Sovereignty, Politics, and U.S. International Airline Policy

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We are living through a period in which international aviation rules must change. Privatization, competition, and globalization are trends fueled by economic and political forces that will ultimately prevail. Governments and airlines that embrace these trends will far outpace those that do not. The U.S. government will be among those that embrace the future.¹

I. THE PROBLEM

A TRULY GLOBALIZED airline industry would be a marketplace that is not fragmented by national boundaries, where airlines make decisions on the provision and price of services according to market conditions, and where common competition, ownership, control, and safety regulations apply. To a considerable extent these conditions reflect the long-standing

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¹ Office of the Secretary, Dep't of Transp., Statement of United States International Air Transportation Policy, 60 Fed. Reg. 21,841, 21,845 (May 3, 1995).
policy objectives of the U.S. government. However, in 2007, for the first time in sixty-three years, U.S. support for liberalization seemed to be weakening as it rejected the European Union's (E.U.) proposal for a transatlantic Open Aviation Area (OAA), which would have embraced both markets. That rejection was ripe with irony as the United States had, for decades, berated the Europeans for subsidizing and protecting their airlines.

This study examines U.S. civil aviation policy and explains the limits on its version of a liberal market, limits that set the United States at odds with globalization trends and the claims of its own 1995 policy statement. For the time being, the United States is not embracing the future.

II. THE CONTEXT

Civil aviation has operated at the interface of economics and politics since the establishment of national sovereignty over air space in 1919. With civil aviation complicated by aspects of security, national prestige, safety, and public service factors, the result in the inter-war period was a highly predatory series of bilateral air service agreements (ASAs). The ASAs created an environment where the strong exploited the weak and political considerations infected the airline system with a plethora of self-serving government regulations. During the Second World War, when the United States began to plan for a more liberal regime, the problem it had to confront was how to cut, or at least loosen the Gordian knot that tied sovereignty to the airline industry. If this problem was not addressed, the marketplace would remain fragmented, and the playing field competitively uneven. Despite this realization, government would continue—arbitrarily it seemed in commercial terms—to control prices, to insist on cabotage (the reservation of domestic flights for its own national airlines), to restrict market entry, frequency, and capac-

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4 See Statement of United States International Air Transportation Policy, 60 Fed. Reg. at 21,845.
ity of flights, and to insist on national ownership and control of airlines.

From 1944 to 2003, the United States applied four successive strategies to try to loosen the Gordian knot and create a more open and competitive international civil aviation system. This was not altruism. The United States has a highly competitive airline industry, and there were profits to be made in the international marketplace. However, U.S. policy-makers also believed that other countries' airlines would benefit as well and, equally importantly, consumers would receive better, more efficient, and cheaper services. These were the factors that drove U.S. policy.\(^7\)

A. THE CHICAGO STRATEGY: 1944

President Franklin D. Roosevelt drew the outline of a post-war international civil aviation industry and he had in mind the body of law brought into existence by Hugo Grotius' famous essay on the freedom of the seas and hoped to transpose that doctrine into the field of air communication.\(^8\) He wanted arrangements by which planes of one country could enter any other country for the purpose of discharging traffic of foreign origin and accepting foreign bound traffic.\(^9\) This radical vision was presented to the Chicago International Civil Aviation Conference in 1944.\(^10\)

The American position was based on three broad principles and what came to be known as the five freedoms of the air. The first principle was that airlines granted rights to fly between countries X and Y would have to be owned and controlled by countries X and Y.\(^11\) This national ownership and control principle was more or less universally applied until the EU invented the concept of community carriers in the 1990s.\(^12\) The second principle was that airlines should be free to offer whatever ser-

\(^7\) See Dobson, supra note 3, at 147–78.
\(^8\) Franklin D. Roosevelt Presidential Library, Berle Papers, Box 169, Articles and Book Reviews 1964–67, folder Articles and Book Reviews 1965, The International Civil Aviation Treaties Twenty Years Later, Columbia University (Mar. 1965).
\(^9\) Memorandum of Conversation by Adolf A. Berle, Dep't of State, U.S. Nat'l Archives, File No. 800.796/495, Nov. 11, 1943.
\(^12\) Scandanavian Airline Systems (SAS) might also be seen as a kind of community carrier as it was owned and operated by more than one country.
vices they wanted between designated international gateways: there should be no pre-determination of capacity and frequency. In 1944, for example, round-trip flights from the United States to the United Kingdom (U.K.) were limited to two per week for the airlines of each country. For Americans, this seemed to unduly constrict the market and they wanted provisions for escalation of capacity if demand justified it. Thirdly, contrary to commonly held views, the United States rejected the idea of unfettered price competition in favor of some form of price stability. As for the five freedoms, they provided for: (i) innocent passage or over-flight; (ii) technical stops for repairs or refueling; (iii) the right to pick up passengers from an airline’s country of origin and disembark them in the territory of the other contracting party; (iv) the right to pick up passengers in the other contracting country and disembark them in the airline’s country of origin; and (v) the right to pick up passengers from the other contracting party and carry them forward to a third party destination. The United States tried to get these freedoms accepted multilaterally, though it was recognized that the five freedoms were highly controversial and that the extent to which they would be granted would depend on bilateral discussions.

