

Open Skies or Open Aviation Area?

Prospects for the Aviation Relations Between the European Union and the United States

Although the European Commission (EC) has been given a mandate to negotiate a trans-Atlantic deal with the United States (US), it is likely to take a long time for the EC and the US to discuss the issues of foreign ownership restrictions, cabotage and the rights of establishment. This paper aims to provide a phased model approach for the European Union (EU) and the US to achieve the aviation agreements in the near future. It analyses key issues between the EU and the US aviation relation. It concludes that the EU negotiators should alter their strategies and seek progress that can be immediately obtained in the first phase of talks, including wet leasing, competition rules, 'fly America'-programs, safety and a 49% foreign investment limit. The issues of cabotage, 100% foreign investment, rights of establishment, staff and slots, which require longer negotiations, are suggested to be addressed in the second phase talks.

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Since the first Bermuda agreement in 1946, the nationality clauses in most bilateral agreements have limited airlines to provide designated services for nearly sixty years. The major obstacle for the US is still the signing of an 'Open Skies'-agreement with the EU.

According to Chang and Williams (2001), nationality clauses lie at the heart of bilateral Air Services Agreements (ASAs). Without them, the value of such agreements is questionable. A key reason why foreign ownership rules remain in place is that they protect national airlines. While the US is reluctant to relax the ownership rules in the near future, they suggested that one solution may be for the EU to find an alternative way to establish a Common Aviation Area, for example, by linking up with like-minded countries first, such as Australia, Canada, New Zealand and Singapore.

On 23 June 2005, the EU signed new aviation agreements with Australia and New Zealand. The agreements will remove the nationality restrictions contained in existing bilateral air services agreements between the two countries and the EU Member States. The new agreements allow any EU airline to operate flights between any EU Member State where it has an establishment and the third country con-

cerned. This is one important agreement of the EU external aviation policies during the past few years. After breaking up the talks with the US in June 2004, both the EU and the US were not ready to go back to the table until August 2005. Instead, they are keen to liberalize ASAs with third countries. For example, the US has signed liberalized ASAs with China in July 2004. Following that, the EU organized an EU-China aviation summit on 30 June and 1 July 2005 in



Beijing. As China and India have the largest populations in the world, the US succeeded in signing an Open Skies with India in January 2005. In addition, four APEC countries (Brunei, Chile, New Zealand, and Singapore) signed a plurilateral agreement with the US on 1 May 2001. The Agreement eliminates the traditional ownership provision found in most bilateral agreements that require an air carrier to be substantially owned by nationals of the designated party.

The EU and the US aviation markets combined account for about 60% of global civil aviation output. Liberalized ASAs between these two markets would set a model for aviation liberalization worldwide. This paper intends to provide a phased model approach for the EU and the US to achieve an aviation agreement in the near future. It analyzes key issues between the EU and the US aviation relation. It concludes that EU negotiators should alter their strategies and seek successes that can be immediately obtained in the first phase of negotiations, including wet leasing, competition rules, 'fly America'-programs, safety and a 49% foreign investment limit. The issues of cabotage, 100% foreign investment, rights of establishment, staff and slots, which require longer negotiations, are suggested to be addressed in the second phase.

Key issues of the EU-US aviation relations

Although the EU and the US have deregulated and liberalized their aviation markets decades ago, bilateral 'Open Skies' agreements, which govern competition between the US and the fifteen EU Member States, stop short of complete liberalization. In general, the current air services between the EU and the US are still restricted to the following things

Phase	Issue	Possible ways for negotiation
Phase 1	Wet leasing	The US changes its regulations and permits European airlines access to wet-lease to the US market.
	Fly America program	EU carriers are allowed to join this program.
	CRAF	The US DOD should be given the emergency authority to suspend the civilian operations of any CRAF participant that fails to immediately meet its CRAF commitments.
	Competition rules	Harmonised competition policies between the EU and US.
	Safety	All foreign airlines must comply with the international standards and procedures of ICAO in order to get operational certification from the relevant CAA.
	Foreign investment to 49%	The US increases its foreign ownership restriction to 49%, and the nationality clauses in ASAs replaced by a "principle place of business" clause.
Phase 2	Cabotage	The US opens its domestic market to EU carriers. In return, the EU opens its Single aviation market for US carriers.
	Foreign investment to 100%	Full foreign ownership is permitted for US and EU national. The nationality clauses in ASAs replaced by a "principle place of business" clause.
	Rights of establishment	EU national is allowed to set up airlines in the US. In return, American is allowed to set up new carriers in EU.
	Labour	A foreign owned US airline remain as US carriers that must comply with US laws including paying taxes in the US and employing US citizens.
	Slots	Setting price at which slot can be sold or replacing the present system with a renewable leasing system that permits long and short leases.

