

## **AICGS/DAAD Working Paper Series**

A Publication of the  
**American Institute for Contemporary German Studies**  
The Johns Hopkins University

AICGS/DAAD Working Paper Series  
**TRANSATLANTIC RELATIONS AS A  
CATALYST TO EUROPEAN INTEGRATION  
THE ACTIVISM OF THE EUROPEAN COMMISSION  
IN THE CASE OF INTERNATIONAL AVIATION**  
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Deutscher Akademischer Austauschdienst (DAAD)  
Research Fellowship Program  
2003

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I would like to thank the American Institute for Contemporary German Studies and the Max Planck Institute for the Study of Societies in Cologne for funding the travels connected to this research. Richard Balme and Jan Rutger toe Laer have made valuable comments on an earlier draft of this paper. My thanks also go to my interview partners for their helpful discussions and time during a period where nobody in aviation had much time to spare.

AICGS would like to thank the Deutscher Akademischer Austauschdienst (DAAD) for funding this AICGS publication as part of DAAD Research Fellowship Program.

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## INTRODUCTION

On November 5, 2002, the European Court of Justice (ECJ) handed down a series of judgments against eight European Union (EU) Member States concerning the bilateral air service agreements between the Member States and the United States (U.S.). Brought to the ECJ by the European Commission in 1998, the ruling concerned the competence division between the EU Member States and the European Commission in the area of international air transport. While the Member States traditionally have exclusive authority over international air service negotiations, the European Union had gained considerable competence over internal aviation matters during the integration of the European aviation market in the 1990s. While the ruling maintained that the Member States had exclusive competence over external air transport negotiations, it did find several items negotiated in those agreements in conflict with the provisions of the European Communities (EC) Treaty. The so-called “nationality clause” negotiated in the air service agreements, it argued, is, in principle, a community competence, as are articles relating to computer reservation systems and intra-EU tariffs in “open skies” agreements.

The ECJ ruling is in many ways a landmark decision that was long awaited by practitioners and observers of international air transport. Overall, the reception of the ruling was very positive. Policymakers and airlines in Brussels, the Member States, and even the United States agree that it was a fair and well thought out decision. Within days of the judgments, however, it became clear that everybody thought so for different reasons. While the European Commission warmly welcomed the ruling as a landmark “victory” for community aviation, the Member States and the United States felt that the thrust of the ruling confirmed the authority of individual countries over international negotiations. For the Commission, the ECJ decision inevitably implied the complete restructuring of international aviation affairs within the EU, while the Member States and especially the United States argued that only some minor modifications would bring the existing agreements in line with EC law.

These opposing visions collided in a series of policy statements. On the day of the ruling, the Commission issued a press release welcoming the decision. Transport Commissioner Loyola de Palacio declared, “[T]oday’s judgment is a major step towards developing a new coherent and dynamic European policy for international aviation [...]. The Commission stands ready to play its part.”<sup>1</sup> The UK government was quickest to react, stating cautiously they did not share the Commission’s interpretation. It argued that the Member States no longer had the competence to renegotiate the clauses in question, so long as they complied with the relevant provisions of EC law. The United States Department of State issued a similar statement in late November and U.S. Deputy Assistant Secretary of State Jeffrey Shane underlined in a public appearance on November 8, 2002 that the United States was willing to renegotiate the elements in question with the individual Member States. To Jeffrey Shane, the ECJ decision “did not have an immediate impact on the rights of U.S. or European airlines.”<sup>2</sup>

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<sup>1</sup> European Commission (2002) “Open sky agreements: Commission welcomes European Court of Justice ruling,” Press Release IP/02/1609, Brussels, November 5, <<http://europa.eu.int/rapid/start/cgi/guesten.ksh>>.

<sup>2</sup> Shane, Jeffrey, 2002: Open Skies Agreements and the European Court of Justice. Paper presented at conference on American Bar Association, Washington, D.C., November 8.

Insisting on its original interpretation, the Commission put forward a communiqué on November 19.<sup>3</sup> To underline the urgency of reorganization, Loyola de Palacio requested that all operations under the agreements in question be suspended until the Commission had the mandate to renegotiate the articles in question. This request was quite radical. Airlines and policymakers both in the Member States and the United States were in disbelief. In the words of an U.S. airline representative, this meant annulling “billion dollar operations.”<sup>4</sup> From a very practical point of view, denouncing the existing agreements was simply not possible and, moreover, was in no one’s interest. The request made such waves throughout the aviation community that Loyola de Palacio chose to assure the Association of European Airlines (AEA) unofficially that her request did not intend to hurt business operations but had been meant for rhetorical purposes.<sup>5</sup> Similarly, the European Commission’s Delegation in Washington, D.C. spent much time and effort reassuring their U.S. counterparts that this should not be considered a hostile act against the United States.<sup>6</sup>

However, when U.S. representative traveled to Europe to meet with representatives of the Member States, the conflict continued. While the U.S. government had made an effort to come up with new clauses that would meet the ECJ’s requirements, the Commission was quite displeased that the United States continued to seek negotiations with the Member States on the issues in question and had appeared at the meeting without invitation. The Commission furthermore criticized the U.S. proposals as minimalist and insufficient.<sup>7</sup> To the U.S. government officials, these reactions were difficult to understand. They considered that they had shown their willingness to renegotiate the air service agreements and had made a concerted effort to help the Member States on the articles in question. In the eyes of a U.S. observer, the Commission seemed “like a child screaming for attention” at a time when the United States just wanted to assure the smooth continuation of business operations.<sup>8</sup>

