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INTERNATIONAL AVIATION

New Competitive Conditions Require Changes in DOT Strategy

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on the Department of Transportation's (DOT) international aviation policymaking. At the request of this Subcommittee and the Senate Subcommittee on Aviation, we have previously reported on the competitive implications of foreign investment in U.S. airlines and liberalization efforts in the European Union. We are also currently examining the impacts of (1) operating and marketing obstacles that U.S. airlines encounter at airports in Europe and Asia and (2) marketing alliances between U.S. and foreign airlines. Our testimony will focus on the results of this work and identify opportunities that we believe are available to DOT to strengthen the competitive position of U.S airlines in international markets.

Our main points are as follows:

-- Over the last decade, the desire of U.S. airlines to compete internationally has increased and the characteristics of the U.S. competitors have changed. The largest U.S. airlines--American, Delta, and United--joined Northwest as major players in foreign markets in place of the failed (Braniff, Eastern, Pan Am) or financially ailing (TWA) incumbents. These carriers have well developed domestic hub-and-spoke networks with which to feed international routes, but their success in gaining greater access to international routes has been limited. The essential problem is that, unlike the U.S. domestic market, international aviation remains heavily regulated. For travel between the United States and foreign countries, fares, routes served, and service frequency are set by 72 inter-government agreements, called bilaterals. Two additional factors greatly complicate the situation: (1) foreign nations, whose markets are usually dominated by one national carrier, are concerned that the more efficient

U.S. airlines will overtake their markets if allowed to compete freely, and (2) the multiple U.S. airlines that serve international markets often have competing interests. It is within this framework that DOT must seek increased international opportunities for U.S. airlines.

-- For their part, many foreign governments have sought to gain greater access to U.S. markets for their airlines. Several, such as the United Kingdom, have attempted to do so while maintaining extensive restrictions on U.S. airlines' access to and beyond their markets. Others, such as Thailand and France, have sought to further restrict access to their markets. In addition, U.S. airlines encounter problems conducting their business overseas. These problems include inconvenient landing or takeoff times or requirements to use a monopoly baggage or cargo handler. Foreign airlines do not face similar restrictions when operating in the United States. Foreign airline efforts to gain access to U.S. markets have included direct investment in U.S. airlines and, increasingly, alliances with U.S. airlines that permit a foreign carrier to market flights by a U.S. airline within the United States as their own. Such "code-sharing" arrangements are also attractive to U.S. airlines because they allow them access to foreign markets that they do not serve directly.

-- DOT's policy goal in negotiating with major aviation trading partners has been to achieve a deregulated environment, referred to as "open skies", in which airlines can fly between countries when they want, where they want, and set fares accordingly. Given the concerns of other countries that U.S. airlines will overtake their national carrier's markets, this goal generally has not been achieved and is not likely to become reality in the foreseeable future. In practice, recent DOT policy

decisions have been driven by the need to resolve crises facing financially weak U.S. airlines. In 1991, for example, DOT gave British carriers extensive access to the United States through code-sharing in exchange for substituting United and American for Pan Am and TWA as the two U.S. carriers allowed to serve London's Heathrow Airport. In concluding this agreement and approving the subsequent USAir-British Airways code-share, DOT conducted little analysis to determine (1) the potential long-term benefits to British Airways, (2) the competitive implications for other U.S. carriers, and (3) whether the United Kingdom--having greatly increased its largest carrier's access to the U.S. market--has any incentive to expand opportunities for U.S. carriers to and beyond Heathrow.

-- While such code-sharing arrangements as USAir-British Airways and Northwest-KLM have clear benefits for the U.S. carriers involved, the growing prominence of code-sharing in bilateral negotiations requires that DOT fully assess the impacts of such arrangements to determine, among other things, their value to foreign carriers. DOT's efforts to do this are handicapped by limitations in the traffic data it currently collects. Moreover, until such time as "open skies" becomes feasible, through multilateral agreements or otherwise, a strategic approach will be needed that draws more heavily on the leverage the United States can bring to bear--access to the world's largest aviation market. The proliferation of code-sharing arrangements is in part an effort to secure indirectly what airlines are having difficulty getting directly--greater access to international gateways and other destinations that are linked with those gateways. Lessons learned from dealing with the airline industry in the domestic market--including the way DOT reviewed and approved airline mergers--serve to