(United Kingdom House of Lords, 2003):

- **EU** carriers can fly directly to the US, only from their own country, whereas US airlines can fly generally from any "Open Skies" EU country to any US point.
- **EU** carriers cannot merge without risking loss of the US traffic rights.
- **Mergers** of EU and US carriers have so far proved to be impossible because of US airline ownership and rights of establishment policies. Some EU airlines have settled for a looser relationship based on alliances or partnerships with US airlines. This still puts many of the potential benefits of cross-border consolidation out of reach.
- **Limits** on cross-border investment mean that failing EU and US carriers have restricted options for fresh capitalization.
- **US** domestic passengers are denied the benefits of foreign competition.

A phased approach

If there is one single question that everyone is interested in concerning the US-EU aviation relation, it is how long it will take until a negotiated result can be achieved. Many observers claim that it will take several years or perhaps even longer. This is probably true if the EU tried to obtain all of its objectives when they entered the negotiations without taking into account the political and legal difficulties in the US. On the other hand, if the EU were to focus on several priorities and accept a phased approach then it could speed up the progress of the overall negotiation. Issues that can be solved in the short run have been put up for negotiations in the first phase. Difficult issues that take more time to discuss have been saved for the second phase (see Table for details).

The first phase

Looking at potential short-term issues that can be addressed as confidence-building measures on the US side, the Europeans could look into resolving the prohibition on US carriers' wet

leasing from European operators. The US thought that this issue could be solved, but it requires serious consideration in terms of safety and security as the FAA will look at its existing rules and at any needed changes to facilitate this activity (Hunnicut, 2003).

The largest and most important specific objective of the US-EU talks was the European Commission's need to eliminate the nationality clause from the framework for ASAs. As a consequence, the US should give up the nationality clause and accept the concept of an "EU carrier". Once that has become a reality, US airlines would face competition not just from Lufthansa at Frankfurt, not just Air France at Paris, but potentially from any and all EU carriers at every EU city. Every EU-US city pair market, heretofore limited to one or two EU national carriers by the operation of the nationality clause, would henceforth be open to all EU carriers. The US has proposed to change its foreign ownership restriction to 49% of voting stock, and a new ownership and



control clause that would authorize any European carrier to operate to the US from any and all points in the EU. Moreover, the US proposal would have eliminated immediately, fully, and permanently, all legal barriers in a comprehensive agreement to the merger of EU carriers, such as the combination of Air France and KLM. Therefore, the EU should accept the 49% foreign ownership and control limit in the first phase, and then to 100% restriction in a second phase.

The second phase

For the US, the most challenging issue, obviously, will be EU proposals requiring amendment of US legislation-like full foreign ownership and control of US carriers and cabotage. The US doubts if EU carriers, like BA, Lufthansa, SAS and Aer Lingus, have the right to operate their own aircraft head-to-head with Southwest, JetBlue, ValuJet and a dozen other US carriers in their established home markets inside the US (Byerly, 2005). Therefore, it is better that a realistic EU negotiation addresses full cabotage and rights of establishment in a second phase.

A major obstacle, which was identified by the authors of the Brattle Group Report, is the opposition of organized labor. Labor opposition could be reduced if airlines made a concerted effort to explain and argue the potential benefits of liberalization as had been done when the first "Open Skies" agreements were signed. However, it will take a long time for the airlines to negotiate with the unions. Therefore, it is suggested that this issue should be tackled in the second phase.

Conclusions

This paper suggests a phased model approach for the US-EU aviation talk. Instead of relentlessly pursuing their press campaign for cabotage rights in the US, the EU negotiators should alter their strategies and seek successes that can be immediately obtained in the first phase of negotiations. The first phase Open

Skies agreement could include the essential core of the US style of Open Skies policies with wet leasing restrictions eased, 'fly America' restrictions removed, foreign ownership limit raised to 49 percent and CRAF, safety, competition rules harmonized. It is suggested that issues like cabotage, full foreign investment, rights of establishment, staff and slots, which require longer negotiations, should be addressed in the second phase. In the best-case scenario, the first phase of such an agreement could come into play in about two years, whereas a full-scale agreement might take up to five years or longer.

As Paul Mifsud has said, "Air law exists only within a nation's borders, ...between nations the proper term is air politics." (Mifsud, 1992). The same thought comes from the authors of the Brattle Group Report when it conducted an Open Skies research for the EU. It describes that the main constraint of the EU-US aviation relation is not because of economics or security, but rather because of politics. Several Congress members present a big obstacle for this air services agreement. Responsible authorities on both sides of the Atlantic cannot be so implacable as to reject any agreement until the "perfect" agreement is reached. Significant change in the aviation industry has almost come incrementally. The two sides need to be realistic about what is achievable in the short run and how, in practical terms, to make progress toward broader liberalization.

Open Skies or Open Aviation Area? The right option is depend upon the EU and US's objectives.

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