

Transatlantic Open Aviation Area: A Template for a Globalised Civil Aviation Industry?

Civil aviation is one of the major driving forces of globalization: it helps businesses to cross national boundaries, it reduces the time for traveling, and it fuels migration. In other words, civil aviation brings speed and connectivity into human life. Despite today's trend of free markets, which is supported by the computer and the internet, this highly technology-intensive industry is crippled by a series of rules and regulations. This is because civil aviation is, by any means, not a normal industry, but rather a highly politicized industry that involves issues such as the sovereignty of individual nations, national security, and diplomacy.



by: Mubashar Hasan

Airlines are often subsidized in order to avoid having them leave the market. Conversely, the entry of new would-be competitors is restricted, or, at least, there are several difficult obstacles to overcome, such as a lack of airport landing and take-off slots¹. Moreover, fares, frequencies, capacity, and the right to pick up passengers are not normally regulated², according to Dobson. *As well as over wholly desirable matters, such as air traffic control, safety and technical standards, there are successive tiers of government regulation: over domestic operators, over foreign operators in the domestic market; over international operators between two states; over intermediate stops in third countries; and over foreign ownership of domestic airlines.*³ Thus, international civil aviation is not just another problem in a changing economic system – it is a serious problem for international relations, as it affects the way governments view one another, the way individual citizens view their own country, foreign countries, and, directly and indirectly, the security arrangements that we live with⁴.

Transatlantic Open Aviation Area

The deregulation of the US civil aviation market and the liberalization of the European market were steps taken to overcome the aforementioned problems in civil aviation. The European Commission (EC) subsequently came up with the idea of establishing a *transatlantic Open Aviation Area* (OAA), which is 'a fully competitive free-trade area with a highly competitive market offering a wide range of route and service choices and low fares for passengers, and also offering cheaper more flexible

cargo services⁵. Two reports, by the Brattle Group and Booz Allen Hamilton and commissioned by the European Commission, suggest that liberalization on the transatlantic markets will have a lot of positive benefits. The report by the Brattle Group, which is called *An analysis of the Economic impacts of an EU-US Open Aviation Area*, expects that fares will drop, that air travel will surge, and that transatlantic travel will increase from 4.1 million to 11 million passengers a year, representing an increase of 9 per cent to 24 per cent following the establishment of the OAA⁵. The report also suggests that intra-EU travel will see an additional boost of 13.6 million to 35.7 million passengers a year – an increase of 5 per cent to 14 per cent⁶. Moreover, Brattle Group says in its report that transatlantic OAA would create about \$5.2 billion a year in consumer benefits through lower fares and increased travel with more than half of those benefits going to transatlantic passengers⁷. Finally, it will increase economic output in directly related industries by \$3.6 billion to \$8.1 billion a year⁸. Subsequently, Booz Allen Hamilton's report *The Economic Impact of an Open Aviation Area between the EU and the US* says that around 80,000 new jobs will be created that are more or less equally divided between the US and the EU⁹. The cargo market will also see an increase, and passengers will see a lot of new routes opening up. It is undeniable that the stakes are enormously attractive in favor of the OAA. The EU and the US had been involved in a number of negotiations before they reached an agreement. Policymakers from both sides of the Atlantic met each other a total of six times between October 2003 and June 2004, before they signed the first phase of the agreement on April 30, 2007. The agreement will be valid for the next five years. There will be a joint committee that will review



Photo 1: *British Airways faces hugely increased competition on its transatlantic routes.*

the implementation of the agreement. This agreement is set to merge EU and US cabotage. In addition, there are hopes that the US will ease restrictions on foreign ownership of US airlines. It is currently impossible for any foreign company to own 49 per cent, and over 50 per cent on a case-by-case basis, of a US airline. More importantly, foreign ownership of voting stock is not allowed to exceed 25 per cent. The agreements have seven objectives: removal of all market access restrictions, opening foreign investment on a reciprocal basis, ensuring effective competition, guaranteeing high standards of safety, security, environmental protection and passenger protection, bringing bilateral agreements into conformity with EU law, and a staged approach with a mechanism to ensure progression to the second stage according to the documents received from the EC.

