U.S. Department of Transportation

Office of the Secretary of Transportation

400 Seventh St., S.W.
Washington, D.C. 20590

AUG 16 1993

SUBJ: Administration's Response to Airline Commission Report

Robert S. Goldner

FROM: for Patrick V. Murphy
Acting Assistant Secretary for Policy and International Affairs

TO: All Working Group Members

Jim New
366-4868

Attached is a draft copy of the Administration's response to the recommendations of the Airline Commission. I believe this product reflects the decisions of the NEC Working Group. If you have any changes or specific word changes please fax them to Jim New (202-366-7483) by close of business Tuesday, August 17. We are also putting this document through the regular OMB clearance process.

We are still working with the White House to determine how and when the report will be released.

Attachment

Members

CEA	Joseph Stiglitz, Expert Economist, Council of Economic Advisors
COMMERCE	Jonathan C. Menes, Acting Assistant Secretary for Trade Development, Department of Commerce
DOD	Major General Jim Klugh, Deputy Under Secretary for Defense, Designate, Logistics
✓DPC	Michael T. Schmidt, Senior Policy Analyst, Office of Domestic Policy, Old Executive Office Building
JUSTICE	Mark C. Schechter, Chief, Transportation, Energy and Agriculture, Antitrust Division, Department of Justice
LABOR	Jack Donahue, Assistant Secretary for Policy
NASA	Wesley L. Harris, Associate Administrator, Office of Aeronautics, National Aeronautics and Space Admin.
NEC	Michael Deich, Special Assistant to the President for Economic Policy, National Economic Council
OMB	Christopher Edley, Associate Director for Economics and Government, Office of Management and Budget
S&T POLICY	Timothy Newell, Assistant Director for Intergovernmental Affairs and Policy, Office of Science and Technology Policy
STATE	Richard E. Hecklinger, Acting Assistant Secretary for Economic and Business Affairs, Department of State
TREASURY	Alicia H. Munnell, Assistant Secretary for Economic Policy, Department of the Treasury
USTR	Donald M. Phillips, Assistant U.S. Trade Representative for Industry, U.S. Trade Representative

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THE ADMINISTRATION'S RESPONSE TO THE RECOMMENDATIONS OF

THE NATIONAL COMMISSION TO ENSURE A STRONG COMPETITIVE AIRLINE INDUSTRY

August 16, 1993

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ADMINISTRATION RESPONSE SUMMARY

Classifications as of NOON, Monday, Aug. 16, 1993

THIS SCHEDULE IS FOR REVIEWERS' USE ONLY. IT WILL NOT BE INCLUDED IN FINAL REPORT.

COMMISSION RECOMMENDATION	IMMEDIATELY ACCEPT	ACCEPT PREMISE – ADDITIONAL WORK NEEDED	UNDER REVIEW – FULL RESPONSE IN 30 DAYS	-REJECT	POSITION DEFERRED	TOTAL
AIR TRANSPORTATION SYSTEM EFFICIENCY & TECHNOLOGY	*7*	*7*	*2*	*1*	*0*	*17*
Global Positioning System	-	2	-	-		2
Restructuring FAA	-	3	-	-		3
Other System Capacity Issues	2	-	-	-		2
Regulatory Burden	3	2	2	1		8
Noise	2	-	-	-		2
AIR TRANSPORTATION SYSTEM FINANCIAL STRENGTH	*13*	*3*	*3*	*6*	*0*	*25*
Furthering Financial Strength	1	1	-	1		3
Bankruptcy	3	2	-	-		5
Tax Policy	5	-	-	4		9
New Entrants	1	-	-	1		2
Role of the Workforce	3	-	3	-		6
MOVING PEOPLE, PRODUCTS & SERVICES TO MARKETS WHEREVER THEY ARE	*10*	*6*	*1*	*2*	*0*	*19*
Toward A Multi-National Regime	-	2	-	-		2
Short-Term Issues	1	3	-	1		5
Other International Airline Issues	2	-	-	-		2
Aerospace Manufacturing	4	1	1	1		7
General Aviation Aircraft Production	1	-	-	-		1
Assuring Service to Small Communities	2	-	-	-		2
TOTAL	**30**	**16**	**6**	**9**	**0**	***61***

STATEMENT BY THE PRESIDENT

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AMERICA'S AIR TRANSPORTATION SYSTEM MUST BE EFFICIENT AND TECHNOLOGICALLY SUPERIOR

The Administration is in full accord with the Commission on the need to keep American's air transportation system the world's most efficient and technologically advanced. Of the Commission's 17 recommendations in this area, we will begin to implement or identify implementation approaches for 14, and continue to evaluate and provide full responses within 30 days on 2 others. Only one recommendation is rejected.

Global Positioning System (GPS)

We fully support the premise of the Commission's two recommendations for enhancing our air traffic control system through implementation of GPS. In this regard, the FAA Administrator has been charged with the task of defining what's needed to change the air traffic control system to a satellite-based system, and to bring together a public-private consortium as a means to expedite the transition to this more technologically advanced system.

Restructuring FAA

We will begin an analysis to determine the most appropriate organizational structure for resolving long-standing problems at FAA: the lack of a predictable revenue stream, inflexible personnel rules, burdensome procurement regulations and detailed oversight by outside bodies. The Commission recommendations for dealing with these complex issues have substantial merit, and will be fully considered in our analysis.

Other System Capacity Issues

We fully accept the Commission's call for a review the high-density rule and the full funding of system capacity elements.

Regulatory Burden

To reduce the industry's regulatory burden, we will undertake a review of the existing regulations, as the Commission recommends. We also will work with the Congress to more clearly define legislative and regulatory objectives, and with industry to obtain cost-benefit impact data during the early stages of rulemaking. Further, we are committed to working out suitable ways to develop and employ more effective cost-benefit analyses and to report the costs and benefits of regulatory actions on an annual basis. Two of the Commission's recommendations involve ongoing rulemakings on drug and alcohol testing and, therefore, will require further review within the framework of the Administrative Procedures Act. While initiating action on seven of eight recommendations for reducing the regulatory burden, we are rejecting the recommendation to subject FAA regulations to an annual regulatory cost budget. In our view, a regulatory cost budget standing alone would distort the rulemaking process and ultimately result in a diminution of safety benefits.

Noise

Finally, we will move immediately on both Commission recommendations concerning aircraft noise restriction and transition to a Stage 3 fleet.

ISSUE: GLOBAL POSITIONING SYSTEM (GPS)

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COMMISSION RECOMMENDATIONS

Set the goal of changing the air traffic control system to a satellite-based navigation system by 1996, *integrated with a modernized ATC system* by the end of 1997.

Accelerate the implementation of GPS and air traffic control modernization through such means as a public-private consortium, designed for expeditious development and implementation of improved technology.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The FAA Administrator has been tasked to accelerate plans for transition of the air traffic control system to a satellite-based navigation system. Beginning in 1994 GPS will be available for private-use Category I precision approaches. This strategic, evolutionary approach calls for use of GPS as a sole means of navigation in oceanic airspace in 1995, with GPS and required augmenting systems available nationwide for Category I precision approaches beginning in 1998.

The Administration recognizes that GPS alone is not sufficient to provide an efficient air transportation system. Accordingly, our goals include: (1) fielding a modular, digital terminal and en route ATC automation system, to include early implementation of Automated En Route ATC functionality; (2) accelerating standards for and certification of GPS during en route, terminal, and precision phases of flight, within constraints of technological capability; (c) working with industry to achieve consensus on standards for currently undefined functions such as datalink; and (d) modernizing the national airspace system to maintain transparency between civil and military flight operations while accommodating national security interests.