At Chicago, largely because of British opposition out of fear that the United States would dominate international services, the Americans were unable to persuade the conference to adopt the commercially important third, fourth, and fifth freedoms. Consequently, a new commercial regime did not emerge from Chicago. The first U.S. strategy had failed; it now turned to a different one to get what it wanted.

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13 See Bermuda Agreement, supra note 11, at annex.
14 See Dobson, supra note 10, at 11–124.
15 Id. at ch. 6.
16 Int’l Civil Aviation Org. [ICAO], Freedoms of the Air, http://www.icao.int/icao/en/trivia/freedoms_air.html. Other rights, which later became significant under a more liberal dispensation, are: (vi) the right to pick up "gateway" passengers in a foreign state and bring them to the airline’s country of origin for transfer to another flight with a foreign destination; (vii) the right to commercial carriage between two states, neither of which is the airline’s country of origin; and (viii) cabotage. Id. These rights became of particular importance in the OAA negotiations.
17 Dobson, supra note 10, at ch. 5.

The main target for the United States after Chicago was the U.K. because it controlled, directly or through client states, so much of the world. Without a modus operandi with the British, there would be great difficulty, if not an impossibility, in developing the international airline market in a way that would deliver something resembling what the United States wanted. In 1946, the two parties met on the island of Bermuda to negotiate an ASA. The Bermuda Agreement, as it became universally known, was dictated by the Americans who played on the British post-war need for reconstruction funding to extract from them terms that were highly favorable to the United States. These terms allowed U.S. airlines to exploit the world market more easily. The Bermuda Agreement provided for airlines "substantially" owned and controlled by either state to operate on a basis of "fair and equal opportunity" through the exchange of the five freedoms and at prices fixed through International Air Transportation Association (IATA) tariff conferences. IATA was and is a cartel of the major scheduled airlines. The pricing recommendations resulting from these conferences were routinely approved by governments and, in the case of the United States, granted anti-trust immunity.

The Americans at Chicago had sought a multilateral agreement on the commercial elements of aviation, but failed. What they then did was to hold up the Bermuda Agreement as a model that others should follow. This could not replace the homogeneity that a multilateral agreement would have provided, but at least it brought some uniformity and order to the system. Under the Bermuda Agreement, fares were fixed by the IATA. Airports had to be designated as international gateways and the frequency of operations had to be agreed upon. Capacity was supposed to be liberal in that it was to be determined by airlines

19 See generally Dobson, supra note 10, at 174–98.
20 Mackenzie, supra note 18, at 63.
21 Id. at 67.
22 Bermuda Agreement, supra note 11.
23 See generally Dobson, supra note 10, at 174.
25 Bermuda Agreement, supra note 11.
26 Id.
to meet whatever demand arose.\textsuperscript{27} At least this moved away from the principle of predetermined capacity levels. Strictly speaking, only \textit{ex post facto} adjustments were allowed after it could be shown that there was over-capacity or that one side was unduly damaging the other's operations. But, in fact, if either government objected to the capacity being flown by the other's airlines, there was great potential for dispute.\textsuperscript{28} Clearly this notionally liberal regime, which the United States urged the rest of the world to adopt, was open to interpretation and some analysts believe that any bilateral system has a tendency toward conservatism and protectionism.\textsuperscript{29} However, the United States had such a dominant position in the early post-war years that, when it was a party to a bilateral agreement, it was able to extract liberal provisions from its partners.\textsuperscript{30} In such cases, the Bermuda Agreement meant something, but elsewhere when the United States was not party to an agreement, the model was distorted and the regime favored by the United States was compromised.\textsuperscript{31} What happened to Bermuda-type agreements according to one highly experienced airline official was that "airlines and governments sat down and said whatever this agreement [the Bermuda Agreement] meant to say we aren't going to let you do more than we want to do."\textsuperscript{32} In Europe, this translated into a highly regulated and protected market where foreign routes were largely limited to capital cities, capacity was divided between state-owned carriers operating under a near universal single designation regime, and revenue was pooled and then divided up among the state-owned carriers.\textsuperscript{33} Nevertheless, the United States benefited greatly from the Bermuda Agreement and from its own power and influence to get the kind of ASAs that it wanted. In addition, notwithstanding the protectionism found in arrangements to which the United States was not a

\textsuperscript{27} Id.

\textsuperscript{28} See ALAN P. DOBSON, FDR and the Struggle for a Post-War Civil Aviation Regime: Legacy or Loss?, in FDR'S WORLD: WAR, PEACE, AND LEGACIES 194–213 (David Woolner et al. eds., 2008).


\textsuperscript{30} DOBSON, supra note 10, at ch. 6.

\textsuperscript{31} See DOBSON, supra note 2, at 6.

\textsuperscript{32} Interview with Robert Ebdon, Head of Gov't Affairs, British Airways (Aug. 5, 1991).

\textsuperscript{33} See generally Bermuda Agreement, supra note 11.
party, the overall system was still much more liberal than the dispensation that had prevailed in the inter-war years.