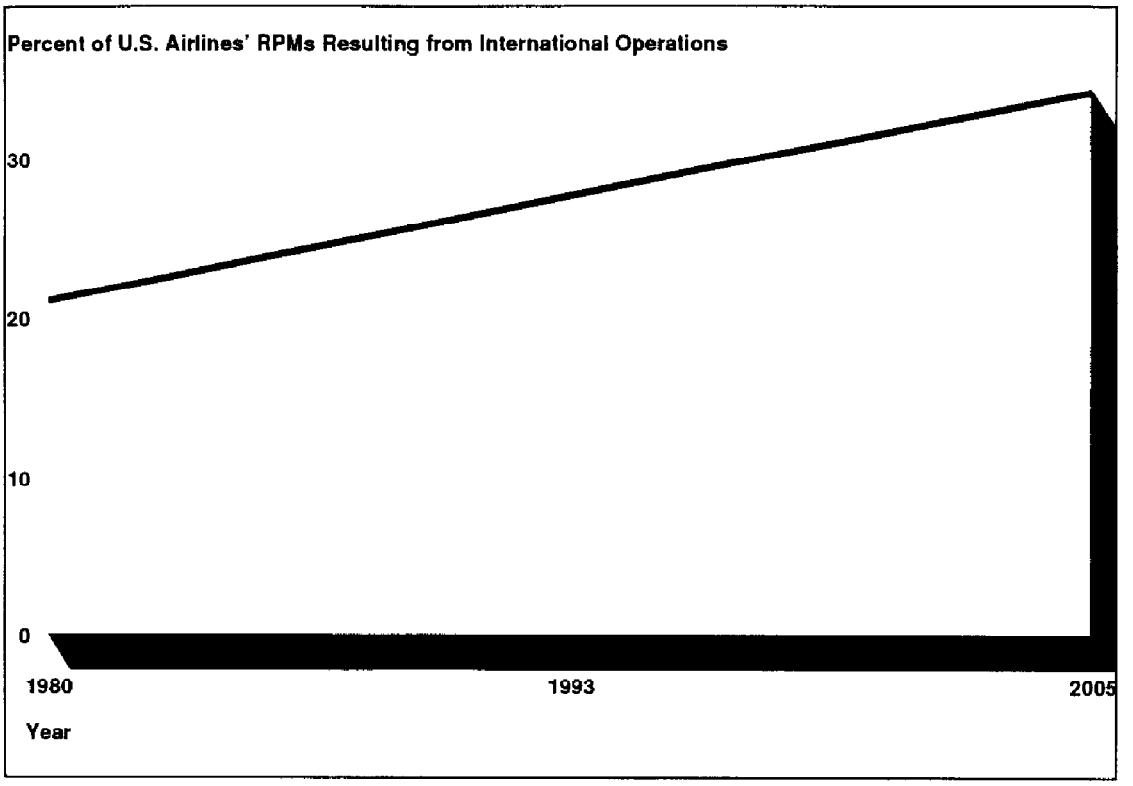
underscore two points that are relevant to international aviation. First, it is important that long term impacts be fully analyzed before making policy decisions. Second, bilateral accords and alliances, like the domestic barriers to competition, are extremely difficult to undo once they are in place.

We recognize that developing a more strategic approach is not easy. Individual crises arise that require immediate attention by DOT. However, by strengthening the level of its analyses, DOT can better position itself to utilize the leverage at its disposal and meet the challenges posed by such issues as code-sharing before crises arise. DOT's announced intention to develop a new international aviation policy provides it with a good opportunity to craft such a strategy. We would now like to discuss these points in more detail.

INTERNATIONAL TRAFFIC HAS BECOME INCREASINGLY IMPORTANT TO U.S. AIRLINES

Since 1980, international operations have become more important to U.S. airlines. Between 1980 and 1993, the international share of revenue passenger miles (RPM) for the U.S. scheduled carriers grew from 21.1 percent to 27.7 percent. This trend is expected to continue. The Federal Aviation Administration estimates that by the year 2005, the international share of the U.S. carriers' RPMs will be almost 35 percent. (Figure 1)

Figure 1: Trend in the International Share of U.S. Airlines' Revenue Passenger Miles, 1980-2005 (in percent)



Source: Federal Aviation Administration.

INTERNATIONAL AVIATION MARKET HAS BECOME MORE DYNAMIC BUT REMAINS HEAVILY REGULATED

Over the last decade, international aviation market conditions have changed. Stronger, more efficient U.S. airlines have replaced the failed or financially ailing incumbents--Braniff, Eastern, Pan Am and TWA. The newcomers actively sought access to the growing international market. Foreign airlines, on the other hand, sought to increase their access to the U.S. However, despite its increasingly dynamic nature, international aviation remains heavily regulated. In addition to having their access to foreign markets greatly limited, U.S. airlines also continue to face a variety of operating and marketing restrictions at a number of major international airports in Asia and Europe.