With regard to the second Commission recommendation to employ a "public-private consortium," this task will be assigned to the Joint DOT/DOD task force that has been established by Secretary Peña and Secretary Aspin to review civil use of GPS. The task force charter will be expanded to identify GPS/air traffic control technology opportunities where a public-private consortium could be used for expeditious development. Analysis will be completed within 120 days and included in a report to be submitted to the Secretaries.

ISSUE: RESTRUCTURING FAA

DRAFT

COMMISSION RECOMMENDATIONS

Create an independent federal corporate entity within the Department of Transportation to manage and fund air traffic control and related functions, including system development, procurement and maintenance. Policy control of the air traffic control system and safety oversight should stay with the federal government.

Establish a panel of FAA and industry experts, with the participation of the Department of Defense, which will report in 90 days on the specific structure and method of implementation, and which will draft legislative proposals for creation of the corporate entity.

The following principles should be embodied in the federal corporate entity's implementing act: (1) ability of the corporate entity to create and use a predictable, stable source of revenues for operations, maintenance and capital investment; (2) ability of the corporate entity to issue long-term bonds for capital purchases; (3) removal of current expenditures and revenues from the federal budget in equal amounts for a fiscally neutral effect; (4) sufficient management flexibility and compensation to attract and retain high-caliber leadership and staff; (5) flexibility to create systems for procurement, staff and budget consistent with best practices in the private sector; (6) flexibility in an orderly transfer of operating functions to the reorganized entity; and (7) continued air traffic control service to the Defense Department, meeting national security requirements.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration agrees with the Commission that FAA's effectiveness has been limited by several factors, including the lack of a predictable revenue stream, inflexible personnel regulations, burdensome acquisition regulations, and detailed oversight by many outside bodies. The Commission's recommendation to create an independent corporate entity with DOT to manage and fund air traffic control (ATC) activities is one approach for improving effectiveness in these areas.

The FAA Administrator, assisted by a committee comprised of DOT and DOD experts, has been given the task to assess, within 180 days, the cost, risk, operational, legal and safety issues associated with this and other potential approaches for improving ATC effectiveness. Congressional representatives, industry leaders, and other aviation experts will be consulted as appropriate. Based on this analysis, the Secretary of Transportation will prepare and present to the President an agenda for change with respect to air traffic control services.

ISSUE: OTHER SYSTEM CAPACITY ISSUES

DRAFT

COMMISSION RECOMMENDATIONS

FAA review the rule that limits operations at "high density" airports with the aim of either removing these artificial limits or raising them to the highest practicable level consistent with safety requirements. (Washington National Airport's legislated limits would not be affected.)

Congress fully fund system capacity elements -- facilities and equipment; airports; research, engineering and development; and FAA operations -- as long as these remain within the federal budget process.

ADMINISTRATION POSITION

Immediately Accept.

The Department of Transportation will conduct a comprehensive examination of the High Density Rule to assess its viability as an efficient air traffic and delay management device and determine what, if any, modifications can be made. In addition to air traffic considerations, the analysis will assess capacity at the airports affected by the rule and the impact on airline competition, fares and service patterns. The analysis also will evaluate the rule's economic, financial and environmental implications, including the process for allocating domestic and international slots and alternatives such as peak-period pricing.

With regard to the Commission recommendation on funding, the Administration will support, through the President's budget, full funding of projects that will have a demonstrable impact on system capacity.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

FAA subject regulations to an annual regulatory cost budget -- except for emergency regulations needed to eliminate a direct and immediate threat to the traveling public.

ADMINISTRATION POSITION

Reject.

The Administration believes that a mechanism to prioritize rulemakings is worthwhile, but is concerned that a regulatory cost budget may distort the rulemaking process and ultimately result in a diminution of aviation safety. Effective utilization of industry resources to enhance system safety should be a consideration in the regulatory process, but not the driving force. Aviation rulemaking must consider not only costs, but also benefits derived. In this regard, the Administration is reviewing and revising the regulatory review process.

Developing an appropriate regulatory cost budget would present significant challenges:

- Selecting the type of regulatory cost budget, *e.g.* (1) cumulative cap, (2) annual limit on present value of costs for final regulations issued for a given year, or (3) annual limit on aggregate costs incurred by industry from all existing regulations throughout the compliance period.

- Determining the appropriate level of the regulatory cost budget to address actual safety needs and negotiating agreement among all parties to abide by established parameters.

- Setting priorities within the budget, *e.g.*, how to handle congressionally mandated rulemaking items, particularly if the sum exceeds the regulatory cost budget; whether to subordinate recommendations by FAA, NTSB, and the industry to Congressionally mandated rulemakings; how to integrate petitions for rulemaking from industry itself within the structure of priorities; and whether exemptions from the budget limit should be allowed.

- Determination of regulatory costs. Since the costs of a rulemaking are usually unknown until the specific requirements have been hammered out, the question arises of whether FAA should be required to withhold rulemakings from one year to the next if the regulatory budget has been exceeded.

- Rulemakings often affect only segments of the industry, such as one type of aircraft or newly certificated versus existing carriers, raising the issue whether the cost burden should be distributed equally across sectors or across airlines.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

Congress and the Department of Transportation be informed of the annual costs their own proposals would impose on the industry.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration believes that all regulatory actions, whether initiated by FAA, DOT or Congress, should be preceded by complete analyses and a full understanding by the originators of all cost impacts. For those rules mandated by Congress or initiated by the Administration, FAA will prepare a preliminary cost/benefit analysis prior to issuing a notice and brief the appropriate officials on the results. Based on guidance from the briefing, FAA will take whatever additional action is necessary, including but not limited to issuing the notice as prepared, modifying the proposal to mitigate the estimated cost burden, or terminating the project entirely.

For existing rules, FAA will invite the aviation industry to submit data on the actual costs incurred to comply with provisions of the regulations. This, coupled with data on benefits, will form the basis for an annual report to Congress.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

Congress, the Department of Transportation and FAA more clearly define legislative and regulatory proposals to address problems effectively and efficiently.

ADMINISTRATION POSITION

Immediately Accept.

FAA currently uses the Aviation Rulemaking Advisory Committee, a group of 61 organizations representing a cross-section of aviation interests, as a way to take advantage of industry technical expertise and experience in developing rules, and to resolve issues in an open forum. FAA solicits input from the Advisory Committee to ensure that prior to beginning work on an Administration initiative or Congressionally directed action, the intent is clearly understood and articulated to allow regulated parties to comply as effectively and efficiently as possible. Should question arise regarding the most efficient or effective way to achieve a legislative or regulatory proposal, FAA will request comments in notices of proposed rulemakings to assist regulated parties in complying in the most efficient and least costly manner.

<u>*ISSUE:*</u> REGULATORY BURDEN

DRAFT

<u>*COMMISSION RECOMMENDATION*</u>

Establish an ongoing and independent mechanism to provide objective outside guidance and expertise to FAA to assist in cost/benefit analysis methods and to review cost/benefit disputes.

<u>*ADMINISTRATION POSITION*</u>

Accept Premise - Additional Work Needed.

The Administration believes this recommendation has merit, particularly with regard to ways to obtain guidance and expertise on cost/benefit methodology. The Office of Information and Regulatory Affairs in the Office of Management and Budget will establish and lead an interagency working group to expand and improve regulatory cost/benefit analysis and to review and resolve significant cost/benefit disputes.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

FAA seek cost impact data from industry early, and industry should provide requested data so the agency can make an informed decision on proceeding with a proposal.

ADMINISTRATION POSITION

Immediately Accept.