What had led to the collision between the European Commission and the United States? Was the core a true misunderstanding over the interpretation of the ECJ ruling or were both the Commission’s actions and the United States’ response part of a larger game of power politics? This paper argues that the present situation results from both different perceptions of the current regulatory situation in Europe and the European Commission’s strategy for furthering integration in aviation within Europe. The Commission is keen on completing the integration of air transport services in Europe, from which external negotiations have so far been excluded. Since the Member States have for a long time been hesitant to grant this mandate, the Commission had to prove to the Member States the value added of making external negotiations a community competence. Relations with the United States are of crucial component of this argument. The rationale behind the actions of the Commission is that if the Commission can convincingly argue that the United States benefits more from the current arrangements than does the EU, that

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<sup>3</sup> CEC, 2002: *Communication from the Commission on the consequences of the Court judgement of 5 November 2002 for European air transport policy*. COM (2002) 649 final. November 19. Brussels: European Commission. <[http://europa.eu.int/comm/transport/air/international/doc/com\\_2003\\_94\\_en.pdf](http://europa.eu.int/comm/transport/air/international/doc/com_2003_94_en.pdf)>

<sup>4</sup> Interview in Washington on April 29, 2003.

<sup>5</sup> Interview in the Brussels on December 5, 2002.

<sup>6</sup> Interview in Washington, D.C. on April 15, 2003.

<sup>7</sup> Interview with a U.S. government representative in Washington, D.C. on March 12, 2003.

<sup>8</sup> Interview with a US airline representative in Washington, D.C. on April 29, 2003.

Member States are too fragmented to bring about change, and that the United States is uncooperative, then a community mandate on negotiations with the United States might actually become a necessity. This paper will explain the evolution of this Commission position and the strategy behind it. The recent clash is nonetheless aggravated by a true misunderstanding about the state of air transport in the EU. While the U.S. vision is oriented towards the past in order to keep operations going as usual, the EU (not only the Commission) is looking towards the future to complete the restructuring of its internal aviation market.

The analysis of this paper is based on 26 semi-directed interviews with government representatives, airlines, and aviation experts from the United States and the European Union.<sup>9</sup> Carried out between September 2002 and May 2003, the interviews have been used to categorize and complement policy statements and other primary and secondary documentation on this subject.

After giving a brief overview of the particular regulatory context of international air transport, the paper compares the positions of the United States and Europe towards further liberalization. A third section then analyses the activism of the European Commission towards greater community competence and a more open transatlantic aviation regime. In conclusion, the paper makes several recommendations to U.S. and EU policymakers for a more promising continuation of common EU-U.S. aviation project.

## **1. THE REGULATORY FRAMEWORK IN INTERNATIONAL AVIATION**

Because of the distances covered, aviation has, from the very beginning, been an international industry. The regulation of trade in air traffic services started almost a century ago. Touching upon a large number of security and defense concerns, commerce in aviation traditionally has been negotiated bilaterally between governments. The following section gives a brief overview of the history and characteristics of global air transport.

### **1.1. The old system**

After several previous negotiated agreements between 1910 and WWII, the present regime of international air transport was put into place in 1944 at the International Civil Aviation Conference in Chicago. Bilaterally negotiated air service agreements constitute its foundation and represent a tight and heavy network of regulation. With the goal of achieving the highest possible degree of uniformity in regulations, procedures, and organization of civil aviation, the “Chicago Convention”<sup>10</sup> furthermore set up a permanent organization, the International Civil Aviation Organization (ICAO). Its mission is to oversee and assure cooperation in and standardization of international aviation.<sup>11</sup> ICAO is a purely intergovernmental organization with 188 member countries

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<sup>9</sup> Most interviews have been one hour to one and a half hours long and include the U.S. Departments of State, Transport and Commerce, the U.S. Congress, the European Commission and its Delegation in Washington, D.C., representatives from the German and U.K. government, the American Air Transport Association, the Airline Pilots Association, the Association of European Airlines, United, Delta and American Airlines, Lufthansa, Air France, British Airways and KLM, the World Trade Organisation and the OECD, as well as several other policy observers.

<sup>10</sup> ICAO Doc. 7300/8 (8<sup>th</sup> edition 2000).

<sup>11</sup> A comprehensive history of ICAO can be found on its web site <http://www.icao.int>.

as of January 1, 2003. The airline industry organized itself in a separate forum, the International Air Transport Association (IATA), founded out of a smaller association in Havana, Cuba in 1945. The role of the producers' organization IATA deserves special attention. In a 1946 service agreement between the United Kingdom (UK) and the United States – called Bermuda I – IATA became designated as the organization tasked with fixing tariffs on UK-U.S. flights. Even though such producer price-fixing was illegal in the United States, subsequent bilateral agreements between other countries specified similar procedures and made IATA the machinery for setting fares and rates among international airlines.

For the business of international air transport, the tight network of air service agreements is decisive. As of the end of 2002, 2054 bilateral agreements have been registered with ICAO. Counting all informal exchanges, additions, and writing, one observer has even estimated the total number of bilateral agreements to be as high as 10,000.<sup>12</sup> The traffic rights negotiated between governments in the bilateral air service agreements cover a large number of details, including points to be served, routes to be operated, types of traffic to be carried, capacity, tariffs and tariff conditions, designation of airlines as well as their ownership and control. This last item is one of the most important ones, because it traditionally requires an airline designated by a country to be effectively owned or controlled by it. In other words, the U.S. government can only designate U.S. carriers and the German government only German carriers. Effective ownership is defined in the United States as less than 25 percent foreign ownership, across the EU as less than 49 percent. Within the current framework, no airline can make seemingly simple business decisions of increasing its flight offers, targeting a new destination, soliciting foreign investment or relocating its headquarters.

