacy, focused on the achievable, balanced by all views, will often produce more demonstrable, long-term benefits.

We appreciate this opportunity to present our views on international aviation to the Committee.

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## TESTIMONY OF PATRICIA A. FRIEND

Mr. Chairman and Members of the Subcommittee, it is a privilege to have this opportunity to share our views with you on international aviation policy. The Association of Flight Attendants, AFL-CIO, represents 36,000 flight attendants at 24 U.S. carriers.

AFA has long believed that U.S. aviation policy must be based on the recognition that aviation services form an integral part of the U.S. infrastructure, essential to the efficient transport of people and goods. In addition, in times of international conflict, our military effectiveness has been significantly enhanced by the participation of U.S. carriers in the Civil Reserve Air Fleet (CRAF) program.

Other countries are similarly dependent on their domestic aviation services. For this reason, their airlines were often state-owned relatively recently. While state ownership is not essential to ensure domestic control, it is important that we preserve the essence of policies now in place to ensure that U.S. carriers are owned and effectively controlled by U.S. citizens. Cabotage, which would permit foreign carriers to fly point to point in the U.S. domestic market, must remain outlawed. The impact of cabotage on the security of our aviation infrastructure would be exceeded only by its impact on the job security of hundreds of thousands of U.S. workers in the commercial aviation industry.

In addition, we have long believed that the bilateral process serves the best interests of U.S. carriers. The process facilitates negotiations which exchange rights for rights and values for values. Transportation issues have their own forum and cannot be traded against communications or banking interests as they might be if aviation were part of a larger General Agreement on Trade in Services (GATS).

While in the past, we have been encouraged by the International Civil Aviation Organization's (ICAO) actions in reviewing existing regulations, we were profoundly concerned to discover, just before a ICAO-sponsored conference late last year, that what was being proposed, with the encouragement of our own government, was a radical restructuring of international aviation regulation. This proposal would virtually eliminate the concept of flag carriers. Proponents of greater liberalization favored four model agreement proposals to eliminate the existing regulatory "barriers" to international aviation.

The first, concerning the right of establishment, addresses legal limits on foreign investment. At the present time, some states prohibit foreign investment in domestic carriers while others set limits to ensure domestic control. The new proposal is two-fold: states would agree to limit barriers to foreign investment and to permit foreign carriers the right to operate in their territory. Under this proposal, British Airways, Japan Airlines or Swissair could then acquire majority control of U.S. carrier or set up a domestic operation in the United States. The latter concept, cabotage, currently is illegal in countries throughout the world.

The second recommendation would permit employment of non-national personnel on foreign-controlled carriers. Foreign nationals could be used to perform managerial, sales technical and operations duties for the airlines. Standard immigration limits would be erased for virtually every category of aviation employee. The availability of U.S. employees skilled to provide such services would not be relevant. This is tantamount to an open invitation for U.S. carriers to export our jobs.

Another provision favored in the four point model would permit a carrier to be owned and controlled by a foreign aviation treaty partner so long as the headquarters of the carrier remained in the state. The final proposal of the group was for unrestricted market access.

Even without this radical restructuring, work that very well could be done by U.S. citizens or green card holders is being shipped abroad today. In the late 1980's, in a strikingly familiar vein, the government proposal to facilitate additional maintenance work on U.S. planes by repair shops overseas. That effort was stopped just as this new attack on our jobs must be.

Such exportation of well-paid U.S. jobs threatens all airline workers. Flight attendants are facing a more immediate challenge. U.S. carriers have stepped up hiring flight attendants abroad, arguing that such moves provide two important: cost savings and foreign language capabilities in a single stroke. American Airlines has hired over 700 flight attendants in Latin America while Northwest employs over 550 hired in various Asian countries. Charter carriers like American Trans Air and Tower also has foreign bases in Tel Aviv, Bombay and New Delhi while United Airlines has flight attendant base operations in Bangkok, Singapore, Taipei, Paris and London. All are non-union with the exception of American's flight attendants in Buenos Aires, United's flight attendants in Singapore and three UAL bases (Taipei, Paris and London) where the carrier has agreed to apply AFA's collective bargaining

agreement. The Taipei, Paris and London bases have both U.S. and local flight attendants represented by AFA.

In July of this year, United plans to open an additional foreign domicile in Hong Kong. United has used foreign domiciles and local hiring as a way around certain contact provisions it finds restrictive. Meanwhile, more and more of our most lucrative, senior positions are being exported to low-paid new hires in foreign countries.

The issue is not just who does the work, but how safe are our skies. In an emergency, how well can flight attendants hired abroad communicate in English? Will passengers understand their commands? Will foreign-born flight attendants understand their fellow U.S.-born flight attendants? Will they understand communications from the cockpit and will they be able to make themselves understood to the cockpit and to the passengers?

This is a relatively new concern and it is important to put it into context. Until recently, international flying was done by TWA and Pan Am. At TWA, in the mid-70's, the carrier closed the foreign flight attendant domiciles and hired language-qualified flight attendants in the U.S. Pan Am always hired language qualified flight attendants in the United States. But all that happened before deregulation.

Now, our carriers tell us that they hire abroad for economic reasons. The carriers may believe that safety is not being compromised since these individuals go through flight attendant training in English. They believe successful completion of training should be proof enough of their English language skills. But flight attendant training is rarely designed to specifically test communication skills in an emergency. Crew Resource Management training will not become mandatory for a few more years. Training is still based on individual exercises rather than emergency simulations involving group interaction.

From our experience on the line, we provide a different perspective. Below are two examples of how important English language proficiency is to safety. In one case, the pilot announced "flight attendants, prepare for landing". This announcement is given during flight to signal the flight attendants to check that seat belts are fastened, tray tables stored, seat backs in the uprights position and carry-on baggage is stowed in preparation for landing. A non-U.S. born flight attendant did not understand the command. Rather than make a cabin check, the flight attendant responded by disarming her door, an action appropriate only when the plane has landed.

In another case, during an evacuation, a foreign-born flight attendant disarmed the door before opening it. The U.S.-born flight attendant near him shouted "close the door" repeatedly, but he did not understand. As a result, the door was not usable for the evacuation. What these two examples illustrate is that the most basic flight attendant responsibilities have not been absorbed, and that language barriers can override current training in the pressure of real world performance of duties. We should not wait for an accident to prove the point.

As the aviation industry globalizes, so does the work. But national protections for workplace safety and health, for fair pay, job security, reasonable benefits and decent working conditions often stay at home. Because globalization is in its early stages, how it will affect worker rights and passenger safety is an unfolding story.

Clearly, the bilateral process has produced benefits to U.S. carriers. As our union celebrates 50th anniversary, Americans continue to enjoy the world's largest and safest aviation industry. U.S. major carriers represent 57% of current world traffic. The Federal Aviation Administration has projected that domestic and international traffic will increase into the next century.

The Federal Government should take steps to build upon our safety record and to enhance our industry's competitive situation while protecting American jobs. The government should also continue to reject efforts to introduce cabotage into the American market. In reviewing U.S. international aviation policy, we urge the Aviation Subcommittee to take into consideration the impact globalization will have on American aviation workers and the safety of passengers.

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VICTORIA L. FRANKOVICH  
PRESIDENT

May 23, 1995

The Honorable John McCain  
Chairman  
Subcommittee on Aviation  
427 Hart Office Building  
Washington, D.C. 20510

Re: International Aviation Policy  
Hearings - May 24, 1995

Dear Mr. Chairman:

Please include the following comments as part of the record for the hearings being held on May 24, 1995 with its focus on the U.S.- U.K. bilateral agreement:

On behalf of the 5,000 flight attendants at Trans World Airlines (TWA) represented by the Independent Federation of Flight Attendants (IFFA), I write to strongly urge congress to promote and encourage a much more liberal bilateral agreement between the United States and the United Kingdom. As employee-owners, the flight attendants share TWA management's concern over the loss of revenue resulting from TWA not operating a New York - London route. It is estimated that the addition of this route could generate an additional \$100 million annually. TWA is the only major carrier without New York - London service. and this heavily impacts its ability to compete in Europe.

TWA's precarious financial condition makes the renegotiating of the U.S.-U.K. bilateral a crucial issue for its employees. Congress is not responsible for management decisions that have placed the carrier in its current situation, nor is it responsible for the previous majority stockholder who negotiated the sale of these lucrative routes. The 23,000 hard-working TWA employees were not responsible for the route sale, but are left, as employee-owners of the airline, to rebuild this airline and secure its, and their,

future. But congress can play a role in assuring that U.S. air carriers compete on a level playing field. The British used the transfer of Heathrow access from Pan Am and TWA to update and expand U.K. carrier rights under the bilateral. Consequently, the current bilateral has six authorized but unused authorities to Heathrow from U.S. gateways. Unlike the recent Delta-Virgin Atlantic code share, TWA would be truly adding new service and giving the consumer another choice from New York.

All 23,000 TWA employee-owners and management have made tremendous sacrifices to rebuild our carrier. Labor-management relations are greatly improved, and new labor agreements have lowered costs. In fact, TWA costs are now among the lowest in the industry while its work force remains one of the most experienced.

It is in the public's and the nation's best interest for U.S.- U.K negotiations to make an open skies bilateral agreement. Just as the U.S. is now taking a stand criticizing Japan for unfair competition, it is also time to confront the British for similar actions. Short of open skies, efforts should be made to assure that existing authorities are available to U.S. carriers; TWA should be awarded a New York - London route.

Please feel free to contact me or our Washington representative Joan Wages at 703-548-3676 with questions.

Sincerely,

A handwritten signature in cursive script that reads "Vicki Frankovich". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Vicki Frankovich



Senator McCAIN. And the record will be left open so that other interested parties or individuals may submit statements.

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STATEMENT OF PHILIP M. CRANE

Chairman McCain, Senator Ford, Members of the Subcommittee:

I appreciate the opportunity to submit, for the hearing record, my views on the negotiations for a new bilateral air agreement between the United States and the United Kingdom. As Chairman of the Trade Subcommittee of the House Ways and Means Committee, I am particularly cognizant of the relationship between international trade in aviation services and international trade in U.S. manufacturing goods.

As I understand it, U.S. negotiators now have within their grasp an agreement with the United Kingdom that would, at long last, permit a second U.S. carrier to operate between our busiest airport, Chicago's O'Hare International, and Europe's most important destination, London's Heathrow Airport. This service, without a doubt, is one of the most important international transportation needs facing the United States today. Not only would it be of great economic benefit to one of America's largest and most significant trading centers, but it represents a major opportunity for all those for whom Chicago is the most direct and convenient gateway between the United States and London.

United Airlines, which operates its primary hub at O'Hare, has long been interested in obtaining Chicago-London authority in order to allow it to compete with the two carriers now providing service on the route, British Airways and American Airlines. Unfortunately, United has been shut out of that market because of the restrictive nature of the existing bilateral aviation agreement between the United States and the United Kingdom, sometimes known as "Bermuda 2. This situation has left the Chicago-London market with higher prices, fewer seats and fewer passengers than would be expected if the Chicago-London route enjoyed true competition. Therefore, the United States should not forego the opportunity to eliminate one of the most significant of the Bermuda 2 restrictions, and in the process, promote such competition on one of its most important transatlantic routes.

I hear that some carriers are urging our government to defer negotiating this new route opportunity until a broader aviation agreement with the United Kingdom can be developed. Certainly, the United States should pursue liberal trade agreements whenever and wherever it can. But that does not mean that U.S. consumers, U.S. exporters, U.S. passengers and U.S. shippers should forego valuable, immediate opportunities while our government negotiators pursue the "perfect" agreement, especially as the peak summer traffic season approaches. A United Airlines route from O'Hare to Heathrow would bring much-needed competition to U.S. consumers in a market currently dominated by a single carrier from each country. In return, British Airways would be allowed two rather limited benefits: (1) a modest expansion of its Philadelphia-London services (thus helping residents of that city cope with the recent termination of American Airlines' Philadelphia-London services) and (2) the opportunity to participate in transporting government traffic in a limited number of markets, under the "Fly America" Act, through its code share partner, USAir (as other foreign code-share partners of U.S. carriers already are allowed to do).

The economic value of these concessions simply does not compare with the benefit to be gained by allowing a second U.S. carrier in the Chicago-London market. Neither could it be argued that, by making these compromises with the other side, the United States has eliminated the incentive for the United Kingdom to negotiate in the next phase of the talks. To the contrary, given the limited scope of the British gains so far, it would appear that the United Kingdom would have every incentive to continue to negotiate in good faith.

In short, successful trade negotiations are exercises in pragmatism. Here, pragmatism plus the clear interests of the United States, argue for concluding a deal with Great Britain that will allow United Airlines to initiate direct service this year between its hub at O'Hare and London's Heathrow Airport. Opportunities this valuable, at a cost this low, have been in short supply where the United Kingdom is concerned. The United States should not pass up this opportunity to bring competitive service to the Chicago-London market on the chance that a better offer will present itself in the next round of talks.

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## STATEMENT OF JEFFREY P. FEGAN

My name is Jeffrey P. Fegan. I am the Executive Director of the Dallas/Fort Worth International Airport, this nation's and the world's *second* busiest in terms of operations. I appreciate the opportunity to submit this written testimony to you on the current U.S./U.K. negotiations. The stakes for DFW Airport and the entire Dallas/Fort Worth Metroplex community in this negotiation are enormous.

During its deliberations, I would respectfully suggest that the Committee focus on three issues as it examines today the current U.S./U.K. aviation relationship.

*First*, how did the U.S. Government come to the decision to seek a "mini-deal" that benefits just one airline and one U.S. city?

*Second*, why is the U.S. Government now shifting its negotiating goals to make a *third* Heathrow route for Chicago its highest priority with the British, while DFW and many other U.S. cities are still looking for their *first* Heathrow service?

*Third*, should the United States' goal with the United Kingdom continue to be a significant opening up of the U.S.-London market, with multiple new opportunities for Heathrow service available for new U.S. cities and airlines? If so, then will the current U.S. mini-deal strategy get us to the finish line?

My airport's and my communities' position is simple. A deal that benefits just one U.S. city and one airline is not going to open-up the U.S.-U.K. market. We do favor an agreement with the United Kingdom, even a small one, so long that it provides real Heathrow opportunities for a number of U.S. cities and airlines. It must be an agreement that "breaks" the current Heathrow "wall" under the *Bermuda 2* agreement that allows only two U.S. airlines to serve Heathrow from a small list of grandfathered U.S. cities (and none from the South or Southwest). The fact is that these limitations have not changed since 1977.

Clearly, Dallas/Fort Worth would prefer to have Open Skies with the U.K. However, it is obvious that the British are not willing to negotiate Open Skies until British Airways decides whether it wants to expand its investment in USAir—a decision that is probably many months off. We see no advantage to an "Open Skies-or-nothing" approach that may take years to resolve. If an interim deal can be negotiated with the United Kingdom that provides *meaningful* opportunities for a number of U.S. cities and airlines, then the U.S. Government should seize the opportunity. In contrast, we see no benefit in a "mini-deal" that is narrowly focussed on one city and one airline.

We do not fathom why U.S. aviation policy should make a *third* Heathrow route for Chicago the top priority when DFW still lacks its *first* route to Heathrow. Other U.S. cities also want Heathrow access, and other U.S. airlines seek their first routes to Heathrow. (United—2—course already serves Heathrow today from four U.S. cities other than Chicago.) We are at a loss to understand why the U.S. negotiating team has chosen such a narrow focus in its approach with the British.

Mr. Chairman, let me be clear with the Committee what the stakes are for DFW in this negotiation.

Dallas/Fort Worth has nonstop London service provided by American Airlines and British Airways. This is one of our premiere international routes. The airlines together offer three daily nonstop flights, and even more during the summer months. But because of the *Bermuda 2* agreement both services are flown into London Gatwick Airport. We have no Heathrow service today. We are convinced that substantial economic benefits would flow to the community if our hub carrier, American, could fly this route into Heathrow.

American and Dallas/Fort Worth have long sought the right for American to be able to switch some or all of its DFW flights into London Heathrow. This issue was tabled and pursued by the U.S. Government during the 1990 Heathrow Successorship Negotiations but rejected by the U.K. at that time. Moreover, DFW/Heathrow switch rights were also a U.S. Government objective throughout the 1992-93 so-called liberalization talks with the United Kingdom.

There are sound economic reasons why Dallas/Fort Worth Airport and its own cities continue to seek a change to *Bermuda 2* that would allow us to receive DFW-Heathrow service. It is well known that existing Gatwick service is not a substitute for Heathrow service for connections to the Continent, Africa and Asia, and to serve the north London market. In—3—particular, there are substantial trade and business relationships between the Dallas/Fort Worth area and the Middle East and South Africa that could be better served with a Heathrow connection.

Dallas/Fort Worth is also competitively disadvantaged compared with other U.S. gateways that now enjoy Heathrow service under the *Bermuda 2* agreement. DFW, the second busiest airport in the world, is restricted to Gatwick service, while New York, Chicago, Miami, Boston, Washington, Los Angeles, San Francisco and Seattle enjoy nonstop London/Heathrow service.

Our business and corporate travelers have nonstop access to over one hundred cities in North America from DFW, and they can fly nonstop to London, Paris, Frankfurt, Tokyo and Sao Paulo. Yet if they want to go to the Middle East or South Africa, we must route them via Chicago or New York because we lack a Heathrow connection. What is just as frustrating is that smaller U.S. cities such as Boston and Seattle can promote their Heathrow service, while DFW cannot.

The United States has already added new Heathrow rights to its negotiating agenda by proposing a second U.S. carrier Chicago-Heathrow route for United Air Lines. Public policy would seem to dictate that DFW should receive its *first* Heathrow access if Chicago is going to receive a *third* Heathrow route (beside flights today by American and British Airways). Adding DFW/Heathrow switch rights would satisfy long-frustrated and long-sought needs of the Dallas/Fort Worth Metroplex. Such a modification to the Agreement should not pose a major hurdle for the United Kingdom.

The fact of the matter is that the new opportunities currently being sought by the U.S. Government mainly serve British interests. Except for a new Chicago-London route for United, the proposed mini-deal does not satisfy any aspirations of Dallas/Fort Worth, its major hub carrier or any other major airline or U.S. community. Besides the United/Chicago route, the mini-deal includes backdoor Fly America rights for British Airways, further approval of the British Airways/USAir code shares, additional Philadelphia frequencies for British Airways, beyond London change of gauge/code-share rights for U.S. carriers, and rather meaningless U.K. airline rights to serve some U.S. cities from U.K. regional airports like Birmingham, Manchester and Glasgow. While new rights for each side are somewhat balanced, the U.S. benefits go principally to one airline and one city.

If the British are to receive something of value in this negotiation—and we think there is a lot in the present package for them—then more U.S. needs than just those of one city and one U.S. airline must be satisfied. At minimum, the U.S. negotiating position must continue to seek new Heathrow switch opportunities including the right for American Airlines to be able to switch its DFW-London services to Heathrow Airport.

We believe strongly that the Administration should stick to its initial U.K. negotiating strategy forged in late March which linked Fly America rights for the U.K. side to increased Heathrow opportunities for U.S. carriers and communities. That strategy *still* holds the most promise of converting a parochial one airline/one city negotiation into an agreement that can benefit a number of U.S. interests and truly open-up the U.S.-U.K. market. Unfortunately, the U.S. negotiators abandoned this approach in their most recent discussions with the United Kingdom.

The U.S. Government's decision made earlier this month to change its position and not seek Heathrow switch rights as part of the so-called Phase 1 "mini-deal" was unwise and should be reconsidered. The limited Phase 1 agreement, as we understand it, would be signed in early June; new Heathrow opportunities would be deferred until Phase 2 which is open-ended and could take months—or years—to complete. The backdoor Fly America rights that the Administration now proposes to include for the United Kingdom in Phase 1—without any Heathrow switch opportunities—gives the United Kingdom most of what it wants, and leaves the United States with little leverage to secure the Heathrow opportunities it seeks in the proposed Phase 2 negotiations.

Surely the "very limited and balanced deal on access to London Heathrow" envisioned by the U.S. Government for Phase 2 can and should be included in the agreement to be negotiated June 1-2. Insisting on this element will not be the straw that breaks the camel's back. Dallas/Fort Worth is not satisfied with the Administration's announced goal of only an agreement on an agenda and a timetable for Phase 2. We truly question whether the deal will ever be consummated.

The U.K. proposals for the mini-deal agreement provided during the recent May round in London raises some fundamental issues that call into question the "mini-deal" strategy that the United States is currently pursuing, and provides support for our position that Heathrow switch rights should be a part of any Phase 1 agreement. It is this broader interim deal the U.S. should be seeking, not the current one city/one airline mini-deal. This is highlighted by two facts.