With assistance and support from the Aviation Rulemaking Advisory Committee, FAA will identify options and opportunities for receiving cost input data early during the regulatory process. The Advisory Committee's participation will foster FAA-industry cooperation and facilitate the early exchange of data so the agency can make informed decisions before proceeding with a proposal. Also, FAA will immediately assign additional resources to the economic analysis component of its regulatory program to develop ways to better identify and communicate accurate, timely cost data between industry and the agency.

ISSUE: REGULATORY BURDEN

COMMISSION RECOMMENDATION

The random drug testing rate be established immediately at 25 percent, which is the rate used for FAA's own safety-related staff, including air traffic controllers. FAA should complete a review within 12 months to reduce the rate to the lowest level possible without reducing the deterrent effect or the statistical reliability of sampling.

ADMINISTRATION POSITION

Under Review - Full Response in 30 Days.

By law, any action must await the completion of an ongoing rulemaking. The Department of Transportation (DOT) issued an Advance Notice of Proposed Rulemaking to gather information on which to base a change in the random testing rate. FAA will now proceed to the next step, which is the issuance of a Notice of Proposed Rulemaking.

The change to the random testing rate for DOT employees, while made only after considerable forethought, was a relatively simple procedural matter involving amending a DOT order. By contrast, the random testing rate for the aviation industry, as for other transportation industries, was established by public rulemaking in accordance with the Administrative Procedures Act. It is essential that the rulemaking to change the random drug testing rate fully adhere to the act's provisions.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

New pre-employment alcohol testing rules not be adopted, and any random alcohol testing of airline employees should be at no more than a 10 percent rate.

ADMINISTRATION POSITION

Under Review - Full Response in 30 Days.

The Administration acknowledges that there are many questions on the value of pre-employment and random alcohol testing, and that imposition of such testing is likely to be costly and controversial. However, the Omnibus Transportation Employee Testing Act of 1991 explicitly includes these tests among the types of tests it mandates.

The Department of Transportation included pre-employment and random alcohol testing in the Notice of Proposed Rulemaking (NPRM) issued to implement the act, and currently has no legal basis for excluding such testing from the final rule. Based on the Commission's recommendation, however, the issue should be reviewed by Congress and legislative relief from these requirements should be considered.

The act does not require any specific rate for random alcohol testing. If random testing is required, the 10-percent rate cited by the Commission is within the range contained in the NPRM.

ISSUE: REGULATORY BURDEN

DRAFT

COMMISSION RECOMMENDATION

The Department of Transportation and FAA undertake a short-range regulatory review effort in close coordination with industry and interested parties to eliminate or amend existing regulations to reduce regulatory burdens consistent with safety and security considerations.

ADMINISTRATION POSITION

Immediately Accept.

The Deputy Secretary of the Department of Transportation will spearhead the recommended review, which will include a systematic evaluation of existing rules under the forthcoming White House regulatory review process, an implementation schedule, and periodic progress reports to industry and the public. Although safety and security must be paramount, there may be rules that are no longer needed or can be revised to provide for more cost-effective approaches.

To avoid wasting resources and duplicating prior reviews, the Department will ask the industry for suggestions on regulatory areas where they believe the regulatory burden exceeds benefits. It is anticipated that FAA's Aviation Rulemaking Advisory Committee, discussed earlier, will play an important role in this regard.

ISSUE: NOISE

DRAFT

COMMISSION RECOMMENDATIONS

Maintain the existing provisions of the 1990 Noise Act which protect the carriers' investment in Stage 3 aircraft by prohibiting enactment of local noise restrictions on Stage 3 aircraft without FAA approval.

The federal government not enact any provision to mandate the replacement, retirement or modification of Stage 3 aircraft for noise purposes.

ADMINISTRATION POSITION

Immediately Accept.

FAA will continue to ensure carrier compliance with the provisions in 14 CFR part 91, *Transition to an All Stage 3 Fleet Operating in the 48 Contiguous United States and the District of Columbia*, which provide for the phaseout of Stage 2 aircraft by the year 2000, with limited waiver provisions. This transition to an all Stage 3 fleet will result in substantial noise relief at all airports, ultimately reducing the population affected by significant levels of aircraft noise from 2.7 million to 400,000.

The transition to an all Stage 3 fleet is moving faster than required by the national schedule. The 1992 operator compliance progress reports filed with FAA show that as of December 31, 1992, the fleet mix of Stage 3 aircraft was 59.3 percent overall and 56.3 percent for domestic aircraft. This is well ahead of the minimum of 55 percent required by December 31, 1994.

FAA will continue to exercise review and approval authority over all local Stage 3 restrictions proposed by airport operators, pursuant to the airport Noise and Capacity Act of 1990 and its implementing regulation. In most cases, the national schedule for transition to an all Stage 3 fleet should achieve the noise mitigation objective of airports and their affected communities. On the rare occasion when an airport operator concludes that additional noise relief is needed, FAA will urge the airport to exhaust all means to work with the local airport users in reaching voluntary agreement on any additional measures.

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THE AIR TRANSPORTATION SYSTEM MUST HAVE THE FINANCIAL STRENGTH TO RESPOND TO RAPID CHANGE

The Administration strongly endorses the Commission's view that the financial health of the air transportation system is central to the vitality of the U.S. and world economies, and is a crucial factor in keeping America competitive in the global marketplace. Of the 25 recommendations proffered by the Commission for furthering the system's financial strength, we are taking actions to implement 16. Three recommendations require further review to evaluate adequately; six recommendations are rejected.

Furthering Financial Strength

We concur in the Commission's assessment that the Department of Transportation (DOT) can and should do a better job of monitoring airlines' financial conditions. DOT has ample authority to do so, as the Commission itself points out, and Secretary Peña is committed to exercising this authority to ensure a healthy, safe and competitive industry. For these reasons, we see no advantage to establishing a Presidentially appointed airline financial advisory committee as recommended by the Commission. While such a committee could bring a diverse perspective to the financial problems and conditions facing the airline industry, the Department already can and does receive this perspective from confidential information provided through meetings with senior representatives of finance, industry and labor. These representatives are more likely to share their business plans, strategies and insights under the existing arrangements than they would before the more public forum suggested by the Commission.

Bankruptcy

We are immediately accepting the Commission's recommendations regarding limits on the time period for bankrupt airlines to assume or reject leases for scarce airport gates; allowing certain governmental bodies to sit on creditors' committees; and clarifying bankruptcy code provisions on aircraft leases. Two other recommendations -- time limits on the filing of a reorganization plan by a bankrupt carrier and participation by the Secretary of Transportation in bankruptcy proceedings -- are accepted in principle, with additional work to be done on implementation mechanisms.

Tax Policy

Enactment of the President's budget plan is a key step in creating the climate for the Nation's economic growth and global competitiveness. This plan reflects the willingness of the Administration to make hard choices affecting all segments of the economy. The various tax-related changes recommended by the Commission were known when those choices were decided. While it does not include all the changes urged by the Commission, the final plan eases provisions of the alternative minimum tax and exempts the airlines from the transportation fuel tax through September 1995, clearly signaling our concern for revitalizing the industry's financial condition. In addition, we fully support the Commission's recommendations regarding the expenditure of Customs, INS and Agriculture inspection fees; rigorous enforcement of existing grant assurance language banning diversion of airport revenues to non-airport purposes; and approval of only those applications for Passenger Facility Charges (PFC) that comport with the PFC statute's criteria. The Commission recommendation on the use of the strategic petroleum reserve to mitigate the impact of jet fuel price spikes is not considered workable.

New Entrants

We fully support the Commission's recommendation that DOT continue to certify new applicants consistent with its rigorous fitness standards. However, the recommendation calling for new entrants to meet the same Stage-3 fleet requirements as existing carriers is rejected. By providing minor relief for new carriers, the existing rule avoids raising a barrier to new entry.