## **1.2. Internal deregulation in the United States and the EU**

Within individual countries, economic regulation was the rule. In the United States, the Civil Aeronautics Board (CAB), established in 1938, controlled entry, exit, tariffs and subsidies of airlines in the domestic markets. Even twenty years later, after the creation of the Federal Aviation Administration (FAA), who took over the regulation of security standards, the CAB remained in place for economic regulation. Since air services were thus under the exclusive control of a governmental agency, even general competition policy – i.e. antitrust law – did not apply to the sector. Similar regulation was the standard throughout the world.

During the late 1960s and early 1970s, criticism of the rigidity and the inefficiency of the system began to grow, drawing from an unusual coalition of consumerist liberals such as Ralph Nader and pro-business economists such as Alfred Kahn, who was the chairman of the CAB in the late 1970s. In 1977, Jimmy Carter made the deregulation of air transport the subject of his presidential campaign. After several studies and despite many skeptics, the Airline Deregulation Act was enacted in 1978 providing for the phasing out of all of the CAB's activities by 1984.

The quick domestic deregulation has led to the virulent re-organization of the American airline service industry, which most observers describe as “chaotic and even frightening.”<sup>13</sup> Especially during the recession years of 1979 and 1980, airlines and the

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<sup>12</sup> Interview in Brussels on November 26, 2002.

<sup>13</sup> Tarry, Scott E., 2000: Globalization and the Prospect of Policy Convergence in Air Transport. In: *Global Society* 14/2, 279-296.

communities they served were no longer guaranteed anything and several large and small airlines went bankrupt. Nonetheless, the 1978 Act opened the domestic market to new market entrants, increased the number of routes served, and lowered the fares. At the time, it was the first thorough dismantling of an entire system of government control of an industry since WWII, and it is now considered a success.<sup>14</sup>

Eager to apply the new solutions to its own air service industry, the United Kingdom deregulated the sector in a similar manner under the Thatcher government in 1979. Both the UK and the Netherlands had always had a somewhat less restrictive air transport policy than the rest of Europe.<sup>15</sup> In most other European countries, by contrast, national control over the airlines was deeply rooted. Although the specific models varied, most countries had very protectionist policies regarding what was considered a public service sector monopoly. Throughout Europe, individual governments held a majority stake or had total control of their national “flag carrier” airlines.

The U.S. experience did little to change this, even though European carriers were operating at a loss. However, it did spark the interest of EU officials and of several national officials from the more liberal member states, who wanted to apply the principles of the common market to intra-European aviation as well.

The first two Commission memoranda on aviation in 1979 and 1984 received a frosty reception from national governments and airlines alike. Despite the lack of interest in an EU-wide solution, a 1984 agreement between the UK and the Netherlands allowed any airline in either country to operate between the two without the need to seek further government approval. With the two countries in favor of further liberalization, the Commission continued pursuing the idea of an EU-wide approach through what has been called a “stick and carrot approach.”<sup>16</sup>

On the one hand, the Commission exploited an ECJ ruling, the *Nouvelles Frontières* decision, to apply pressure on the reluctant member states. The *Nouvelles Frontières* decision of 1986 annulled a French judgment against a number of private airlines and travel agencies operating in France. These had been accused of violating the French Civil Aviation Code by selling cheap, non-approved tickets. The ECJ ruled in favor of these agencies, arguing that the price-fixing mechanisms of the French Civil Aviation Code distorted competition within the EU and were therefore incompatible with the competition law in the EC. Based on this decision, the Commission called upon all European airlines following similar procedures to abandon their activities. Although this would have been impossible, the pressure that was applied to these governments augmented the political weight of pro-liberalization forces in France and Germany.

Be that as it may, positive incentives were necessary as well, as the firm opposition of Italy, Greece, Denmark, and Spain threatened to block a unanimous Council decision. While the southern countries argued that they did not have the capacities to adjust to the increased regional air traffic proposed by the Commission package, Denmark feared that

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<sup>14</sup> Kasper, Daniel M., 1988: *Deregulation and Globalization: Liberalizing International Air Services*. Cambridge, M.A.: Ballinger; Kahn, Alfred E., 1988: I Would Do It Again. In: *Regulation 1988/2*.

<sup>15</sup> In particular, both followed a multi-airline policy, negotiating rights for more than just one flag-carrier on international routes. With a strong consumer lobby, the UK pioneered low cost air travel in the 1960s and 1970s and was the only country in Europe to establish an independent regulatory authority for aviation in 1971. Cf. Kassim, Hussein, 1996: Air Transport. In: Hussein Kassim / Anand Menon (eds.), *The European Union and National Industrial Policy*. London: Routledge, 106-131.

<sup>16</sup> O'Reilly, Dolores/Alec Stone Sweet, 1998: The liberalization and reregulation of air transport. In: *Journal of European Public Policy* 5/3, 441-466.

the changes would unbalance its regional development policies. Brokered by the Commission, the governments in favor of the proposal suggested a compromise. The regional airports in question in the four countries were to be excluded from liberalization during a first stage on liberalization, but further measures could not be delayed in the mid-1990s. On the basis of this compromise, an EU-wide agreement on the air transport package was reached in late 1987.