*First*, the U.K. is proposing that exercise of the new United/Chicago rights is contingent on, among other things, receipt of a Justice Department letter apparently stating that carriage of code-share Fly America traffic by British Airways will not violate U.S. antitrust laws. Such a letter normally would require three to four months processing time by Justice from date of submission. The only point to rushing to conclude the "mini-deal" on June 1-2 and forgoing new Heathrow opportunities until Phase 2 is arguably so that United can operate its new Chicago route

through the peak summer season. The U.K. position would make this an impossibility, and undercuts the argument for a mini-deal limited to Chicago/United only.

Second, the United Kingdom is raising the Fly America "ante" by insisting on rights on the New York/Newark and San Francisco-London sectors on top of the Washington/Baltimore-London sectors offered by the United States. If major Fly America routes like New York-London are included in the Phase 1 deal, there is little incentive for the United Kingdom to return for Phase 2. Moreover, the U.K. strategy of trying to "frontload" Fly America rights in Phase 1 calls into question their sincerity about trying to reach promptly in July a Phase 2 agreement.

In light of the problems highlighted by the U.K.'s May proposal, Dallas/Fort Worth has urged the Administration to seek inclusion of the balanced Heathrow exchange in the Phase 1 negotiations. While this may mean that an agreement cannot be reached June 1-2, it is not clear that an early agreement will result in any immediately useable new rights for the United States (i.e., Chicago/United). We would rather see an agreement reached later this summer that is balanced for both sides, including some Heathrow switch rights, rather than the proposed Phase 1 and Phase 2 linkage that would carry with it, in our opinion, a high probability of failure and mutual recrimination.

In summary, DFW Airport supports the negotiation of an interim deal with the United Kingdom at this time provided that the Agreement includes some new Heathrow opportunities for both sides. One such opportunity should be the right for American Airlines to switch its DFW-London flights to Heathrow. We are opposed to the current U.S. Government effort to conclude a parochial one airline/one city mini-deal. The key for us is an agreement that provides some Heathrow opportunities for multiple U.S. cities and airlines and "breaks" the current *Bermuda 2* restrictions that limit which U.S. cities and airlines can have Heathrow service. We believe that such an agreement can be achieved this summer, and we urge the Committee to encourage the Administration to pursue that path.

Thank you.

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#### STATEMENT OF JEFFREY HAMIEL

The Minneapolis-St. Paul Metropolitan Airports Commission ("MAC") owns and operates a system of seven airports in the Minneapolis-St. Paul metropolitan area. The largest of those airports is Minneapolis-St. Paul International ("MSP"), which is a major hub for Northwest Airlines. MSP receives international air service from Tokyo, Amsterdam, Frankfurt, and from a number of Canadian cities. MAC requests that this testimony be considered and entered into the record of the hearing on international air service held by the Subcommittee on May 24, 1995.

At that hearing, Kenneth Mead, Director of Transportation and Telecommunications Issues with the U.S. General Accounting Office, testified that DOT should weigh the value of international air service agreements based on an economic analysis that demonstrates the comparison of costs and benefits of the proposed agreement's terms. While MAC agrees, MAC feels strongly that GAO's recitation of the factors to be weighed in the cost-benefit balance is too limited. In particular, the value of international air service to U.S. communities must be included in any valid calculation of the benefits of international air service agreements. MAC supports and would emphasize the testimony offered to this effect by Mr. George Doughty of the Lehigh-Northampton Airport Authority on behalf of a number of airports.

MAC has had a recent demonstration of the benefits that a new liberal air service agreement can have on the air service to a single destination, and of the economic benefits of such new service. In April, the United States signed a liberal air service agreement with Canada. That agreement created an "open skies" regime between the United States and all but three Canadian cities. In April, before the new Canadian agreement, MSP was receiving 61 international flights a week. By July, MSP will be receiving almost three times that number of international flights, with the majority coming from Canada. MAC projects that the economic benefits to the community of the new air service will be approximately \$500 million in the first year, in expenditures by tourist and business travelers, in new economic activity created by enhanced trade opportunities, and in other direct and indirect benefits. Similarly, Northwest's recently instituted weekly MSP Tokyo service is projected to have economic benefits of approximately \$80 million per year. MAC notes as well that while MAC is pleased to receive international service from Northwest, our hubbing carrier, many of the economic benefits of new international service to communities are independent of whether the service is provided by a United States or foreign carrier.

These economic impacts are concrete, practical benefits to U.S. communities and U.S. citizens. These real benefits should be weighed in the cost-benefit balance when

the "value" of a new air service agreement is calculated. A calculation that stops with assessing the impact on air carrier revenues is invalid; not only does it omit economic benefits to U.S. communities of increased service from U.S. carriers, but it counts as a cost the increased access to the U.S. market for foreign carriers, even though such service will create new opportunities for economic growth in the U.S. communities served. In summary, a carrier-centered economic analysis is too limited and will result in more restrictive agreements, fewer international flights, and missed opportunities for U.S. communities.

MAC appreciates this opportunity to present its views on this subject to the Committee.

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#### STATEMENT OF MARY ROSE LONEY

My name is Mary Rose Loney, and I am the Director of Aviation for the city of Philadelphia. Among other things, my office oversees the operation of Philadelphia International Airport. I am providing this Statement to the Senate Aviation Subcommittee to express Philadelphia's views regarding the important issues which the Subcommittee is exploring at its May 24 hearing concerning proposed changes to the United States-United Kingdom bilateral aviation relationship. I ask that this statement be considered and received for the record.

For the reasons below, the city of Philadelphia strongly supports the package of proposed changes which have been discussed at the recent U.S.-U.K. aviation talks. As matters now stand, it appears that after several rounds of painstakingly slow negotiations the two sides are close to an agreement on substantially liberalizing the U.S.-U.K. aviation regime, in a two-phase process. The first phase will, among other things, authorize a second U.S. carrier to fly between Chicago and London, allow British Airways to operate a second daily Philadelphia-London service, provide open-skies for U.S. carriers at U.K. regional airports, and significantly increase the flexibility of U.S. airlines to operate codeshare service beyond London to Europe.

As for Philadelphia-London service, the proposal to authorize double-daily service by British Airways *will simply allow Philadelphia to maintain its historic level of twice-daily London service.* Philadelphia's historic level of London service was temporarily lost when American Airlines terminated its Philadelphia-London flights early this year, and no U.S. carrier has sought to replace that service. In fact, Philadelphia is one of the most underserved international U.S. gateways relative to its population and traffic levels. Thus, authorizing a second daily London service will create economic benefits where they are most needed and deserved.

Moreover, while the increased Philadelphia-London service might aid British Airways, it benefits Philadelphia and the Tri-State region much more. Frequent, dependable London air service is vital to the citizens, businesses and economy of this region. A number of economic studies have shown that the value of international air service (provided by either a United States or foreign carrier) to a gateway community ranges in the hundreds of millions of dollars annually. This economic impact on the community far outstrips the financial impact of the air service on the air carrier itself. International air service not only increases travel options for local and connecting passengers, it spurs economic growth by creating jobs, spurring exports, expanding tourism and attracting new business. Consequently, *by any reasonable measure, the proposal to authorize increased Philadelphia-London service by British Airways is a net benefit to the United States.*

For similar reasons, it is abundantly clear that the phase I agreement as a whole would product net economic benefits for the United States. The economic impact on the Philadelphia and Chicago regions from expanded London services, coupled with the financial benefit to United Airlines from new Chicago-Heathrow service and the positive impact on U.S. carriers from expanded code-sharing opportunities and service to U.K. regional points, far outweigh the relatively limited benefits available to the United Kingdom from the phase I agreement.

White this initial phase of liberalization provides enormous benefits to the United States, it is not surprising that, as merely the first step in a continuing process, it does not accommodate the "wish list" of every U.S. airline and every U.S. community. If the United States were to insist on an agreement which accommodated all those interests at once before taking any initial steps, the United States would never reach an agreement to liberalize aviation with the United Kingdom, or with any other trading partner for that matter. The important point is that the package now on the negotiating table not only provides significant, tangible benefits to the United States, but it is a vital *first step* to even broader liberalization of U.S.-U.K. aviation relations. If we do not take the first step, there will be no second step, *i.e.*,

no liberalization with the United Kingdom for the foreseeable future. That would be a tragic lost opportunity.

The second phase of liberalization, which the two sides have begun to explore, will provide additional opportunities for U.S. airlines to serve London Heathrow and Gatwick airports, as well as relaxation of U.S.-U.K. charter rules, pricing, and cargo services. However, this broader liberalization will not occur unless the initial phase is first agreed upon. If the two sides fail to agree on the first phase, the United States will lose not only the enormous benefits available initially but also will lose the opportunity for the substantial additional benefits that are expected from the second phase.

In a perfect world, Philadelphia would prefer to have an agreement that creates full and immediate liberalization of the U.K. aviation regime. Yet, all realistic observers understand that ideal is not achievable. On the other hand, the U.S. has a rare and valuable opportunity to begin the process of meaningful liberalization with the U.K. now. Philadelphia submits that the U.S. should seize this opportunity, to make real, demonstrable progress where it is achievable as a first step, and then to pursue vigorously a broader liberalization in the second step. By doing so, the U.S. will take a pragmatic, effective approach with an enormous payoff that will benefit the traveling public, the airlines, and the communities of this country.

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NATIONAL AIR CARRIER ASSOCIATION



1730 M STREET, N.W., SUITE 806, WASHINGTON, D.C. 20036



STATEMENT OF

EDWARD J. DRISCOLL

PRESIDENT AND CHIEF EXECUTIVE OFFICER

NATIONAL AIR CARRIER ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE AND

TRANSPORTATION

UNITED STATES SENATE

U.S./U.K. BILATERAL

MAY 24, 1995

Mr. Chairman, Members of the Committee. I am Edward J. Driscoll, President and Chief Executive Officer of the National Air Carrier Association (NACA). We are pleased to have this opportunity to present our views with respect to the U.S./U.K. bilateral negotiations and specifically to address the Fly America Act as well as the requirement to negotiate a broad-based agreement which would include a so-called Belgian Charter Article, as well as pricing and cargo operations including beyond rights on a fifth freedom basis to points beyond the United Kingdom.

NACA represents United States certificated airlines who operate under the provisions of Part 121 of the FAR's, and who perform scheduled and charter services on a worldwide basis for the movement of passengers, cargo, and combination services. Services are provided domestically as well as internationally. Our member carriers are: American Trans Air, Evergreen International Airlines, Miami Air International, Rich International Airways, Southern Air Transport, Tower Air, and World Airways, Inc.. Attached as Exhibit 1 is a summary of what each of the carriers offer to the general public, including their areas of operation, type of aircraft, and performance data.

Mr. Chairman, I would like to address several subjects. These include national security requirements, the Civil Reserve Air Fleet program (CRAF), and the Fly America Act. These three subjects are all inter-related and each is an essential part of the whole. In



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addition, I will address commercial requirements for charter and beyond rights for scheduled service.

**The National Security Requirements.**

The United States is totally dependent upon airlift for immediate deployment of its combat elements to areas throughout the world when emergencies arise.

While the U.S. has an organic fleet, composed of military aircraft, these are insufficient to provide the level of support and the capability needed to deploy troops and equipment to the far corners of the world.

The deployment is supported by the Civil Reserve Air Fleet program. As you know, this program requires civil air carriers to commit capability in support of national defense objectives whenever CINCTRANSCOM or the Secretary of Defense declares an airlift emergency. The National Airlift Policy of 1987 provides the guidance. The Civil Reserve Air Fleet program was activated during Desert Shield/Desert Storm and the U.S. air carriers distinguished themselves in the degree of support they provided to the military, without which the tremendous outpouring of men, munitions and arms by the U.S. and other nations to the Persian Gulf could not have been achieved.

**The Civil Reserve Air Fleet Program.**

The Civil Reserve Air Fleet program is an essential element of national security and is dependent upon incentives to ensure that the air carriers are able to provide the capability assigned during emergencies. Peacetime air transportation requirements are one of the incentives that stimulate the air carriers to make that capability available to meet Department of Defense objectives when required.

It is interesting to note that during Desert Shield/Desert Storm, even though foreign governments and carriers, especially the NATO nations, were requested by the highest level of the United States Government to provide aircraft to support the deployment of forces in support of the U.N. action, no European country nor foreign carrier responded by volunteering aircraft.

All of our member carriers participate in the Civil Reserve Air Fleet program and offer capability in support of military operations during peacetime as well as during emergencies.

The NACA carriers are really the first line of support to the military in event of emergency by offering capability either on a voluntary basis or pursuant a call-up of the Civil Reserve Air Fleet.

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While our carriers are the smaller U.S. carriers, their contributions to a Stage 1 are relatively large. The NACA carriers provide sixty-six percent of the passenger capability and twenty-five percent of the cargo capability to the military under a Stage 1 call-up in support of emergency or war-type operations.

The NACA carriers have a distinguished record in support of emergencies on a worldwide basis over an extended period of time involving many different emergencies, the most notable being in support of Desert Shield/Desert Storm.

#### **Fly America Act.**

The Fly America Act was specifically designed to ensure that government-financed traffic is moved on U.S. aircraft, if available, and only moved on foreign aircraft when U.S. capability is not available or in areas where U.S. aircraft do not operate.

The Department of Defense has two programs inter-related for the movement of Department of Defense traffic. One program is administered by the Air Mobility Command (AMC), who has annual contracts in excess of \$500 million for the movement of traffic, cargo, passengers, in full plane-load lots. In addition, the Department utilizes the services of the GSA City Pairs program in moving substantial (individually ticketed ) traffic, possibly in excess of \$1 billion, by U.S. scheduled carriers, within the U.S.

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and between the U.S. and foreign points.

It order to participate in either program, the carriers must be members of the Civil Reserve Air Fleet and have aircraft committed to that fleet by specific tail number which they would make available to the DOD upon the call of CINCTRANSCOM or the Secretary of Defense, depending on the state of emergency whenever an emergency situation exists.

Foreign carriers are permitted to move U.S. Government financed traffic under code-share arrangements pursuant to a Comptroller General's decision of 1991. (See exhibit 2).

NACA and its carriers do not support a policy that permits the use of foreign carriers. Several scheduled carriers as well as NACA have petitioned the Comptroller General to reconsider the 1991 decision. It is our understanding that this matter is under consideration.

Mr. Chairman, we do not support the exchange of government traffic with the U.K.

We do not believe that there is sufficient justification for permitting code-share arrangements between BA and USAir for government traffic.

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Surely, before the U.S. exchanges this right, the Department of Transportation (DOT) must make an economic case that this is in the best interest of the U.S.

To date we have seen no statistical evidence that would justify any grant.

**Charters, Cargo and Beyond Rights.**

It is essential that the U.S. obtain expanded rights for charters and cargo as well as fifth freedom beyond rights for scheduled services.

The charter arrangement should be a Belgian-type charter provision and the cargo regime should be open-skies. Fifth freedom beyonds should be unlimited and should eventually be based on an open-skies regime.

This concludes my prepared statement.

NATIONAL AIR CARRIER ASSOCIATION  
POINT PAPER  
ON  
CODE SHARE AND THE FLY AMERICA ACT

1. The U.S. law is clear that government financed or sponsored traffic must move on U.S. air carrier aircraft if available unless exempted pursuant to a bilateral agreement or multilateral agreement between the United States and a foreign government or governments provided such agreement is consistent with the Goals for International Aviation Policy and provides for exchange of rights or benefits of similar magnitude. (49 U.S.C 40118)
2. Except in one limited case; i.e., U.S./Brazil bilateral, the U.S. has never entered into an exchange of government-funded traffic pursuant to a bilateral/multilateral in furtherance of the provisions of the "Fly America Act" 49 U.S.C. 40118.
3. No code-share agreements cover the exchange of government traffic. The U.K. understands this. Notwithstanding its USAir/British Airways code share arrangements, the U.K. has stated in a document filed with the National Commission to Ensure a Strong Competitive Airline Industry, that the "Fly America Act" must be amended or provision made to exchange government traffic under any revised liberal agreement between the U.S. and the U.K.
4. It is our understanding that a majority of code-share agreements entered into between foreign carriers and U.S. carriers do not cover blocked space but permit the movement of traffic between the carriers on an actual ticketed basis without the guarantee of use of any number of seats; therefore, no blocked-space arrangement exists as assumed in the Comptroller General's decision.

5. The National Airlift Policy of the United States signed by the President in 1987 was sponsored by the Department of Defense. The Department of Defense coordinated the policy within the Executive branch of government and submitted it to NSC for approval of the President. While the Department of State, DOT and other agencies are mentioned therein, that was for the purpose to emphasize that the Policy to be negotiated by the U.S. in bilateral arrangements with foreign governments and approved and directed by the Department of Transportation by in furtherance of and in support of the National Airlift Policy of the United States.

6. To that end the Department of Defense, by letter from the Deputy Secretary of Defense dated June 16, 1994, restricts the movement of DOD traffic to U.S. flag carriers who are members of the CRAF program. That includes, not only traffic awarded by the Air Mobility Command under contracts with that service, but also the individually-ticketed traffic being moved under GSA-sponsored contractual arrangements. (Copy attached)

7. All arrangements for the use of CRAF carriers require the execution of a contract by the U.S. carrier by which it agrees to provide specified numbers of aircraft at the call of CINTRANSOM, Secretary of Defense, etc., under given circumstances and to provide those aircraft within 24 to 48 hours with at least four U.S. crews per aircraft.

8. Foreign carriers are ineligible to participate in the U.S. CRAF program although they may be part of the NATO program. Foreign carriers cannot participate in the AMC contracts nor under Department of Defense directive, move DOD-sponsored traffic unless U.S. air carriers are not available.

9. Major European carriers and European governments did not provide any voluntary lift in support of Desert Shield/Desert Storm deployments even though requested at the highest level of the U.S. government. Therefore, to permit foreign carriers to transport

U.S. financed or sponsored traffic works to the detriment of the U.S. carriers, the Department of Defense and national security objective.

EJD:hm  
5/22/95





## THE DEPUTY SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

16 JUN 1994

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS  
 CHAIRMAN OF THE JOINT CHIEFS OF STAFF  
 UNDER SECRETARIES OF DEFENSE  
 DIRECTOR, DEFENSE RESEARCH AND ENGINEERING  
 ASSISTANT SECRETARIES OF DEFENSE  
 COMPTROLLER  
 GENERAL COUNSEL  
 INSPECTOR GENERAL  
 DIRECTOR, OPERATIONAL TEST AND EVALUATION  
 ASSISTANTS TO THE SECRETARY OF DEFENSE  
 DIRECTOR, ADMINISTRATION AND MANAGEMENT  
 DIRECTORS OF THE DEFENSE AGENCIES  
 COMMANDERS OF THE UNIFIED COMMANDS

SUBJECT: Policy Memorandum on Transportation and Traffic Management

The partnership between the Department of Defense (DoD) and U.S. civil air carriers is critical to our ability to mobilize, deploy, and sustain our forces. This alliance is embodied in the Civil Reserve Air Fleet (CRAF) program which provides for civil air carriers to contractually pledge their airlift resources to support DoD mobility requirements in times of emergency or contingency in return for a portion of DoD's peacetime airlift business.

Because maintaining an effective relationship with the commercial air carrier industry is essential to our national defense, I have directed the United States Transportation Command (USTRANSCOM) to revitalize the CRAF program. To support this revitalization of CRAF, the following policy is established:

- (1) DoD shall utilize CRAF carriers to the maximum extent possible unless there is a documented negative, critical mission impact; and
- (2) in accordance with applicable law, all future acquisitions of DoD airlift services will require CRAF membership, if the carrier is CRAF eligible, as a prerequisite for award. This policy shall be disseminated to all levels in the Department, including the individual traveler and shipper of DoD cargo.

In furtherance of this policy, unless there is a documented negative, critical mission impact, the following priorities in order of precedence, will be used for passenger and cargo airlift:

- a. Air Mobility Command (AMC) arranged/operated airlift

- b. General Services Administration (GSA) arranged/contracted airlift on CRAF carriers
- c. Other U.S. CRAF carriers
- d. DoD-approved U.S. flag carriers
- e. Non DoD-approved U.S. flag carriers (for individual travel)
- f. DoD-approved foreign flag carriers
- g. Non DoD-approved carriers (for individual travel)

An integral part of this revitalization program is to provide airlift service that is responsive to customer needs. Toward that end, USTRANSCOM, in coordination with the DoD Components, is directed to perform a recurring assessment of airlift policy compliance with emphasis on identification of factors which cause deviation from the policy. This will be accomplished using commercial off-the-shelf systems to the maximum extent possible to identify systemic non-use of specific contracted routes, an evaluation of the customer's reasons for non-use, and recommended corrective action. A report will be provided to the Deputy Under Secretary of Defense (Logistics) by December 15 of each year, reflecting a summary of airlift policy compliance, service shortfalls, and recommendations for improvement.