Role of the Work Force

We are immediately accepting the three Commission recommendations on promoting the retention and expansion of aviation industry jobs; requiring carriers seeking approval for an international route transfer or undergoing a major change subject to DOT regulation to advise the Department of their plans to protect potentially displaced workers; and adopting policies that encourage a new, cooperative partnership between labor and management. Three related recommendations involving employee stock ownership plans raise policy concerns that require further study.

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ISSUE: FURTHERING FINANCIAL STRENGTH

COMMISSION RECOMMENDATION

A presidentially appointed airline financial advisory committee be created to further the financial health of the airline industry; to review the financial condition of individual airlines composing such industry; and to advise the Secretary of Transportation when an airline's financial condition poses risks to the public or to the industry. The committee should be bipartisan and include senior members from finance, industry and labor.

ADMINISTRATION POSITION

Reject.

As explained below, the Administration believes that the proposed financial advisory committee would be redundant of the Secretary's existing authority and powers to provide advice to airlines and to seek advice, formally or informally, from industry experts.

The Department's staff continually monitors and regularly reports to the Secretary on the state of the airline industry and the condition of individual carriers. Staff also perform internal analysis of airline financial and traffic results, based on financial and traffic data filed with the Department monthly and quarterly, as well as aviation trade reports, news articles, studies and academic journals. The proposed committee would add another layer to the decisionmaking process, adding to the costs of government and, to the extent that it engenders delay, to the costs of the industry as well. Moreover, in our view airlines would be reluctant to continue sharing business plans and other information with DOT if they knew that outsiders, including representatives of other airlines, would be privy to it. In addition, the Secretary already meets on a regular basis with airline executives, transportation academicians, aviation consultants, Wall Street airline analysts, and Congressional leaders to discuss issues affecting the airline industry and individual carriers.

DRAFT

ISSUE: FURTHERING FINANCIAL STRENGTH

COMMISSION RECOMMENDATION

DOT should monitor and review the financial health of the airlines. If necessary, the Secretary could review a company's business, capital or financial plans with the advisory committee's assistance. The Department should continue to review in advance major changes in an airline's ownership and control (e.g., leveraged buy outs). If there are concerns, the Secretary would raise them directly with the airline's management or board.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration agrees that the Department can and should place increased emphasis on monitoring the financial health of the airlines, but as noted earlier, sees no need for a Presidentially appointed advisory committee. Section 401(r) of the Federal Aviation Act requires airlines to meet DOT fitness requirements on a continuing basis in order to retain their operating authority. Typically, the Department has under review, and receives confidential data related to, various fitness elements for as many as 20 to 30 carriers, including data on finance, operations, ownership and control, business plans, and citizenship.

Given the dynamics of the airline industry, the Department will increase the attention it gives to the financial condition of individual carriers and the industry overall. Specifically, this will include attention to competition within the industry, ownership changes, financial trends, and a close working relationship with industry leaders, labor and financial experts.

ISSUE: FURTHERING FINANCIAL STRENGTH

DRAFT

COMMISSION RECOMMENDATION

If an airline repeatedly fails to heed warnings or concerns of the Secretary, the DOT can exercise its existing authority. New Department of Transportation regulatory authority is not recommended.

ADMINISTRATION POSITION

Immediately Accept.

Under section 401(r) of the Federal Aviation Act, the Secretary can, after proper notice and a hearing, modify, suspend or revoke an airline's authority if he determines the airline no longer meets the Department's fitness requirements. This authority has provided a strong incentive for airlines to comply with fitness requirements and to promptly correct deficiencies identified by the Department.

DRAFT

ISSUE: BANKRUPTCY

COMMISSION RECOMMENDATION

Bankruptcy judges be required to make findings, subject to judicial review, for granting an extension of the current 120-day limit and impose an absolute limit of 1 year on the exclusive right of a bankrupt carrier to file a reorganization plan.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The premise of this recommendation is that delay in bankruptcy proceedings creates economic problems. This concern about current bankruptcy practice transcends cases involving air carriers. The Administration will work with the Congress, which is considering legislative proposals on this issue, to determine whether existing time limits are consistent with the goals of the bankruptcy laws.

ISSUE: BANKRUPTCY

DRAFT

COMMISSION RECOMMENDATION

[Set] limits on the time period for bankrupt airlines to assume or reject their leases for scarce airport gates. These public assets should not be tied up and under-utilized for extensive periods of time to the detriment of surrounding communities and the traveling public.

ADMINISTRATION POSITION

Immediately Accept.

The Congress is considering legislative proposals on this issue. The Administration will work with the Congress to develop an acceptable approach that will prevent unnecessary harm to the traveling public and to communities.

DRAFT

ISSUE: BANKRUPTCY

COMMISSION RECOMMENDATION

Allow governmental bodies, such as the PBGC and airports, whose claims are not based on tax liability, to sit on creditors' committees.

ADMINISTRATION POSITION

Immediately Accept.

The Administration will work with the Congress, which is considering legislative proposals on this issue, to develop acceptable language that would allow governmental bodies to sit on creditors' committees.

DRAFT

ISSUE: BANKRUPTCY

COMMISSION RECOMMENDATION

Clarify provisions in the bankruptcy code with respect to aircraft leases. Lessor concern about potential impacts of bankruptcy on their leases should be allayed, allowing other airlines to obtain better lease terms for aircraft.

ADMINISTRATION POSITION

Immediately Accept.

The Administration will work with the Congress to codify recent court decisions which clarified that the lease provisions of Section 1110 of the Bankruptcy Code cover parties with security interests, lessors of such equipment, and conditional lessors of such equipment. Maritime and railroad leases would be covered as well.

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ISSUE: BANKRUPTCY

COMMISSION RECOMMENDATION

Make the Secretary of Transportation a statutory party to airline bankruptcy proceedings.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration accepts the premise that the broad public interest should be represented in airline bankruptcy proceedings, which traditionally are concerned only with issues related to the debtor and its creditors. We will examine the appropriateness of new approaches by which public-interest considerations could be raised in bankruptcy proceedings.

ISSUE: TAX POLICY

DRAFT

COMMISSION RECOMMENDATIONS

Amend the AMT so that airlines and other capital intensive industries are not forced to pay taxes at a time they report losses.

Exempt airlines from any proposed transportation fuel tax.

Roll back the ticket tax and the cargo waybill tax to their pre-1990 levels of 8 percent and 5 percent respectively.

[Allow] full deductibility for airline employee per diem payments.

Reduce the FAA budget allocation from the Trust Fund from 75 percent to 70 percent in recognition of the overpayment by airline users, and the public benefits of aviation.

ADMINISTRATION POSITION

Immediately Accept recommendations on the Alternative Minimum Tax (AMT) and the fuel tax exemption. **Reject** other recommendations.

The Administration was aware of these Commission recommendations prior to the recent enactment of the President's budget plan, which marks a hard-won, critical first step in establishing the foundation for sustained economic growth and control of the federal budget deficit. The plan as enacted provides relief from the Alternative Minimum Tax for many capital-intensive businesses, including airlines. It also provides a temporary exemption from the 4.3 cents-per-gallon fuels tax for gasoline and jet fuels used in commercial aviation prior to October 1, 1995. For the airline industry, we estimate these provisions will provide financial benefits amounting to $1.4 billion for fiscal years 1994-1998. A roll back of ticket tax and waybill taxes and allowing full deductibility for per diem payments, on the other hand, would reduce federal revenues by $4-$5 billion over the same period. With respect to FAA's allocation from the Trust Fund, the recommended action would entail increasing the General Fund's allocation. This would merely shift costs to the general taxpayer without changing the total funds available to be appropriated for FAA programs.