Aims of the Agreement

The major aims of the first-stage EU-US air transport agreement are:

- ✦ US accepts the *Community air carrier concept*.
- ✦ Unlimited code-sharing for both sides.
- ✦ Free pricing, except that US carriers cannot lead prices on intra-EU routes.
- ✦ New opportunities for EU airlines to provide aircraft with crew to US airlines on international routes.
- ✦ Access for EU airlines to certain *FLY America* traffic
- ✦ EU airlines qualify for antitrust immunity
- ✦ Guarantees concerning permissible percentage ownership by EU nationals, including possibility to exceed 50 per cent of total equity. Also guarantees of fair and expeditious consideration of transactions involving EU investment in US airlines.
- ✦ Right to limit US investments in EU airlines reciprocally to 25 per cent voting equity.
- ✦ Acceptance by US of any EU airline owned or controlled by EU or ECAA citizens.
- ✦ Unilateral acceptance by US of EU ownership and control of any airline in the EEA, ECAA, and 18 African countries.
- ✦ Both sides will co-operate in the regulatory sector especially in the sector of security, safety, competition, government subsidies and environment.
- ✦ Commitment to cooperate in the application of competition regimes to agreements which have an impact on the transatlantic market.
- ✦ Recognition that government subsidies and support may affect fair and equal opportunity of airlines to compete.

Implications for EU

This agreement will lead to several developments on transatlantic

routes. First, this agreement will be helpful to the EU, because, in terms of air transport policy, as this draft agreement says, it is based on reciprocity, even with an imbalance in favor of EU airlines. EU carriers do not have the right of cabotage in the US market, but neither do US carriers have the right of cabotage in EU member states. EU carriers have been granted unlimited 7th freedom rights for cargo flights and 7th freedom rights between the US and ECAA countries (European Common Aviation Area, including Norway, Iceland, Croatia, Serbia etc.), while the OAA agreement does not grant any new 7th freedom rights for US carriers. In support of this statement, a spokesperson of the Commission says, that 'there are numerous additional benefits of the agreement such as anti-trust immunity for alliances between EU and US air carriers, or a close cooperation in aviation security¹⁰⁷. Ensuring that second-stage negotiations will be taken seriously, a mechanism was put in place that would allow the EC to suspend certain rights if there is no progress in second-stage negotiations¹¹.

Implications for British Airways

Second, the agreement will put British Airways (BA) under immense pressure. Heathrow is currently the world's busiest airport, and many of its almost 70m passengers a year are in transit¹². 'Materialization of this agreement means that carriers operating North Atlantic services from Heathrow can pick up large amounts of additional traffic¹³⁷, which means that BA would lose business. Analysts at Deutsche Bank calculate that more than £400m (\$780m) of BA revenue could be at risk¹⁴. British Airways earns more than half of its operating profits from flights crossing the Atlantic.¹⁵

Competitive Implications

Third, the agreement will create competition. Europe's airline industry has already started to change because of the first-phase agreement. Many European carriers are considering setting up operations in cities other than their home base. Interest in mergers has grown too: Texas Pacific Group, a giant private-equity firm, has launched a bid for Spain's Iberia, in partnership with British Airways¹⁶. Alitalia has attracted several bids, including one from Russia's Aeroflot. Interestingly, various business-class-only operators have recently entered the market. Germany's Lufthansa offers a transatlantic service called Business Jet¹⁷. L'Avion, a French start-up, launched a service between Paris and New York in January¹⁸. Several operators have begun flying between London airports and America, including Maxjet, Silverjet and Eos Airlines¹⁹.

On the other hand, the low-cost charter airlines might put pressure on the traditional flag carriers and on established private carriers on transatlantic routes by offering low-cost fares. Ryanair, Europe's biggest low-cost carrier, announced plans on April 12, 2007 to offer flights to Baltimore, Rhode Island and to New York for as little as €10 to €12 each way²⁰. On the other hand, American Airlines as well as Southwest Airlines are considering going international, while JetBlue, another US low-cost airline, is also thought to be eager to join the fray²¹. According to the *Times*, if the plans are carried out, prices for passengers would be slashed, and a much wider choice of service would be available, from the top-end offered by BA and Virgin, to aircraft on which everything from food to entertainment will cost extra.²² However, according to an industry analyst, 'it would be interesting to see how they (low-cost carriers) would compete with legacy carriers, though there are certain advantages of the low-cost model, such as higher utilization rates and in-flight service charges, which are unlikely to work as well on longer sectors²³'.