The 1987 package began the transfer of EC authority over EU-wide air transport service trade and began a gradual liberalization. Under qualified majority voting introduced by the Single European Act, two further packages were adopted in July 1990 and July 1992. By April 1, 1997, the internal air transport market among the 17 states of the European Economic Area (EEA) was completed. By far the most important one, the third package transformed national carriers into “community airlines.”<sup>17</sup> It opened up all traffic rights to Community airlines, including the freedom to provide cabotage and the right to carry passengers or cargo between two points of a country that is not the home country of the airline. The system created by the EU was based on the idea of a Community license. Any airlines whose capital is held mostly by a Member State or its nationals can obtain this license and has automatic access to the Community market. Within the EEA market, traffic on all international routes is unrestricted and fares are no longer submitted to the national authorities for approval, although some control mechanisms persist in special instances and some public service obligations remain.

Originally an international market, the EEA market resembled the U.S. market from 1997 onward. The Member States do, however, retain the authority over air traffic control and international air service negotiations with non-EEA governments. Currently, the harmonization of air traffic control is the subject of another EU proposal called the Single European Sky, making external negotiations the only resort of exclusive Member State control in European aviation.

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<sup>17</sup> Mawson, J., 1997: Air Transport Liberalization in the European Union: An Assessment. In: *Regional Studies* 31/8, 807-822.



## 2. LIBERALIZATION OF INTERNATIONAL AVIATION

In the process of internal deregulation, international aviation also became a target for reforms. The most successful policy aimed at liberalizing international aviation are the “open skies” agreements started by the United States. The European Union, however, considers the bilaterally negotiated open skies agreements biased and insufficient solution for global air transport and has been working for some time on ideas for more ambitious projects.

### 2.1. The United States

The United States set out to reduce international regulation in the late 1970s. A new bilateral agreement between the United States and the UK in 1977 – called Bermuda II – and a U.S.-Netherlands agreement in March 1978 set the trend for bilateral agreements that were less restrictive on the pricing, capacities, and designation rights. Nonetheless, airlines remained severely constrained in responding to market volatility and sought new solutions, which led to the interconnected developments of strategic alliances and the U.S. policy of “open skies.”

#### *Strategic alliances*

Experiences in the U.S. domestic market during the 1980s showed that the airlines most likely to survive were those that exploited economies of scale. Since consolidation beyond national boundaries was impeded by the very strict nationality clauses fixed in the bilateral agreements, the seminal response of airlines was to pool their resources. With this pooling strategy, airlines can only add destinations to a route network and offer increased frequency of services to customers by using its partner’s flight entitlement without having to acquire resources.

The mid-1980s was the high time for mergers, acquisitions, and alliances within the domestic U.S. market. Cross-border alliances only started in the late 1980s, notably with a joint-marketing initiative of Delta, Swissair, and Singapore Airlines. More ambitious mergers seemed virtually impossible because of the tight specifications of the bilateral air service agreements. The financial difficulties of two American carriers, Northwest Airlines and USAir, however, led a loosening of these controls, as foreign investment into the ailing airlines seemed one of the few feasible solutions. Political leaders in Minnesota and Michigan lobbied the federal government to support a deal between Northwest and KLM Royal Dutch Airways, while leaders in Pennsylvania and New York worked to help secure British Airways investment in USAir.<sup>18</sup> The success of these agreements is evidenced by the “mega alliances” that exist today.

#### *Open Skies*

Operating an international alliance could, however, be considered a distortion to fair competition and needed to be approved. The fact that cross-border alliances were tolerated by the U.S. government was part of a larger policy project. The granting of anti-trust immunity for an alliance came at the price of opening the market of the airline’s country.

Former principal carriers, such as Trans World Airlines, Pan American, and Eastern Airlines had suffered considerably from the restructuring and sold the international routes

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<sup>18</sup> Tarry, Scott E., 2000: Globalization and the Prospect of Policy Convergence in Air Transport. In: *Global Society* 14/2, 279-296.

to what became collectively known as the “big three”: United, Delta, and American Airlines. Their size and virtual dominance in the U.S. domestic market placed them in an excellent position to expand aggressively into foreign markets. However, with the exception of a few liberal-minded countries, most foreign governments were not keen on the idea of opening their markets to U.S. predators. When the financial difficulties of Northwest and US Airways made cross-border alliances into the U.S. market attractive to foreign carriers, the U.S. government used the opportunity to make the facilitation of alliances an integral part of its efforts to open the skies in Europe.

Since alliances were made with countries that had only one international airline, the calculation worked out: what was good for KLM was good for the Netherlands, and so the government considered the trade-off a fair one. The first open sky agreement was signed between the United States and the Netherlands in September 1992. After a package of open sky agreements with smaller European countries, the next important step was the open sky agreement with Germany in 1996, with antitrust immunity being granted to an alliance between United Airlines and Lufthansa. By the end of the year 2002, 86 open sky agreements had been signed, 59 of them with the United States. While the majority of these agreements were again between two countries, one multilateral agreement was negotiated between the United States, New Zealand, Singapore, Brunei, and Chile in November 2000.<sup>19</sup> The agreement is open to new entrants, and several U.S. policymakers see the future of international liberalization in similar multilateral open sky agreements.<sup>20</sup>

## 2.2. Europe

While the open sky trend is considered very successful by U.S. policymakers and airlines, their European counterparts are more skeptical. Despite their considerable benefits, bilateral open skies agreements between the United States and 11 of the EU member states fall short of complete liberalization, restricting business operations in several ways. Most importantly, foreign entities cannot own and control more than 25 percent of a U.S. carrier (“ownership and control”) or establish a new carrier within the United States (“right of establishment”). A foreign carrier cannot provide domestic services within the United States (“cabotage”) or lease an aircraft with a crew to a U.S. company (“wet-leasing”). Finally, foreign carriers are also excluded from a government program that assigns U.S. government personnel on flights operated by U.S. carriers (“Fly America”).