ISSUE: TAX POLICY

DRAFT

COMMISSION RECOMMENDATION

Expenditure of funds on improving facilitation of passengers and cargo arriving in the U.S. should be in rough approximation to the amounts collected in Customs, INS and Agriculture inspection fees.

ADMINISTRATION POSITION

Immediately Accept.

This recommendation reflects current Administration policy. For example, the Immigration and Naturalization Service has a proposal to increase its fee by $1 to enable greater spending on improvements in passenger and cargo inspection services.

ISSUE: TAX POLICY

DRAFT

COMMISSION RECOMMENDATION

Rigorously enforce existing AIP grant assurance language barring diversion of airport revenues to non-airport purposes.

ADMINISTRATION POSITION

Immediately Accept.

The Congress gave airport sponsors Passenger Facility Charge authority because of a perceived shortage of capital to meet airport development needs. The Airport Improvement Program is intended to assist airports in meeting their capital needs and to ensure that capacity and safety improvements are made. The diversion of airport revenues for non-airport purposes would be antithetical to these goals; it would likely raise the costs to airport users and the cost of air travel, or result in decreased service. Moreover, it is inappropriate for a local government to increase charges on airport passengers, many of whom are not residents of the local area, to pay for the costs of local services unrelated to airport use.

DRAFT

ISSUE: TAX POLICY

COMMISSION RECOMMENDATION

Continue close scrutiny of PFC applications and approval of only those projects which meet the PFC statute's criteria.

ADMINISTRATION POSITION

Immediately Accept.

FAA will continue to exercise its review and approval of Passenger Facility Charge (PFC) applications, based upon the PFC statute, its implementing regulation, and the application process now in place. Upon receiving a PFC application from an airport, FAA will review the application and make a determination on whether the application is substantially complete (*i.e.*, includes all information required by regulation to permit the FAA to make its decision), and then publish a notice in the *Federal Register* announcing the completed application and providing a 30-day comment period.

FAA's decision on a PFC application will be made after the *Federal Register* review and within 120 days of the date the application is first submitted. The eligibility criteria for a PFC application reviewed by FAA are defined by the PFC statute. Eligible projects are those airport development and planning projects that are eligible under the Airport Improvement Program (AIP) and noise compatibility measures that are eligible for federal assistance. Construction of gates and certain related facilities also are eligible. Further, to be eligible an airport must provide justification that a PFC project preserves or enhances safety, security, or capacity of the national air transportation system; reduces noise or mitigates noise impacts resulting from an airport; or furnishes opportunities for enhanced competition between and among air carriers.

Tom Callie X2801
~~X2223~~
-Thrs - 12 - 2
-Friday-

X5619 Mike

DRAFT

ISSUE: TAX POLICY

COMMISSION RECOMMENDATION

When jet fuel prices rise substantially due to war or other national emergency, the President consider releasing crude oil from the [strategic petroleum] reserve as a means of addressing the adverse impact of those price spikes on the airlines and our economy.

ADMINISTRATION POSITION

Reject.

The purpose of the Strategic Petroleum Reserve (SPR) is to deal with a severe interruption in the supply of crude oil. When the prices of all fuel products, including jet fuel, rise substantially because of a severe supply interruption, the President would consider releasing crude oil from the SPR. The Commission's recommendation would link the price of a particular petroleum product (jet fuel) to the use of the SPR to control that price. Our national energy policy, however, reflects the needs of all users, not one particular class such as airlines. Moreover, since crude oil is a fungible commodity, efforts to lower the price of jet fuel through releases from the SPR alone are unlikely to succeed.

DRAFT

ISSUE: NEW ENTRANTS

COMMISSION RECOMMENDATION

The Department of Transportation continue to be receptive to certificating new applicants who can meet the rigorous scrutiny of the Department under its fitness standards.

ADMINISTRATION POSITION

Immediately Accept.

The Federal Aviation Act specifies that the Department should encourage entry into air transportation markets by new carriers. This has been and will continue to be the Department's policy. Staff at the Department make an effort to educate prospective airline entrepreneurs of the certification requirements and procedures, and provide substantial guidance and assistance to new entrant applicants in perfecting their applications.

DRAFT

ISSUE: NEW ENTRANTS

COMMISSION RECOMMENDATION

New carriers be required to meet the same requirements for fitness, operations and maintenance, including Stage 3 fleet requirements, as existing carriers.

ADMINISTRATION POSITION

Reject.

In nearly all respects, new carriers must meet all of the requirements for fitness, operations and maintenance that established carriers must meet. In one instance--the Stage 3 noise requirements--new entrant carriers are accorded relatively minor relief so as not to create a barrier to new entry. The requirements for both new entrants and established carriers will converge by 1998.

Making new entrants meet the Stage 3 requirements applicable to established carriers appears at odds with the Commission's recommendation that the Department be receptive to certificating new entrants. Furthermore, much of the testimony in Commission's public record argues forcefully for not changing the requirements of the 1990 Noise Act.

ISSUE: ROLE OF THE WORK FORCE

DRAFT

COMMISSION RECOMMENDATION

Policies which promote the retention and expansion of aviation industry jobs be developed to the extent they are consistent with our international obligations.

ADMINISTRATION POSITION

Immediately Accept.

To explore potential labor-management issues, Secretary Peña will continue to facilitate discussions between airline labor and management. In addition, the Departments of Labor and Transportation have asked to identify ways to highlight job opportunities in the aviation industry.

<u>*ISSUE:*</u> ROLE OF THE WORK FORCE

DRAFT

<u>*COMMISSION RECOMMENDATION*</u>

The Department of Transportation require acquiring airlines in the purchase of substantial assets or routes to advise DOT of the plans to protect potentially displaced workers.

<u>*ADMINISTRATION POSITION*</u>

Immediately Accept.

In the future, any carrier seeking approval for an international route transfer will be directed, in the Department of Transportation's standard evidence request, to provide its plans for protecting potentially displaced workers.

ISSUE: ROLE OF THE WORK FORCE

DRAFT

COMMISSION RECOMMENDATION

The airlines and the federal government make a top priority the adoption of policies that encourage a new, cooperative partnership between labor and management.

ADMINISTRATION POSITION

Immediately Accept.

The Administration is deeply committed to accelerating the evolution of labor-management relations, throughout the economy, in the direction of collaboration and flexibility. This commitment has been evidenced most recently by the involvement of the President and the Secretaries of Labor and Commerce in sponsoring a national Conference on the Workplace of the Future, and by the creation of a new Office of the American Workplace within the Labor Department.

Furthermore, the work of the Dunlop Commission on the future of worker-management relations is now underway and will explore new initiatives in this area. In this regard, the airline industry offers clear opportunities for improving efficiency and flexibility through new-style workplace practices. (Southwest Airlines, for instance, is an exemplar of worker involvement and collaboration.)

At the same time, the Administration recognizes that workplace transformations take time, and collaboration cannot by itself rescue firms from a financial crisis. Worker involvement and other workplace reforms must not be seen as last-ditch expedients to be tried only when all else has failed, but as systemic improvements to shore up the long-term productive potential of all firms.

ISSUE: ROLE OF THE WORK FORCE

DRAFT

COMMISSION RECOMMENDATIONS

The Employee Retirement Income Security Act (ERISA) and the appropriate internal revenue code provisions be amended to allow a company to offer its own debt securities to employees as part of a qualified plan.

Amend the Internal Revenue Code (Section 415) provisions that limit qualified stock plans to 25 percent of an employee's income in certain cases.

[Allow] deferral of taxes on capital gains on shares sold to employees in public companies if certain conditions are met.

ADMINISTRATION POSITION

Under Review - Full Response in 30 Days.