For thirty years, the United States remained content with this more liberal regime, but then, in the 1970s, new and more radical ideas arose. By the mid 1970s, new economic theory was emerging, particularly from the Chicago School in the United States, that challenged the conventional wisdom of Keynesianism and the idea that regulating industries, like civil aviation, was necessary for public and consumer interests. No one really knew what the net effects on a large airline market would be if it were to be deregulated, but once Jimmy Carter became president in 1977, people soon found out.

In his first message to Congress on March 4, 1977, President Carter capitalized on the impact that Senator Edward Kennedy made with high profile hearings in the U.S. Senate on the possible consequences of deregulation and announced that one of his main goals was to free the American people from the burden of over-regulation. He urged the Congress to reduce federal regulation of the domestic commercial airline industry. It took nearly two years before the 1978 Airline Deregulation Act became law, but when it did its effects reverberated across the Atlantic and around the world. Its impact grew both because of further political action taken by the United States and because of market dynamics, which came into play during the first phase of U.S. domestic deregulation. Competitive forces began to seep into the international terrain just as the Carter Administration turned its attention to developing strategy for dealing with the overseas marketplace. The 1978 U.S. government policy statement argued that the guiding principle of United States aviation negotiating policy should be to trade competitive opportunities, rather than restrictions, in negotiations. It went on to assert that the United States should aggressively pursue its own interests in expanding air transportation and reducing prices.


rather than accepting the self-defeating accommodation of protectionism. Concessions in negotiations should only be given in return for progress toward competitive objectives, and those concessions themselves should be of a liberalizing character.38

Some of this was so liberal that it seemed like folly to America's established international carriers such as Pan American World Airways and Trans World Airlines. In response, partly because of their lobbying and partly because of broader political concerns, members of Congress passed the International Air Transportation Competition Act in 1979 to try to rein in the Administration and ensure that ASAs were more clearly in America's immediate interests.39 Congress placed more emphasis on equal benefits and tried to ensure that infatuation with liberalization did not blind the U.S. Department of Transportation and the Carter Administration to the dangers of imbalance in ASAs that would disadvantage U.S. airlines: they might cede market opportunities without commensurate reciprocation.40 The Act specified that the United States should only grant access to the U.S. domestic market in return for "benefits of a similar magnitude for U.S. carriers or the traveling public with permanent linkage between rights granted and rights given away."41 There was also an admonition that there should be a:

strengthening of the competitive position of United States carriers to at least assure equality with foreign carriers, including the attainment of opportunities for United States air carriers to maintain and increase their profitability, in foreign air transportation.42

Even so, liberal ASAs have been pursued by U.S. administrations with varying degrees of vigor ever since. By 1980, a dozen had been renegotiated. While most were with fairly insignificant players, agreements with Holland, Belgium, and West Germany, all concluded in 1978, were to have important consequences for spreading competition and stimulating change in the sclerotic

39 Interview with Jeffrey N. Shane, former Undersecretary for Policy, U.S. Department of Transportation, Mar. 13, 2008 (on file with author).
40 Id.
42 Id.
European aviation market.\textsuperscript{43} This was the first and most enduring of American strategies to deregulate the international marketplace; the second was a Show Cause Order (SCO) promulgated by Alfred Kahn, Chairman of the Civil Aeronautics Board (CAB), the industry regulator in the United States.\textsuperscript{44}

Since IATA began its tariff conferences to fix air fares in 1945, its recommendations had regularly received approval from the U.S. CAB.\textsuperscript{45} This was vital because as the CAB approved, it also granted the airlines immunity from U.S. antitrust laws, which would otherwise have prohibited this cartel-style operation.\textsuperscript{46} With Kahn at the CAB, things changed. On June 9, 1978, the CAB suggested that IATA fare setting might not be in the public interest and thus would not warrant antitrust immunity.\textsuperscript{47} It issued a SCO requiring IATA to justify its current practices.\textsuperscript{48} The SCO provoked international outrage. It was seen as the worst type of American unilateralism and as an attempt by the CAB to stop inter-airline fare agreements and destroy IATA's role as a fare coordinator.\textsuperscript{49} The SCO did not destroy the IATA but, over the following years, its fare-setting role was increasingly diminished. The SCO specifically helped to push the Europeans into a more competitive transatlantic price regime in 1982, negotiated under the auspices of the European Civil Aviation Conference (ECAC) and the U.S. State and Transportation Departments.\textsuperscript{50} Regulation was at least beginning to give way to some price competition.

Acting in tandem with U.S. liberalization strategies were market forces, some preceding the legal and institutional moves for reform, others released and nurtured by them. The conventional wisdom was that economies of scale could not be reaped by airlines.\textsuperscript{51} An airline could get bigger and possibly make more overall profit, but on a pro rata basis, profit margins would remain constant, or would more likely decline, as larger operations meant more management difficulties.\textsuperscript{52} These assumptions were about to be destroyed.