EU observers therefore feel that the aviation market under the open skies agreements is biased, as several of these rights are not restricted within the EU market. For example, the United States is the world’s biggest lessor of aircrafts for cargo-operations, generating more than \$1 billion a year from contracts from wet-lease contracts within Europe.<sup>21</sup>

Furthermore, the fragmentation of the European market is perceived to be an advantageous for U.S. carriers. While European carriers can only fly to the United States from their home country, U.S. carriers can fly from any “open skies” EU country to any U.S. point. U.S. carriers have also been ceded the right to fly from one open skies country in the EU to another, which is effectively a form of cabotage. While it is true that this

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<sup>19</sup> For further information, see <http://usinfo.state.gov/regional/ea/apec/opensky.htm>.

<sup>20</sup> Interviews in Washington, D.C. on April 10 and 24.

<sup>21</sup> House of Lords, 2003: *“Open Skies” or Open Markets? The Effect of the ECJ Judgements on Aviation Relations between the EU and the USA*. Session 2002-3 17th Report. April 8. London.

right is little used by passenger airlines, it does facilitate the cargo operations of U.S. cargo airlines within Europe. Most importantly, carriers within the EU can only merge if the United States does not refuse to grant the same traffic rights to the new company. Over the past decades, for example, British Airways and KLM have talked repeatedly about merging. Since BA is considerably larger than KLM, the merger would have been primarily British. The open sky agreement with the United States, however, specified that the Netherlands could only designate a company that was 51 percent Dutch. The necessary renegotiation of these agreements would then mean that the merger would take place if the United States approves it, which often involves other concessions.<sup>22</sup>

These imbalances have led the industry within Europe to start thinking about new approaches to liberalization. To European airlines, “open skies” seems fundamentally biased towards the United States, which has the political clout to negotiate anything they want. Even though they do maintain that alliances have been of great benefit to the airline industry in Europe, they call it the “crutch” of the existing system, which becomes more and more outdated and inappropriate to global airline business operations.<sup>23</sup>

In an effort to find a Europe-wide solution, the Association of European Airlines (AEA) proposed a plan for a common aviation area between the United States and Europe that would go well beyond open skies. After some initial discussion within the EU, the plan for a so-called Transatlantic Common Aviation Area (TCAA) was proposed to the United States in 1999.<sup>24</sup> As one U.S. observer recalls, the project landed “with a thud.” U.S. policymakers and airlines were not very enthusiastic of what they considered a very “European” proposal. To the United States, open skies are a much more promising tool for deregulating international air transport. As one policymaker put it, “the TCAA proposal had ‘regulation’ written everywhere. We counted the number of times the word appeared on the first couple of pages and came to 15!”<sup>25</sup> To the U.S. side, it seemed counterproductive to work at deregulating international air transport with a new regulation proposal. Even though most participants admit that the proposal stimulated some very interesting discussions, they felt that it was not in U.S. interests to move forward on what felt like “an invitation to join the European aviation area.”<sup>26</sup>

### 3. COMMISSION STRATEGY FOR FURTHERING AVIATION INTEGRATION

At the time the meetings occurred in 1999, it was the European Commission, not simply AEA, who spoke for European interests on these issues. Since then the Commission has relentlessly pursued this project. The recent noise around the ECJ ruling should be considered part of this objective. In fact, the tensions with the United States have worked to help the Commission argue the case for the further integration of

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<sup>22</sup> In this particular case, the United States wanted to use the occasion to renegotiate its access into Heathrow airport in London.

<sup>23</sup> Interviews with EU airline representatives on November 27 and December 2, 2002.

<sup>24</sup> AEA, 1995: *EU External Aviation Relations*. Policy Statement. October. Brussels: Association of European Airlines. <[http://www.aea.be/Topics&Views/downloads/EU\\_EXT\\_AVrel.pdf](http://www.aea.be/Topics&Views/downloads/EU_EXT_AVrel.pdf)>; AEA, 1999: *Towards a Transatlantic Common Aviation Area*. Policy Statement. September. Brussels: Association of European Airlines. <short version: <http://www.aea.be/Topics&Views/downloads/tcaa.htm>>

<sup>25</sup> Interviews in Washington, D.C. on April 2 and 10, 2003.

<sup>26</sup> Interview with a U.S. government representative on April 10, 2003.

aviation. The following section lays out the motivation for the activism of the European Commission throughout this process.

### 3.1. Integrating Europe

At the beginning of the move towards an external negotiating mandate were two distinct interests. For one, the European Commission wanted to complete the internal aviation market that it had created throughout the 1990s and was kept from doing so by the constraints of the existing regulatory framework of international aviation. Several major European airlines also felt that the existing system hindered important developments in European aviation, most importantly the consolidation of a nationally fragmented system. When they realized that the Commission wanted to become active on the issue, they jumped at the occasion to get involved in order to maintain some say in what they considered a very important policy development. While the Commission could provide policy relevance to AEA's proposals, the airline association provided legitimacy to the Commission's project – two ingredients that made the coalition last until today.

In the process of air transport integration within Europe, the European Commission considered from very early on the possible benefits of negotiation authority over aviation agreements with third countries, most notably the United States. When the Commission expressed these ideas, the European airlines quickly reacted. In June 1995, AEA submitted comments to the EU Member States and the Commission on the request for an external mandate. Only several month later, by October 1995, AEA had written a very detailed proposal on what they felt should be negotiated through an EU-U.S. aviation agreement, which they called a transatlantic common aviation area.