Entry of Stronger, More Efficient U.S. Airlines Has Changed International Market Conditions

The emergence of the largest U.S. airlines as major participants in international markets has changed the nature of international aviation competition. By 1992, the financially ailing incumbent U.S. international airlines had been largely replaced by stronger domestic airlines--American, Delta, and United--on major routes to Europe and Latin America. In addition, United joined Northwest as a major competitor on routes to the Far East. The newcomers, with well-developed domestic hub-and-spoke networks, could feed traffic from interior, non-gateway U.S. cities to their newly acquired international routes. Moreover, these airlines were generally more productive and had lower operating costs than many of their foreign competitors and had greater financial resources than the U.S. airlines they replaced. In addition, they introduced into international markets the innovative operating and marketing practices, such as yield management systems, that they had developed to compete in the deregulated U.S. market. As a result, these airlines became formidable international competitors.

For their part, foreign airlines sought to increase their access to the U.S. market. Three foreign airlines, for example, made direct investments in U.S. airlines: SAS purchased equity in Continental (1988), KLM invested in Northwest (1989), and British Airways invested in USAir (1993). More recently, many foreign carriers have entered into alliances with U.S. airlines that allow them access to U.S. domestic traffic by marketing flights provided by a U.S. airline within the United States as their own. Under such a code-sharing arrangement, a U.S. and foreign airline use each other's two-letter designator code (e.g., "BA" for British Airways) to list flights in computer reservation systems. Under British Airways' code-sharing arrangement with USAir, for example, a USAir Cleveland-Philadelphia flight connecting to a British

Airways Philadelphia-London flight is shown on CRS displays as a "BA" online connection, with an asterisk indicating that the Cleveland-Philadelphia segment is a code-share. Such code-sharing is valuable because it allows (1) foreign airlines to connect U.S. passengers traveling from non-gateway U.S. cities to its international network and (2) U.S. airlines to serve foreign markets indirectly that they do not serve directly.

Despite Changing Market Conditions, International Aviation Remains Heavily Regulated

In contrast to the U.S. domestic market, in international markets fares, routes, the number of competitors, the number of seats, and the frequency of flights are set by bilateral agreements between governments, covering service between the United States and 107 countries. (App. I lists typical provisions contained in bilateral agreements.) Although some countries, such as the Netherlands, have reached agreements with the United States that remove such restrictions, the rigid, regulated regime that governs the international marketplace has generally remained.

Emergence of More Efficient U.S. Airlines Has Caused Foreign Countries to Maintain or Attempt to Increase Access Restrictions

Despite continuing restrictions, the U.S. market share of traffic between the U.S. and other countries has increased. In the transatlantic market, the U.S. share increased from 42 percent in 1980 to 47 percent in the first half of 1993. In the Far East market, the U.S. share has increased from 41 percent in 1980 to 53 percent in the first half of 1993. In the South American market, the U.S. share increased from 45 percent to 50 percent during that period. These increases reflect in part the substitution of stronger, more efficient U.S. competitors in those market. In response to this growth, some countries, such as the United Kingdom, have maintained extensive restrictions on U.S. airlines'

access to and beyond their markets. Others have renounced their bilateral agreements with the United States in an attempt to restrict U.S. airlines' access to their traffic. For example, in 1989, Thailand renounced its bilateral agreement with United States. Likewise, in May 1992, the French government renounced its bilateral with the United States because of the U.S. share of traffic between the United States and France had risen from 49 percent in 1980 to 70 percent in 1992.

Over the last decade, DOT, in conjunction with the U.S. Department of State--based on the success of domestic deregulation in lowering air fares and expanding service--sought to negotiate bilateral agreements that would increase competition in international markets. DOT's goals included securing agreements that would (1) designate several airlines to serve the same route or routes, (2) increase airlines' freedom to set fares and capacity, and (3) eliminate discrimination and unfair competitive practices faced by U.S. airlines abroad. Ultimately, the agency sought to achieve a deregulated international environment, commonly referred to as open skies.