Implications for Airports

Fourth, this agreement will put massive pressures on slots at airports on both sides of the Atlantic. The demand for new services to the US from London resulting from this agreement is expected to lead to an upturn in the level of slot trading. In the case of Heathrow, it is not possible to accommodate all new slot applications, as the airport has limited capacity, but certain airlines may be willing to sell slots to other parties when they think it is commercially worthwhile in doing so. The slot co-ordinator for Heathrow, for instance, says demand already far outstrips supply²⁴. Incumbent operators claim "grandfather rights" over 97 per cent of all slots, and most of those that are left are, at times, unsuitable for transatlantic services²⁵. Even when Heathrow's long-awaited new Terminal 5 opens in the near future, runway capacity will be the same. As a whole, London Heathrow and Gatwick, Paris Orly, Frankfurt, Dusseldorf and Milan Linate are already desperately short of capacity²⁶. By 2010, another 15 or so European airports will experience similar shortages²⁷. On the other side of Atlantic, demand is also increasing. "Demand, right now, is overwhelming," says William DeCota, aviation director of the Port Authority of New York and New Jersey²⁸. The airports JFK, La Guardia and Newark, all within 25 miles of the Statue of Liberty, form one of the busiest airport systems in the world²⁹. Those three airports already handle just over 100m passengers a year, a figure that is forecasted to rise to 125m or even to 150m by 2015³⁰. Therefore, a report says, 'the current OAA deal could unleash a round of slot trading between carriers who operate short-haul services from Heathrow and long-haul airlines vying for transatlantic slots'. For example, BMI holds valuable slots that it would love to use for more lucrative long-haul routes. Slot trading therefore becomes an essential part of facilitating new services and encouraging greater competition as a consequence of the deal.

Finally, this agreement will open up new routes. As the American experience of deregulation and the European experience of liberalization have opened up new routes in their respective markets, the transatlantic market will also see new routes opening up. For example, even as the provisional agreement has yet to come into effect, a new route between the US and the Ireland is already planned to open in October 2007³¹.

US Ownership Debate

Apart from this possible development, the first phase of this agreement has some downsides as well. The US has yet to make moves to ease the rules concerning ownership and control. Recent reports say that it is unlikely that the US government will allow foreign ownership of American airlines. A strong lobby in the US is currently working to tighten the ownership control rule even after the agreement. According to the *Financial Times*, the US House transportation and infrastructure committee proposes to further limit the discretion of the US transportation department in determining when a US airline is under the 'actual control' of US citizens, thereby limiting the scope of activities that can be undertaken by foreign airlines and investors³². The crucial wording of the committee proposal says that US citizens would have to exercise control in a US carrier of 'all matters pertaining to the business and structure of the air carrier, including operational matters such as marketing, branding, fleet composition, route selection, pricing, and labor relations³³'. This would appear to rule out the franchise operations for European airlines agreed upon in the April treaty and to confirm fears in the UK, that little or no progress can be made in a stage-two negotiation. BA chief executive Willie Walsh said right after the deal that the EU had been 'naive to believe the US will deliver on the next stage of liberalization without sanctions³⁴'. On the other hand, The *Economist* forecasts that the ownership restrictions are largely theoretical in any case: it is unlikely that European airlines would rush to buy their American counterparts, even if they could³⁵. Therefore, proponents of liberalization are disappointed because of this argument. 'We wanted a giant leap and got baby steps', says Anthony Council of IATA³⁶. So, the bottom line at the moment is that the US has made no substantial concessions on control, it has only made cosmetic changes to ownership, and it did not move on cabotage, which casts a shadow on the success of this agreement.

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First Phase Success Considerations

It can be assumed from the aforementioned argument that the establishment of the transatlantic OAA would open up the new routes, and that it will give more choices of fares to consumers. It will foster mergers and acquisitions, and it will also create more and more competition. As a result, this open aviation area would liberalize major markets of global civil aviation. Can this open aviation area work as a model or as a template for the rest of the world?