The Administration welcomes the Commission's discussion of the importance that employees play in ensuring a strong, competitive air transportation system, and its recommendations for encouraging employee stock ownership plans (ESOPs). We agree that expanded employee participation in ownership, by creating an entrepreneurial partnership between management and employees, can strengthen an enterprise. We also believe, however, that the precise construct of a program which can best stimulate employee participation, while adequately safeguarding employee interests from potentially excessive financial risk, requires additional study. The Departments of Labor and Treasury will undertake a review to assess various ESOP and other "gainsharing" programs to determine (1) those programs which can best stimulate employee involvement and (2) the benefits and risks which can accrue to the employee and to the enterprise.

It should be noted that the recommendation on expanding the category of employer securities held by an ESOP to include debt securities represents a radical departure from the purpose of ESOPs, which is to serve as a vehicle for increasing employees' ownership stake in their employer. Also, eliminating the allocation limits would benefit highly compensated employees by providing unlimited tax deferral of their earnings, and expanding tax-free rollover treatment to sales of publicly traded stock would be inconsistent with the objective of encouraging sales to an ESOP by owners of businesses for which there is no readily available market. Furthermore, permitting inclusion of debt provides a tax benefit that would increase employees' potential for loss, with no potential for gain, and increase the risk to workers since their jobs and their savings would be tied to one employer.

DRAFT

THE U.S. AIR TRANSPORTATION SYSTEM MUST BE ABLE TO MOVE PEOPLE, PRODUCTS AND SERVICES TO MARKETS WHEREVER THEY ARE

The Administration heartily subscribes the principle laid down by the Commission that to compete effectively in the global market, the U.S. must use air travel to its competitive advantage. We will begin immediately to act on 16 of the 19 Commission recommendations in this area. We are placing one recommendation under further review because it appears to increase the government's role in the aerospace sector, and are rejecting two recommendations as unduly restrictive to Presidential authority.

Toward a Multi-National Regime

We are committed to moving toward multi-national aviation agreements with like-minded countries and will develop strategies for achieving liberal, multi-national accords along the lines envisaged by the Commission.

Short-Term Issues

We will continue to enforce current bilateral aviation rights through appropriate means and to seek interim agreements liberalizing air cargo and charter services. We also will develop and submit a legislative proposal for amending the Federal Aviation Act to allow foreign investors to hold up to 49 percent voting equity, consistent with our international obligations and interest in advancing a more liberal international aviation structure. Likewise, we will develop options for elevating the stature of international air service negotiations, including the creation of an ambassador-at-large, and for strengthening the aviation career track at the Department of State. However, the Commission recommendation on avoiding unilateral sanctions is considered an unwarranted restriction on the President's authority to conduct foreign policy.

Other International Airline Issues

The Departments of State and Transportation will begin immediately to draft legislation to amend the Warsaw Convention to increase the airline liability cap for international air travel. In addition, we agree with the Commission on the need to protect national security and the defense interest in the CRAFT program, and will assure this need is considered as we develop a legislative proposal to raise the limitations on foreign investment.

Aerospace Manufacturing

We are immediately accepting the Commission's recommendations to strengthen and expand the coverage of international agreements containing disciplines on government subsidies and involvement in manufacturing projects; to properly enforce international trade obligations and eliminate subsidies, offsets and other unfair practices; and to strengthen ongoing efforts by FAA and the State Department to harmonize international standards for the manufacture and initial certification of aircraft. We also will pursue ways to maximize leverage under GATT to counteract illegal subsidies and to encourage domestic and international cooperation among airframe, component, and engine manufacturers. With respect to the Commission's recommendation on increasing Export-Import Bank funding, we believe further review is needed to determine the appropriate extent of any additional government involvement. As with the case of international air services, we are rejecting the recommendation to avoid unilateral sanctions on the export of aerospace products.

General Aviation Aircraft Production

We agree with the need for a statute of repose as recommended by the Commission, and will work with the Congress to obtain enactment.

Assuring Service to Small Communities

Finally, we support and will seek ways to implement both Commission recommendations for ensuring air service to small communities.

DRAFT

ISSUE: TOWARD A MULTI-NATIONAL REGIME

DRAFT

COMMISSION RECOMMENDATIONS

U.S. negotiating efforts focus on creating a multi-national operating environment for airlines free of discrimination and restrictions.

Liberal, multi-national agreements be negotiated that encompass provisions for passenger and cargo services; charters; cross-border investment and ownership; comparable traffic rights; fifth/sixth freedom traffic rights; fair market access and doing business opportunities; system capacity; government subsidies; and customs and immigration facilities.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration shares the Commission's view that the current bilateral system of aviation negotiations is outdated. Aviation is now a global industry. Although the leverage provided by our large domestic aviation market has historically allowed U.S. air carriers to benefit from the bilateral regime of aviation agreements, it has become clear in recent years that the bilateral structure limits commercial opportunities, distorts competition, and restricts the ability of U.S. airlines to compete in many foreign markets.

In this context, the Administration concurs with the Commission's assessment that we should begin shaping a multi-national approach to international aviation negotiations. As the Commission recognizes, achieving a liberal multi-national regime for aviation is not a realistic short-term goal, however. There is unlikely to be the requisite interest in such a regime among our principal negotiating partners in the near term.

The existing Interagency Committee on Aviation issues will examine the role each possible negotiating option (*e.g.*, bilateral, regional, multi-national, and global "network" of like-minded countries) could play in moving toward our liberalization objectives in the sort, medium and long term. The specific provisions for multi-national agreements suggested by the Commission will be considered in this context.

ISSUE: SHORT-TERM ISSUES

DRAFT

COMMISSION RECOMMENDATION

The Federal Aviation Act be amended to allow the U.S. to negotiate bilateral agreements that permit foreign investors to hold up to 49 percent voting equity in U.S. airlines, providing those bilateral agreements are liberal and contain equivalent opportunities for U.S. airlines; the foreign investor is *not* government-owned; there are reciprocal investment rights for U.S. airlines; and the investment will advance the national interest and the development of a liberal global regime for air services.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration acknowledges the desirability of reducing restrictions on U.S. air carriers' access to the international capital that could contribute to their growth and competitiveness. Consistent with the international obligations of the United States, we will work to determine the circumstances in which a liberalized investment policy will advance the national interest and contribute to the development of a liberal international structure for aviation. To this end, we will work with the Congress to develop legislation to amend the Federal Aviation Act to allow foreign investors to hold up to 49-percent voting equity.

A judicious adjustment of restriction on foreign investment could promote competition, increase travel options open to the public, create jobs for U.S. workers, and otherwise promote the economic security of the United States. We also recognize the potential value of foreign investment liberalization as a means of promoting the development of a more liberal international regime for air transportation services.

As the Commission noted, however, air transport is a highly regulated and strategically important industry that is unique in requiring reciprocal bilateral arrangements for "trade" rights. In this unique structure, a higher foreign ownership component than permitted by current law could permit a foreign airline to obtain greater access to the U.S. market with compensatory public benefits for the United States. As the same time. U.S.-owned carriers could be placed at a structural and competitive disadvantage. We therefore accept the Commission's premise that investment-related access to, through, and beyond the U.S. market is valuable, and we share the Commission's belief that such access through investments greater than 25 percent of the voting interest should be provided only when it will advance the national interest and the development of a liberal global regime for air services.

DRAFT

ISSUE: SHORT-TERM ISSUES

COMMISSION RECOMMENDATION

Enforce current bilateral aviation rights through all means, including renunciation and suspension of privileges and services when violations occur.

ADMINISTRATION POSITION

Immediately Accept.