Because of foreign opposition to extending deregulation, these attempts to negotiate liberal bilateral aviation agreements have produced mixed results. For example, DOT concluded bilateral agreements with several countries, including Belgium, Germany, Jamaica, the Netherlands, and Singapore that reduced restrictions on U.S. airlines. However, only the agreement with Germany involved a major aviation trading partner. Moreover, the liberal U.S.-Germany agreement has since been supplanted by a temporary accord that limits growth opportunities for U.S. airlines. Other major aviation trading partners, such as the United Kingdom, have refused to liberalize their agreements with the United States, and others, such as Japan, have declined to further liberalize their agreements.

In 1987 the European Union (EU) moved gradually to liberalize aviation regulations and create a single EU air travel market.[1] In 1993, the EU implemented the third and final phase of measures aimed at reducing the power of individual member countries to intervene in airline pricing, market access, and the amount and frequency of service offered by European carriers on routes within the Union. As we reported, however, individual EU countries are not prepared to cede control of their international aviation policies to the EU. As a result, the United States will continue to negotiate with the individual EU countries for the foreseeable future.

U.S. Airlines Continue to Face Operational and Marketing Restrictions in Overseas Markets

In addition to the extensive regulation of international operations, U.S. airlines have also experienced a variety of "doing-business" problems at a number of international airports in the Far East and Europe.[2] Although these problems do not affect only U.S. airlines, foreign airlines generally do not face the same restrictions when operating in the United States. These problems reduce U.S. airline competitiveness, efficiency, and profitability in foreign markets. They include (1) inadequate access to competitive landing and take-off slots at foreign airports, (2) inadequate or inefficient passenger and cargo terminal facilities, (3) operating restrictions and high airport fees, and (4) cargo processing delays.

Some U.S. airlines complain that even though they have the right under bilateral agreements to serve Frankfurt's Rhein-Main,

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[1] International Aviation: Measures by European Community Could Limit U.S. Airlines' Ability to Compete Abroad (GAO/RCED-93-64, Apr. 26, 1993). The EU was formerly the European Community.

[2] At the request of this Subcommittee, we are currently examining these problems and their competitive impacts.

London's Heathrow, and Tokyo's Narita airports, they are unable to secure sufficient take-off and landing slots, or are unable to obtain slots at commercially competitive times. In addition, they are required to use inadequate facilities such as overcrowded or old passenger terminals, insufficient passenger check-in counters, and limited cargo warehouse space. For example, at Tokyo's Narita Airport, U.S. airlines and other foreign airlines occupy half of an old, overcrowded terminal as it undergoes renovation, while Japan's national airlines occupy a spacious new terminal. Adequate, convenient terminal space, according to U.S. and foreign airline representatives, is an important factor in attracting the business traveler, who generally flies more frequently and pays higher fares, and thus is a more profitable passenger than the leisure traveler.

Operating restrictions include limits on the ability of U.S. airlines to provide certain passenger and cargo services, such as using their own personnel to address the needs of passengers or handle baggage, that they customarily perform at U.S. airports. For example, the Frankfurt-Rhein-Main, Madrid-Barajas, Milan-Malpensa, Rome-Fiumicino, Paris-Charles de Gaulle, and Paris-Orly airports prohibit U.S. and other airlines from baggage handling for themselves. Instead, only one or two entities, either the airport authority or the national airline, are allowed to provide handling services. As a result, U.S. airlines often pay much higher prices for these services. Similarly, cargo problems include delays in or high costs for freight forwarding and customs processing. For example, at Narita Airport, U.S. airlines must pay the Japanese customs bureau about $1,000 an hour for overtime work, while U.S. customs offices at international airports provide round-the-clock service at no extra cost. Other cargo problems include difficulties in obtaining brokerage licenses or delivering cargo to customers. For example, the Republic of Korea's regulations prohibit foreign companies from operating trucking companies there, forcing U.S. airlines to hire less efficient Korean trucking

companies, raising operating costs and causing a loss of custody over express packages.

DESPITE SEVERAL CONSTRAINTS, DOT HAS SUBSTANTIAL LEVERAGE TO STRENGTHEN U.S. AIRLINES' POSITION IN FOREIGN MARKETS

In attempting to increase the opportunities for U.S. airlines in international markets and reduce the many doing-business problems they encounter, DOT, in conjunction with the State Department, faces a difficult challenge. DOT must negotiate increased freedoms for U.S. airlines in a highly regulated international environment while balancing the competing interests of the multiple U.S. airlines that serve international markets.