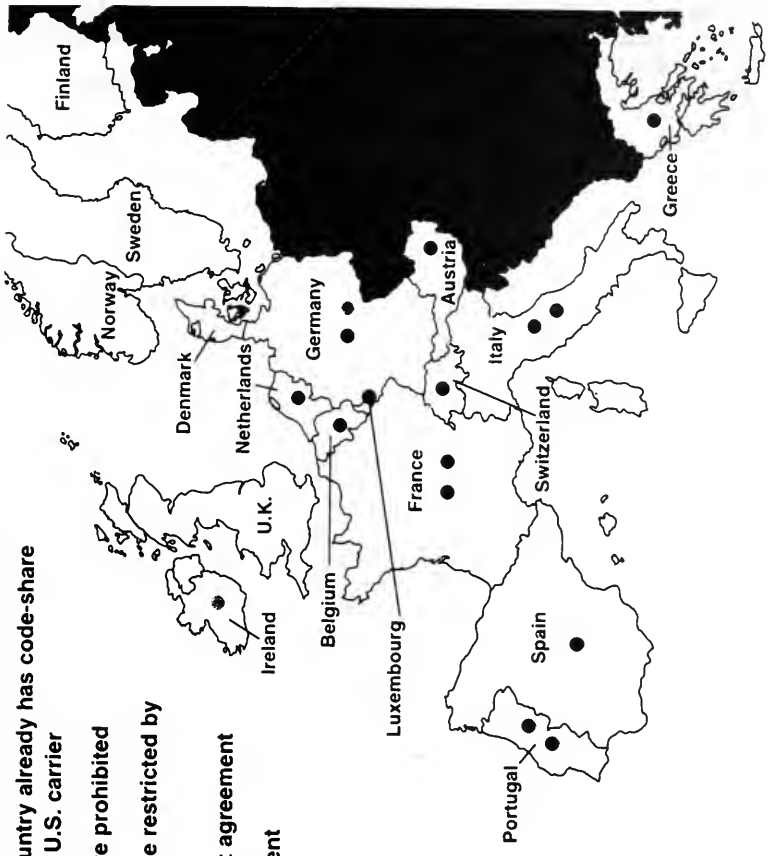
USTRANSCOM will develop a single requirements identification process which will address the DoD Components' requirements for all passenger airlift services, so that AMC and GSA contracted airlift requirements are identified simultaneously to allow an optimum mix to be achieved. When airlift is procured to satisfy these requirements, the requester may be responsible for reimbursement of any unused airlift services acquired on their behalf.

This policy will be effective on October 1, 1994. All DoD, Component, and Agency directives and regulations shall be modified to reflect this guidance. USTRANSCOM shall forward language to the Defense Acquisition Regulatory Council consistent with this memo, recommending inclusion in the Federal Acquisition Regulation (FAR).

A large, stylized handwritten signature in black ink, appearing to be 'J. L. ...' with a long horizontal stroke extending to the right.

# **Beyond U.K. Code-sharing Restrictions – Western Europe**

- Only major carrier in country already has code-share agreement with another U.S. carrier
- Third country code-share prohibited
- Third country code-share restricted by bilateral
- Renounced air transport agreement
- Shannon stop requirement
- Limited economic value



**Exhibit 2**

Senator MCCAIN. Thanks again for your patience today. Thank you for participating in what I think is a very important hearing. This hearing is adjourned.  
[Whereupon, at 1:45 p.m.; the hearing was adjourned.]

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## APPENDIX

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### QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS THERETO BY ROBERT L. CRANDALL

*Question.* Can you tell us if and when you expect the 600,000 threshold for O'Hare/Heathrow to trigger?

*Answer.* This is no longer an issue, because on May 5, 1995, the United States and the United Kingdom agreed on an amendment to Bermuda 2 to give the U.S. the right to a second designation on the Chicago-London route.

Without such agreement, the designation provisions of Bermuda 2 would have applied. In brief, these provisions state that only one airline of each country may be designated at each U.S. gateway, except New York, Los Angeles, Boston, and Miami. A second airline may be designated at other gateways, such as Chicago, when the total one-way traffic carried on the segment by the airlines of both parties exceeds 600,000 per year (or the traffic carried by either the U.S. or the U.K. carrier exceeds 450,000 per year) in two consecutive 12-month periods. We believe the 600,000 threshold would likely have been reached within the next 2 years.

Two additional points are important. First, the capacity provision of Bermuda 2, contained in Annex 2 of the agreement, limits U.S. carriers to 150 percent of the authorized frequencies of U.K. airlines. This effectively means that U.K. airlines, mainly British Airways, decide how much capacity U.S. airlines, such as American, can offer (the control can work in reverse, but the United States never exercises these capacity controls). For example, the U.K. was able to use Annex 2 to prevent American from adding a second Dallas/Fort Worth-London flight for many years.

Second, a restriction in the March 1991 amendment to Bermuda 2 prevented American from adding more Chicago-London capacity than that of British Airways until summer 1994. We simply could not add a third flight during the first 3 years of operating this route.

*Question.* Do you know British Airway's [sic] boarding data for this market? Does BA board more passengers than American?

*Answer.* According to the Department of Aviation, City of Chicago, in 1994, British Airways enplaned approximately 310,000 revenue passengers in both directions, and American enplaned approximately 245,000 revenue passengers in both directions.

*Question.* American Airlines currently is the exclusive U.S. carrier with service from Chicago O'Hare to London Heathrow. To what extent would a new, competing route for United Airlines take business away from your airline?

*Answer.* We estimate that United will divert substantial amounts of traffic and revenue from American, and very little from British Airways. United has a larger share of the Chicago market than American, because it holds a larger number of O'Hare slots under the FAA High Density Rule. United can therefore operate a significantly larger hub, enabling it to command the loyalty of a premium share of local passengers, and to connect traffic from more cities west of Chicago as well.

*Question.* As I understand it, your company opposed this deal because you want a bigger deal further opening access to the U.K. Doesn't American already have more access to the U.K. than any other U.S. carrier?

*Answer.* The premise of the question is incorrect. As my testimony pointed out, to be effective in transatlantic markets, American needs the opportunity to compete

effectively with British Airways for all four types of traffic flows from the United States to London and beyond:

- Gateway to gateway (e.g., Chicago-London)
- Behind U.S. gateway to U.K. gateway (e.g., Denver to London)
- U.S. Gateway to beyond U.K. gateway (e.g., Chicago to Rome)
- Behind U.S. gateway to beyond U.K. gateway (e.g., Denver to Istanbul)

What American seeks is equivalent economic opportunity, meaning the right to compete for all combinations of traffic. Through its recently enlarged alliance with USAir, British Airways can now sell more than nine times as many city-pair markets (often called "O&D" or "Origin and Destination" markets) as can be sold by any U.S. carrier—including American—which operates its own aircraft between the United States and the United Kingdom.

*Question.* As I understand it, American Airlines is concerned about the element of Phase 1 that would permit British Airways to competitively bid for Fly America traffic through USAir, its U.S. code-sharing partner. Doesn't American Airlines currently bid on Fly America traffic carried on South African Airways and Quantas [sic]?

*Answer.* Yes, but there is far less U.S. government traffic to South Africa and Australia than to the U.K.!

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QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY ROBERT L. CRANDALL

*Question.* In your view, have the Departments of Transportation and State been effective in negotiating agreements with other nations? Are we getting appropriate access to Asia, which is probably the largest growth market in the world?

*Answer.* No, in general, we do not believe that DOT and State have been effective, nor do we believe that the United States has secured sufficient access to Asia, particularly to Japan, which is by far the largest and most attractive individual market, and which is the only commercially viable gateway to other Asian cities.

*Question.* What are your biggest frustrations with the bilateral negotiation process itself?

Is it a problem that both DOT and DOS have a role in the process?

Does DOT perform sufficient economic analysis before considering certain proposals?

Are you afforded appropriate access to information?

Is it frustrating that U.S. carriers are usually not present in negotiations, while foreign carrier representatives are?

*Answer.* We have three major frustrations with the negotiating process. First, U.S. negotiators do not make effective use of the leverage inherent in representing a country with the largest air travel market in the world, accounting for more than 40 percent of the total world market. Second, the United States pursues a narrow proconsumer philosophy that subsumes the interests of other stakeholders in the airline industry, such as employees, communities, shareholders, and lenders. Negotiators for other countries do a far better job of balancing these interests, while still representing consumer needs. Third, the United States is the only country with a fully deregulated—and therefore highly competitive—airline industry. Thus, the views of U.S. carriers always differ, while those of foreign airlines and their governments are always congruent.

In our view, the combined DOT and State role does create problems. There appears to be resentment in both directions. DOT believes it has the most expertise, yet is forced to take a secondary role in negotiations. Unlike the relationships between USTR and the industries it champions, neither State nor DOT seem to hold the interests of U.S. airlines in high regard. Both departments keep us at arms length and resent the need to consult us.

We have seen no indication at DOT of robust, intellectually defensible economic analyses of prospective bilateral transactions. Certainly the Department does not share such information with us, either before consultations begin or while they are in process.

With respect to information access, first, we certainly would benefit from DOT sharing whatever data they have prepared but do not now distribute. We provide DOT and State with substantial amounts in information, but the flow is mostly one way. Second, most carrier representatives would appreciate greater substantive discussion in advance of consultations, which would eliminate the last-minute, crisis atmosphere that surrounds many negotiations, and would foster better transactions. Third, although airlines supply DOT and State with detailed information and recommended positions, we never learn U.S. positions in advance. We hear these posi-

tions for the first time when they are tabled in the negotiating sessions. By contrast, foreign negotiators brief their national carriers on specific positions in advance of the plenary sessions.

With regard to the participation of U.S. carriers in negotiations, the former U.S. approach of relying on one airline industry representative was woefully inadequate. Since early 1994, U.S. carrier representatives have been able to join the delegations during their plenary sessions. However, State has made it clear to us that this is an experiment. We have urged that this inclusiveness be made permanent, so that U.S. carriers will be on equal footing with foreign airlines, who have always participated.

One unfortunate aspect of permitting U.S. carrier participation is that private "chairmans' meetings" have proliferated. Shifting most substantive discussion behind closed doors moves the process in the wrong direction.

**Question.** Have you noticed a significant loss of business since British Airways began code-sharing with USAir? What do you estimate your losses (or lost revenue) to be?

**Answer.** Yes. We estimate that British Airways has diverted \$20 to \$30 million in transatlantic revenues from American, and has shifted substantial domestic revenue from American to USAir.

**Question.** Are you aware that the government did little to no economic analysis before it approved the British Airways/USAir code-share? Does it concern you that they gave so little thought to how it would affect you? Is it also a concern that DOT still is not doing much analysis of how code-sharing alliances will affect the U.S. airline industry?

**Answer.** Yes, yes, and yes! As noted above, we think it is unconscionable for DOT and State to conduct bilateral negotiations—the outcome of which would have enormous economic implications for individual U.S. carriers—without performing and sharing careful economic analyses.

**Question.** What access do you currently have to Heathrow or Gatwick? Ideally, what access do you need to compete effectively?

**Answer.** This summer, American will operate four daily flights to Gatwick: two from Dallas/Fort Worth and one each from Raleigh/Durham and Nashville (on June 15, American announced that it was canceling its Nashville-London service effective on October 1, because it cannot compete with British Airways on a route which British Airways supports with a codeshare hub in Philadelphia and a real hub at Heathrow). This summer, American will operate 13 daily flights to Heathrow: six from New York/Kennedy, three from Chicago, two from Boston, and one each from Miami and Los Angeles.

But access to London airports is only part of this issue. To be effective in transatlantic markets, American needs the opportunity to compete with British Airways for all four types of traffic flows from the United States to London and beyond:

- Gateway to gateway (e.g., Chicago-London)
- Behind U.S. gateway to U.K. gateway (e.g., Denver to London)
- U.S. Gateway to beyond U.K. gateway (e.g., Chicago to Rome)
- Behind U.S. gateway to beyond U.K. gateway (e.g., Denver to Istanbul)

What American seeks is equivalent economic opportunity, meaning the right to compete for all combinations of origin and destination traffic flows. Through its recently enlarged alliance with USAir, British Airways can now sell more than nine times as many city-pair markets (often called "O&D" or "Origin and Destination" markets) as can be sold by any U.S. carrier—including American—which operates its own aircraft between the United States and the United Kingdom.

**Question.** In your view, is a two-phase deal a mistake? Could you elaborate?

**Answer.** Yes, American believes that a two-phase mini-deal is a mistake. As I stated in my testimony, no incremental deal can rectify the substantial imbalance in Bermuda 2 that favors the United Kingdom. Indeed, in his testimony, Secretary Peña admitted that Bermuda 2 favored U.K. airlines, and that admission was prior to conclusion of the mini-deal. No mini-deal that provides each side with equal new opportunities could thus re-balance the relationship. Incrementalism cannot be a solution. Comprehensive liberalization is the only viable course.

Moreover, we do not place much stock in the vague U.K. commitment to negotiate phase two at a later date. On several occasions in the past, U.K. promises for subsequent negotiation evaporated once it secured what it sought. For example, in 1993, after DOT approved the initial round of the British Airways/USAir combination, the U.K. promised to begin negotiation on a wholesale liberalization of Bermuda 2—a promise which subsequently proved empty.

**Question.** Are you aware that DOT's Acting Assistant Secretary for Aviation and International Affairs, Pat Murphy, recently said that access to Gatwick and

Heathrow will be on the table only in so-called Phase 2? Do you believe that the subject of more access to Heathrow and Gatwick should be considered in Phase 1?

**Answer.** Unfortunately, the agreement reached on June 5 has rendered this question moot. We opposed bifurcation of the mini-deal negotiation, without success. We will press DOT and State to achieve greater Heathrow access in phase two.

**Question.** Do you believe that the U.S. can do a more expansive deal with the United Kingdom than that envisioned by the current negotiating framework? If so, what are the components that should be included?

**Answer.** Yes. Our recommendations for wholesale liberalization of the U.S.-U.K. relationship include the following:

- Much greater access for U.S. cities to Heathrow Airport.
- Opportunities for U.S. carriers to sell the same city-pairs that U.K. airlines now offer to transatlantic passengers, by allowing unlimited fifth freedom traffic rights beyond U.K. gateways, exercisable by either codesharing or actually flying one's own aircraft (the codesharing provision agreed to on June 5 did not permit carriage of local traffic beyond London). To be truly reciprocal, this provision should require the United Kingdom to secure in advance, from its EU partners and from other countries, access for U.S. airlines to a substantial number of points beyond the United Kingdom.

- Elimination of Annex 2 of Bermuda 2 on all routes; this provision has allowed the United Kingdom to exercise unilateral, a priori capacity controls, rather than allowing the marketplace to determine appropriate levels of capacity.

- Elimination of the pricing restrictions in Bermuda 2 that prevent American from offering U.K. travelers competitive prices to and from U.S. cities.

**Question.** What do you think it will take in order to create an "open skies" agreement with the British, including adequate slots at Heathrow?

**Answer.** We do not believe that the United Kingdom will agree to broad liberalization unless it faces renunciation of Bermuda 2, and understands that, without an agreement, U.K. airlines will face substantial reduction of U.S. access. Although such a scenario would be painful for both sides, American believes that we could withstand the opposite restrictions more easily than could British Airways or Virgin Atlantic.

Heathrow slots and other U.K. infrastructural constraints add complexity to this issue. The United States always provides foreign carriers with the slots they need at controlled airports. We believe that we are entitled to reciprocal treatment, without excuses. Each country must manage the required growth of airport facilities and infrastructure.

**Question.** Is the bilateral process working, as a generalization? What would you do to improve the process, both in terms of substance and in terms of transparency?

**Answer.** No. Please see the answer to the above question on our frustrations with the bilateral negotiating process.

**Question.** If you were United, wouldn't you want to have this mini-deal? If this answer is yes, then why shouldn't we endorse it?

**Answer.** Yes. Although the first phase of the mini-deal was good for United, and to a lesser extent for USAir, the net effect on U.S. carriers as a whole will be adverse. British Airways will benefit far more than United will. Until the United States starts to make bilaterals on the basis of collective benefit to U.S. airlines, the United States will continue to lose overall position.

**Question.** What is your view of the British Airways/USAir code-sharing component of the mini-deal? Doesn't it give British Airways everything it could need over the near term? Conversely, if no agreement is reached, don't we have British Airways in a difficult position?

**Answer.** The first phase of the mini-deal did in fact give British Airways everything that it wanted in the short term. That is why we suspect that the United Kingdom will not negotiate phase two in good faith.

**Question.** Does your airline feel that the proposed "starburst" element of Phase 1 is of significant value?

**Answer.** The starburst codesharing provision is of modest benefit. The value of rights beyond the United Kingdom has diminished significantly in recent years, because of (1) bilateral and other restrictions on codesharing into these countries, (2) French renunciation of its civil aviation agreement with the United States, and (3) the fact that most European carriers have already entered into combinations that preclude an alliance with American or any other U.S. carrier. The map on the following page underscores this assessment.

**Question.** Does your airline have any suggestions, or alternative approaches, as to how the United States might obtain a more liberalized agreement with the United Kingdom?



Answer. Please see the answer to the above question on what it will take to create a liberalized agreement with the United Kingdom.

*Question.* In general, does your airline believe that code-sharing is pro-competitive or that it will lead to greater "open skies" opportunities? Please explain.

Answer. For over a decade, American's emphasis has been on vigorous expansion with our own aircraft, which creates U.S. jobs and economic opportunity. Codesharing creates artificial, virtual networks that require no capital investment. Since capital-free combinations will always do better financially than capital-intensive individual competitors, codesharing is profoundly anticompetitive in the long term. We are greatly disappointed that our government has been indifferent to this reality, and has made decisions that disadvantage firms, like American, that are willing to invest in the growth of America.

Despite our opposition, the DOT has approved most of the codesharing proposals presented to it. Thus, our efforts to overcome the huge advantages that Bermuda 2 confers on British Airways have been compounded by the competitive disadvantages imposed by the British Airways/USAir codesharing combination, and, more recently, by the Virgin/Delta arrangement. Despite assurances from Administration officials that we would be given offsetting opportunities to be fully competitive in the U.K. market, no new, comparably rewarding service rights have been obtained. In effect, our government has told us to stop buying airplanes and make deals to partner with foreign airlines.

*Question.* Does your airline believe that changing the limits on foreign control and ownership of U.S. airlines would increase the possibility of true liberalization with Britain?

Answer. No. We do not believe that changing laws governing foreign ownership of U.S. airlines would improve prospects for a greatly liberalized air transport agreement with the United Kingdom.

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#### ANSWERS OF DELTA AIR LINES TO SENATOR LARRY PRESSLER'S QUESTIONS ON THE U.S.-U.K. AVIATION NEGOTIATIONS

**QUESTION 1.** An opponent of an incremental negotiating strategy would likely argue that approval of the Delta/Virgin Atlantic code-sharing agreement gave your airline indirect access to Heathrow from four U.S. gateway cities thus undermining our leverage in the current negotiations to press for greater direct access to Heathrow for all our carriers. How do you respond to these critics?

Answer. The Delta/Virgin Atlantic arrangement did not create any leverage for the U.S. in negotiating a more liberalized bilateral agreement with the U.K. The British offered to approve the Delta/Virgin Atlantic arrangement on an extrabilateral basis almost immediately after the April 12, 1994 announcement of the alliance. It was the U.S. Department of Transportation that mistakenly believed that it could withhold approval of the transaction and somehow force the British to negotiate on liberalization. The DOT approach proved to be in error in October 1994 when the British proposed resumption of negotiations with a negotiating proposal that did not include any new access to Heathrow or Gatwick. At this time, the British Government proved that additional access to Heathrow was linked to British Airways intentions of further investment in USAir, not on the approval of the Delta/Virgin Atlantic code-share relationship.

**QUESTION 2.** I find it extremely interesting that the Delta/Virgin Atlantic code-sharing arrangement was approved shortly before the current round of talks commenced. Don't you think it would have been more prudent for the United States to use the leverage from the Delta/Virgin Atlantic arrangement to get a more liberalized agreement in the negotiations?

Answer. There was no leverage to be had from such an arrangement as the British had already announced from the outset of the Delta/Virgin Atlantic relationship that it would approve the code-share arrangement on an extrabilateral basis. The real leverage the U.S. might have had would have been British Airways' intention of further investment in USAir.