\textsuperscript{43} See Dobson, supra note 2, at 22–28.
\textsuperscript{44} See Dobson, supra note 3, at 150–55.
\textsuperscript{45} Id.
\textsuperscript{46} Id.
\textsuperscript{47} Id.
\textsuperscript{48} Id.
\textsuperscript{49} Id.
\textsuperscript{50} ECAC is the European sister organization to ICAO.
\textsuperscript{51} Interview with Cyril Murphy, Vice President United Airlines, July 1, 1991.
\textsuperscript{52} Id.
What was discovered were economies of scale . . . , that is, you organized your system in such a way that you were able to consolidate large amounts of traffic at a point and then redistribute that traffic. For each unit . . . that you flew, if you had . . . higher load factors on that piece of equipment; in effect you had a more productive piece of equipment—a more productive unit of production.53

This was the hub-and-spoke configuration of routes.54 As U.S. government policy pursued liberal, bilateral ASAs, which opened up more and more U.S. international gateways based on the old domestic carriers’ hubs, American Airlines (AA), United Airlines (UA), and Delta carried all before them.55 Well positioned through their inter-connected hubs and their vast number of feeder spokes to assemble large numbers of passengers, there seemed an irresistible logic that the traditional domestic operators should now use their dominance over the U.S. domestic market, approximately forty percent of the entire world civil aviation market,56 to thrust out their spokes into the international sphere, and that is precisely what they did. This destroyed U.S. traditional overseas carriers, which did not have well-developed U.S. domestic networks to feed passengers into their international gateways.57 All of a sudden, the civil aviation system was changing rapidly and newly unleashed competition was having major impact. Among other things, this unsettled many airlines and some governments in Europe and prompted more intense thinking there about liberalization.58

There were doubts and hesitations about deregulation in the United States, and opposition from both the vested interests of the established U.S. international carriers and naturally protec-

53 Id.
54 Id.; see also Margaret M. Blair, The Economics of Post-September 11 Financial Aid to Airlines, 36 IND. L. REV. 367, 374–76 (2003).
56 Barry James, Gingerly, EU and US Move toward Open Skies, HERALD TRIBUNE, Sept. 2, 1996.
57 Interview with Cyril Murphy, supra note 51.
58 For the story of changes in Europe, see Dobson, supra note 2. The new configuration of operation—hub and spoke—would not have been possible without a quantum leap forward in the technology of computers. By the mid 1980s, the major computer reservation systems could “juggle one hundred million fares at a single time.” See B.S. Peterson, Bluestreak: Inside JetBlue, the Upstart that Rocked the Industry 101 (2004).
tionalist segments of the U.S. Congress were forceful. The Reagan Administration was initially cautious, but the changes that reform brought about seemed overwhelmingly positive for U.S. airlines generally and for the traveling public. By 1990, U.S. airlines carried twice as many international passengers as they had in 1980, increasing their market share by 20%; and routes proliferated and capacity and frequency grew apace. By the early 1990s, it now seemed right to capitalize on these gains and renew the drive for even more liberalization.


"Open-skies" meant free pricing, open routes and destinations, and unrestricted third, fourth, and fifth freedom rights. It also offered antitrust immunity to approved international airline alliances as one of the main inducements for other countries to enter agreements. Antitrust-immunized alliances provided better access to the U.S. market. Such alliances overcame many of the artificial obstacles to a globalized marketplace that had arisen because of the issue of sovereignty over air space. Alliances provided better access to feeder services and onward distribution flights to and from major international gateways than anything the traditional freedom rights could offer. They allowed the domestic and regional operations of one partner to distribute and assemble passengers in connection with the long-haul operations of the other on a reciprocal basis through code-sharing agreements or by otherwise dovetailing their operations with their partners. These services were otherwise prohibited by cabotage, by the absence of fifth freedom rights, or by the fact that the other partner could not operate them profitably.

The United States had great success with open-skies agreements. It negotiated the first with the Netherlands in 1992, but

60 Id.
61 Id.
64 See id. at 305.
65 Id. at 299.
66 Dobson, supra note 58, at 160–63.
many more followed over the years as liberalization took hold in Europe. The European Commission, capitalizing on pro-competition decisions by the European Court of Justice and working closely with the U.K. and the Netherlands, pushed through a three-stage package of reform that culminated in the creation of the single European aviation market. By 2002, of the twenty-five E.U. member states, fifteen had open-skies agreements with the United States. Once again, the United States was leading the world airline system forward to lower cost flights delivered in a more seamless and efficient way through code-sharing, combined marketing, and frequent-flyer programs. The international airline regime was closer than ever to a globalized marketplace that operated largely on commercial lines.

However, problems abided. Some were specific: for example, the 1977 Bermuda 2 ASA between the U.K. and the United States, and its partial re-negotiation in 1980, restricted the United States to two carriers operating into Heathrow, the largest international hub in the world. This provoked outrage over the years in the United States, which determined it had to obtain freer access. But the story is not all one-sided: the United States, for all its championing of liberalization, had several measures in place which annoyed its civil aviation partners and led to charges of hypocrisy. Even after deregulation, there was never a free U.S. aviation market. U.S. airlines in difficulties are allowed Chapter 11 protection, under which they can operate under favorable terms while seeking to regain financial viability. The U.S. Civil Reserve Air Fleet (CRAF) allows the U.S.