The TCAA project was very innovative and might have been a reaction to a very short-lived discussion on a World Trade Organization (WTO) solution for global air transport liberalization. Most European airlines preferred a regionally specific arrangement to a more global approach through the WTO, because such an agreement must be negotiated in detail. Several major European airlines realized that an EU external aviation policy could be beneficial if it would help to “maximize [airlines'] growth, economic viability, and competitiveness.”<sup>27</sup> The rationale behind the AEA's proposal was the need for consolidation within Europe. For the Commission, the demands of the AEA highlighted the incompleteness of the internal aviation market. While free movement and free right of establishment should be a natural business operation of Community carriers, the designation article in air service agreements blocked this possibility. Even though the AEA statement underlined that the EU had yet to prove the “added value” of an EC solution, the project corresponded to the interests of the European Commission and was quickly adopted as a transport policy objective.<sup>28</sup>

National governments were much less convinced. Each government had an experienced staff of external negotiators who have dealt with the issue for a very long time. Of the 2054 bilateral air service agreements in place, almost 1500 were operated by EU Member States. Since most agreements were not “open sky” agreements, regular meetings with the partner governments were needed to re-evaluate frequency,

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<sup>27</sup> AEA, 1995: *EU External Aviation Relations*. Policy Statement. October. Brussels: Association of European Airlines. <[http://www.aea.be/Topics&Views/downloads/EU\\_EXT\\_AVrel.pdf](http://www.aea.be/Topics&Views/downloads/EU_EXT_AVrel.pdf)>

<sup>28</sup> An overview of the Commission's objectives for international air transport can be found on its website: [http://europa.eu.int/comm/transport/air/international/index\\_en.htm](http://europa.eu.int/comm/transport/air/international/index_en.htm).

designations, and other issues of concern.<sup>29</sup> Even though the European Commission did start a sub-unit in the Directorate General for Transport and Energy (DG TREN) that dealt with issues of bilateral air service negotiations, most EU Member States felt the Commission was understaffed and not well experienced in this domain.<sup>30</sup>

### 3.2. Overcoming opposition

Eager to overcome the doubts expressed by national governments, the European Commission prepared another “carrot and stick” approach similar to the one used in the integration of internal aviation. On the one hand, they reoriented their demands towards distinct types of external mandates, insisting mainly on the one that would apply to the United States, and commissioned a study of the benefits of a common EU solution. On the other hand, they seized the ECJ to press legally for their vision. That radical interpretation of the decision and harsh rhetoric against the United States were a further means of pressing their cause.

Even though the Commission might in theory be interested in all types of bilateral negotiations, the clearest benefit would be for negotiations with the United States.<sup>31</sup> Relying on the TCAA concept, the Commission and AEA argued publicly that the U.S. open sky policy did not create a level playing field. Only if the European countries spoke up with one voice could this disequilibrium be overcome. The idea of a TCAA permitted the Commission furthermore to argue the need for a “new” solution, not just a multilateral open sky agreement that would still have Member States at the negotiation table.

On a more aggressive note, the Commission also argued that the old bilateral agreements, and, most importantly, the nationality clause were in conflict with the concept of a Community carrier established through the third liberalization package voted on by the Council of Ministers. As it turned out, free right of establishment and cabotage within Europe meant little to carriers that operated international flights. The only airlines to fly service between two points of another member state or established themselves outside of the country that they were owned by were European low cost carriers such as Ryanair or Easy Jet – who fly, for example, between Paris and Nice. In December 1998, the European Commission brought seven cases against the open sky agreements of Austria, Belgium, Denmark, Finland, Germany, Luxembourg, and Sweden and an eighth against the bilateral “Bermuda II” agreement between the United Kingdom (UK) and the United States in December 1998.<sup>32</sup> A second batch was later brought to the ECJ against countries that had concluded open sky agreements with the United States after that date.

During the years that the ECJ decision was pending, the Commission continued to work up a consensus on a EU-U.S. agreement within the EU Member States. They also traveled to Washington, D.C. to meet with their U.S. counterparts to discuss the existing proposals. Even though the U.S. side was quite intrigued by the proposal, they found it

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<sup>29</sup> House of Lords, 2003: *“Open Skies” or Open Markets? The Effect of the ECJ Judgements on Aviation Relations between the EU and the USA*. Session 2002-3 17th Report. April 8. London.

<sup>30</sup> Interviews with government and airline representatives in the EU on November 18, 27, December 2 and 5, 2002.

<sup>31</sup> Cf. [http://europa.eu.int/comm/transport/air/international/index\\_en.htm](http://europa.eu.int/comm/transport/air/international/index_en.htm).

<sup>32</sup> In October 1999, the Netherlands decided to join the Court cases in support of the other Member States.

“overly ambitious” and “very European.”<sup>33</sup> Several propositions, such as the harmonization of competition law or a change in ownership requirements, would furthermore require statutory change in the United States and had little to no chance of passing in Congress.<sup>34</sup> With the lack of real negotiating power on the European side, the United States therefore just shrugged its shoulders and told the Europeans to come back when they had a mandate. Faced with the doubts of their Member States and the resistance of the United States, DG TREN commissioned a study on the benefits of an open aviation area between the EU and the United States from a U.S. consultancy, the Brattle Group.<sup>35</sup>

On November 5, 2002, the ECJ finally issued the ruling on the first batch of air service agreements, ruling that the nationality clause and several other areas covered by the open sky agreements were issues of exclusive competence of the European Commission, even though external negotiations remained in the competence of the Member States. The question immediately arose as to how the articles in question should be brought into conformity with Community law. Judging by the radical statements issued by the Commission, they wanted to assure that they would be part of a solution. In a first communication dated November 19, 2002, the Commission therefore called upon the Member States to denounce existing operations under the agreements in question. In a second communication on February 26, 2003, it modified its position, arguing that it was necessary to distinguish between the infringements and the need for a wider mandate.<sup>36</sup> In an effort to structure the discussion, it also clearly distinguished between different kinds of requests: (1) a specific mandate to negotiate an Open Aviation Area with the United States; (2) a horizontal mandate for international negotiations in those areas considered Community competence; and (3) a procedure for coordination and information on international negotiations between the Commission and the Member States.