**QUESTION 3.** As I understand it, Delta Air Lines is greatly concerned about extending British Airways the limited right to bid competitively for Fly America traffic. Doesn't Delta, through its foreign code-sharing partners Varig, Sabena and Swissair, currently carry Fly America traffic?

Answer. Delta remains concerned about extending any Fly America rights to British carriers or to the carriers of any nation that does not have a market open to U.S. carriers. The Fly America Act was passed by Congress to channel U.S. taxpayer-financed traffic to U.S. carriers. In return for the opportunity to bid on this traffic, U.S. carriers were obligated to participate in the Civil Reserve Air Fleet pro-

gram (CRAP) and dedicate a percentage of their long-haul fleets to the Department of Defense to be used in time of national emergency. British Airways, were it allowed to carry Fly America traffic, would have no such obligation in time of emergency. Given the highly restrictive nature of the U.S.-U.K. relationship, we believe negotiating away such rights is contrary to the letter and spirit of the Fly America Act.

Delta has told the U.S. Government that it disagrees with the GAO interpretation of the Fly America Act that allows foreign airlines to carry U.S. Fly America traffic as long as a U.S. code is used on the flight. We think this too is contrary to the letter and spirit of the Fly America Act and that U.S. carriers operating U.S. registered aircraft should be given priority in carrying such traffic.

#### ANSWERS OF DELTA AIR LINES TO SENATOR JOHN MCCAIN'S QUESTIONS ON THE U.S.-U.K. AVIATION NEGOTIATIONS

**QUESTION 1.** Have you noticed a significant loss of business since BA began code-sharing with USAir? What do you estimate your losses (or lost revenue) to be?

**Answer.** We have not noticed significant losses per se due to the USAir/BA alliance. What Delta has noticed is a significant loss of interline revenues from British Airways since the inception of the USAir/BA relationship. Prior to the alliance, Delta would carry a significant amount of domestic connecting traffic from British Airways. That traffic now flows to USAir. While Delta cannot adequately project any losses it has realized from the USAir/BA alliance, we can point to the fact that BA has stated that its alliance has added over \$100 million in revenues on an annual basis. We do not believe that that revenue is coming from market stimulation but is instead being diverted from U.S. carriers. Additionally, the British market share of the total U.S.-U.K. traffic has grown since the inception of the USAir/BA relationship.

**QUESTION 2.** Are you aware that the government did little to no economic analysis before it approved that BA/USAir code-share? Does it concern you that they gave so little thought to how it would affect you? Is it also a concern that DOT still is not doing much analysis of how code-sharing alliances will affect the U.S. airline industry?

**Answer.** Delta understands that little, if any, economic analysis was done prior to approving the code-share agreement. Any analysis that was done was not shared with U.S. carriers. Delta is greatly troubled that such an arrangement was approved by the U.S. Government without a thorough economic review being done.

**QUESTION 3.** What access do you currently have to Heathrow or Gatwick? Ideally, what access do you need to compete effectively?

**Answer.** Delta currently operates to Gatwick from Atlanta and Cincinnati. Delta has tried to increase its service to Gatwick from Atlanta in the last two years but the additional frequencies were denied by the British Government in order to protect British Airways.

Delta does not have access to Heathrow in its own right due to the fact that the Bermuda II agreement only allows two U.S. carriers to serve Heathrow. Those two U.S. designations are currently used by United and American airlines.

Delta has an alliance with Virgin Atlantic Airways that allows it to display its code on Virgin's flights from Heathrow to New York (JFK), Newark, San Francisco and Los Angeles. Delta also displays its code on Virgin's Gatwick services to Orlando, Miami and Boston. This authority was granted on an extrabilateral basis.

**QUESTION 4.** In your view, is a two-phase deal a mistake? Could you elaborate?

**Answer.** Delta has repeatedly argued against phased liberalization with the U.K. In our view, such an approach only allows British carriers to enjoy their preferred position under the Bermuda II restrictions. The British will seek to delay or restrict any liberalizing measures for as long as possible. We have seen this to be the case in the phase 2 negotiations. To its credit, the U.S. Government has recently rejected offers for additional Heathrow service due to cumbersome restrictions placed on these offers.

The incremental approach advanced by Secretary Peña earlier this year was a grave mistake. The first phase did not produce any meaningful basis for true liberalization because the British do not have the same goals as the U.S. It is not possible to "transition" to liberalization when the two parties do not agree on the ultimate objectives necessary to accomplish a market-based bilateral.

**QUESTION 5.** Are you aware that DOT's Acting Assistant Secretary for Aviation and International Affairs, Pat Murphy, recently said that access to Gatwick and Heathrow will be on the table only in so-called Phase 2? Do you believe that the subject of more access to Heathrow and Gatwick should be considered in Phase 1?

Answer. Delta believes that additional Heathrow access should be taken up as soon as possible. We were concerned that once the British received the additional authority they desired in Phase 1 (double daily flights between Philadelphia and Heathrow), they would not be forthcoming with meaningful access to Heathrow in Phase 2.

We have seen this to be the case in Phase 2 as the British have repeatedly offered the U.S. very limited access to Heathrow. Initially, the British insisted on offering only one Heathrow slot for U.S. carriers that was burdened with a number of restrictions. In the most recent round of Phase 2 discussions, the British offered the U.S. two new Heathrow opportunities, the first of which was offered with only a limited number of gateways and the second opportunity, which was admittedly less encumbered, was only to be available in 1997. Both of these services would have been restricted to a single daily frequency for a period of two years. Delta opposed acceptance of this proposal as it was viewed as perpetuating the existing bilateral restrictions rather than an example of truly liberalizing the market. Again, Delta believes the British continue to delay any meaningful move toward liberalization, seeking instead to perpetuate their dominant position for as long as possible.

QUESTION 6. Do you believe that the U.S. can do a more expansive deal with the U.K. than that envisioned by the current negotiating framework? If so, what are the components that should be included?

Answer. Delta continues to believe that the U.S. must insist on moving this important aviation relationship toward a more liberalized regime as soon as possible. The initial scope of Phase 2 should consider issues beyond the five chosen topics of Heathrow/Gatwick access, pricing, cargo and charter liberalization and Fly America rights.

The U.K. agreement remains as a testimony to micro-managing a large marketplace in order to protect the interests of an entrenched carrier. The regulatory tools granted to the British through the Bermuda II agreement enable them to restrict capacity, pricing and designations. These artificial limits on competition must be removed. The U.S. should insist that every major aspect of the agreement be discussed during so-called liberalization talks, including the elimination of all Annex 2 capacity restrictions.

QUESTION 7. What do you think it will take in order to create an "open skies" agreement with the British, including adequate slots at Heathrow?

Answer. An open skies agreement with the British will not be achieved until the British are forced to accept liberalization or risk forfeiture of their dominant position. Given their superior position in the marketplace (dominant position at Heathrow, hubs on both sides of the Atlantic, access throughout the U.S. while restricting U.S. carrier access into and beyond the U.K.) the British have no incentive to liberalize the marketplace. At this point in time, the British have all the operating authority they need. There is no incentive on their part to liberalize as they dominate the transatlantic marketplace between our two countries.

The only way the U.S. can change this situation is to renounce the U.S.-U.K. Air Services agreement and force service reductions by British carriers. However, this would likely force counter-retaliatory measures by the U.K. that could seriously disrupt service between the two countries. Unless the U.S. is prepared to take such draconian measures and deal with the immediate consequences that develop, the chances of true liberalization in the next few years are very slim.

Delta has advocated that renunciation should be considered by the U.S. in the absence of sweeping changes in the U.S.-U.K. aviation marketplace. The Bermuda II agreement is a monument to protectionism and it greatly benefits British interests to the detriment of U.S. carriers. In the name of pursuing a more balanced marketplace, the U.S. should insist that both countries move at a rapid pace toward liberalization. Absent an agreement in principle on this issue, the U.S. should consider drastic measures such as renunciation and interruption of service to illustrate the depth of our frustration and the strength of our resolve.

8. Is the bilateral process working, as a generalization? What would you do to improve the process, both in terms of substance and in terms of transparency?

Answer. It appears the bilateral process has outlived its usefulness. Too often we have seen countries turn to the bilateral process to seek restrictions rather than enhancements of the marketplace. In an effort to thwart this trend, the U.S. took the bold step of negotiating open skies agreements with a block of nine European nations. Delta supports these efforts aimed at breaking out of the bilateral mold to embrace a more market-oriented multilateral approach. We encourage more initiatives of this type and hope such examples will force more restrictive nations to negotiate on a multilateral level to attain the operating authority they seek.

However, the death of bilateralism is not at hand. Unfortunately, many nations continue to embrace the protections that are available through restrictive bilateral

agreements. Delta feels the U.S. must continue to press forward in its efforts to seek liberalized agreements, either bilaterally or multilaterally, in order to persuade restrictive nations of the opportunities that lie in facilitating rather than restricting growth in global aviation markets.

**QUESTION 9.** If you were United, wouldn't you want to have this mini-deal? If this answer is yes, then why shouldn't we endorse it?

Answer. United, as the single U.S. beneficiary of the June mini-deal, understandably favored the conclusion of such a deal. It was able to offer service from its primary hub to Heathrow. However, the U.S. once again allowed the U.K. to dictate the terms of a bilateral exchange. The U.K. decided to use a "divide and conquer" strategy by offering to bestow a valuable benefit on one U.S. carrier. That carrier in turn applies pressure on the U.S. to accept the deal to the exclusion of any other benefits for U.S. carriers. In return, the British choose the operating authority they will demand for such an exchange and the restrictive bilateral situation is perpetuated with only a minor improvement that benefits the narrowest of interests.

The U.S. has been involved in such exchanges with the U.K. for decades now and the result has been a bilateral regime with limited benefits for a few chosen carriers. The U.S. should not endorse such deal making as it is unfair, divisive and ultimately forces a number of carriers to compete in this very important market with only limited resources. U.S. carriers are the most efficient and competitive carriers in the world. The U.S. should be seeking to capitalize on these strengths rather than allowing our foreign competitors to restrict the marketplace and perpetuate protectionism.

**QUESTION 10.** What is your view of the BA/USAir code-sharing component of the mini-deal? Doesn't it give BA everything it could need over the near term?

Answer. The conclusion of the June mini-deal merely allowed British Airways to display its code on a number of smaller U.S. cities served by USAir. Prior to the June mini-deal, British Airways had already blanketed the U.S. with its code by utilizing virtually the entire USAir domestic system. Approval of the most recent tranche of code-share cities modestly improved BA's access to the domestic U.S. market.

This final tranche of code-share approval does give BA almost everything it needs in terms of access to the domestic U.S. market. We have seen in Phase 2 that the British are now seeking access to Fly America traffic that is dedicated for carriage by U.S. airlines only. However, it is understandable, as there is no additional source of traffic for the British to seek—they have some twenty U.S. gateways with rights to a number of countries beyond the U.S. and access to the entire U.S. domestic market. All of these rights have been granted and blessed by the U.S. Government through the bilateral negotiating process. In the meantime, U.S. carriers remain helpless in their efforts to increase their presence into and beyond the U.K.

**QUESTION 11.** Conversely, if no agreement is reached, don't we have BA in a difficult position?

Answer. No. As mentioned above, BA possesses all the operating authority it desires into the U.S. Additionally, BA will continue to enjoy its dominant position at Heathrow and its overall dominant position in the U.S.-U.K. market. At this point, the British do not desire anything of significant value from the U.S. Until BA decides how much further it would like to proceed in the U.S. market (i.e. ownership and control of a U.S. airline) the British have no incentive to negotiate valuable operating rights for U.S. carriers into and beyond the U.K.

**QUESTION 12.** Does your airline feel that the proposed "starburst" element of Phase 1 is of significant value? If so, why?

Answer. The starburst element of the mini deal is of very limited commercial value. No U.S. carrier has plans to either operate on its own or to code-share in a significant manner beyond London, making starburst rights virtually meaningless to U.S. interests. Since concluding the mini-deal, Northwest Airlines has taken advantage of the starburst authority by placing its code on KLM services via the Netherlands to a number of U.K. points. However, most of these flights are to regional U.K. airports that provide a very limited number of passengers. Also, because these services transit Amsterdam, they are not competitive with existing nonstop and connecting services through London to U.K. regional points.

**QUESTION 13.** In general, does your airline believe that code-sharing is pro-competitive or that it will lead to greater "open skies" opportunities? Please explain.

Answer. Delta is a strong proponent of code-sharing. We have a number of code-share partners throughout the world including Swissair, Sabena, Austrian, TAP, Malev, Finnair, Virgin Atlantic, Varig, Aeromexico and Singapore Airlines. Code-sharing allows Delta to introduce, maintain or improve its presence in a number of markets where it might be economically impossible to do so.

Code-sharing is a pro-competitive development that has allowed a number of airlines to increase their market presence without dedicating aircraft, staff and other expensive resources to provide these services. As cost-efficiencies become increasingly important for U.S. operators, code-sharing is likely to continue its prominent position.

Whether code-sharing will ultimately lead to greater "open skies" remains to be seen. Code-sharing has been a catalyst for some countries to open up markets in order to get similar access in the U.S. The U.S. has effectively made code-sharing a standard for exchange with a number of European nations. We hope similar efforts can be made with Asian nations in the future as we believe code-sharing is a practice that will evolve into an even more valuable marketing tool in the future.

QUESTION 14. Does your airline believe that changing the limits on foreign control and ownership of U.S. airlines would increase the possibility of true liberalization with Britain or other nations?

Answer. Delta supports the recommendations made by the National Commission to Ensure a Strong, Competitive Airline Industry. The Commission endorsed the idea of Congress changing existing U.S. laws to allow foreign nationals to own up to 49 percent of U.S. carrier voting stock. Allowing that level of ownership would be conditioned on the country in question having a liberal bilateral agreement with the U.S., that the carrier seeking investment in the U.S. is not substantially controlled by a foreign government and that reciprocal investment opportunities for U.S. interests are available.

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QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS THERETO BY MR. JEFFREY H. ERICKSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF TWA

TRANS WORLD AIRLINES, INC.

*Government Affairs*  
*October 31, 1995*

The Honorable LARRY PRESSLER

*Chairman, Committee on Commerce, Science, and Transportation,  
United States Senate, Washington, D.C. 20510*

DEAR SENATOR PRESSLER: Attached please find TWA's response to questions provided after your May 24, 1995 hearing on international aviation policy. We have also provided a floppy disk that includes the data under the file name TWAMAY24.ANS. The word processor software used for the document was Word for Windows 6.0.

TWA apologizes for the delay in providing its response to you. In our August 29, 1995 communication relating to your July 11, 1995 hearing, we provided a consolidated answer to the May 24 post-hearing questions. Following your subsequent enquiry, we have expanded on our earlier statement to include all of the questions on the May 24, 1995 hearing. We hope that these answers are to your satisfaction and provide a more complete understanding of TWA's views.

Sincerely,

JEFFREY H. ERICKSON -  
CHIEF EXECUTIVE OFFICER

QUESTION 1. I have heard some suggestion that US international aviation policy tends to focus on our largest carriers and occasionally overlooks other carriers. Has this been TWA's experience?

Answer. TWA does not believe that US aviation policy deliberately focuses on the largest carriers. Because they are larger and serve several continents, the Government naturally deals with them across a broader range of issues than it does with some smaller carriers. We do believe, however, that the government focuses much too intensely on code-sharing which particularly benefits large carriers such as United and Delta. For example, this summer, the US failed to reach an agreement with South Africa because US negotiators insisted on third-country code-sharing over Europe—authority that would primarily benefit United's code-share partner Lufthansa. TWA and other carriers stand ready to off direct service to South Africa, but the US valued code-sharing so highly that it refused to reach an agreement on direct service.

QUESTION 2. Mr. Erickson, could you tell us how much revenue you anticipate a New York/Gatwick or New York/Heathrow route would generate for your company?

Answer. TWA believes that the New York-Heathrow route would generate revenues of approximately \$100 million per year. In addition, by filling the largest gap in its transatlantic route structure, TWA will improve its revenues by \$20-40 million per year on other transatlantic routes.

QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY MR. ERICKSON

QUESTION 1. Have you noticed a significant loss of business since BA began code-sharing with USAir? What do you estimate your losses (or lost revenue) to be?

Answer. Since TWA has only limited service to London from its St. Louis gateway, it is not a significant participant in US-UK travel. Therefore, the USAir/BA code-share has not had a significant impact directly on TWA's business. However, we note that BA representative estimated that, between April 1994 and March 1995, its alliance with USAir produced \$100 million in revenue for BA. (GAO Report RCED-95-99, International Airline Code Sharing, pp. 34-35) The GAO concluded that the gains of BA were largely at the expense of other US airlines. (p.35)

QUESTION 2. Are you aware that the government did little to no economic analysis before it approved the BA/USAir code-share? Does it concern you that they gave so little thought to how it would affect you? Is it also a concern that DOT still is not doing much analysis of how code-sharing alliances will affect the US airline industry?

Answer. TWA is unaware of the extent of economic analysis research the government used

in deciding the BA/USAir code-share agreement. Our perception is that the government has little concern about the impact of code-sharing on other US carriers. We have tried several times to convince the government that code-sharing primarily diverts traffic from US flag carriers to foreign flag carriers, but our impression is that the US government has an exaggerated idea of the benefits that the US flag code-sharing partner receives from these alliances. In TWA's opinion, for the most part, the US carrier receives nothing more than ticketing fees, with the foreign flag carrier carrying most of the passengers and receiving most of the revenue. This does not seem to concern the US government.

QUESTION 3. What access do you currently have to Heathrow or Gatwick? Ideally what access do you need to compete effectively?

Answer. TWA currently serves the St. Louis-Gatwick route. However, service between New York's JFK airport and London Heathrow is a key element in its strategy to restore the profitability of its international network. London accounts for 32% of all transatlantic travel, and without access to that traffic flow, TWA is severely handicapped. TWA is also hampered in attracting high-yield business travel, which prefers Heathrow to Gatwick by substantial numbers.

QUESTION 4. In your view, is a two-phase deal a mistake? Could you elaborate?

Answer. TWA believes that the US two-phase approach has been demonstrated to be a mistake. The US reached a very limited Phase I deal, on the basis of promise by the British that they would negotiate additional Heathrow rights in Phase II. The Phase II negotiations have now been suspended because the British proposals were so extremely limited, were designed to limit US flag choice to airlines that would provide only limited new competition with BA, and would have made it impossible for TWA to institute its New York-Heathrow service. The results of Phase II demonstrate that breaking the deal into two parts was a mistake.

QUESTION 5. Are you aware that DOT's Acting Assistant Secretary for Aviation and International Affairs, Pat Murphy, recently said that access to Gatwick and Heathrow will be on the table only in so-called Phase 2? Do you believe that the subject of more access to Heathrow and Gatwick should be considered in Phase 1?

Answer. TWA believes that the subject of access to Heathrow and Gatwick should have been the first issue raised by the US and should have been considered in Phase I. The basic problem in negotiating with the British is that they have such a comprehensive route system to the United States that there is very little left with which to entice them into negotiations. To give the British most of their remaining goals in the US in Phase I made it extremely difficult to negotiate added access to Heathrow in Phase II.

QUESTION 6. Do you believe that the US can do a more expansive deal with the UK than that envisioned by the current negotiating framework? If so, what are the components that should be included?

Answer. TWA believes that the US can reach a more expansive deal with the UK only by fundamentally redefining the grounds for negotiation. This requires a challenge to BA operating rights in the US. TWA believes that BA relies unduly on sixth freedom traffic and that almost 50% of its total traffic comes from points beyond the United Kingdom. As the fundamental purpose of bilateral agreements is to meet

the needs of third and fourth freedom traffic, BA is violating the principle of the bilateral. Unfortunately, the arbitration and the capacity provisions of the bilateral do not provide an opportunity to challenge this illegitimate reliance on beyond traffic. If BA's service were geared to the needs of third and fourth freedom traffic, it would offer far less capacity between the US and the UK. In order to achieve a broader negotiation of US carrier rights, it may be necessary to renounce the agreement and limit BA's capacity to that justified by the needs of the local market.

**QUESTION 7.** What do you think it will take in order to create an "open skies" agreement with the British, including adequate slots at Heathrow?

**Answer.** It may be necessary to renounce the current bilateral in order to achieve "open skies."

**QUESTION 8.** Is the bilateral process working, as a generalization? What would you do to improve the process, both in terms of substance and in terms of transparency?