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67 Shane, supra note 59.
73 Id.
government, in times of crisis, to call upon U.S. civil airlines for up-lift capacity to transport troops abroad and, in return, the Fly America Act reserves all official government air travel for U.S. airlines. The United States has also traditionally prohibited wet leasing of foreign aircraft, i.e., aircraft supplied with their own foreign crews. However, all these rather specific matters pale to insignificance when set against U.S. cabotage and ownership-and-control laws, which restrict foreign access to the U.S. market. Of course, cabotage and ownership-and-control laws apply to all other countries as well, but this is such a significant issue regarding the U.S. domestic airline market because it is so huge, amounting to 35–40% of the entire world airline market.

This was the state of play in the international airline system and in the development of U.S. policy when the E.U. brought about a crisis that forced the United States and the E.U. to speedily assemble for negotiations. In those negotiations, the E.U. tabled proposals that would have created a single aviation market for the United States and the E.U. and provided a template for the rest of the world to follow them in moving swiftly to a truly single, globalized civil aviation market. The E.U. was willing to change things regarding cabotage and ownership-and-control, but the United States, notwithstanding all the liberal policies that it had nurtured over the years, baulked at this.

III. THE POSSIBILITY OF A TRANSATLANTIC OPEN AVIATION AREA

Negotiation of the U.S.-E.U. Air Transport Agreement was made necessary by a 2002 European Court of Justice ruling that the bilateral open-skies agreements between European Union countries and the United States were contrary to Community

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77 James, supra note 56.
78 DOBSON, supra note 2, at 166–85.
79 Id.
80 Much of this section is based on interviews conducted by the authors, Alan P. Dobson and Joseph A. McKinney, on March 11 and 12, 2008 with Paul Gretchen, U.S. Department of Transportation; Will Ris, Vice President for Government Affairs American Airlines; Rebecca Cox, Vice President for Government Affairs Continental Airlines; and Jeffrey Shane recently retired from the U.S. Department of Transportation.
law.81 Between 1987 and 1997, through a series of reforms, a single European aviation market had been created among the E.U. member countries.82 These reforms removed restrictions among the E.U. countries on the provision of air services, provided for harmonization of aviation regulations, and invented the concept of community as opposed to national carriers.83 There were no longer to be national but community ownership-and-control laws.84 The European Commission considered bilateral open-skies agreements to be inconsistent with community law (because they recognized the concept of national rather than community carriers) and also inconsistent with the spirit of a unified E.U. market, because they granted some member states commercial operating rights to the United States which were unavailable to others.85 Consequently, the Commission brought suit at the Court of Justice against eight member countries challenging the legality of their bilateral ASAs with the United States.86 The Court of Justice ruled that the “nationality clauses” of the bilateral agreements were a violation of community law.87 This threatened turmoil in the transatlantic aviation market.

The Commission had long harbored the desire for sole competency to negotiate with outside countries concerning aviation services, but the Court of Justice, realizing the politically explosive nature of the issue, instead gave the Commission shared competency with the member states to negotiate such agreements.88 Negotiations with the United States for an ASA with the E.U. to supersede the numerous bilateral agreements with member state countries began in June 2003.89

From the time of the Second World War, as we have seen, the United States had been the demander for open markets and for increased competition in the provision of aviation services. This

82 See generally DOBSON, supra note 2, at 82–148.
83 Id. at 148.
84 Id. at 175–78.
85 Id. at 174–75.
86 Id. at 174.
88 See generally DOBSON, supra note 2, at 175.
89 Id. 178.
was particularly the case after the U.S. airline industry was deregulated beginning in the late 1970s. However, in the most recent negotiations the tables were turned. The E.U. came to the negotiations proposing an OAA that would have provided for deep integration of the U.S. and E.U. markets for air services. A major E.U. goal, and a necessary one in view of the Court of Justice decision, was that the United States recognize E.U. airlines as community carriers. This would mean freedom for airlines of any E.U. country to begin airline service from any point in the E.U. to any point in the United States. The E.U. also proposed that E.U. and U.S. cabotage should be merged, and that restrictions on foreign ownership be removed, so that mergers of E.U. and U.S. airlines were not hindered. Finally, the E.U. envisioned harmonization of competition and safety regulations so as to attain a fully integrated market. In preparing the ground for the talks, the E.U. commissioned the U.S.-based Brattle Group to analyze the economic effects of an OAA. Its findings seemed to epitomize the kind of benefits to be reaped from liberalization which the United States had sought for so many decades:

- Annual transatlantic passenger numbers would increase from 4 million to 11 million, meaning transatlantic travel as a percentage of total global air travel would increase by 9% to 24%;
- Intra-E.U. air travel would also increase significantly, to 35.7 million passengers per year, an increase of 13.6 million;
- Consumer benefits of $5.2 billion would be created annually as a direct result of increased competition, lower fares, and increased passenger numbers;
- Directly related industries would experience an increase in economic output of $3.6 billion per year, taking the total to $8.1 billion per year.

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90 Id.
91 Id. at 179.
92 Id.
93 Id. at 178.
94 Id.
96 Id.
The question was, would the Americans stay true to their long-standing position of demanding the lifting of regulations in order to release the dynamics of the marketplace, or would their liberalism give way to the forces of economic protectionism, partly informed by what many saw as spurious political and security concerns?