The success of the first-phase agreement between the US and the EU will depend on the ease of the issue of foreign ownership and control of US airlines. The whole agreement is trapped at this point. The lobbying of different groups in the US especially has put doubts on the future success of this agreement. Jacques Barrot, European transport commissioner, has written to both Mary Peters, US transportation secretary, and to James Oberstar, chairman of the US House transportation and infrastructure committee, to express his concern at the move by the Democratic-led committee to further tighten the existing tough restrictions on foreign ownership and control of US airlines³⁷. Therefore, there is widespread concern among European analysts that, without gaining the substantial allowance on foreign ownership and control over US airlines, it was unwise to strike an agreement with the US. What is really the case here, is it a win-win agreement?

Europe's main motive behind the idea of a transatlantic OAA with the US was to gain a foothold in the big American market, as 70 per cent of Europe's civil aviation revenues come from overseas operations. Therefore, Europe has united under the umbrella of 'community airlines' through three-stage reform packages in order to create a ground to bargain with the USA from a stronger position. Prior to the OAA, the US was striking bilateral agreements with individual EU countries, and was thus exploiting their weaker position by providing feeder flights for foreign airlines on transatlantic routes.

However, the Europeans have failed to achieve exactly what they were looking for from the first-phase agreement, which is a firm commitment of easing restrictions on foreign ownership and control of US airlines. On the other hand, the US has gained access to Heathrow airport, for which they were longing for. Therefore, one can say that the agreement is not evenly balanced. This approach is not supported by the UK, the pioneer country of European market reforms. However, there was justified reason for the UK to resist or take a position against the draft agreement, because the deal does not showcase a win-win situation for both sides. Rightly so, British Prime Minister Tony Blair contacted President Bush to explain that Britain could not commit to the deal, unless the US committed itself to liberalizing access to its own market³⁸. Furthermore, it was because of Britain's insistence that a five-month delay was agreed on, which will put implementation back to 30 March 2008, and, more importantly, Jacques Barrot made it clear that, if there were no movement on US ownership and control in subsequent stages of negotiations by 2010, the EU would consider withdrawing from negotiations³⁹. However, even if the EU withdraws from the agreement by 2010, the US will have gained the most, given the fact that the US will enjoy the unlimited 7th freedom in the EU without opening its market to the EU till 2010. It will be interesting to see now, how 'reciprocal' the agreement will become in future.

Uncovering Controversial Issues

Nevertheless, this agreement brought a ray of light over different controversial sectors of the EU-US civil aviation relationship. Issues such as recognition of community airlines by the US and access of the EU airlines to 'certain' Fly America traffic are among those issues. Recognition as community air carrier means BA can fly from Germany to America or Lufthansa can fly from Portugal to the US. Furthermore, access to the Fly America

traffic means expansion of the existing EU market. However, benefits for the European airlines would have been much greater if Europeans were to have access over gaining majority voting stocks in US airlines. Thus, it is essential here to analyze the issue of foreign ownership and control, because it seems that the fate of the proposed free market model of the OAA is depending on this crucial issue.

Foreigners are currently allowed to own over 50 per cent of a US airline, but not more than 25 per cent of voting, i.e. controlling stock. It means that a European could buy the majority share of a US airline, but that, at the same time, he is not allowed to control the company. As a result, the airlines will be regulated by the US authority. This issue is crucial in another sense, because if the US allows foreigners to buy a controlling stake in a US airline, a foreign carrier would not need a cabotage right, as it will be an owner of a US airline, and, naturally, they would be able to fly anywhere in the US, so the point of cabotage becomes immaterial. However, the US is not enthusiastic at all to open its market. Based on comments from industry experts and on recent reports published in media, it can be argued that there are two apprehensions behind the reluctance of the US to release foreign ownership and control, which are labor and security.