TWA believes that the bilateral process does not work well, but there is no better alternative at this time. The bilateral process fails when the other country has no additional needs in the United States, as in the case of the UK, or when it fears for the economic health of its own carriers, as in the case of France. Too often, in order to maintain a competitive balance, it degenerates into careful calculation of traffic that can be gained by the carriers of each country. The greater public interest, and particularly the importance of air transportation as the infrastructure for economic development, is all too often ignored. We are not sure that a multilateral process would be any better. It may degenerate into multiple countries carefully calculating their economic balance in air transportation terms. It would also take far longer to accomplish anything.

**QUESTION 9.** If you were United, wouldn't you want to have this mini-deal? If this answer is yes, then why shouldn't we endorse it?

**Answer.** United may have wanted the mini-deal as originally proposed, but we are not entirely sure that it is happy with the final agreement. Under its original proposal, it would have the right to operate multiple frequencies with large B-747 and B-777 equipment. The final deal limited it to one B-767 per day. In exchange for that, BA got the right to add one B-747 from USAir's Philadelphia hub. Thus, even the grant of the Chicago route to United was imbalanced in favor of the British.

**QUESTION 10.** What is your view of the BA/USAir code-sharing component of the mini-deal? Doesn't it give BA everything it could need over the near term? Conversely, if no agreement is reached, don't we have BA in a difficult position?

**Answer.** The BA/USAir code-share component was a relatively minor aspect of the mini-deal because BA had already received code-share access to all of USAir's major points. The third group of code share points had relatively little traffic potential. Subsequent events have shown that BA apparently wants much more—the right to carry US government traffic on its own tickets without being limited by code share requirements.

**QUESTION 11.** Does your airline feel that the proposed "starburst" element of Phase 1 is of significant value?

**Answer.** The proposed "starburst" code share element is of little value to the US, and of no value to TWA, which lacks adequate access to London. The problem with the starburst code share is that most of the service beyond London is operated by British Airways and other major European carriers who either have their own code share agreements, or provide service directly between the US and the beyond point. While there may be other carriers available, major US carriers may not want to place their codes on them. These carriers are unknown to American consumers and may not provide service of the quality required by US passengers. A US carrier must be very careful before entering into a code share agreement under the proposed starburst provisions with such carriers.

**QUESTION 12.** Does your airline have any suggestions, or alternative approaches, as to how the US might obtain a more liberalized agreement with the UK?

**Answer.** As discussed above, TWA believes that the only way to achieve a liberal "open skies" agreement with the United Kingdom is to threaten BA's undue reliance on sixth freedom traffic. Under the long-standing principles of international aviation, the fundamental purpose of bilateral agreements is to meet the needs of third and fourth freedom traffic as defined in the Chicago Convention. If BA abided by these principles, it would not be operating double daily B-747 on many of the routes on which it now provides such service. If the US government cannot find a way to bring this issue to the attention of the United Kingdom within the context of the current bilateral, the US may have to consider renunciation.

**QUESTION 13.** In general, does your airline believe that code-sharing is procompetitive or that it will lead to greater "open skies" opportunities? please explain.

TWA believes that code sharing may be moderately procompetitive if it provides new service in markets that would not otherwise receive it. However, it is usually standard interline service dressed up in the garb of on-line operations. TWA has never been able to understand the claim that code sharing will lead to open skies and therefore cannot comment on it. Code-sharing can be an effective tool to serve markets that cannot be economically served directly, and to develop new markets. However, as code-sharing is currently constructed, it often provides more benefits to foreign airlines than to US carriers. The foreign airlines carrying the US carrier code have access to Fly America traffic, and often attract passengers who believe they are on a US flag airline. The traffic diverted to foreign carriers can undermine direct flights operated by US airlines with their own aircraft and crews. This results in the loss of jobs for US labor.

Moreover, TWA is also concerned that US policy in the last few months has shifted to supporting code share rights for third-country carriers at the expense of the direct service of US flag carriers. For example in the recent South Africa negotiations, an agreement could have been reached except for the fact that the US demanded that South Africa accept code share operations by US flag carriers. When pressed on this issue, the US Government argues that even when operated totally by foreign flags, US carriers benefit because they share in the profits. TWA does not understand that most code shares, such as the United /Lufthansa deal, fall in this category. In such code shares, the US carrier receives a ticketing fee, most of which flows through to travel agents and credit card companies. The ticketing fee to the US carrier is simply a payment for normal interline services rendered by the carrier. It should not be the basis for an important US Government policy.

**QUESTION 14.** Does your airline believe that changing the limits on foreign control and ownership of US airlines would increase the possibility of true liberalization with the British?

Answer. TWA believes that the US government should have possible expansion of foreign ownership of US carriers available as a tool for trading in bilateral relationships. TWA understands that the government believes the only way to achieve true liberalization with the British is to give it the opportunity to own as much as it wants of USAir. While this may have been true previously, recent developments, particularly the potential merger between United and USAir, have cast doubt on this approach.

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QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS  
THERETO BY MR. GREENWALD

*Question 1. According to the May 24, 1995 issue of Aviation Daily, United Airlines recently released a study regarding the 600,000 revenue passenger issue on the O'Hare/Heathrow route. Please share the findings of that study with us.*

A copy of the study, prepared for United by The Campbell Aviation Group, Inc. and entitled "Analysis of Price and Service Competition in the Chicago-London Air Transportation Market," is attached hereto.

*Question 2. In your opinion, when, if ever, do you expect the 600,000 revenue passenger threshold on the O'Hare/Heathrow route currently controlled by American Airlines and British Airways to trigger?*

The findings of the study of competition in the Chicago O'Hare/London Heathrow market sponsored by United indicate that, absent an agreement between the United States and the United Kingdom to designate a second U.S. carrier in the market, the incumbents could have manipulated the 600,000 revenue passenger threshold as long as necessary to forestall entry by another U.S. carrier. The data indicate clearly that the market has been stunted by the lack of capacity offered by American and British Airways. By constraining capacity through the use of smaller aircraft and reduced frequencies, the incumbents were able to increase fares, which more than compensated for the reduction in traffic volume required to keep total revenue passengers below 600,000. So long as the incumbents are able to continue to make a profit in the market while keeping capacity below the threshold, they would have no incentive to increase capacity to the threshold level and allow a second U.S. carrier into the market.

*Question 3. Mr. Greenwald, I understand that the City of Chicago was unable to testify at the May 24th hearing. Although I know that United does not speak for Chicago, could you describe the benefits you see for the City of Chicago, the State of Illinois and the Midwest region from the mini-deal.*

Without presuming to speak for Mayor Daley or Governor Edgar, I believe they would agree that the presence of U.S. carrier competition in the Chicago O'Hare/London Heathrow market will bring a number of important benefits to the City,



State and region. Perhaps most important, passengers from Chicago and the surrounding communities, currently pay higher fares than in comparable markets fortunate enough to have competitive service. Competition will bring prices down. Competitive service also will afford local passengers a variety of service offerings and frequencies from which to choose. In addition, passengers for whom Chicago is the logical gateway to London will no longer be shunted to other points to enable the incumbents to avoid the 600,000 revenue passenger threshold. With this additional traffic, the City of Chicago, State of Illinois and the entire Midwest region will reap economic benefits from traffic which should rightfully be flowing through O'Hare.

*Question 4. I understand that, along with your code-sharing partner Lufthansa, you recently successfully bid for Fly America traffic between Atlanta and Frankfurt. Could you tell us how much this opportunity to competitively bid for Fly America traffic saved U.S. taxpayers?*

United's bid for Atlanta-Frankfurt traffic under the "Fly America" program proposed to permit government passengers to fly either non-stop on flights carrying United's code and operated by Lufthansa or on a direct flight over Washington/Dulles on United-operated aircraft. Using GSA's traffic projection for the Atlanta-Frankfurt segment multiplied by the difference between United's fare and the fare offered by Delta, which operated the route under the program last year, the total savings could amount to as much as \$189,000.

#### QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY MR. GREENWALD

*Question 1. It has been reported in the press that your airline developed the framework for this mini-deal with the British Government. Is that the case? If so, do you believe that carriers should be off negotiating bilateral agreements with other governments?*

The United States Government negotiated the mini-deal with the British government. United has not engaged in negotiations with the British government regarding this or any other agreement.

*Question 2. How do you justify the mini-deal being in the public interest? Isn't it uniquely beneficial to UAL and Chicago?*

The exchange of rights is in the public interest because it will enhance competition in a number of markets. United's entry into the Chicago-London market will provide competitive U.S. carrier service and competitive prices for both local and connecting passengers at Chicago. Passengers in the Philadelphia-London market will also benefit because British Airways will replace capacity that was lost when American abandoned the route. The agreement will also establish the right for U.S. carriers to expand their code-share services to points in the United Kingdom and Europe, making them more competitive with European carriers such as British Airways. The enhancement of competition and the expansion of U.S. carrier competitive opportunities have been cited by DOT in its International Air Transportation Policy Statement as two goals of U.S. international aviation policy that would serve the public interest. The mini-deal and the competitive benefits it will produce meet that standard.

*Question 3. How should the remainder of communities outside of Chicago feel about the mini-deal since they don't get anything from it?*

Communities throughout the midwest region served by O'Hare will benefit from U.S. carrier competition to London. These passengers will be able to travel over the most convenient gateway to London at fares that reflect the effects of competition. Until now, if these passengers wanted to travel on a U.S. carrier to London, they could have been shunted to far less convenient locations by the incumbents as part of their efforts to keep service at O'Hare below the 600,000 threshold. East coast communities such as Washington, D.C. and Philadelphia are also major beneficiaries of this deal.

These communities will also benefit by the expansion of U.S. carrier code-share services beyond London. The opportunity for international travel on code-sharing carriers can offer passengers competitive fares and a "seamless" experience that takes them from their home towns to a wide variety of European destinations and beyond.

*Question 4. What is your view of the British Airways/USAir code-sharing component of the mini-deal? Doesn't it give British Airways everything it could need over the near term?*

The British Airways/USAir code-share component of the mini-deal primarily benefits the passengers and communities served by the USAir/British Airways code share alliance. By renewing the code-share as part of the mini-deal, the United

States is merely agreeing to take action to renew services that are already being provided and which it had already agreed to approve.

*Question 5. In a letter to President Clinton dated May 11, the Transportation Trades Department of the AFL-CIO said that a waiver of the Fly America Act requirements "would deal a severe blow to the interest of U.S. air carriers and their employees who have seen 120,000 jobs disappear in just the past five years. . . . For aviation employees, the Act serves to preserve their competitiveness at a time when lower-wage foreign workers are encroaching on the jobs of America workers in virtually every sector of the U.S. economy."*

*Similarly, in a May 10 letter to the President, the Transport Workers Union of America cited the widespread, across-the-board impact such a waiver would have on U.S. aviation jobs: "U.S. government tax dollars will be going to pay for services by British carriers when there are many U.S. carriers serving these markets that could handle the business—carriers that employ U.S. workers, and fly U.S. manufactured planes, maintained and serviced in the United States."*

*As an employee-owned company, please tell us what is United's view of the proposed Fly America waiver, and how your views of this particular provision affect your position on the mini-deal as a whole. In other words, how much importance do you accord this provision within the context of the overall mini-deal?*

*Does your interest then in obtaining the Chicago-Heathrow authority supersede your objections to the Fly America waiver proposal?*

You have some very effective ads touting that your company is employee owned and operated. Tell me, how do your unionized employees feel about giving away the Fly America provision? Doesn't it make sense to you and to them that government workers traveling at taxpayer expense should support U.S. carriers?

The Fly America Act requires that transportation by air of Government persons or property be "provided by" U.S. flag carriers. The Departments of State and Transportation and the GAO have all issued policy statements interpreting this provision which permit foreign carriers operating under code-share arrangements with U.S. carriers to fly Government-paid traffic. The rationale behind these policies is that the U.S. carrier sells the ticket, receives a portion of the revenue, and assumes responsibility for the completion of the flight, regardless of the fact that it is being operated on the partner's aircraft.

Currently, every U.S. carrier authorized to place its code on flights operated by foreign carriers is eligible to bid for U.S. government traffic which would be transported on flights operated by the foreign carrier. This includes Delta on Virgin Atlantic; American on South Africa Airways and QANTAS; Continental on SAS and Alitalia; and United on Lufthansa, etc. British Airways does not now have access to Fly America traffic because USAir is not currently authorized to place its code on BA flights. Under the mini-deal, USAir's code would be placed on BA flights solely for the purpose of permitting BA to transport Fly America traffic.

It is important to remember that the amount of Government-sponsored traffic at issue is minimal. At most four gateways (BWI, IAD, NYC, SFO) would be involved as part of the negotiating package. United's calculations indicate that the maximum amount of annual revenue available to BA would be under \$2 million—assuming it won all the awards. American did not even bid on the carriage of New York-London Government-paid traffic for this year. With respect to traffic out of the four potential gateways, the principal U.S. competitor affected would be United.

The small amount of U.S. government traffic carried by foreign carriers under code-share arrangements is not likely to affect U.S. jobs. Indeed, this has never before been raised as an issue with respect to the involvement of other code-share alliances in Fly America service and BA is likely to have even less impact because of the agreed limits on its participation.

United's employee-owners have not objected to this portion of the mini-deal. They see the value of U.S. carrier competition in the Chicago-London market as far greater than the minimal impact the addition of British Airways might have among other foreign carriers whose U.S. code-share partners already bid for Fly America traffic.

*Question 6. Mr. Greenwald, not so long ago, United was one of the most vociferous advocates of a comprehensive, liberalized air services agreement with the United Kingdom. You repeatedly argued for "reciprocal economic opportunities and "equivalent benefits."*

How then do you rationalize your support for the mini-deal in light of your previous statements?

Shortly after Secretary Peña took over at the Department of Transportation, the DOT gave an ultimatum to the British when it approved the British Airways/USAir alliance. DOT would approve the arrangement for one year and the British were

told that they must enter into a deal that would "eliminate restrictions that undermine competition and which limit U.S. carrier access to the British markets."

As it turned out, the British were not then prepared to engage in a wholesale liberalization of our aviation relationship. Now, however, the British are ready to enter into a deal that represents real progress toward improving U.S. carriers' position in the U.K. market. They are willing to accept an agenda and schedule toward Phase II which will include still more benefits.

The United States cannot allow the perfect to become the enemy of the good. We should accept the deal that has been negotiated and go back to the table to discuss Phase II. If we continue to take an all-or-nothing approach in seeking expanded opportunities with our trading partners like the British, we will never break the impasse that has kept U.S. carriers hamstrung from competing effectively in the U.S.-U.K. market. If we do not take the steps available to us to move forward, United will continue to be shut out of the Chicago-London market by manipulation of the 600,000 threshold and passengers served through Chicago will continue to be denied the benefits of U.S. carrier competition.

*Question 7. It is surprising to me how little it took for you to change your position. From this mini-deal, you are getting one flight a day on a route already served by two other carriers. Do you find that additional authority sufficient to ameliorate your concerns about equal treatment? Doesn't United have unused frequencies to Heathrow, such as those from Denver and Seattle? Isn't it true that access from those cities is also very important to United? How does this mini-deal help on that score?*

United continues to be concerned about achieving a balance of benefits in the U.S.-U.K. market. The path to achieve this goal, however, appears clearly to be in accepting the terms of the mini-deal, with its promise of future expansion of U.S. carrier opportunities in the U.S.-U.K. market. Among the immediate benefits for United is the realization of one of our company's long-term goals—linking its domestic hub at Chicago with its European hub at London Heathrow. With this linkage, we will be able to optimize the efficiencies of two major hubs and pass the benefits, in terms of both service and price, on to our customers.

United does not have authority to serve Heathrow from Denver. We do have authority from Seattle and service over that route will be restored in 1996. To the extent that the mini-deal represents a step forward in the liberalization process, it contributes to the momentum toward a more open regime.

*Question 8. How profitable do you envision this Chicago-Heathrow route to be? If it could be that profitable for United, don't you agree that such a route would be equally or more valuable for a city that doesn't have any Heathrow access?*

Last year, United commissioned a study to analyze the price and quality of non-stop air service between Chicago and London. A copy of the study, conducted by The Campbell Aviation Group, Inc., has been provided for the hearing record. The conclusions reached by the study demonstrate that Chicago has the poorest level of service of any U.S. city with two or more non-stop air carriers in the market, and significantly higher prices. This is true even in comparison with cities that have smaller populations than Chicago, but more competitive service to London. Providing competitive U.S. carrier service in the Chicago-London market is, therefore, an important priority for U.S. negotiators.

United's designation as the second U.S. carrier in the market also will bring significant benefits to passengers in Chicago and in the midwest region for whom O'Hare is the most convenient major hub airport. Chicago is the busiest airport in the world, and United is the largest hub operator at that airport. Being able to link its domestic hub at Chicago with its principal European hub at London Heathrow will enable United to maximize the price and service benefits possible only through that linkage.

Moreover, Phase II of the mini-deal offers the opportunity for expanded access to Heathrow for many new communities. These opportunities would not be available but for the "mini-deal."

*Question 9. Mr. Greenwald, if United needed access to the United Kingdom, why didn't you bid for any of the regional flights out of Chicago? Why didn't United bid for Stansted?*

The opportunity presented by the mini-deal is not merely access for United to the United Kingdom. The key for United is the opportunity to link our primary domestic hub at Chicago O'Hare with our primary European hub at London. Serving regional airports, while perhaps important over the long term, is not as significant as being able to realize the benefits of the efficiencies represented by service between two major hubs. Moreover, splitting our London services between two U.K. airports would increase the costs of our European services significantly.

*Question 10. If Bermuda II is restrictive and balanced in favor of British carriers, what incentive does the United Kingdom have, now or in the future, to negotiate away their substantial advantage?*

The British government has recognized the need to make changes in our bilateral relationship. The mini-deal is evidence of this recognition. It offers incremental adjustments to the agreement which U.S. carriers can use to begin to compete more effectively against the British carriers.

*Question 11. In 1993, after the DOT approved the British Airways-USAir code-share agreement for the first time, the British promised to engage in negotiations to liberalize the bilateral agreement. However, nothing ever came of that British promise. Mr. Greenwald, it is clear that you are a strong supporter of the incremental approach.*

*Given the previous experience with British promises to continue toward liberalization, what support do you have for your position that the incremental approach has worked in the past or will work in the future?*

U.S. carriers and communities have benefitted from past mini-deals to varying degrees, but by far the biggest beneficiaries have been Delta and American, the two carriers now objecting most vociferously to a new mini-deal with the United Kingdom. Delta and American are each operating a number of routes in the United States-United Kingdom and United States-Japan markets which are among the benefits they received from mini-deals with those countries.

History indicates that the United Kingdom is prepared to make the incremental adjustments to the bilateral reflected in the proposed terms of the mini-deal. We are optimistic that the United Kingdom will move forward with this package.

*Question 12. Mr. Greenwald, in your statements regarding the current negotiations, you criticize opponents of the proposed deal as simply being those parochial interests that have the most to lose if an agreement is reached.*

*Doesn't United, however, have the most to gain from a Phase I deal and, therefore, isn't it merely seeking to enhance its own "parochial" interests?*

*How do you explain the opposition of the deal by those who don't even serve the Chicago-London market? What exactly do they have to lose?*

The "mini-deal" represents a breakthrough in the impasse that has stymied progress in our aviation relations with the United Kingdom. A number of carriers and communities will benefit from its terms in both Phase I and Phase II, United among them. The largest U.S. carriers in the transatlantic market, stand to lose the most if they are faced with increased competition from U.S. carriers to London and beyond as a result of the "mini-deal". To the extent that midwestern U.S. citizens now will have attractive service and price options to London through Chicago, our flights will compete with those of other carriers at other gateways. Their opposition is understandable from that perspective.

*Question 13. Does your airline feel that the proposed "starburst" element of Phase I is of significant value? If so, why?*

In 1991 the United States agreed to allow British carriers to code-share with U.S. carriers in a starburst pattern at U.S. gateways. This enables BA to code-share at USAir's hubs on virtually all flights in USAir's flight banks—a so-called "starburst" pattern.

U.S. carriers did not obtain the same right in the 1991 MOU, but are limited to the same number of code-share flights at London as they have transatlantic flights serving London—the so-called "one-in-one-out" pattern. The right to starburst at London would give U.S. carriers the ability to use that gateway like a hub.

United, for example, could offer more code shares with its partners British Midland and Lufthansa. American also has a code-share relationship with British Midland that could benefit. Delta has code-share relationships with Virgin Atlantic, Swissair, Sabena and Austrian Airways and could benefit from a starburst operation with one or a combination of these carriers.