The OAA was politically much farther than the United States was prepared to go.\(^9\) There was little resistance to the concept of community carriers, so the United States conceded on this point early in the negotiations.\(^8\) After all, because the Court of Justice had ruled that bilateral agreements with nationality clauses violated community law,\(^9\) recognition of the concept of community carriers, in the end, probably could not be avoided without chaos in the industry. Furthermore, there was little opposition to the concept on the part of U.S. airlines or any of the interest groups associated therewith. While it was recognized that there would be increased competition on certain transatlantic routes, the U.S. companies were in a relatively strong position and did not consider this prospect a serious threat.\(^10\)

On the issues of cabotage and relaxation of foreign ownership limitations, however, the political equation was entirely different. The U.K. had for many years insisted that if the United States wanted more competitive airline markets, then competition must not stop at the water's edge, meaning that the United States must allow cabotage rights to foreign carriers and also allow foreign ownership of airlines.\(^1\) The U.K. demand was widely interpreted as intentionally setting hurdles which it knew were politically impossible to jump in order to avoid conceding increased access to Heathrow Airport.\(^2\)

In the negotiations for the U.S.-E.U. Air Transport Agreement, strong opposition by U.S. airline industry labor organizations made cabotage essentially a dead issue from the start. British Airlines and Virgin Atlantic continued to push for cabotage.

\(^9\) See generally Dobson, supra note 2, at 175.
\(^8\) Id. at 178–79.
\(^9\) Id. at 175.
\(^10\) Id. at 178–84 (For example, instead of only Lufthansa being able to fly from German international gateways to the U.S., every other community airline would now be able to as well).
\(^2\) Id. at 17.
tage, however, as a strategy in the view of some for preventing consummation of an agreement that would open access to Heathrow. For most airlines, cabotage is not as important an issue as one might think, because alliances that have been given antitrust immunity serve as an effective substitute for cabotage in that alliance partners collect and distribute passengers in the United States for E.U. airlines and in the EU for U.S. airlines. Even if cabotage rights were granted, it is unlikely that E.U. airlines would establish hubs in the United States because of the great expense involved, and alliances already perform much the same function. It is the opposition of labor and their allies and protectionist factions within Congress that are the main problems.

Foreign ownership and control of U.S. airlines is also strongly opposed by pilot and airline industry labor organizations. In addition, the issue is complicated by national security considerations. The U.S. military possesses the right through Craf to make use of civilian aircraft to supplement its airlift capabilities during times of hostilities. There is some fear that, if airlines in the United States came under foreign control, these rights might be compromised, or at least the use of the aircraft could become complicated by political considerations.

The European Commission negotiators realized early that cabotage was too sensitive politically to be dealt with in the first stage of the negotiations. They thus switched their attention to ownership and control but also eventually realized that

103 Id. at 15.
104 See id. at 17.
changes would be impossible during the election year of 2004. Consequently, they took to the Transport Ministers a draft agreement in which the major concession of the United States was recognition of the concept of community carriers. The E.U. Transport Council rejected this agreement as insufficient and sent the negotiators back to get some movement on the matter of foreign ownership and control. They also wanted to see concessions on wet leasing, the right of European airlines to provide services to the U.S. military, and changes in the Fly America Program.

U.S. Secretary of Transportation Norman Mineta was furious and negotiations did not resume until late in 2005. During these negotiations, E.U. negotiators were surprised to receive signals that movement on the foreign ownership-and-control issue might be possible. Mineta intimated that, while changing the statute limiting foreign ownership and control of airlines in the United States would not be possible, a reinterpretation of the statute by the Department of Transportation could provide some room for liberalization. This gave what turned out to be false hope to the E.U. negotiators that change with regard to the foreign ownership-and-control issue might be possible.

The U.S. Department of Transportation issued a notice of proposed rule making (NPRM) that would, through executive decree, change the interpretation of the statute that limited foreign ownership and control of U.S. airlines without having to


112 Kars & Stout, supra note 101, at 7.

113 De Meschal & Bashe, supra note 108, at 16.

114 Id.

115 DOBSON, supra note 2, at 181-82.


117 See generally DOBSON, supra note 2, 179-83.

involve Congress. According to the terms of the NPRM, while matters relating to safety, company documentation, and any aspects of national security would have to remain under control of the American majority owners of an airline, on commercial matters, the minority shareholders could be given control. Apparently, some miscommunication and misunderstanding occurred within the U.S. Department of Transportation concerning whether this change of interpretation was feasible. The negotiators were apparently basing their opinion on the conviction that such an interpretation was possible. The language of the original statute concerning foreign ownership and control could be construed more liberally. However, over the years the statute had evolved through court decisions that then had been incorporated by Congress into law in ways that would have made the reinterpretation of the statute unable to withstand legal challenge.

In any case, the Department of Transportation failed to anticipate the firestorm of political opposition to the NPRM. Airline labor unions and pilots' associations opposed the NPRM out of fear that it could result in job losses. Because of the influence of their labor constituents, both Senator Daniel Inouye (D, Haw.), Chairman of the Senate Committee on Commerce, Science and Transportation, and Representative James Oberstar (D, Minn.), Chairman of the House Transportation and Infrastructure Committee, strongly opposed the measure. The personal friendship of Senator Inouye with Senator Ted Stevens (R, Alaska), Vice Chairman of the Senate Committee on Commerce, Science and Transportation, assured that the Chairman

120 Id. at 67,394.
122 Id.
123 Id.; see also Interview with Rebecca Cox, Vice President for Government Affairs, Continental Airlines (Mar. 11, 2008) (on file with author).
would have the Vice Chairman’s support. Against such formidable congressional opposition, the Department of Transportation did not have the status or clout to make the NPRM stick without strong pressure from the White House. However, this issue was not perceived as having high enough priority for the President to expend political capital to ensure that the reinterpretation of the statute was maintained.