This challenge is heightened by the fact that foreign governments are often averse to competition by the more efficient U.S. airlines. France, for example, renounced its bilateral agreement with the United States in 1992 largely because Air France's share of the U.S-France market was in steep decline vis-a-vis the U.S. airlines. Finally, in negotiating with foreign governments, DOT must balance the often competing interests of multiple U.S. airlines that serve foreign markets. In negotiating with the United Kingdom in an attempt to obtain increased access for U.S. airlines, for example, DOT must balance the desire of such airlines as Delta to obtain access to Heathrow Airport--the world's largest international airport--against the desire of American and United, which already serve Heathrow, to obtain valuable rights to serve European destinations from Heathrow (commonly referred to as "beyond rights").

Despite these constraints, DOT has substantial leverage at its disposal to induce foreign governments to open their markets. U.S. leverage is rooted in the desire of foreign carriers to obtain greater access to the U.S. market, which accounts for 40 percent of the world's aviation traffic. Although many foreign airlines serve

U.S. gateways, they recognize that they could greatly increase their revenues if they were able to connect U.S. passengers travelling from non-gateway cities to their international routes. In addition, enhanced access to the U.S. market for foreign airlines means the right to serve additional U.S. gateways, coterminalize gateways[3], and carry traffic between non-U.S. points immediate to or beyond U.S. gateways.

DOT'S ABILITY TO DEPLOY LEVERAGE HAS BEEN LIMITED BY THE NEED TO RESOLVE CRISES AND BY INSUFFICIENT ANALYSIS

Over the last decade, DOT has pursued an international aviation policy that attempts to maximize the benefits for U.S. consumers through creating a more competitive international air travel market. Key components of DOT's recent policymaking, however, have been strongly influenced by the need to resolve crises facing financially weaker airlines--such as those facing Pan Am in 1991, Northwest in 1992, and USAir in 1993. This reactiveness has raised questions about how effectively DOT utilizes its substantial leverage. DOT's ability to deploy this leverage, as well as assess the long-term competitive impacts of its actions, are handicapped by limitations in the traffic data the agency currently collects.

DOT's Level of Analysis Prior to Approving Code-Sharing Arrangements Can Be Strengthened

In approving code-sharing arrangements between U.S. and foreign airlines, DOT conducts little analysis of long term

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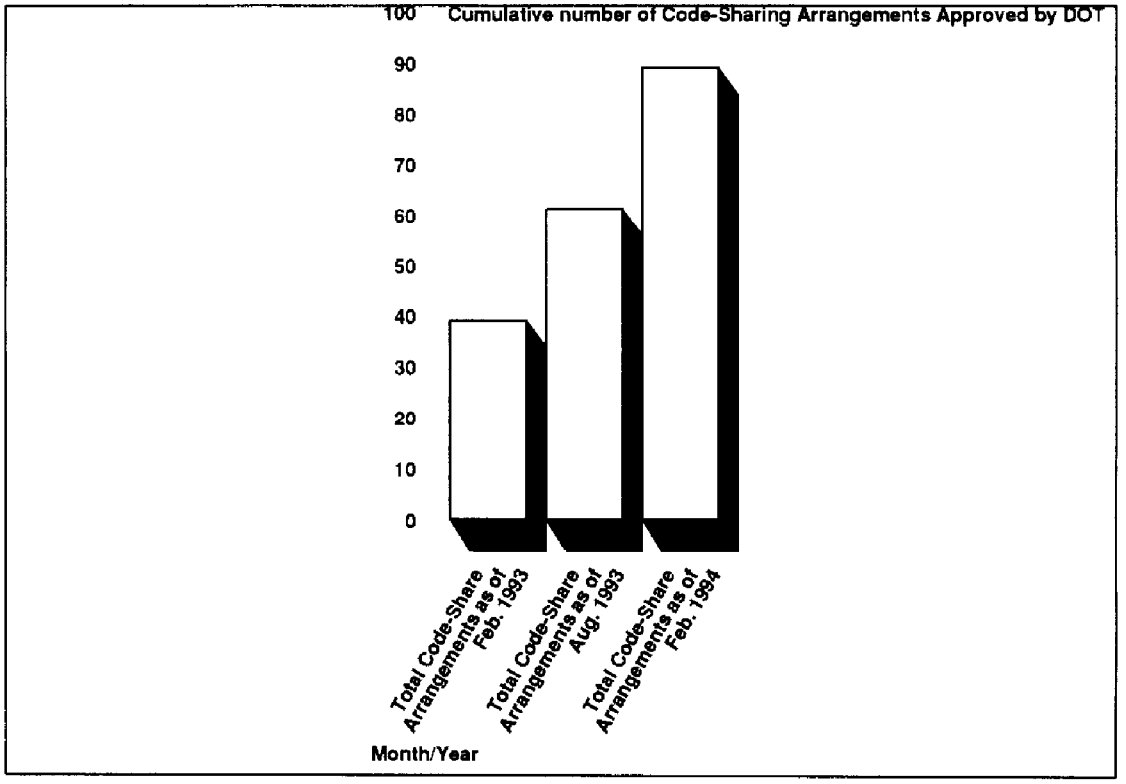
[3]Coterminalization is the right of an airline to serve two or more points in a foreign country on the same flight, provided these points are contained in the same route (e.g., Alitalia is permitted to serve both Boston and New York on a flight from Rome).