The Administration strongly supports the Commission's recommendation on using all the means at our disposal to defend the air service rights our carriers exercise under the terms of our bilateral aviation agreements. When disputes cannot be resolved expeditiously through negotiation or, where appropriate, through dispute resolution mechanisms, we will not hesitate to use other means to enforce our bilateral aviation rights, including procedures and remedies provided by the International Air Transportation Fair Competitive Practices Act of 1974 and the imposition of sanctions such as the suspension of privileges and services. We also accept the Commission's view that the option of denouncing unsatisfactory or disadvantageous bilateral agreement should be considered in appropriate cases.

ISSUE: SHORT-TERM ISSUES

DRAFT

COMMISSION RECOMMENDATION

Elevate the stature of international air service negotiations and appoint an ambassador-at-large to lead them; and strengthen the aviation career track at the Department of State to enhance continuity and expertise in the field.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration shares and strongly supports the Commission's views on the importance of negotiating international air services agreements. We fully accept the premise that this process merits regular high-level attention; indeed, international air service negotiations already receive such attention at both the Departments of State and Transportation.

At the Department of State, aviation issues, including negotiations, are the full-time responsibility of a Deputy Assistant Secretary and a Special Negotiator. the Assistant Secretary of State for Economic and Business Affairs is involved in aviation matters on a daily basis, and issues related to negotiations with key partners also command the attention of the Under Secretary of State for Economic and Agricultural Affairs,

At Transportation, Secretary Peña recently reorganized responsibilities at the Assistant Secretary level to focus more time and attention on aviation matters. An Assistant Secretary for Aviation and International Affairs has international air service agreements as a top priority, and the Secretary himself is personally involved in many international aviation matters.

Given the attention that is now devoted to international aviation agreements, we question the need to establish the position of ambassador-at-large at this time. However, we will further explore options for elevating the status of international air service negotiations, including the recommended ambassador-at-large position, at such time as a multi-national approach to negotiations can be developed and launched.

With regard to strengthening the State Department's aviation career track to enhance continuity and expertise, State has already undertaken a review of current staffing of key aviation jobs. We are working with personnel and other relevant divisions to finds ways to ensure that key staff remain in place for a longer period of time. These steps may include restructuring positions and extending standard tours of duty. At the Department of Transportation, aviation staff are career employees permanently assigned to the Office of International Aviation.

DRAFT

ISSUE: SHORT-TERM ISSUES

COMMISSION RECOMMENDATION

Conclude interim agreements liberalizing air cargo and charter services if those agreement support the overall objective of multi-national liberalization.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration accepts the Commission's premise that it may be possible to use sectoral air cargo and/or charter service agreements (negotiated on a bilateral or multi-national basis) to promote the goal of global liberalization of air services. The Departments of State and Transportation will take the lead in exploring prospects for sector-specific agreements to determine whether and how such agreements could be shaped to support a multinational liberalization effort.

Air cargo is a logical and obvious choice for efforts to pursue more liberal arrangements in a specific sector. We have experience in dealing with air cargo separately from passenger service, since U.S. deregulation began with the cargo sector. Cargo is less visible, and therefore less politically sensitive, than passenger services. In addition, cargo travels in only one direction and is often indifferent to circuitous routing or changes in aircraft. A complicating factor, however, is the fact that the majority of cargo shipments now travel in the belly of passenger-carrying aircraft.

In 1991, U.S. officials held two rounds of exploratory talks on a U.S.-EC cargo liberalization regime. These talks were suspended because the EC Commission lacked (and continues to lack) a negotiating mandate from EC member states.

Charter services is another area which is less politically sensitive than scheduled passenger services and therefore an area for further exploration.

ISSUE: SHORT-TERM ISSUES

DRAFT

COMMISSION RECOMMENDATION

Avoid the use of unilateral sanctions against international air services unless passenger safety concerns are involved. This would not preclude sanctions for violations of a bilateral agreement.

ADMINISTRATION POSITION

Reject.

The Administration cannot accept a recommendation that would constrain its latitude in foreign policy matters. Although such decisions are made only after extensive and careful review, the imposition of unilateral sanctions that include air services is sometimes necessary for compelling foreign policy and national security reasons. For example, the United States unilaterally prevents almost all business, including air services, with Vietnam, Cuba, North Korea, and Libya. In some cases, the Administration is required by law to impose controls unilaterally.

DRAFT

ISSUE: OTHER INTERNATIONAL AIRLINE ISSUES

COMMISSION RECOMMENDATION

The U.S. amend the Warsaw Convention by ratifying Montreal Protocols 3 and 4 and approve a supplemental compensation plan.

ADMINISTRATION POSITION

Immediately Accept.

The Administration strongly agrees with the Commission's belief that the current airline liability system is antiquated and that high priority should be given to the establishment of an international liability system that adequately serves the interests of passengers and shippers. The Departments of State and Transportation will jointly advise Congress of the Administration's intent to pursue ratification of the Protocols and passage of a supplemental compensation plan, and will work with other agencies and Congress to achieve ratification.

Prompt ratification of the Montreal Protocol 3 and passage of supplemental compensation plan legislation would establish an absolute liability system to guarantee the payment of compensatory damages, both economic and non-economic, for the injury or death of international airline passengers without individual limitation. This system would cover all passengers purchasing tickets in the United States for international travel as well as all U.S. citizens and permanent residents traveling internationally anywhere in the world. In the case of Montreal Protocol 4, ratification would streamline cargo documentation requirements for shippers.

DRAFT

ISSUE: OTHER INTERNATIONAL AIRLINE ISSUES

COMMISSION RECOMMENDATION

Protect national security and defense interests by assuring that cross-border investment and ownership do not adversely affect the availability of aircraft for the CRAF program.

ADMINISTRATION POSITION

Immediately Accept.

The Administration agrees that the availability of civil aircraft to meet emergency airlift requirements is vital, and fully concurs that national security and defense interests must be taken into account in decisions on cross-border investment and ownership. The Departments of State, Transportation and Defense will take the lead in ensuring that national security and defense are adequately considered as we develop legislation to raise the limitation on foreign investment, and on all other related decisions as well.

DRAFT

ISSUE: AEROSPACE MANUFACTURING

COMMISSION RECOMMENDATION

Strengthen and expand the coverage of international agreements that contain disciplines on government subsidies and government involvement in aircraft manufacturing projects.

ADMINISTRATION POSITION

Immediately Accept.

The Administration fully accepts this recommendation. We are seeking to tighten further the disciplines on government support and subsidies currently contained in the GATT aircraft agreement and to expand the coverage of that agreement to other countries which produce large and small civil aircraft and their components.

In the 1992 U.S.-EC "Agreement Concerning the Application of the GATT Agreement on Trade in Civil Aircraft," both parties committed to make their utmost efforts to ensure that similar disciplines to those contained in the bilateral agreement are incorporated in the 1979 GATT aircraft agreement at the earliest possible date, and to expand the coverage of the disciplines proved by that Agreement. At the request of the U.S. and EC, signatories of the GATT aircraft agreement consented to participate in multi-lateral negotiations to improve and expand the existing agreement. Non-signatory countries to GATT and the GATT aircraft agreement have also been invited to participate in these negotiations.

ISSUE: AEROSPACE MANUFACTURING

DRAFT

COMMISSION RECOMMENDATIONS

Properly enforce international trade obligations and U.S. trade laws and eliminate subsidies, offsets, purchasing and sourcing incentives and unfair international trading practices.

The Department of Commerce, with the Secretary maintaining full discretion, should use the maximum means available under the GATT to counteract illegal subsidies.

ADMINISTRATION POSITION

Immediately Accept.