*Question 14. In general, does your airline believe that code-sharing is procompetitive or that it will lead to greater "open skies" opportunities? Please explain.*

United continues to support efforts to achieve liberalized bilateral agreements with a broad range of our trading partners. No single airline, however, can realistically expect to serve every country or city in the world. To achieve our goal of providing a "seamless" product in the international air transportation market, we must encourage policies that create an environment conducive to efficient alliances among carriers. Support for such alliances encourages governments to liberalize their aviation agreements with the U.S. in order to permit their carriers to participate in these arrangements.

*Question 15. Does your airline believe that changing the limits on foreign control and ownership of U.S. airlines would increase the possibility of true liberalization with Britain or other nations?*

United has supported proposals to increase the limits on foreign ownership. In the right circumstances, the consumers can benefit from breaking down and, ultimately, eliminating nationality barriers to free trade. Multi-national alliances are an important step forward in this process. These alliances help to encourage foreign governments to break down barriers to fuller participation for their carriers in these arrangements. This, in turn, moves nations toward greater liberalization of aviation markets.

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QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS THERETO BY THOMAS WEIDEMEYER

*Question 1. Please describe for us the particular problems your company experiences under the current U.S./U.K. agreement.*

The current bilateral agreement is flexible to a certain extent with regards to air cargo services. At the present time, UPS is one of three designated carriers that are able to utilize beyond rights out of the United Kingdom. It is fortunate that one of those available beyond points is Germany, where UPS has its European air hub. However, other than Germany, the remaining beyond points (Netherlands, Belgium and Turkey) do not provide flexibility for UPS to plan future operations. We would not, for example, be able to operate to France or Spain and carry traffic between those points. UPS now has extensive operations within Europe, supported by over 30,000 European employees. UPS needs to have the flexibility to operate its air system in the most efficient manner in order to provide the best service for our customers.

*Question 2. I understand a Select Committee of the British House of Commons recently recommended cargo liberalization, a concept in Phase 2 of the negotiations. What would the immediate and long-term effect of cargo liberalization be for your company?*

As I stated in my formal comments, UPS was perplexed by the fact that the Select Committee's recommendations, as they related to cargo liberalization, were ignored by the U.S. negotiators in the Phase 1 proposal. Other portions of the report, related to passenger issues, were adopted as part of Phase 1. We should have used this report to put pressure on the U.K. Government to include cargo liberalization.

Cargo liberalization would allow UPS to plan its operations in the most efficient manner. Intra-European beyond rights are critical to UPS. As important as this is to UPS, it is of greater importance to our customers. As barriers to trade are broken down through the WTO and NAFTA, we cannot continue to allow transportation to be shackled by regulations imposed by regulators. We need innovative trade solutions that allow airlines to move goods and people in as free a manner as possible.

QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY THOMAS WEIDEMEYER

*Question 3. Does your company feel that the proposed "starburst" element of Phase 1 is of significant value?*

The starburst element deals with passenger code-share operations, which is not a concern to UPS. However, the ability to code-share in this manner appears to be of significant value by allowing those airlines the flexibility to mesh schedules and provide customers with the most options.

*Question 4. Would your company support or oppose renunciation of Bermuda 2 by the United States as a means of obtaining a fundamental change, and possibly "open skies," in the aviation service between the United States and Britain?*

UPS would not support renunciation unless we were convinced that it was necessary as part of a broader strategy to deal with the aviation operations between our two countries. We are not convinced that renunciation, in and of itself, is the answer to the problem.

For example, both France and Thailand have renounced their respective agreements with the United States and, from a practical matter, nothing has substantially changed because the two governments still operate under a comity and reciprocity arrangement. The operations that existed prior to the renunciation basically still exist. In that case, renunciation does nothing more than make a political statement of unhappiness with the current document.

If the United States is to use renunciation as a tool, it will only be effective if all services are stopped. Such an action would put tremendous pressure on both sides to reach an agreement. Unless all services are stopped, the incumbent concerns that are the root of the problems with Bermuda 2 will not be addressed. However, it is

questionable whether the DOT or DOS would follow this course of action in any event.

*Question 5. Does your company have any suggestions, or alternative approaches, as to how the U.S. might obtain a more liberalized agreement with the United Kingdom?*

The historical rate of change in the U.S.-U.K. bilateral relationship is one of the slowest. This is mainly due to the powerful incumbents on both sides that want to expand their holds on the U.S.-U.K. market to the detriment of expanding opportunities for other carriers. If we continue to pursue a liberalized agreement under the conditions and assumptions of the past, we are doomed to failure.

Transportation regulators currently control the aviation trade agenda between our two countries. Although the DOT has pushed for "open skies" agreements and has been successful in many other instances, the United Kingdom DOT is clearly not of the same mind. As a result, at the end of the day we will still have regulations that limit, not expand, what U.S. carriers are able to do in this market.

In order to make a significant change in this aviation relationship, the United States must begin looking at the aviation relationship as a *trade* relationship, not a *transportation* relationship. Perhaps the guidelines we should operate under should be *Uruguay (GATT)*, not *Bermuda 2*. This will take a fundamental change in our way of thinking about aviation relationships and it is doubtful that there will be a lot of support for this concept in the beginning.

*Question 6. Does your company believe that changing the limits on foreign control and ownership of U.S. airlines would increase the possibility of true liberalization with Britain?*

The statutory limit on foreign ownership should be the same as that for auto-makers, real estate investors, or electronics firms. In other words, the idea of limiting foreign ownership in carriers—or the right to establish a carrier in a foreign country—is out of date and does not serve a useful purpose. If UPS were able to establish its own airline within the European Union, for example, we would not be faced with the operating problems that we now have. The end result of eliminating foreign ownership restrictions would be better service for both our customers and the traveling public.

In an ideal world, there should be few limitations on lifting this restriction. However, as the only Fortune 100 company whose primary competitor is the government, in the form of the U.S. Postal Service, we understand the impact of government-owned carriers and the issue of state subsidies. This must be taken into account.

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QUESTIONS ASKED BY SENATOR HOLLINGS AND ANSWERS THERETO BY SECRETARY  
PEÑA

*Question 1. Prior to the decision to seek a mini-deal, what was done to seek industry views on the merits of a mini-deal?*

Answer. In the negotiations process with the United Kingdom, we followed our standard practice of seeking industry views on the merits of the issues being negotiated. This was done in several ways. First, we held a public meeting for all interested U.S. interests. This included scheduled and charter airlines, airports and other civic interests, and labor representatives. These same representatives were subsequently invited to submit letters commenting on the negotiations. Finally, and perhaps most importantly, these industry representatives were invited to attend the talks as members of the U.S. delegation. That way, they were available to comment on any aspect of the mini-deal as the negotiations developed.

*Question 2: The Department of Transportation has embarked on a strategy of opening up the European market through negotiations with nine countries under an "open-skies" agreement. Is it your view that this could facilitate the ability of U.S. carriers to serve Europe? Would this have a positive effect on the U.S.-U.K. relationship?*

Answer. Yes, the open-skies aviation agreements that we have initialled with the nine European countries will create improved opportunities for U.S. airlines to serve Europe. Most important, U.S. airlines will have new options for participating in the globalization of air services, U.S. communities will have new opportunities to attract international air services, and travellers and shippers will benefit from expanded air service options.

The United States decided to pursue the nine country initiative because international air transportation has entered a "watershed" era that requires airlines to think and act from a global perspective. Thus, a liberalized aviation environment is essential.

A key goal of the open-skies agreements is to create an environment that will give airline managements the flexibility to respond to demands from travellers and shippers for truly "global" air services.

As for the second part of your question, I believe there will be a positive impact on the open-skies negotiations with the United Kingdom and other countries. As U.S. airlines and the national airlines of the nine countries begin to use the opportunities provided to them in the open-skies agreements, this will create a competitive dynamic that British and other European carriers cannot ignore.

**Question 3.** Cargo operators play an important role in our economy. Under the proposed mini-deal scenario, cargo rights would be addressed under phase 2. Yet, the British House of Commons Transport Committee, in a 1994 report, recommended seeking liberal cargo rights first. What impact do you believe the House of Commons report has had on the ability of cargo operators to gain a more liberal agreement?

**Answer.** The House of Commons recommendation for extensive cargo liberalization should provide a very positive impetus for moving forward on cargo issues with the British. Moreover, I believe that the House of Commons report correctly identifies cargo issues as unlikely to be as contentious as passenger issues. In addition, I understand that there is a commonality of interest between U.S. and U.K. carriers in their desires to see additional liberalizations introduced into the cargo regime. Now that the phase 1 deal has been completed, we will move quickly to the phase 2 negotiation that includes cargo issues. I am pleased to inform you that the first round of those talks began on June 20 with a working group meeting.

**Question 4.** The General Accounting Office has suggested that the U.S. needs better data to assess the benefits of code sharing, before it negotiates away such rights. In granting the British the right to code-share in 1991, then-Secretary Skinner praised the agreement. Did we then have the type of data GAO now seeks to determine if we should grant the right to code-share?

**Answer.** The GAO has recommended that (1) U.S. airlines, as part of their regular reporting of traffic data to DOT, identify which passengers traveled on code-share flights and (2) foreign airlines involved in such alliances with U.S. carriers be required to report data on their code-share traffic to DOT. Neither type of information was available in 1991. At that time, no large-scale code-share alliances were in place from which such data could have been collected.

Since the beginning of 1994 we have been requiring U.S. carriers that participate in the larger strategic code-share alliances to file special Origin and Destination reports with the Department. Currently these include Northwest, United, and USAir in conjunction with their alliances with KLM, Lufthansa, and British Airways, respectively.

Certainly we would like to have the additional data recommended by the GAO—fare basis Origin and Destination data for passengers that are carried entirely on foreign carriers. However, we cannot simply require foreign carriers to report this information. Normally, getting this kind of data would involve a time consuming rulemaking process that in the end may or may not be successful. The difficulty we have experienced in getting even more basic information from foreign carriers in the past does not encourage us, particularly in any reasonable timeframe.

GAO suggests the alternative of making the submission of such information a condition for approving a code-sharing alliance. This is not as promising as it may seem. Apart from a foreign carrier simply not wanting to do this, developing the information required and the systems to process the information would be an expensive undertaking for foreign carriers and might discourage alliances. It is quite likely that this would come at the expense of the U.S. carrier partner that stands to gain from the alliance.

While the foreign carrier data would improve our ability to do certain kinds of analyses, I do not believe that it is critical for assessing the effects of the broad-based, strategic alliances. In addition, we already require carriers, including foreign carriers, to file a substantial amount of information of various kinds. For analyses where the missing foreign carrier data are needed, we have developed methods of estimating it from the data already reported to us. We are also considering the possibility of devising a method of routinely estimating foreign carrier data, perhaps using a modeling approach. While this is not ideal, we have not yet concluded that time-consuming efforts to require additional data from foreign carriers would be preferable.

I can assure you, however, that as developments occur, we will not hesitate to take the necessary steps to obtain information that we decide we must have to perform our regulatory analysis properly, despite resistance from foreign carriers.

**Question 5.** Currently, the Departments of Transportation and State share the responsibility for negotiating bilateral agreements. Each Department devotes substan-

tial resources to the negotiations. Do you believe that the current dual authority role is appropriate or would it be more efficient if only DOT had such authority?

Answer. I believe that the Departments of Transportation and State have traditionally worked well together to advance U.S. international aviation objectives. The Departments perform complementary roles in assuring that aviation negotiations are guided by the Administration's primary international aviation goal of open competition while also taking into account the perspectives of our bilateral aviation partners. The Department of Transportation brings aviation policy guidance, economic analysis, and technical expertise to the negotiating table. The Department of State brings insights into the broader, foreign policy factors affecting the negotiating positions and objectives of our negotiating partners. Melding these perspectives allows the U.S. Government to pursue agreements that benefit both sides and provide a stable basis for the development and expansion of U.S. carrier international aviation networks.

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QUESTIONS ASKED BY SENATOR ROCKEFELLER'S AND ANSWERS THERETO BY  
SECRETARY PEÑA

*Question 1.* Mr. Secretary, there has been some significant debate about whether or not the United States should accept a "mini deal" with the United Kingdom that makes progress, but does not get everything we may want. I support the mini deal as a step in the right direction. Do you think a mini deal is good for the United States?

Answer. We have long recognized the need to liberalize our aviation relationship with the United Kingdom, and the current deal represents an important first step in that process. Although it does not provide all the market opening opportunities that we ultimately hope to achieve, the first-step package provides immediate and meaningful additional service opportunities that will enhance competition and provide additional access to the international air transportation system for travellers and shippers. Our economic analysis confirms that the deal provides significant economic benefits to U.S. carriers and U.S. communities.

*Question 2.* Did you look at opportunities for expanding this mini deal?

Answer. I would have much preferred to see a broader package of rights in the first-step package. However, we were much closer to agreement on some elements than on others, and some elements in the first-step package concern operations for this summer season. I did discuss the possibility of an enlarged package with my U.K. counterpart, but he was not prepared to proceed on that basis. My assessment was that it was important to secure the immediately achievable rights as quickly as possible and to link agreement on those rights to a commitment to begin the second-step negotiations on the basis of an agreed agenda and timetable.

*Question 3.* As I understand it, the earlier mini deal proposal didn't outline the scope of Phase 2 of the negotiations. Isn't part of the Administration's mini deal proposal now to include an agreement on what will be covered in Phase 2, along with a timeframe for these negotiations? Doesn't that help make the case that we should get the benefits of Phase 1 now?

Answer. Agreement on a second-step agenda and an expedited timetable for addressing the second-step issues were essential prerequisites for moving forward to conclude the first-step package. Once we were able to secure a U.K. commitment to adhere to an announced schedule of additional meetings on the second-stage issues, I believe that it was appropriate to take advantage of the immediately available opportunities, which are of significant economic benefit to U.S. airlines and communities.

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QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS THERETO BY DOT

*Question:* I understand from a recent GAO study there is some question about DOT's present-ability to analyze the economic benefits of code-sharing agreements with foreign carriers. What are your views and what actions does the Department plan to take to remedy this problem?

Answer: The Department has a great deal of data available with which to analyze the impact of code sharing alliances. For example, all passengers that fly at least one segment of their journey on a U.S. carrier are sampled in the United States Origin and Destination (O&D) Survey. This gives us access to fare and routing information for all markets involving a U.S. point behind a U.S. gateway, and gateway-to-gateway and gateway-to-beyond gateway markets where a U.S. carrier does the international flying. We also receive a special code-share report from three U.S. carriers involved in major strategic alliances. In addition, both United States and for-



oreign carriers report all traffic between United States and foreign gateways. Finally, all service of United States and foreign carriers can be obtained from the Official Airline Guide. Used in combination, these data sources allow us to make reasonable estimates of code-sharing alliance impacts.

On the other hand, there are significant gaps in our data, which, if filled, would allow much more complete analysis. In particular, we have no fare and market data for international passengers who begin or end their trip at a U.S. gateway on a foreign carrier. We plan to take steps in the near future to fill this data gap.

*Question: In assessing the cost and benefits of increased access for British Airways to serve Philadelphia, have you factored in the considerable economic benefits such service could have on Philadelphia and the large surrounding communities who rely on that airport? Also, have you considered the economic benefits of an additional Chicago route for the city of Chicago, the State of Illinois, and the Midwestern region?*

Answer: The economic analysis of the additional frequencies for British Airways at Philadelphia focused on the traffic and revenues accruing to or diverted from the U.K. and U.S. airlines to assess the balance of benefits of this change. Clearly there are enormous benefits for consumers and these cities and their surrounding communities flowing from the added service and competition that were not included in the analysis.

*Question: With regard to the threshold mechanism or "trigger" provided in the Bermuda II agreement: Who is responsible for monitoring this threshold? How close is the 600,000 threshold in the Chicago-London market? Are the boarding statistics available to the public?*

Answer: The Department of Transportation receives traffic data from U.S. and foreign airlines for all U.S.-foreign city-pairs, which gives us the capability to monitor traffic developments on individual routes.

Under the U.S.-U.K. Air Services Agreement, new entry is allowed in a city-pair market served by only one airline from each side if revenue passenger traffic exceeds 600,000 passenger for two consecutive 12-month periods. Revenue passenger traffic on the Chicago-London route has closely approached 600,000 threshold but has not reached it. Traffic data submitted to the Department are commercially sensitive, and the Department treats them on a confidential basis for 3 years. Therefore, current boarding statistics are not available to the public.

*Question: Why, in your judgment, hasn't Chicago's traffic reached the 600,000 threshold when just recently, Washington-Dulles, which is smaller than O'Hare, reached the trigger? Has DOT considered that American and British Airways could be engaging in anti-competitive practices—by periodically reducing capacity so that the 600,000 mark is never crossed? If so, has DOT or the Justice Department investigated this?*

Answer: The amount of traffic that moves in individual city-pair markets is a function of many inter-related factors. A large percentage of the traffic that uses both the Chicago and Washington gateways originates in, or is destined to, other cities in the United States, since these gateways function as hubs for American and United, respectively. These connecting passengers have multiple routing choices. The number and location of the gateways that individual airlines are seeking to support influences traffic patterns. In American's case, the combination of local gateway traffic and connecting traffic was supporting three established and three recently awarded routes east of Chicago. In addition to its three west coast gateways, United has only two east coast gateways—Washington (a major connecting hub) and New York. Therefore, United's connecting traffic flows would be much more concentrated than American's and contribute to Washington reaching the 600,000 passenger level.

The number of flights that can be operated under the capacity annex in the U.S.-U.K. agreement and the equipment mix of the airlines operating the services are also relevant. For example, if the British refuse to allow United to increase the number of flights in the Washington-London market, United can gain capacity by operating Boeing 747 aircraft; American does not have that option at Chicago since it does not operate that aircraft type. American was given an extra-bilateral capacity increase at Chicago to operate to London's underdeveloped Stansted Airport. When that experimental service proved uneconomical, American was not allowed to move the capacity to Heathrow.

Consequently, given the numerous factors that affect traffic flows in this market, many of which are outside an airline's control, the Department has not found a basis for requesting a Department of Justice investigation of the Chicago-London route.

*Question: I understand the Phase I negotiations imposed a restriction on the type of aircraft that United can use in the Chicago-London market. Is it typical for DOT*

*to negotiate over the size of the aircraft? Is British Airways limited to the size of aircraft it can use between Philadelphia and Heathrow?*

Answer: It is not typical for the Department to negotiate over the size/type of aircraft to be used to provide international air services, particularly in large, developed aviation markets such as that between the United States and the United Kingdom. We would have much preferred to follow that policy in this case. The British, however, were not prepared to accept United's entry without a restriction (Boeing 767 aircraft or similar with no more than 211 seats). The aircraft restriction is temporary. After January 15, 1997, United will be able to use whatever aircraft it believes best suits market demand. As is the case with all other U.S.-London routes for both U.S. and U.K. airlines, no aircraft size limitation applies to British Airways' Philadelphia-London services. However, we understand that the newly authorized flights are being operated with a Boeing 767 aircraft.

*Question: Why did DOT approve the Delta/Virgin alliance? Why would you approve the code-share request after waiting 10 months, arguably lose important leverage, and then enter negotiations with the British in March?*

Answer: The Department approved this alliance because the operations would offer important public benefits in the form of new service opportunities. In particular, Delta gained the opportunity to market services to Heathrow in competition with United and American. At the time of approval, our assessment was that withholding this authority had only marginal leverage value, which was outweighed by foregone competitive benefits, and that we should move forward so that the substantial public interest benefits would be available for the summer traffic season. Moreover, we believe that the approval actually cleared the way for moving forward on our two-step liberalization initiative.

*Question: Was an economic cost-benefit analysis conducted on the Delta/Virgin alliance? What did the United States gain by approving that deal?*

Answer: Yes, a detailed balance of benefits analysis was done. The alliance enhanced competition on the seven routes involved and some interior U.S. markets by adding in effect a third U.S. carrier at Heathrow. Although the revenues were small relative to the revenues of the enormous U.S./U.K. market, Delta's share was substantial. The alliance augmented the competitive position of two small players in the U.S./U.K. market. The greatest diversionary impact on any carrier was on British Airways.

*Question: Why hasn't the Administration considered putting the liberalization of the international aviation regime on the agenda at the G7 meetings to encourage a multilateral approach among the world's economic powers?*

Answer: As set out in the Administration's International Aviation Policy Statement, the United States is prepared to work either bilaterally or multilaterally to achieve an open aviation environment on a global basis. A representative of the Department, along with representatives of many of the G7 countries, is currently involved in an ongoing study under the auspices of the OECD to identify the barriers that prevent aviation from having the type of global market access that characterizes most other economic sectors. With respect to moving aviation liberalization forward in the G7 forum specifically, a majority of the G7 participants continue to pursue protectionist approaches in the aviation sector in contrast to their general trade philosophies in other sectors. Unfortunately, therefore, its use as a forum for positive change in aviation liberalization does not appear promising at this stage.