competitive impacts.[4] Between 1987 and February 1993, DOT approved 39 international code-sharing arrangements, but since February 1993 the total number of such arrangements approved by DOT has more than doubled to 89. (See fig. 2). According to DOT officials, the agency has rejected only one code-sharing application since 1987.

Figure 2: Growth in the Total Number of Code-Sharing Arrangements Between U.S. and Foreign Airlines Approved by DOT, Feb. 1993 to Feb. 1994



Source: DOT.

The nature of these code-sharing arrangements has also changed. Originally, these agreements linked a U.S. and foreign carrier in a specific city-pair market. Although these limited

[4]At the request of the Chairman, Subcommittee on Aviation, Senate Committee on Commerce, Science, and Transportation, we are currently examining the competitive impacts of these arrangements and DOT's policymaking in this area.

arrangements are still prevalent, several carriers have entered into more "strategic" alliances, whereby a U.S. and foreign carrier code-share in a large number of markets. Such strategic alliances often grant foreign airlines extensive access to the U.S. market. Examples of such alliances include those between United and Lufthansa, Northwest and KLM, and USAir and British Airways.

Despite the growing importance of code-sharing, DOT's practice has been to approve these agreements while conducting little analysis to determine the benefits being granted to foreign carriers or the long term impacts on (1) other U.S. airlines--particularly those that have been unable to obtain direct access to the foreign market involved--and (2) the incentives left for foreign countries to increase access to their market. DOT's ability to assess code-sharing's effect on traffic movements within the United States and between the United States and other countries is hindered by limitations in the traffic data it collects. First, DOT's data do not indicate which flights involve code-sharing. Second, the data do not always denote which code-share partner is actually operating a flight. For example, DOT's traffic data may show a passenger travelling from Chicago to Geneva via New York as travelling on Delta throughout even though Swissair transported the passenger from New York to Geneva. DOT officials responsible for collecting this data told us that for code-share flights, some carriers identify the operating carrier while others do not.

Third, because DOT's data only provide information on trips that at some point involve a U.S. carrier, the data do not provide information on foreign carrier code-share traffic if a U.S. carrier is not involved. For example, DOT does not collect traffic data on flights originating in Detroit and travelling on KLM aircraft to Amsterdam. Even though the flights are Northwest/KLM code-share flights, no data are collected because no U.S. carrier is involved in the actual transporting of passengers. Because of these three limitations, DOT cannot effectively analyze shifts in traffic from

U.S. to foreign carriers caused by code-sharing or determine the extent to which code-sharing benefits foreign airlines.

Acknowledging that such limitations have hindered their ability to assess the value of and impacts caused by code-sharing, DOT officials have recently asked two U.S. airlines--Northwest and USAir--that code-share with foreign airlines to file special reports on their code-share traffic starting in mid-May 1994. The utility of this request is limited, however, because it does not require these airlines or any other U.S. airline that code-shares with foreign airlines to change their regular traffic reporting to identify code-shared flights. In addition, it provides DOT with no information on code-share traffic in which only a foreign airline's aircraft is used. Several DOT analysts emphasized to us that, in addition to the special request, they will probably need broader and more detailed information from all U.S. carriers that code-share in order to fully analyze code-sharing's impacts.

Because it has done little analysis of code-sharing's impacts, DOT has not determined the value of code-sharing agreements to foreign airlines. As a result, there is concern that DOT may have granted foreign airlines increased access to the U.S. market without obtaining equivalent opportunities for U.S. carriers in foreign markets. For example, as a result of its desire to bolster cash-strapped Pan Am and TWA by replacing them with United and American as the U.S. airlines allowed to operate at London's Heathrow Airport, DOT reached an agreement in 1991 with the United Kingdom that allowed British Airways extensive access to the United States market via code-sharing. At the same time, the agreement continued to limit to two the number of U.S. airlines that could serve Heathrow Airport and continued to severely restrict the ability of those airlines to serve destinations beyond Heathrow. DOT officials told us that they did little analysis to determine the value of such code-sharing rights before concluding this agreement.