The apprehension of US aviation workers was also reflected in the research, conducted by the Brattle Group. US aviation workers fear that this transatlantic OAA could replace US aviation workers by cheap EU workers. A large body of research based on the experience of the EU's internal market suggests that the opposite is the case, with liberalization boosting the prospects of aviation workers rather than harming their interest⁴⁰. Changing this protectionist mindset is therefore necessary in order to deliver the benefits of an open aviation area between Europe and the US. As a result, the US approach seems very confusing. On the one hand, it conducted the first phase of the transatlantic OAA agreement under the condition that it would allow the transatlantic mergers and takeovers, while on the other hand, a powerful bloc is lobbying to pass a bill in Congress to restrict foreign ownership and control. A valid question might arise – are there moves afoot to make ownership and control even tighter in the US?

Another possible argument in support of US protectionism is that civil aviation is an industry that directly deals with security,

Photo 2: London Heathrow Airport is the most admired European hub for U.S. carriers. Photo by Christel Sinsen





Photo 3: American Airlines coming in “on final”. Courtesy of AA

which is why the US is not very positive about releasing the issue of foreign ownership and control. The 9/11 terrorist attacks especially justified this argument. If foreign ownership and control had been released, a terrorist group could have easily been an owner of an US airline and could have repeated it – more significant is the civil reserve air fleet. However, this is purely a hypothesis. But then again, for how long will the US not compromise with market forces? There are examples that the US allows foreign ownership and control in other sensitive sectors. Foreigners in the US are allowed to own companies in highly sensitive industries, such as defense, communication companies, etc⁴¹. Therefore, it still is very vague, why America is not allowing foreigners to take a stake of its domestic civil aviation market. An additional speculation behind the American protectionism could be that the easing of foreign ownership and control would jeopardize some of the dominant air carriers’ market niche in the US domestic market. However, if that were the case, it would be a very nationalistic approach and a completely contradictory one as well. According to Dobson, movement on the issue of ownership and control is always unlikely⁴². If one were to interpret this statement, it would mean that there will be no liberalization on transatlantic routes in the near future. The present movement of lobbying against foreign ownership and control does give ground for such skeptical statements, made by Dobson.

Benefits of a Transatlantic OAA

However, if the transatlantic open aviation area were established soon in the form as envisioned by the Europeans, and if each side were to take positive action as outlined in the agreement, the US would release its control over ‘foreign ownership and control in a US airline’, creating many opportunities of a positive outcome for the global civil aviation industry.

More routes will be created, as the European and American liberalization processes saw the emergence of low-cost airlines, and it is even possible that new low-cost airlines will start operating on transatlantic routes from both sides of the Atlantic. There is evidence that the number of mergers will increase, and that slot allocation at busy airports will be of vital importance to the transatlantic industry. In addition, this agreement holds a promise to lower national control and increase business control over the industry, as the agreement recognizes that ‘government subsidies and support may affect fair and equal opportunity of airlines to compete’. It means that one can expect the US and EU experience of ‘more market entry, new routes and low fares’ to be introduced in the transatlantic route as well.

Modal for Global Civil Aviation

Now the question is whether this transatlantic OAA can work as a model for a globalized aviation industry in the future or not? There are two possibilities: first, the transatlantic OAA will not work as a template for a globalized aviation industry, but rather as a regional model. And the second possibility is that it can work as a template for a globalized aviation industry.

The EU-US agreement is unlikely to be a model for a globalized aviation industry, because, according to Mark Nicklas, ‘most countries in other parts of the world simply are not yet ready to expose air transport to market forces⁴³’. Nicklas from the EC added that, ‘if the two biggest aviation markets agree on a new framework for international air transport, it is our hope that it will have an influence on the rest of the world⁴⁴’. Therefore, transatlantic OAA could be the basis for a plurilateral agreement of like-minded countries. Nicklas added that the agreement explicitly refers to the possibility of extending the Agreement to third countries - Article 18(5) -, and to both sides’ intention ‘to establish a precedent of global significance to promote the benefits of liberalization in this crucial economic sector’. The transatlantic OAA will work as a regional model rather than a model for a globalized industry in the near future, because the geographical position of many of the like-minded countries is situated within Europe and the Americas. A highly probable outcome of this agreement is that a free-trade area could exist in civil aviation in the West, at least for a while. This is the most realistic prediction, because the world is fragmented in different trading blocs, at this point, such as NAFTA, EU, and ASEAN etc. So, there is very little chance that the whole world would turn to one market, following this agreement, especially in the case of civil aviation. But again, that would be one step further than the present situation, because the US is currently the major player in this industry, and it is getting bigger by striking its open skies agreements with Asian countries, such as India. If the OAA successfully works, the EU will join the game. That means expansion of the market.