Further complicating the issue was a conflagration of political opposition that erupted in 2006 after a Dubai company, DP Ports, purchased a British company, P&O, that was managing six major U.S. ports and a number of smaller ones. U.S. Coast Guard intelligence officials raised some concerns about the national security implications of having U.S. ports managed by a Dubai firm, and several U.S. politicians rose up in opposition to having the Dubai firm manage the ports. Public opinion was easily incited against the idea as well. While the NPRM was in no way related to the ports issue, those opposed to the NPRM could in the prevailing climate easily argue that, on national security grounds, even the commercial aspects of U.S. airlines should not be under the control of foreigners.

In addition to all of these complications, Continental Airlines came out strongly in opposition to the NPRM. For Continental, the opposition was not based upon genuine opposition to foreign ownership. Instead, its opposition was a strategic ploy. Continental was not a member of an immunized alliance, unlike a number of other American airlines such as

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126 Tom Mays & Jesse J. Holland, Inouye Attests to Steven’s Honesty, BOSTON GLOBE, Oct., 10, 2008 (noting Inouye and Steven’s friendship).
127 Interview with Jeffrey N. Shane, supra note 39.
133 Interview with Jeffrey N. Shane, supra note 39.
134 Id.
United. They would be able to juggle take-off and landing slots at Heathrow Airport under a liberalized regime with their alliance partners, but Continental could not, and would only be able to get slots if it were possible to buy them. So Continental's real goal was to block progress in the negotiations until the Department of Transportation applied pressure on some airlines to sell Continental landing slots at Heathrow. According to European Commission rules, the trading of landing slots in a secondary market is illegal. However, this policy has never been enforced and slots have been regularly traded at Heathrow and sanctioned by the British High Court. Eventually, Continental was able to purchase slots at Heathrow, and it then dropped its opposition.

By this time, however, the Department of Transportation realized that it would have to backtrack. It issued a statement of clarification concerning the NPRM stating that any delegation of authority to foreigners to make decisions concerning commercial aspects of a U.S. airline would have to be revocable. In issuing the NPRM initially, the Department of Transportation spoke of its potential for increasing foreign investment in U.S. airlines. For potential foreign investors, however, a delegation of foreign control of commercial activities that could be easily revoked could hardly be expected to favorably affect their investment decisions. In any case, the statement of clarification


did little to mollify political opposition to the NPRM, thus shortly after the election of a Democratic majority in both houses of Congress in the mid-term elections of November 2006, the Department of Transportation in December withdrew the NPRM.\footnote{Press Release, U.S. Dep't of Transp., U.S. Dep't of Transp. withdraws Int'l Inv. Rule—Commits to Working on Open Skies Agreement (Dec. 5, 2006), http://www.dot.gov/affairs/dot110006.htm.}

Even though the E.U. Transport Ministers had said that changes in U.S. foreign investment-and-control regulations were essential to reaching agreement, in the end they approved an agreement without them.\footnote{See generally Air Transport Agreement, U.S.–E.U., Apr. 27, 30, 2007, 46 I.L.M. 470, available at http://www.state.gov/pleur/n-jeu/c21824.htm [hereinafter Air Transport].} The situation remained that no more than twenty-five percent of the voting stock of a U.S. airline may be owned by foreigners, and any semblance of "actual control" by foreigners is still prohibited.\footnote{\textit{Id.} annex 4, at art. 1.} Two-thirds of an airline's board must be U.S. citizens, and generally, the majority of equity shares must be U.S.-owned.\footnote{\textit{Id.} annex 4, at art. 3.} The United States was able to achieve its major goal in the negotiations—increased access to Heathrow Airport through E.U. acceptance of open skies—and, in the end, conceded little apart from recognition of E.U. community carriers.\footnote{Press Release, U.S. Embassy London, Turbulent Times: Regulations, Sec. & Profitability in the Airline Industry (Mar. 5, 2007), http://www.usembassy.org.uk/ukpapress47.html.}

The agreement did deliver a new liberal regime that goes beyond anything that has existed previously except within the national domestic market and the E.U.'s regional market. However, it falls far short of what the E.U. proposed, and, while further stages of development are envisaged, what many see as existing imbalances of benefits gained and opportunities still sought will make further progress extremely difficult. From the perspective of the Europeans, the United States now has cabotage rights within the E.U. through what the United States sees as fifth freedom rights between the member states (though one should note that U.S. airlines do not use these fifth freedom passenger rights). The attempt by the E.U. to gain what it saw as comparable rights in the United States through a merging of E.U. and U.S. cabotage, or through changes to U.S. ownership and control laws, both failed. U.S. concessions on recognizing
the concept of community carriers on cargo and seventh freedom rights (the right to commercial carriage between two states, neither of which is the airline's country of origin),\textsuperscript{147} and on some modifications to the Fly America Program hardly balanced the benefits it acquired through access to Heathrow and the symbolic importance for U.S. officials of achieving an open-skies regime for all of the E.U.