DOT's approval of code-sharing arrangements without analyzing the competitive implications is similar to its actions in approving domestic mergers during the 1980s. As we reported in 1989, domestic mergers were approved with little analysis of the long-term competitive implications.[5] Some airline officials contend that code-sharing will have several negative long-term impacts, including: (1) countries like the United Kingdom and Germany, which have already obtained extensive access for their largest airlines to the U.S. market through code-sharing arrangements, will no longer have an incentive to open their highly restricted markets to U.S. airlines and (2) competition will be limited if the dominant airlines in a market code-share. Less competition could lead to higher fares. In addition, concerns exist that code-sharing airlines gain an unfair marketing advantage because they are allowed to list the same flight twice in computer reservation systems (once under the U.S. code and once under the foreign code). Travel agents prefer to book flights that are listed on the first CRS screen, and multiple listings crowd out the number of flights listed on the first screen.

On the other hand, international code-sharing has positive benefits. Code-sharing with a foreign airline allows U.S. airlines to serve international markets that they could not otherwise serve. Delta's recent code-sharing agreement with Virgin Atlantic, for example, will--if approved--allow Delta to list in computer reservation systems service to Heathrow. Although it is not allowed under the British bilateral to directly serve Heathrow, Delta will be able to list Virgin Atlantic flights to Heathrow as its own. As a result, Delta will be able to market to U.S. travelers an online service to Heathrow, even though it involves a change of carrier. In addition, many U.S. airline representatives contend that code-sharing between U.S. and foreign airlines

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[5] Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

enhances international competition by allowing airlines that could not otherwise do so to enter a market in competition with the airlines already serving that market. For example, Delta will be able to compete with United, American, and British Airways on routes between Heathrow and the United States.

Although our current examination of code-sharing has not reached a point to allow us to make definitive conclusions about the practice, our preliminary observation is that code-sharing does not lend itself to categorical conclusions. This observation is similar to what we reported concerning foreign investments in U.S. airlines.[6] As with each foreign investment arrangement, each code-sharing agreement is different and must be examined on a case-by-case basis. A full examination would analyze the potential:

-- increases in traffic and revenues that will accrue to the foreign airline from connecting U.S. traffic from nongateway cities to its international routes;

-- incremental traffic and revenue gains for the U.S. code-share partner;

-- traffic and revenue losses for other U.S. airlines competing in the affected markets;

-- decline in international competition on routes currently served by both code-sharing partners; and

-- effect on the incentives left for foreign countries to increase access to their markets if the specific code-share is approved.

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[6]Airline Competition: Impact of Changing Foreign Investment and Control Limits of U.S. Airlines (GAO/RCED-93-7, Dec. 9, 1992)

By strengthening the level of its analysis, DOT can better position itself to utilize the leverage at its disposal and meet the challenges posed by such controversial issues as code-sharing. Without such information, however, DOT will be limited in its ability to effectively negotiate increased freedoms for U.S. airlines in international markets.

Other Issues Affect U.S. International Aviation Policy

DOT and the State Department's ability to strengthen the competitive position of U.S. airlines in foreign markets is also limited by the (1) State Department's policy of rotating staff and (2) DOT and State's policy of greatly restricting the participation of U.S. passenger and cargo airlines in bilateral negotiations.

Currently, U.S. bilateral negotiating teams are chaired by career foreign service officers at the State Department who are assigned for a temporary period. As the President's Commission to Ensure a Strong Competitive Airline Industry concluded, this practice of staff rotations limits U.S. expertise at the negotiating table.[7] To improve the level of aviation expertise resident at the State Department, the Commission recommended that State strengthen its aviation career track.

Some U.S. passenger and cargo airlines have also raised concerns about DOT and State's policy of not allowing U.S. airlines to directly participate in or observe bilateral negotiations. Although representatives of foreign airlines often participate in bilateral negotiations, U.S. passenger and cargo airlines are represented by an industry trade group, the Air Transport Association. Some U.S. passenger airlines, such as American, and

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[7] Change, Challenge, and Competition, The National Commission to Ensure a Strong Competitive Airline Industry (Washington, D.C.: Aug. 1993).

the Air Freight Association told us they believe that DOT and State's restriction on direct airline participation greatly limits the two agencies' ability to effectively represent and strengthen the competitive position of U.S. airlines in foreign markets. Other airlines noted, however, that such participation by airlines would unduly favor the largest U.S. airlines. Likewise, other affected parties such as airport operators emphasize that if airlines are allowed to participate in bilateral negotiations then they should be allowed similar rights.