Outlook

Alternatively, there are indications that other parts of the world may form regional pacts along the same lines, thereby facilitating greater liberalization. It is essential here to explore where Article 18(5) could lead the interested groups to. According to Edwards, a senior economics and policy advisor of the British Civil Aviation Authority, ‘if other parts will agree to reform their prospective markets, the transatlantic OAA could expand⁴⁵’. This means that, in the long run, a Korean or an Indian investor could invest and buy majority stakes in an EU airline or in US airlines, whereas an American or a European could own Middle Eastern or South Asian or an African airlines, but, before that could happen, Korea, India, the Middle East, or any of the South Asian countries needs to come forward with a similar mentality to reform their own markets. So the scenario could be like this: if a region would be liberalized, other regions will be interested to reform their own market and will eventually want to join in with a bigger region for greater freedom and greater business. Thus, the separated regions will be unified as one. As 60 per cent of the air transport industry will be a free-market area, the rest of the world will naturally become interested to have a slice of the free-market zone by making reciprocal agreements. Robyn, co-author of the Brattle group report,

also supports this argument. She says, ‘we believe complete liberalization would be beneficial to consumers in all markets, not just the transatlantic market⁴⁶. In fact, the gains would be even greater in those markets that do not yet have the substantial liberalization that the US and Europe enjoy⁴⁷. However, there is skepticism towards this argument. Staniland notes that ‘the real problem is that many members of the ICAO clearly do not want to move into this direction, perhaps fearful of US domination or for the reasons of national pride and national security that have dogged this industry⁴⁸. Based on different predictions from industry experts and analysts, it can be said that globalization on transatlantic route is a slow process, and that it could work as a regional free-market model at first. Nevertheless, there are numerous possibilities that market forces will open this region to the rest of the world later, thus making the OAA as a template for a globalized aviation industry: an industry in which there are no restrictions on foreign ownership and control, in which cabotage in any country for foreigners is allowed, in which there are no government subsidies to flag carriers, in which those will thrive who can survive by competition, and finally, in which there are limits on price setting and slot allocations. However, one needs to see that the true characteristic of economic globalization is reflected in the transatlantic aviation industry. Economic globalization is really about getting rid of government and, sometimes, of industry controls in order to have a worldwide free market. For that purpose, countries need to reform their own markets. They need to change traditional national control over foreign investments and mergers. They will also have to compromise national interest with market forces. The US, especially now, needs to act quickly to remove foreign ownership and control. This is the country that got rid of a set of heavy civil aviation regulations in 1978, which showed the world what can be achieved through market liberalization. Now, as the biggest market of the world needs to be deregulated, the Americans are taking a step back. It is a nationalistic approach in every sense, and a contradictory one for the country that was arguably the starter of globalization. Nowadays, an Indian or a Bangladeshi can become a Briton or an American after migration. On top of that, those migrants contribute to the British and US economies, and they also contribute to the Indian economy. So, the traditional nationalistic approach on foreign ownership and control needs to be abolished by the US for the greater good. On the other hand, the EU established a legendary free-market model by asserting the idea of the Single European Aviation Market (SEAM). The SEAM eliminated the idea of nationality, and it turned the national airlines into the community airlines. In addition, the EU is now working towards the idea of unifying airspaces of the individual EU countries by asserting the idea of Single European Sky. Ironically, these EU countries had been at war with each other several times. Yet, they changed their mindset in this globalized period. The EU has seen the benefits of being unified rather than being scattered. The history of civil aviation has also been encouraging. If one looks back at the 1900’s when the sovereignty of airspace was asserted and the whole industry was regulated through bilateral agreements after World War II, it is quite amazing that the two biggest markets of global civil aviation are at least trying to reach a reciprocal agreement to establish an OAA. Therefore, the present agreement can already be seen as a historic step forward. Everything is possible. Who would have thought, standing in the city of Berlin in 1945 amid the devastations of war, that there would be an EU? Who would have thought in the 1970’s that McDonald’s would ever sell their burgers in Moscow’s Red Square?

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