For the United States, these issues seemed very different. While the wider mandate seemed a long-term issue for the United States, it was concerned about the continuation of their current transatlantic operations. The U.S. government therefore organized a meeting with several representatives of the EU Member States in Paris in late February 2003 and proposed what they thought were appropriate remedies to the articles found problematic by the ECJ. As a U.S. participant remarked, “the meeting was very lively until a representative of DG TREN ‘crashed the party.’” The Commission had decided to participate in the meeting, which “put a chill on the discussion.”<sup>37</sup> According to the Commission, the Member States very wisely refused to enter into negotiations on an issue in which the competences were either unclear or very definitely belonged to the European Commission, as was the case with the nationality clause.<sup>38</sup> While the Commission was thoroughly displeased with the U.S. efforts to negotiate with the Member States individually, the U.S. officials simply did not understand that why the Commission would need to be included in a discussion between “sovereign states.”

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<sup>33</sup> Interviews in Washington on April 2 and 10, 2003.

<sup>34</sup> Interviews in Washington on April 10, 24, and May 19, 2003.

<sup>35</sup> It is interesting to note that this study was initially a project of AEA. The Commission soon decided that it would be more appropriate for them to adopt this study and took over the organization.

<sup>36</sup> CEC, 2003: *Communication from the Commission on the relations between the Community and third countries in the field of air transport*. COM (2003) 94 final. February 26. Brussels: European Commission. <[http://europa.eu.int/comm/transport/air/international/doc/com\\_2003\\_94\\_en.pdf](http://europa.eu.int/comm/transport/air/international/doc/com_2003_94_en.pdf)>

<sup>37</sup> Interview in Washington, D.C. on April 29, 2003.

<sup>38</sup> Interview in Washington, D.C. on May 15, 2003.

This latest clash between U.S. representatives and the European Commission seems to be a real case of mismatched understandings of the current state of air transport competences within Europe. While the European Commission insists on shared competences and demands to be a participant in the discussion, the United States still believed that the Member States have exclusive authority over external negotiations. Both base their positions on the wording of the ECJ ruling, and looking at the period between the ruling and the decision on a negotiating mandate, both positions are defensible.

### 3.3. The Future

In the period between which the two communiqués were issued by the European Commission, the Brattle Group finished their report on an Open Aviation Area between the EU and the United States – the name was changed to dissociate the project from the old TCAA.<sup>39</sup> While addressing the main concerns of the United States, the report estimated that economic benefits would fall, especially on the European side. European governments have become increasingly interested in the project, since all but four European Member States already had open sky agreements with the United States and felt that a common position would be more beneficial if the market is already open.<sup>40</sup> As one EU airline representative put it,

We already have an open-sky agreement with the US and we can therefore only win from a solution. Everything that we had to give up has been given up. We have nothing to lose. That may be an egotistical way of looking at it, but it's pragmatic. It's not an ideological undertaking.<sup>41</sup>

Even the United Kingdom, which had traditionally been very hesitant to enter into negotiations of opening their market for fear of opening Heathrow airport, a European solution is considered advantageous. As a government representative remarks, “we have had such a difficult time negotiating by ourselves with the Americans, the EU can only be more successful.”<sup>42</sup> A consensus on the European side seems therefore likely. The Council of Transport Ministers will meet on June 5-6, 2003 and most observers expect an external negotiating mandate, at least for negotiations with the United States, to be granted to the Commission at that time.

Once the mandate has been granted to the European Commission, the United States has affirmed that it is willing to enter into negotiations. However, the United States has several reservations towards the project as proposed thus far. European and American views diverge considerably with respect to competition law (especially in the context of airline aid in the aftermath of 9/11), ownership and control, wet-leasing, and cabotage. For security reasons and because of labor concerns, none of these issues could be substantially changed, particularly not if it required the vote of Congress. The United States therefore prefers a less ambitious proposal that would resemble a multilateral open

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<sup>39</sup> Moselle, Boaz et al., 2002: *The Economic Impact of an EU-US Open Aviation Area*. Study prepared for the European Commission. December. Washington, D.C.: The Brattle Group. <[http://europa.eu.int/comm/transport/air/international/doc/brattle\\_aviation\\_liberalisation\\_report.pdf](http://europa.eu.int/comm/transport/air/international/doc/brattle_aviation_liberalisation_report.pdf)>

<sup>40</sup> Only the UK, Ireland, Spain, and Greece have not concluded open skies with the United States.

<sup>41</sup> Interview on November 18, 2002.

<sup>42</sup> Interview on May 20, 2003. Interestingly, the U.S. observer put it similarly, “after all our frustration in negotiating with the British, it cannot be worse with the Commission.”

sky agreement, precisely what the Europeans do not want. The United States also has their own list of items that they consider non-tariff barriers to entry in the EU aviation market, such as the Europe-wide ban on night-flights or the access restrictions to Heathrow airport.