The British insisted on a provision in the Transport Agreement stating that, in the "Stage 2" negotiations (which began in May 2008), unless the United States agrees to changes in its policies regarding foreign ownership and control, the E.U. will have the right to withdraw from the agreement.\textsuperscript{148} Under the timetable established for the "Stage 2" negotiations, the earliest suspension of rights under the treaty could occur would be summer of 2012.\textsuperscript{149} Withdrawal from the treaty is highly unlikely, however, because of the chaos this would bring to the transatlantic and, potentially, the whole world aviation market.

Significant changes in U.S. foreign ownership-and-control rules will be extremely difficult to effectuate in the foreseeable future for political reasons. Successive administrations have attempted to change the rules for decades without success. The Democratic successes in the White House and Congress in 2008 have rendered the chances for changing the rules very low indeed for a variety of reasons including opposition from organized labor.\textsuperscript{150} Without a Republican Congress with which to work, any president's chances of changing the rules would be slim.

Perhaps the most likely trigger for change would be a financial crisis facing a U.S. airline that could be resolved only by its purchase by a European airline. If there were the prospect of large job losses in the absence of a foreign acquisition, then organized labor's usual objection to such an acquisition could be muted. At today's fuel prices, many U.S. airlines are facing se-

\begin{footnotes}
\item[148] Air Transport, \textit{supra} note 143.
\item[149] Id.
\end{footnotes}
vere financial challenges. Some are almost certain to face bankruptcy. It is possible that out of these circumstances could emerge an opportunity to change U.S. regulations on foreign ownership and control that would not otherwise be possible.

IV. CONCLUSION

Since agreement was reached on the first phase of the E.U.-U.S. aviation agreement, there have been a number of significant developments. The industry continues to be troubled by the worldwide economic slow-down and the dramatic rise in fuel costs. According to IATA, twenty-four carriers have gone bankrupt or out of business with U.S. carriers alone heading for a $5.2 billion loss in 2008. Among other things, this has encouraged further consolidation in the U.S. domestic market with the merger of Delta and Northwest Airlines, and Continental and United Airlines agreeing to a close alliance. Furthermore, cooperation and the strengthening of U.S.-E.U. based airlines have been made specifically possible by the outcome of the 2007 agreement. Antitrust immunity has been granted to the alliance between AirFrance/KLM and Delta/Northwest airlines. That, along with the fact that Continental, Northwest, Delta, and US Airways have all acquired slots at Heathrow, has made the long-desired immunized alliance between BA and AA more likely. With more effective competitors now able to fly out of Heathrow, fear of BA/AA dominating transatlantic routes is

152 Id.
diminished, and therefore, arguments against granting immunity to their proposed alliance weakened. BA, AA and Iberia have had negotiations for such an alliance.\textsuperscript{159} Such developments might ease the difficulties of the major European and American carriers and stave off dangers of financial collapse. The consummation of an immunized alliance with Iberia and AA might also ease BA’s concerns about losing its privileged position at Heathrow, without getting what it saw in 2007 as commensurate compensation in terms of better access to feeder and distribution services in the United States. Such services might now be possible via AA. If both these eventualities materialized, they would reduce the pressure on the United States to move forward to change ownership-and-control and open cabotage. If they do not materialize, then pressures will remain, but whether they would be forceful enough to bring change is doubtful.

At the end of the day, the United States was, and always has been, only prepared to loosen the Gordian knot that tied sovereignty to the airline industry. In this sense, the United States did not depart from its traditional policy in 2007. It favors a more liberal and competitive market, but it is not prepared to endanger what key political factions within the United States see as an industry that has important national security aspects, nor are powerful economic groups prepared, rightly or wrongly, to endanger U.S. jobs through “unfair” competition from state-owned carriers and foreign labor, which is paid less and has lower standards for working conditions.

The vision that came out of the European Commission would have cut the Gordian knot between national sovereignty and the airline industry, and then temporarily re-tied it to a form of regional sovereignty that embraced both the E.U. and the United States. But this was with the hope of cutting the Gordian knot yet again, so that all states could enter the OAA, thus creating a truly globalized airline industry, where the Gordian knot would no longer tie it to sovereignty but to universally agreed rules and procedures of commercial intercourse. The market would decide (except on the provision of subsidized services on social welfare grounds) routes, rates, and capacity within a marketplace that had common establishment, competition, and safety rules. There are ongoing follow-up negotiations between the

E.U. and the United States, which began in the summer of 2008, but whether the vision of a single market embracing the E.U. and the United States will be realized depends largely on political forces in the United States. At the time of this writing, much is in flux with changing configurations in ownership and alliances, and continued buffeting of the economics of the industry, but whatever emerges at the end of the day, there is a huge domestic hill to climb before the United States can reclaim its leadership of deregulation and liberalization in the international civil aviation market. And, until it does, further globalization of the market can only proceed, if at all, incrementally and elsewhere.