*Question: You emphasized in your statement how important Heathrow is for the airlines in terms of attracting the business traveler. Is Heathrow similarly important to cargo carriers? What restrictions are there on U.S. cargo carriers operating to and from Heathrow? Are they similar to those faced by U.S. passenger airlines?*

Answer: Cargo airlines have different requirements than passenger airlines, and Heathrow does not occupy the same central focus. In fact, Federal Express has concentrated its London operations on Stansted Airport (with its additional space for sorting and recombining shipments) even though its predecessor, Flying Tigers, operated from Heathrow. For some airlines, London itself has not been a central element of their United Kingdom operations. For example, UPS has chosen to serve East Midlands airport, although the airline is also interested in Heathrow access in the longer term.

Cargo services between the United States and the United Kingdom are virtually deregulated; and the entry, capacity, and city pair restrictions that apply to passenger services do not apply to all-cargo services. However, U.S. cargo airlines are interested in expanding their service networks beyond the United Kingdom, and fifth freedom rights are still restricted. The remaining traffic distribution rules for London airports allow U.K. authorities to restrict all-cargo operations at Heathrow and Gatwick during peak hours. However, the Department is not aware that this

potential restriction has prevented U.S. airlines from operating commercially viable cargo services to the United Kingdom.

Further cargo liberalization is an important element of the second-phase liberalization talks.

*Question: What effect do you expect DOT's open skies initiative with the nine small European countries to have on the British as those markets open up?*

*Answer: The effect of these new agreements can only be positive. Travellers to Europe and points beyond—historically the United Kingdom's backyard and Heathrow's great strength—will now have new service options, including services by code-sharing. This effect should encourage the British to loosen the operating constraints at London or risk losing substantial traffic to other transfer points in Europe.*

*Question: In 1994, DOT hired a consultant, Gellman Research Associates, to study the competitive impacts of code-sharing. Gellman concluded, 'if DOT wants to continue to monitor the effects of international code-sharing on airlines and consumers, it should consider expanding the reporting requirements for code-sharing operations, particularly those of foreign carriers.' Gellman repeatedly emphasized this point noting, 'it is strongly suggested that DOT consider the possibility of obtaining ticketing information from foreign carriers.' In its recent report on code-sharing, the GAO also made a number of recommendations along this line. What actions will DOT take in response to these two independent studies to improve its data?*

*Answer: DOT is actively considering approaches to fill the gap in foreign carrier data as suggested by the two studies, including the possibility of extending to foreign airlines the current data collection requirements that apply to U.S. carriers, and we hope to implement changes in the near future.*

#### QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY DOT

Mr. Chairman, Department analysis of your post-hearing questions for the record indicates that your concerns are focused in about a dozen broad areas. In an effort to answer your questions as clearly as possible, we have taken an issue-specific approach in responding to those concerns.

Issue 1: Analysis of Current U.S.-U.K. Regime

Issue 2: Elements of the First-Step Package

Issue 3: Analysis of the First-Step Package

Issue 4: Incremental Approach to U.K. Negotiations

Issue 5: Chicago Issues

Issue 6: Fly America Issues

Issue 7: Heathrow Access Issues

Issue 8: U.S. Negotiating Strategy: Policy

Issue 9: U.S. Negotiating Strategy: Analysis

Issue 10: Antitrust Immunity and Code Sharing

Issue 11: European Union Implications

In addition, several questions did not fit these categories, and we have therefore addressed those Issues individually.

Issue 1: Analysis of Current U.S.-U.K. Regime Answer: The U.S. carrier share of the U.S.-U.K. market has been declining. For example, our carriers' share of the United States-London market declined from 46.6 percent for CY 1993 to 43.6 percent for CY 1994. There are a variety of reasons why this shift in market share is occurring.

- Domestic restructuring, such as Continental's decision to dehub at Denver, is reducing U.S. traffic. Continental's Denver-London passengers are down by several thousand per month. Continental has now suspended this service.

- International restructuring, such as Northwest's alliance with KLM is also giving the appearance of reduced U.S. share. Comparing CY 94 with CY 93, Northwest reports the largest decline of any U.S. carrier in the United States-London market, or 75,000 passengers. But its passengers traveling to and beyond Amsterdam was increased by 174,000. Thus, its United States-London decline is more indicative of the strength of its alliance with KLM at Amsterdam rather than a weakness in its United States-London traffic flows. Northwest has chosen to route its European traffic over Amsterdam rather than London. Similarly, we would expect that United will redirect some of its U.S.-Europe traffic over Frankfurt rather than London. Success or failure cannot be measured by measuring traffic flows in a single market.

- Individual carrier performance is also a factor. As in any market, some carriers do better than other carriers. For example, although both British carriers are doing very well, by far the fastest growing carrier in the United States-London market, measured in terms of year over year percentage increase in passengers, is American

Airlines, which demonstrates that a U.S. carrier can effectively compete. And while United's growth has been relatively flat, it has not served its premier U.S. hub (O'Hare) to London. Delta's overall traffic is down, because it has been replaced at the Detroit gateway by Northwest, but Delta's Atlanta/Cincinnati-Gatwick service is performing well.

The U.S. carrier share is declining primarily because the British carriers' traffic is growing rather than because U.S. carrier traffic is declining. Like American, the British carriers' traffic growth is strong. And BA's growth does not appear to be primarily due to its code-share relationship with USAir, as it is experiencing solid growth at every U.S. gateway and not just USAir hubs. The likely source of this growth is British Airways successful development of its beyond-London markets.

This is why our policy is to gain access to these beyond markets for our carriers in order to compete for this developing market. Northwest is successfully achieving this result over Amsterdam, United is working toward this result over Frankfurt, and other U.S. carriers will develop their competitive alternatives. This is consistent with our international aviation policy statement, which establishes as its fundamental objective the establishment of a market-oriented international aviation system so that our efficient, competitively seasoned carriers can compete.

While we have extensively examined the specific elements in the first phase of the U.S.-U.K. mini deal, and such issues as competitive advantages of serving Heathrow versus Gatwick, the value of lost market share, and revenue loss by carrier due to the British Airways/USAir code share agreement, our primary focus must be to pursue opening up international markets so that our carriers will be able to compete in the rapidly growing market involving cities behind the large foreign gateway cities. This forms the economic underpinnings of the international aviation policy statement and provides the framework for the challenge we and our industry face.

Issue 2: Elements of the First-Step Package Answer: On June 5, the first-step agreement on liberalization of the U.S.-U.K. aviation relationship was signed. The elements of this first-step were: a new U.S. airline on the Chicago-London Heathrow route; star-burst code-share authorization; open access to U.K. regional points and London's Stansted and Luton Airports from all cities in the United States; increased service by British Airways in the Philadelphia-London market; and the ability for U.S. airline alliance partners to put their codes on U.K. transatlantic flights in five city-pair markets to compete for U.S. Government-financed traffic. The grant of additional flights in the Philadelphia-London market for British Airways was strongly supported by Philadelphia interests in the wake of American's decision to withdraw from the market. U.S. airlines are already using regional rights. The new Chicago service, which was awarded to United Airlines, and expanded code-sharing based on the star-burst entitlement by several U.S. airlines will begin this fall.

In addition to the immediately available new opportunities, the first-step agreement contained a commitment for the two sides to negotiate a second phase of liberalizations. I insisted that the two sides agree to an intensive schedule of negotiations over the summer before the first-step deal was signed. The schedule includes a preparatory meeting at the technical level, which was held in Washington on June 20-22, and plenary meetings the weeks of July 17, August 7, and September 11. The second-step agenda includes liberalization of the charter, cargo, and pricing regimes; "very limited, balanced" access to Heathrow and/or Gatwick, and further access to U.S. Government-financed traffic.

Issue 3: Analysis of the First-Step Package Answer: With regard to Philadelphia-Heathrow service, British Airways will receive the right to operate a second round trip for the winter season and an additional 70 days during the summer season. In exchange the United States gets a more valuable second designation on the Chicago-Heathrow route and potentially valuable 'starburst' authority.

With regard to the 'starburst' authority, which is the right to unlimited code share authority beyond London airports and into U.K. cities from third-country points, such as Amsterdam, for the U.S. carriers and beyond U.S. gateways for the British carriers, the revenue potential for U.S. carriers is clearly very large. Based on the conservative assumptions that no new service is added (making the Issue of congestion at Heathrow irrelevant), but loads on U.S. carrier service to London could be increased to a higher, but achievable level due to added flow from new code share traffic, the U.S. carriers could add as much as \$150 million in revenue, which would mostly go to the bottom line. The British, on the other hand, would be able to use this right primarily with the British Airways' service at Miami for beyond traffic to South America. The potential there, using parallel assumptions, is much less, in the area of \$20 million. In constructing our analysis, we did not consider the possibility that British Airways would select a new U.S. code share partner. USAir has an ideal network in the eastern United States to feed the United Kingdom and any

new alliance would have to receive approval of DOT and the Department of Justice, and would be scrutinized for antitrust implications.

The Fly America benefits in the first phase for the British Airways/USAir alliance are very limited, relating only to gateway traffic to London at five U.S. gateway cities (no behind U.S. gateway traffic is involved). The value to British Airways, should USAir win all these GSA contracts, is estimated to be at most \$5 million.

Issue 4: Incremental Approach to United Kingdom Negotiations Answer: As I noted in my opening statement, from the beginning of this Administration, it has been my goal to liberalize our aviation relationship with the United Kingdom. I inherited an unsatisfactory relationship, and we have considered all options to find the most effective way forward. I have seriously explored the possibility of simply renouncing the Agreement; however, there was no broad-based support for pursuing that option from either U.S. airlines or communities. In the meantime, while looking into ways to remove restrictions, I have determined to honor the commitments that the United States has made previously, just as we expect our bilateral partners to honor their commitments to us even if they are seeking changes in the aviation relationship.

Consistent with the negotiating strategy laid out in the International Aviation Policy Statement, I determined to pursue an incremental policy of liberalization with the British. It does not reflect my preferred approach; however, the only viable alternative course would, in my assessment, have been to allow the regime to stall and remain static for U.S. interests while U.K. airlines continued to enjoy the benefits secured by the British side in 1991. Such a result would not have been in the overall best interests of the United States, and we have secured rights from which U.S. airlines and cities are already benefiting.

I would have preferred a larger first-step deal, and I personally pushed hard with my U.K. counterpart to expand its parameters. In addition, in light of the controversy surrounding the proposed package, I also explored whether we could move forward separately on cargo liberalization. Neither of these approaches were acceptable to the British. Consequently, I determined to move forward on the first-step package, since our analysis showed that there were important benefits for U.S. interests in that package and conclusion of the first-step package would allow us to move forward to liberalize other areas of the aviation relationship.

Before agreeing to finalize the first-step package, I insisted that an intensive schedule of negotiations on the second-step elements be set out. I am confident that we will be able to move forward on the second-stage elements since, in at least some areas, the British have real-world operational needs that can only be addressed through further agreement. However, I am under no illusions that the British will not want to move as fast or as far as we will want to. Hard bargaining and negotiations lie ahead, but I am convinced that we can make progress that will allow U.S. interests to participate more successfully in the market. Successful conclusion of the second-stage talks will bring important liberalizations to this market that should benefit airlines and consumers through enhanced competition.

I believe that the British will have to look increasingly at the access that their European competitors are securing in the U.S. market. In that respect, the success of our "open skies" initiative and the real possibility of an open skies agreement with Germany should begin to be reflected in the British negotiating approach. However, a major factor determining the pace and timing of liberalization after the second-stage elements is probably highly dependent on British Airways' interest in pursuing its relationship with USAir. If that interest is rekindled, it should provide an important incentive to the British to move forward more quickly to a fundamental restructuring of the whole aviation environment. A higher level of voting stock ownership in U.S. carriers may be an important factor for the British in moving toward the liberalization that we are seeking.

In the interim, I intend to continue to pursue incremental progress in this relationship if our assessment confirms that the step-by-step approach is moving us toward our liberalization objective and our analysis confirms that the deal is favorable to U.S. interests. At the same time, we will continue to explore any options that hold promise for moving forward more quickly.

Issue 5: Chicago Issues Answer: You are correct that, under the U.S.-U.K. Air Services Agreement, new entry is allowed in a city-pair market served by only one airline from each side if revenue passenger traffic exceeds 600,000 passengers for two consecutive 12-month periods. Revenue passenger traffic on the Chicago-London route has closely approached 600,000 threshold but has not reached it. The amount of traffic that moves in individual city-pair markets is a function of many inter-related factors. For example, a large percentage of the traffic that uses the Chicago gateway originates in, or is destined to, other cities in the United States, since this gateway functions as a hub for American. These connecting passengers have mul-

multiple routing choices. The number and location of the gateways that individual airlines are seeking to support influences traffic patterns. In American's case, the combination of local gateway traffic and connecting traffic was supporting three established and three recently awarded routes east of Chicago. Therefore, American's traffic flows would be much more diverse than, for example, United's since United only has two east coast gateways to London. United would also be carrying Chicago-London passengers, who have chosen to use United's connecting services, and that traffic is not counted in the Chicago-London numbers for the purposes of the 600,000 trigger.

The number of flights that can be operated under the capacity annex in the U.S.-U.K. agreement and the equipment mix of the airlines operating the services are also relevant. For example, if the British refuse to allow United to increase the number of flights in the Washington-London market, United can gain capacity by operating Boeing 747 aircraft; American does not have that option at Chicago since it does not operate that aircraft type. American was given an extra-bilateral capacity increase at Chicago to operate to London's underdeveloped Stansted Airport. When that experimental service proved uneconomical, American was not allowed to move the capacity to Heathrow.

Consequently, given the numerous factors that affect traffic flows in this market, many of which are outside an airline's control, the Department has not found a basis for investigating carrier behavior on the Chicago-London route.

However, the British, in recognition that the Chicago-London market was approaching the trigger level, were prepared to advance the startup date for competitive service. They were not prepared to authorize a service to Heathrow from another gateway. Therefore, U.S. authorities faced the choice of accepting a benefit for a U.S. airline and a U.S. city, which was on offer, or forgoing an opportunity to add competition at the largest U.S. gateway without competitive service. Consistent with the International Aviation Policy Statement negotiating guidelines for reluctant bilateral partners, I determined that seeking new entry on the Chicago Heathrow route was in the public interest.

Issue 6: Fly America Issues Answer: As part of the first-step package, U.K. carriers in cooperation with U.S. partners received very limited rights to carry Fly America traffic. The transportation must be implemented by code-sharing with a U.S. airline on whose code the government-financed traffic would travel. These rights were limited to only five named U.S. gateways, and the inclusion of this element in the mini-deal package was, like any other, a function of the total balance of benefits perceived as being created. We have no specific plans regarding Fly America Issues for the next rounds, regarding this rather as an Issue for the United Kingdom to raise. If we ultimately achieved 'total commercial liberalization' with the United Kingdom, this would presumably include open code-sharing rights, pursuant to which U.K. carriers could carry any Fly America traffic in cooperation with their U.S.-carrier partners, given that the GAO has ruled in favor of allowing Fly America traffic to travel on code-shared flights.

Issue 7: Heathrow Access Answer: The ability to serve Heathrow Airport has been subject to constraints since Bermuda 2 was negotiated in 1977. In 1980, a significant number of new U.S. gateways were added to the Agreement for both sides. However, as part of their policy to encourage the development of Gatwick as a major London airport, the British insisted that both U.S. and U.K. airline services from these new U.S. gateways not operate to Heathrow. In addition, access to Heathrow was grandfathered for Pan American, TWA, and British Airways. That remained the situation until the 1991 negotiations allowed the United States to replace Pan American and TWA with United and American. The combination of these two restrictions has served to limit those U.S. cities that can receive Heathrow service. For example, Detroit and Minneapolis are both eligible for Heathrow service; however, they both receive London (Gatwick) service from Northwest. Assuming that one of the Heathrow carriers (United and American) were interested in providing such service, we would have to remove Northwest from the routes, since only one U.S. carrier can operate between Detroit and London and between Minneapolis and London.

I want to emphasize that I am fully aware of the inequities that these restrictions create for U.S. airlines and U.S. cities. That recognition has caused me to focus on Heathrow access as a core element of liberalization, and I sought to include an element in the first-step package that would begin to break down these restrictions. Although that element was not accepted by the British, the conclusion of the first-step package provides the basis for moving forward to the next step. That agenda includes "very limited, balanced" access to Heathrow and/or Gatwick. Realistically we will not be able, at this point, to accommodate all the Heathrow aspirations of

U.S. carriers and cities; and we anticipate awarding the opportunities that we do secure in a comparative selection case.

Although there is no question that Heathrow is already a heavily utilized airport, the number of air transport operations at Heathrow continues to grow year over year. The growth is attributable to improved air traffic control, high-speed turnoffs from the runways, additional taxiways, and selective overbooking of slots. The Heathrow Airport authority expects modest growth to continue. However, the growth is spread throughout the day and is least likely to occur in the highly congested, narrow band in which transatlantic services are usually scheduled.

Under the European Union Code of Conduct on slot allocation, 50 percent of newly available slots are reserved for new entrant carriers. This rule would benefit new entrant U.S. airlines, but not American or United. However, American and United have been able to increase their slot holdings at Heathrow. The latest information that we have on activity at Heathrow is summarized below.

#### *AIR TRANSPORT OPERATIONS AT HEATHROW AIRPORT*

12 months ended	Year over Year Cu- mulative	Percent Change	
March 31, 1990 .....	351,300	.....	.....
March 31, 1991 .....	361,200	2.82	2.82
March 31, 1992 .....	373,900	3.52	6.43
March 31, 1993 .....	388,100	3.80	10.48
March 31, 1994 .....	397,200	2.34	13.07

Issue 8: U.S. Negotiating Strategy: Policy Answer: Your questions raise a number of Issues that relate not just to our decisions in negotiating with the British, but to our negotiating policy generally. The formulation of negotiating policy is a fluid and constantly changing process, reflecting many variables; such a complex environment may indeed appear 'somewhat confused.' A position that made strategic sense at one point may be less wise at another, as we discuss in the specific context of the United Kingdom above [Issue #4]. We are accordingly constantly reevaluating our negotiating policies seeking ways to achieve market liberalization. Review of relevant economic data has always underlain our decisionmaking in this area, and a new Office of Aviation and International Economics has been created within the aviation and international policy office to promote this function.

Our partners in the ongoing negotiation process are the industry and communities affected, which offer views and recommendations periodically on strategy and specific goals. Moreover, industry and community representatives have been invited to join the official delegations individually; an offer that is accepted to varying degrees depending on the significance of the specific talks. Such interests' various trade associations have, of course, been represented on such delegations for many years. With respect to your specific question, United Air Lines has participated in the process like any other major carrier and has been accorded similar treatment; we are unaware of any improper negotiating tactics on that carrier's part.

Similarly, negotiating strategies vary from country to country. The goal of securing open-skies agreements with the small countries was calculated to give our carriers greater market access to Europe at a time when our larger bilateral partners are less prepared to proceed with such agreements. A country may be small and yet represent a substantial competitive opportunity; for example, one of our largest and most successful alliances, that of Northwest with KLM, operates via the Netherlands, one of the continent's smaller countries. The recently negotiated 'mini-deal' with the United Kingdom includes rights for such alliances to operate into British regional airports exactly the type of destination that may be impractical for a U.S. carrier to serve on its own. Thus, the small-country initiative both generated useful operating rights in their own right and served to put further competitive pressure on other European countries. The United Kingdom may not march in lockstep with Luxembourg, but neither it nor any other European country can ignore the market forces unleashed by agreements with eight such countries (of which Luxembourg is the second smallest, and probably the least significant in passenger aviation relations with the United States).

Finally, there are fundamental differences between our circumstances in aviation negotiations, including with the United Kingdom, and our trade talks. In our relations with the British, our basic rights are governed by a bilateral agreement (including certain elements provisionally in effect); unless we are prepared to abandon that agreement by denunciation, we are obliged to follow its terms. Moreover, in

contrast to the trade context, we have significant rights that our carriers are exercising in serving the United Kingdom; the British government has generally withheld our bilateral rights. However, our reluctance in granting certain operating rights to the British Airways/USAir alliance—rights that were available under our bilateral understandings—represented our ongoing dissatisfaction with our aviation relationship; further delay could have compromised the rights available to U.S. carriers.