A last factor that might play into the U.S. stance is the current crisis in air transport within the United States. According to an estimate of the American Air Transport Association, the recession, the shock of 9/11, and the reduction in traffic due to the war in Iraq will keep the U.S. aviation sector as a whole unprofitable until 2006.<sup>43</sup> On the one hand, this means that the U.S. government and U.S. carriers are concerned about assuring their survival, not about expanding business opportunities.<sup>44</sup> On the other hand, the proposed aviation area would reduce the foreign ownership restrictions, which is a way of assuring new sources of investment into the ailing U.S. sector. As long as no concrete investment proposal is on the table, this discussion is somewhat academic, but several U.S. policymakers affirmed that the need for foreign investment might raise the interest in the EU-U.S. proposal.

#### 4. POLICY RECOMMENDATIONS

Since negotiation between the EU and the United States will start soon after a European mandate is granted to the Commission, this paper ends with some policy suggestions for these U.S.-EU meetings.

For U.S. policymakers, an issue that will need to be taken into account is the changed nature of air transport within the EU. This concerns both the nationality clause and right of establishment within the EU. Even though the Member States continue to have competence over external air service negotiations, they can no longer enter into bilateral agreements in the area of ownership and control clauses. The nationality restrictions, in turn, constitute the heart of a bilateral agreement, precisely because they are agreements between governments. By confirming Community competence over the nationality clauses, the ECJ ruling does have implications for the future of bilateral air service agreements more generally.<sup>45</sup> The judgment also clearly indicates that all Community carriers have the right to establish themselves in each other's territories and to apply for international market access like national carriers. Belgium would therefore have to allow a Dutch carrier to operate a flight between Brussels and Canada, if there were enough frequencies to accommodate the request. The only country that could block the operation would be Canada. So far, U.S. policymakers have chosen to ignore this change in the right of establishment principle, because some Member States themselves have in several instances refused to grant the right for an international route to the carrier of another Member State. While it is true that Member States are not necessarily eager to abide by the new standard, they will have to adapt to the changed legal conditions. In a worst-case scenario, the Member States might even be pursued internally, within the framework of Community jurisprudence.

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<sup>43</sup> ATA, 2003: *Airlines in Crisis: the Perfect Economic Storm*. March 11. Washington, D.C.: Air Transport Association. <<http://www.airlines.org/public/industry/bin/AirlinesInCrisis.pdf>>

<sup>44</sup> Interviews in Brussels and Washington, D.C. on November 27, 2002 and April 29, 2003.

<sup>45</sup> On this argument, see René Fennes, 2003: "The European Court of Justice Decision on Bilateral Agreements – the Future of Relations." *Air and Space Lawyer*. 17/3. 14-19.



Nonetheless, it is important to distinguish between the two separate objectives the European Commission has pursued. The heated rhetoric following the ECJ decision was directed at national governments, even though it did address the U.S. open sky agreements. The best way of proceeding, as the United States has done so far, is simply not to take the most radical statements very literally.

For the EU policymakers, the most difficult tasks still lie ahead. For the Commission, its credibility as an external negotiator will depend on the agreement it will be able to reach with the United States, while the U.S. government will “not be distraught,” as they put it, if no agreement is reached.<sup>46</sup> It would, therefore, seem wise not to be overly ambitious. To the U.S. government, the terms “harmonization” or “convergence” are foreign jargon, and U.S. officials are generally quite opposed to the creation of new regulatory mechanisms. The Brattle Group report has done very good work in addressing the most important U.S. concerns.<sup>47</sup> However, as long as the debate rests on the academic reflection on necessary elements of a deregulated aviation area, it has little chance of moving forward. As several observers confirm, this will only go somewhere “if there is a concrete proposal that benefits business.”<sup>48</sup> This will especially be the case if changes requiring the approval of Congress arise. With financial lobbying being restricted to U.S. nationals only, Congress might only be swayed if U.S. carriers and the communities served are behind the project. While several large U.S. carriers today agree that a reform of ownership and control requirements, for example, might be beneficial, a solid base of U.S. support for the project will need to be one of the European Commission’s objectives throughout the negotiations. It is unlikely that this support will materialize in the near future.

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<sup>46</sup> Interviews in Washington, D.C. on April 24 and 29, 2003.

<sup>47</sup> Most U.S. policymakers that I questioned specifically on this issue find it a very good piece of academic writing.

<sup>48</sup> Interviews with U.S. government and airline representatives on April 10, 29, May 19.

## CONCLUSION

From a Washington perspective, what is at stake is a potentially interesting attempt to negotiate a common aviation area between the EU and the United States. For the European Commission, it is much more. External negotiations with the United States not only provide the basis of more flexible business operations in transatlantic aviation, they also imply the completion of the internal European aviation market and an increased policy competence for the Commission itself.

The diplomatic difficulties between the European Commission and U.S. policymakers and carriers result from these divergent interests. Moreover, the European Commission has employed a conscious strategy of defining its goals against the U.S. objectives in order to rally the European Member States behind its proposals. The arguments against U.S. influence on European aviation were part of a two-fold power play. Economically, the Commission – joined by AEA – aims at creating a “more leveled playing field” for its aviation industry. By proposing a common aviation area between the EU and the United States, it hopes to overcome the disadvantages of the nationally fragmented transatlantic market and to move beyond the U.S. policy of open skies. Institutionally, the European Commission played a power game against its own Member States. Through reference to the economic interests and the opposition of the United States, as well as the utilization of the ECJ, it was able to move very close to being granted new competences. The European Commission has almost won the institutional game over new competences. The economic game in which it is engaged with the United States, however, is only beginning.

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