CONCLUSIONS

Foreign markets have become increasingly important to the bottom lines of U.S. airlines. However, the success of U.S. airlines in these markets is limited because they continue to face extensive access restrictions and numerous operating and marketing impediments. In attempting to reduce these barriers, DOT has employed an open skies approach. It is now apparent, however, that a truly open skies environment is unlikely in the foreseeable future. As a result, we believe that DOT's efforts would be more effective if it adopted a strategic approach that better utilizes its substantial leverage--greater access to the world's largest aviation market--to induce foreign countries to open their markets.

We recognize that developing such an approach is not easy. Individual crises arise that require immediate attention by DOT. Likewise, DOT must represent multiple carriers when negotiating with foreign governments that are usually representing the interests of a single national carrier. However, we believe that DOT can develop a strategy that is less ad hoc and more rooted in fuller assessments of the long-term impacts of its policymaking on the competitive position of U.S. airlines in foreign markets. DOT's current effort to issue a new international aviation policy provides the agency a good opportunity to craft such a strategy. We believe that DOT must approach this task with a sense of

urgency, however. The nature of international aviation competition is changing rapidly. The number of code-sharing arrangements between U.S. and foreign airlines, for example, has more than doubled within the last year. Furthermore, bilateral agreements set precedents and are difficult to undo.

In our view, a more strategic approach would include (1) better analysis by DOT of long-term competitive impacts before reaching agreements with foreign governments or making major policy decisions, (2) improved analytical capability by identifying code-share flights in its traffic data, (3) additional expertise and experience in international aviation at the State Department, and (4) a review of the existing policies that severely restrict the participation of U.S. passenger and cargo airlines and other affected parties in bilateral negotiations. With these elements, DOT, working with the State Department, can more effectively capitalize on the leverage it has to bear and thus strengthen the competitive position of U.S. airlines in international markets over the long term.

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This concludes our testimony. We would be happy to respond to any questions you may have.

TYPICAL PROVISIONS CONTAINED IN BILATERAL AGREEMENTS

Area of Regulation	Provision
Pricing: Establishes prices to be charged by designated airlines for services over the agreed routes.	Double Approval: Fare requires the approval of both governments before it can take effect. (most restrictive) Country of Origin: Fare requires the approval of the U.S. government for U.S. origin traffic and the approval of the foreign government for foreign origin traffic Double Disapproval: Both countries must veto a fare before it can be rejected. (most liberal)
Designation: Establishes the airlines that may offer services over the agreed routes.	Single Designation: Only one airline may operate on a given route or routes (most restrictive) Multiple Designation: More than one airline may operate on a given route or routes (ranges from two to unlimited)
Routes: Establishes the points an airline may serve en route, within, and beyond a country's territory.	--Route description that names specifically each point that may be served for the entire length of the permitted flights. (most restrictive) --Route description that provides for airlines to serve "named points in the home country to named points in the granting country and beyond". (most liberal)
Capacity: Establishes the volume and types of services to be offered by designated airlines over the agreed routes.	Predetermination: requires governmental approval of the capacity to be offered by the designated airlines (most restrictive). Ex Post Facto Review: both governments may review the capacity offered by the designated airlines in the event the either nation became dissatisfied with capacity levels.

RELATED GAO PRODUCTS

International Aviation: Measures by European Community Could Limit U.S. Airlines' Ability to Compete Abroad (GAO/RCED-93-64, Apr. 26, 1993).

Airline Competition: Strategies for Addressing Financial and Competitive Problems in the Airline Industry (GAO/T-RCED-93-11, Feb. 18, 1993).

Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines (GAO/RCED-93-7, Dec. 9, 1992).

Aircraft Certification: Limited Progress on Developing International Design Standards (GAO/RCED-92-179, Aug. 20, 1992).

Airline Competition: Industry Competitive and Financial Problems (GAO/T-RCED-92-28, Feb. 21, 1992).

Airline Competition: Effects of Airline Market Concentration and Barriers to Entry on Airfares (GAO/RCED-91-101, Apr. 26, 1991).

Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

Barriers to Competition in the Airline Industry (GAO/T-RCED-89-65, Sept. 20, 1989, and GAO/T-RCED-89-66, Sept. 21, 1989).

Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

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