#### Issue 9: U.S. Negotiating Strategy: Analysis

Answer: The Department is committed to increasing the level of economic analysis of international aviation issues and developments. Last November I announced the creation of a new office composed of experienced senior aviation analysts and economists that would focus on macro and micro-analysis of international aviation issues to give the Department the analytical underpinnings which are clearly necessary to develop a sound medium-to long-term strategy in the international aviation policy arena. The international policy statement issued by the Department is grounded in just such a macro analysis of the trend toward globalization and the use of multinational networks which are currently being achieved through code-sharing alliances but may also be achieved by the development of networks by U.S. carriers.

The new office also performs micro-analysis of particular bilateral issues, such as the first phase of the agreement with the United Kingdom. As the negotiations progressed, variations in the analysis were analyzed, such as the value of Fly America rights from various U.S. cities, and used by our negotiating team.

While the GAO report on code-sharing alliances was critical of the Department's level of analysis of such alliances in the past, it noted with approval the Department's current commitment to more thorough analysis as demonstrated by the creation of the new Office of Aviation and International Economics. A great deal of analysis of aviation alliances has been done over the past 2 years by the staff of this new office and even more emphasis will be placed on such analysis in the future as the staff is augmented. With regard to data, the Department is working on getting all the information necessary to conduct a fulsome analysis of all code sharing alliances in the future.

Issue 10: Antitrust Immunity and Code Sharing Answer: Code-sharing generally promotes competition in the industry, by enhancing operating efficiencies and facilitating entry into markets that would be uneconomical for a carrier to serve with its own aircraft. In any event, U.S. industry is confronted with code-sharing alliances as a growing fact of life. These general conclusions are consistent with the findings of "A Study of International Airline Code-Sharing", conducted for the Department by Gellman Research Associates.

It is likely that international airline consolidation will take place whether or not U.S. carriers participate. . . . U.S. carriers will have to compete in an environment where there will be large airline alliances, and with the existing broad-based alliances involving some U.S. carriers, the question facing DOT is not whether U.S. carriers should participate, but rather whether any limitations should be placed on their participation. Gellman Study, at 118 Obviously, this generalization requires careful application in any specific context, as when antitrust immunity is sought for a particular alliance or operation. In negotiating the liberal agreements with the 'small countries,' we emphasized our policy of examining such requests on a case-by-case basis.

The Department continues to consider actively the question of antitrust immunity. Where the overall net effect of a particular transaction for which immunity is sought is procompetitive and proconsumer, there may be important benefits to be gained from granting immunity in appropriate cases. The existence of an "open skies" environment, and the elimination of other competitive restrictions, would be key factors in any consideration of a request for immunity. These parameters apply equally to review of the Northwest/KLM alliance. The Department of Justice conducted its usual assessment of the competitive implications of that alliance when antitrust immunity was first sought, and we have continued to monitor that operation's progress; we are noting competitive benefits, such as increased market and traffic development and corresponding competition. It is too early, however, to determine whether other alliances are achieving comparable results.

#### Issue 11: European Union Implications

Answer: It is difficult to predict precisely what the role of the European Union will be in our future bilateral negotiations. Certainly member states already consider the European Union in negotiating with us on a bilateral basis. Meanwhile, we are prepared to negotiate liberalizations to our aviation relations in either a bilateral or multilateral context, as the circumstances warrant.

Question: *The United States has set forth star-burst code-sharing as a primary U.S. objective in these negotiations as a potential to U.S. airlines operating in the*



*U.S.-U.K. market. The grant of such rights would also result in benefits to airlines of third countries. Yet the United States has refused to table a request from a small U.S. scheduled niche carrier, Tower Air, to operate beyond services between London's Stansted airport and India. While the term "star-burst" implies unlimited opportunities is it not, in fact, a right limited to a small number of code-share partners? Why does the United States want to obtain rights for third country airlines? Why won't the United States secure Tower's request which would result in direct benefits to a U.S. carrier?*

Answer: There is no inconsistency between promoting starburst code-sharing and our handling of Tower's desire for Stansted-London authority. Starburst code-sharing confers some benefits on third-country carriers as a side effect, but its primary value is obviously the benefits to U.S. carriers who, by code-sharing over foreign code-sharing partners' hubs, may serve points in the United Kingdom that would otherwise be impractical. (The right also includes code-sharing over U.K. points with a British partner.) In constructing the first-step package, we regarded this as a substantial benefit that is potentially available to all U.S. carriers. By contrast, Tower's request has encountered a cool reception with our British counterparts, and did not incorporate well into the first-step package; we will, however, pursue the matter again in our ongoing contacts with the British.

*Question: I would ask that the Administration explain in full with respect to negotiations with Hong Kong: (1) the reason for the Administration's delay in concluding a stand-alone agreement; (2) the current status of affairs; and (3) the course of action to be pursued.*

Answer: I share your interest in seeing the United States and Hong Kong conclude a stand-alone Air Services Agreement. The two sides have been engaged in negotiations over several years to achieve that result. The most recent round of negotiations was held in December 1994 and deadlocked over two issues: retention of the opportunity to operate a Round-the-World service, which is contained in the current U.S.-U.K. Agreement; and the availability of fifth freedom opportunities for all-cargo operators. Since the December round, negotiators have continued to explore informally ways to bridge the outstanding gaps. In a June meeting with my Hong Kong counterpart, we confirmed our mutual interest in seeing a successful conclusion to these long-standing negotiations. We have developed and coordinated with interested U.S. parties a new proposal that I hope will allow the two sides to achieve a stand-alone agreement quickly.

*Question: Multiple-listing of code-share flights crowds competitive listings off the computerized reservations system screens and seems to be an unnecessary and anti-competitive outgrowth of code-sharing. In a recent report, GAO recommended regulatory reform on this issue and cited pending petitions filed with DOT by American Airlines and TWA. Can you tell us whether DOT plans to take any action to curtail this abuse, and if so, what action is contemplate and when?*

Answer: In the Department's review of its computer reservations systems rules, we considered requests from several commenters to regulate display of code-share flights. At that time we found that the record did not support action in this area on competitive grounds. Moreover, listing a service more than once allows each participant in a code-share operation to establish its own market presence, increasing service options for passengers and encouraging code-sharing partners to offer better service by coordinating their flight connections. Subsequently, as you are aware, American and TWA have asked the Department to reconsider regulating the display of services. However, there is no consensus within the U.S. industry that such regulation is needed or appropriate. The Department will be considering all the comments received on this Issue in determining the appropriate regulatory approach.

*Question: Mr. Secretary, in your prepared statement you stated that the DOT has already acted on more than 80 percent of the recommendations of the Commission to Ensure a Strong Competitive Airline Industry. As a supporter of many of the Commission's proposals, I would be very interested in hearing a detailed account of what the DOT has done in this regard particularly on international issues.*

Answer: The Administration adopted 49 of the 61 recommendations of the Commission and has taken action to promote the adopted recommendations. The following is a partial list of actions in support of the Commission recommendations:

**Montreal Protocols**—The Administration urged the Senate to ratify Montreal Protocols 3 and 4. It also formed a high-level working group to try to fashion a legislative package that would be acceptable to the disparate interests of the affected parties. It has since authorized carriers to explore a substantially improved intercarrier agreement as an interim measure.

**Bankruptcy Law Amendments**—The Administration supported amendments which limit the time period for bankrupt airlines to assume or reject their leases for scarce airport gates; allow government bodies on creditors' committees; and cod-

ify court decisions with respect to aircraft leases. With the exception of a 60-day limit on assumption of airport gate leases, the changes were adopted into law on October 22, 1994 as Public Law 103-394.

**Acceleration of GPS**—The FAA has followed a very aggressive program to move GPS toward being an operational system.

**International Aviation Policy**—The Department developed and Issued an international aviation policy statement that incorporates many of the recommendations of the Commission.

**European Union Air Cargo Negotiations**—The Administration initiated exploratory talks with the European Union on the creation of a fully unrestricted air cargo market. We are prepared to renew those talks when the European Union is in a position to do so.

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#### QUESTIONS ASKED BY SENATOR HUTCHISON AND ANSWERS THERETO BY DOT

*Question: Did your Department comparatively analyze the economic benefits that would result from an additional Chicago-Heathrow route as opposed to the benefits that would result from new Heathrow authority for any other major cities seeking such authority? If so, could you provide us with a copy of it following this hearing? Without such analysis, how do you determine what the U.S. economic interest in these negotiations is?*

**Answer:** We have shared with the Committee our findings on the first-step package, which included the value of the Chicago-Heathrow service. In addition, the Department has analyzed the value to some of the other cities seeking new London service. Service to additional cities will be the subject of negotiations in the second phase of our ongoing negotiations with the United Kingdom. Our analysis shows that the additional Chicago service produced greater benefits than new London service to other cities analyzed.

*Question: If, the Chicago-Heathrow route is worth \$10-\$12 million, shouldn't we assume that access to Heathrow from other U.S. cities that do not currently have any Heathrow access would be of equal or even greater value?*

**Answer:** Such valuations reflect several variable in addition to current service levels, including the size of the market, degree of hub activity, and geographic advantages. In this case, our analysis concluded that the net benefit to the U.S. industry on the Chicago-Heathrow route was much larger than the \$10-\$12 million that you cite and is substantially more than for other U.S. cities analyzed.

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#### QUESTIONS ASKED BY SENATOR MCCAIN AND ANSWERS THERETO BY KENNETH MEAD

*Question 1. Has a sufficient amount of economic analysis been conducted to guarantee that the proposed mini-deal will accrue substantial new benefits for U.S. passengers, airlines, and shippers?*

As GAO has previously reported, there have been numerous occasions when DOT has not undertaken sufficient economic analysis to gauge the benefits and costs of its agreements on affected parties. In the case of the recent mini-deal, DOT did attempt to value the benefits and costs of the various elements, and it concluded that U.S. airlines would benefit more than British carriers from the agreement. However, DOT's analysis is based on limited hard data and rests on a number of assumptions over which reasonable people could differ. DOT's initial assessment was that the mini-deal generated as much as three times as many benefits for U.S. carriers as for British carriers. The differential was later scaled back and DOT's more conservative projection is that U.S. carriers benefit more than British carriers, but the U.S. advantage is much less than previously estimated. Our review of DOT's approach suggests that it is possible that the benefits might be roughly the same for both parties.

Two elements of DOT's analysis of the mini-deal are particularly open to question. First, the value of the increase in British Airways' operations out of Philadelphia. DOT assumed that British Airways would be successful in utilizing this added capacity and operate with an 80 percent load factor in the summer and 67 percent during off-peak periods. The equipment was assumed to be a B-767. Based on available data, DOT projected a \$450 mear. One-way fare. This results in about \$10 million revenues during the peak and \$21 million annually during the off-peak periods. Our analysis of data supplied to us by USAir and British Airways suggests that the Philadelphia-London route has a high proportion of first class and business traffic and the yields maybe as much as one-third higher than those used by DOT to estimate BA' revenues.

The second element open to question is the value of so-called "starburst" rights. DOT postulates that the size of the beyond London market is very large—30 million passengers/year. Given current load factors, DOT assumes that the carriers can handle substantial amounts of additional traffic. With 85 percent load factors, the annual value of the new beyond rights could be \$100 million for American Airlines and \$50 million for United Airlines. British Air would gain \$22.5 million from increased rights to Latin America. While there are some restrictions on the opportunities for third party code-sharing to most major European destinations, DOT expects that the nine new "open skies" countries in Europe and the Middle East countries are expected to present sufficient opportunities to realize the gains. In any event, DOT projected an annual benefit to U.S. carriers of \$60 million as realistic. Its original analysis had projected U.S. carrier revenue benefits as great as \$150 million from these starburst rights. It is very difficult to know with any precision as to whether DOT's estimates are reasonable. All of the starburst traffic is "stimulated" traffic and since DOT does not assume lower fares, it must assume that the added schedules will induce more traffic. This assumption is not well-supported, but is not readily disproved either. It is also true that the benefits from starburst rights will not be realized immediately but will develop over time. In any case, the value of future benefits should be discounted to reflect both inflation and the uncertainty of their ever being fully realized.

Taking these factors into consideration, we believe the evidence suggests that the mini-deal probably benefited both parties roughly equally. While this normally would be an acceptable outcome, the dissatisfaction with prior agreements that favored the British and the absence of further rights that the United States could grant and the continuing limits on U.S. access do offer reasons for concern.

*Question 2. This year U.S. carriers received 70 awards for travel between U.S. cities and London, and GSA estimates that the government passengers on these routes number up to 18,250 per month. At an average fare of \$615, total Fly America revenues for U.S. carriers-carriers that employ U.S. workers and fly U.S.-manufactured aircraft—could be as high as \$134 million per year in the United States-London market alone. Given the amount at stake here, to your knowledge, has DOT conducted any economic analysis of the Fly America Act proposals in the mini-deal?*

We were unable to verify that GSA estimates the value of the U.S.-London government traffic to be \$134 million annually. We discussed these numbers with GSA officials responsible for the Fly America program and they could not verify them either. According to GSA officials, there were 70 awards for U.S. city-London service for 1995. However, they told us that the number of travellers was much less than 18,250 per month. While accurate data are unavailable, GSA officials told us that data from the Department of Defense combined with GSA's "rule of thumb" that military traffic is about two-thirds of total Fly America traffic indicate that total monthly Fly America traffic to London would be about 3,500 and would be worth about \$1.6 million. DOT used similar data to develop to its estimate of the value of Fly America to British Airways.

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LETTER TO FEDERICO F. PEÑA FROM GEORGE W. BUSH

STATE OF TEXAS,  
Office of the Governor, May 24, 1995.

Hon. FEDERICO F. PEÑA,  
Secretary, of Transportation, 400 Seventh Street, SW., Washington, DC.

DEAR SECRETARY PEÑA: Thank you for keeping me informed of your progress in the current United States/United Kingdom negotiations to revise the bilateral agreement on air rights between the two nations.

I understand that another round of talks is scheduled for early June. I want to encourage you to hold fast to your commitment to obtaining "switch rights" for unused routes serving London's Heathrow Airport, so that carriers in other cities can have the opportunity to compete for this critically important access to the European air travel market. If we fail to demand switch rights now, it may be years before the British seriously address the issue again.

Heathrow access is essential for our state's Dallas/Fort Worth International Airport. As the second busiest airport in the world in terms of operations, DFW Airport should have a chance to compete for its first Heathrow route before another airport is granted its third.



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I strongly urge you to remain firm in insisting that any agreement must include switch rights for airports such as DFW International Airport.

Sincerely,

GEORGE W. BUSH.

LETTER TO SENATOR PRESSLER FROM GEORGE F. DOUGHTY

LEHIGH, NORTHHAMPTON AIRPORT AUTHORITY,  
July 13, 1995.

Hon. LARRY PRESSLER,

*Chairman, Committee on Commerce, Science and Transportation, U.S. Senate Washington, DC.*

DEAR MR. CHAIRMAN: The following is in response to your letter dated June 13, 1995 requesting my response to several additional questions relating to the U.S.-U.K. mini-deal.

At the present time I am employed by the Lehigh-Northampton Airport Authority which is responsible for the operation of Lehigh Valley International Airport located in Eastern Pennsylvania; serving the cities of Allentown, Bethlehem, and Easton and other adjacent communities constituting a market area of 2.5 million people.

This airport, at various times in the past few years, has received international service to Toronto, Canada on a preclearance basis since full international designation was not received by the airport until 1994. We have been and continue to be actively seeking replacement service into Canada including, not only Toronto, but potentially Montreal as well. We are also involved in developing charter business to Mexican resort areas.

During the time when I was Deputy Director of the Baltimore/Washington International Airport, I was heavily involved in the operational issues relating to accommodating international air service. As Director of Aviation in Denver, I led a significant marketing effort to attract additional air service between Denver and overseas destinations primarily in Europe. Also, I was very actively involved in supporting changes to the bilateral with Canada.

Denver had scheduled international service to London, several points in Mexico, and charter service from a number of other overseas destinations including Germany and the Netherlands. During this time I helped found the organization known as United States Airports for Better International Air Service (USA-BIAS) and have been a long time advocate of liberalization of U.S. international air service agreements.

I am very pleased to respond to your question concerning the impact of Denver International Airport on service to nonhub regional communities in the western U.S. It is quite true that the cost of landing fees and space rental at Denver International Airport has essentially doubled over the costs that were available to airlines at Stapleton. This is to be expected when a completely new facility is provided. Denver International represents a "quantum leap" in additional capability and capacity. It is unfortunate, however, that mismanagement of the project in the last few years added to the future debt service cost of the airport. Airport fees are between 3 and 4 percent of total airline expenses. This is surprisingly small given the benefits the airline receives from the facilities.

Although Denver represents a doubling of these costs, the new airport virtually eliminates delay in the Denver area. Delay costs impact major expense areas such as crew costs and fuel. As you know, Denver was one of the most delay plagued airports in the U.S. and these delays not only created an inconvenience and a time cost for passengers, but were a source of significant operating costs to the carriers. Current computer modeling techniques are not able to accurately quantify delay, but there is no question that the savings are significant. It is, therefore, unlikely that the increased rental fees at Denver International are the real reasons for loss of service.

As you know, Continental Airlines no longer operates a hub in Denver and that was not because of the cost of the new airport, but simply because United Airlines increased their service substantially and reduced Continental's market share to a point where the hub was no longer profitable. They, therefore, made a business decision to utilize those aircraft elsewhere. Obviously, it is very easy for an airline to say to a community when service is reduced or eliminated that the Denver Airport's costs were the reason. You may be aware that many communities with American Airlines service into Dallas/Fort Worth are experiencing the same problem. They have either lost service or jet service has been changed to turboprop. This consolidation on the part of many of the major carriers is not localized at Denver, but much more widespread.

I believe that smaller communities need to take a much more active role in controlling their own air service issues. In a deregulated environment communities are subject to the corporate decisions of the airline companies serving them. Those decisions may or may not be in the interest of the community. Many cities are becoming proactive in attracting and retaining air service by using financial incentives or even directly contracting for the service they need. I am hopeful that this trend will continue.

With regard to the current discussions with the British, I would suggest that this Committee continue to carefully monitor this process. There have been certain commitments made by the Administration with regard to the second phase of these discussions, and it is important for the Committee to monitor the process to see if, in fact, it produces the additional liberalization that the Administration has suggested it will. At this time I do not believe there is any other action that the Committee needs to take.

USA-BIAS and ACI-NA have, of course, been very active in encouraging the U.S. Government to liberalize relationships with other nations with regard to air service. In the recent past that level of participation has been adequate. I am concerned with the new policy which essentially allows anyone and everyone to attend the negotiations. I think the prior process where a representative of the airports and a representative of the airlines were permitted to attend the negotiations was, in fact, more productive and less disruptive to the process. Prior to airport/community representatives the importance of the new air service to the economy of the United States has been underestimated and the advantages of service being provided by a U.S. rather than non U.S. carrier has been overestimated.

I recognize that there are a number of dormant authorities available. To some extent this is a result of the desire of the major U.S. carriers to operate service only from their principal U.S. hubs or the more traditional gateway cities. I do not believe that it means that no additional cities could be viable. It is my opinion that there has not been a great deal of creative thought by the U.S. airline industry on how to provide overseas service; particularly European service from major U.S. cities that do not happen to be airline hubs. I think low fare service between some of these communities and the U.K. could be successful. Over time these currently dormant authorities will eventually be utilized.

At this point it is difficult to predict who will be losers in this mini-deal process. If the second phase is not successful, then it is possible that some communities that might otherwise have received service could lose out. This is only speculation at this point.

I would not advocate, and at the present time ACI-NA and USA-BIAS does not advocate renunciation of Bermuda II as an effective means of obtaining the bilateral agreement between the U.S. and Britain. I think the better approach is to continue to negotiate with the British while surrounding them with liberalized agreements with other European countries. I think that will probably be the greater pressure on the British government to liberalize their own relationship because they will begin to lose flow traffic over Heathrow and to some extent Gatwick into European points, because of the access becoming available directly to those countries.

As a matter of general business ethics I think code sharing is on its face, fraudulent, and therefore code sharing in any form, in my view, is inappropriate. Joint fare arrangements or other initiatives between U.S. and European carriers can be advantageous and a value to consumers; but code sharing simply leads the passenger to assume that they have a single carrier connection or even a through flight on the same aircraft when in fact, they have a connection from one carrier to another that is subject to the potential problems of any other carrier to carrier connection.

I have no opinion on the issue of changing the limits on foreign ownership of U.S. airlines.

I hope the above is responsive to your questions. Please contact me should you require anything further.

Very truly yours,

GEORGE F. DOUGHTY,  
*Executive Director.*



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