The Administration will vigorously enforce existing trade agreements and U.S. trade laws. Without such enforcement, these agreements and laws would have little meaning. We are especially vigilant in monitoring compliance by the Airbus partner governments of the 1992 U.S.-EC civil aircraft agreement, which imposes a cap on government supports and subsidies for aircraft development and production.

ISSUE: AEROSPACE MANUFACTURING

DRAFT

COMMISSION RECOMMENDATION

Adopt explicit goals and devise policies to encourage domestic and international cooperation among airframe, component and engine manufacturers in order to increase their ability to attract sufficient investment capital to support new product development, manufacture and marketing of new products.

ADMINISTRATION POSITION

Accept Premise - Additional Work Needed.

The Administration believes that the decision on whether and when to cooperate with other manufacturers is a decision best left to the manufacturers themselves, and thus does not agree with the concept that it should adopt "explicit goals and policies to encourage cooperation." However, we recognize that the trend toward globalization of aircraft manufacturing may require the government to play a more active role in facilitating cooperation in order to ensure that U.S. industry is not disadvantaged in the global marketplace. Barriers to cooperation identified by our industry will be examined expeditiously.

ISSUE: AEROSPACE MANUFACTURING

DRAFT

COMMISSION RECOMMENDATION

Increase Export-Import Bank funding levels and lending authority for large and small aircraft to the extent necessary to provide parity in financing for U.S. manufacturers compared with their foreign competitors.

ADMINISTRATION POSITION

Under Review - Full Response in 30 Days.

The Treasury Department will lead an interagency review of the Commission's recommendation in the context of Eximbank funding levels and our international obligations under the Large Aircraft Sector Understanding. Other agencies that participate in the ongoing export credit negotiations, include State, Commerce, Eximbank, USTR, OMB, AID and TDA, will participate in this effort.

On Eximbank funding, Eximbank's programs are constrained in two ways: (1) by an annual authorization on the dollar volume of new loans, guarantees, and insurance currently; and (b) by a subsidy budget, which covers the funding and risk subsidies inherent in Eximbank's authorizations. The subsidy budget is required by the Federal Credit reform Act of 1990. Charges to the subsidy budget for particular transactions largely reflect foreign country and borrower credit risks.

Given its current subsidy budget, Eximbank will find it particularly difficult to support a host of competing subsidy-intensive exporter needs. Among these are U.S. aircraft manufacturer sales efforts involving the start-up airlines in the high-risk Newly Independent States and Eastern European markets.

The Large Aircraft Sector Understanding, signed in 1985 by the U.S. and major European large aircraft producing countries, levels the competitive playing field in terms of export financing by setting out guidelines on official export credits supporting the sale or lease of large (70 plus seats) aircraft. The objectives of this Understanding are to equalize competitive financial conditions between participants and to neutralize official financing as a factor in the choice among competing aircraft.

ISSUE: AEROSPACE MANUFACTURING

DRAFT

COMMISSION RECOMMENDATION

Increase efforts to harmonize international standards for the manufacture and initial certification of aircraft and encourage further cooperation between U.S. and foreign certification and inspection agencies.

ADMINISTRATION POSITION

Immediately Accept.

The Administration shares the Commission's view that the lack of harmonized international aviation regulations creates an unnecessary burden on airlines, manufacturers, and civil aviation regulators. To the extent that U.S. and foreign standards diverge, the aviation industry incurs significant economic costs. To reduce this burden on the airline and aerospace industries, we strongly support efforts to develop uniform standards to facilitate airplane design, type certification, monitoring of continued airworthiness, and safety and security oversight. We also believe that cooperation toward the development of reciprocal acceptance of nations' standards for maintenance crew training facilities (*e.g.*, simulators), and other such areas would benefit the aviation industry by reducing redundant costs.

To implement this recommendation, FAA will strengthen its ongoing global effort to reduce the regulatory and economic burdens that different nations' regulations place on U.S. companies. FAA will expedite work with European countries to achieve common performance-based standards and to ensure that European Joint Aviation Requirements are harmonized with the Federal Aviation Regulations. FAA will also continue to provide technical assistance for safety and airworthiness and to encourage the development of regional aviation authorities.

To support and complement these actions, the Department of State and FAA are working to update the existing Bilateral Airworthiness Agreements with a more flexible "Bilateral Aviation Safety Agreement" format that would cover such areas as flight simulators, aircraft maintenance, and noise standards in addition to current aircraft certification procedures. This format is intended to permit the implementation of technical agreements in a more timely manner.

DRAFT

ISSUE: AEROSPACE MANUFACTURING

COMMISSION RECOMMENDATION

Avoid placing unilateral sanctions on manufacturers' export of aerospace products unless those sanctions are necessary to protect the national security.

ADMINISTRATION POSITION

Reject.

The statutory basis for export controls extends beyond U.S. national security, aiming also at broader foreign policy objectives. These include promoting human rights, reducing regional instability, fighting terrorism, reversing specific policies of foreign countries (*e.g.*, apartheid) and implementing UN decisions to impose sanctions for a variety of reasons. The Administration cannot accept a recommendation that is so broadly inconsistent with its legal obligations, Administration policy, and prevailing views in the Congress.

ISSUE: GENERAL AVIATION AIRCRAFT PRODUCTION

DRAFT

COMMISSION RECOMMENDATION

Enact a statute of repose for general aviation aircraft which would limit the liability of manufacturers of these aircraft to 15 years from the date of manufacture.

ADMINISTRATION POSITION

Immediately Accept.

The Administration supports a limited liability provision for this specific industry. Bills have been introduced in the Senate and House that would limit product liability for general aviation aircraft to 15 years. Through the Department of Commerce, we will work with Congress to obtain enactment.

ISSUE: ASSURING SERVICE TO SMALL COMMUNITIES

DRAFT

COMMISSION RECOMMENDATION

Develop policies which encourage service to small communities.

ADMINISTRATION POSITION

Immediately Accept.

The Essential Air Service (EAS) Program provides a safety net for small communities -- whether subsidized or not -- that guarantees that they will continue to be linked to the nation's air transportation system. The smallest and most isolated communities receive the most direct benefit, but other benefits accrue to the whole transportation system and the country as a whole. For these reasons, the Administration supports continuation of the EAS program. Specifically, we will continue supporting the development of new airports and the improvement and expansion of existing airports. Satellite airports may be able to act as reliever airports and allow under-served communities to receive increased service levels. We will also continue to support new entrants in their attempts to become operational. This includes, among other things, working with them to perfect their fitness applications, a prerequisite to beginning service. Additionally, we will continue our efforts to assure that new entrants have adequate opportunities to compete in the marketplace on a level playing field. And we will continue to work with small cities to promote new air service applications as well as new entry into specific markets by existing airlines.

ISSUE: ASSURING SERVICE TO SMALL COMMUNITIES

DRAFT

COMMISSION RECOMMENDATION

Maintain the federal Essential Air Service program at sufficient levels to serve its legislated purpose.

ADMINISTRATION POSITION

Immediately Accept.

For the immediate future, the Administration will continue to assure that the Essential Air Service program is executed in a manner consistent with Congressional intent. We also will develop multi-year strategies addressing federal participation in supporting small community air service. This approach is needed to provide local communities and the airlines that would serve them with the increased certainty necessary to facilitate long-range planning. Greater certainty should also benefit businesses considering plans to locate in small-town or rural America. In addition, we will pursue alternatives to the current blanket eligibility of communities in the Essential Air Service program which were "grandfathered" by the Deregulation Act of 1978.

DRAFT

QUICK REFERENCE: COMMISSION RECOMMENDATIONS AND ADMINISTRATION POSITIONS

Immediately Accept means the Administration is acting, or shortly will act, to implement a recommendation in full.
Accept Premise - Additional Work Needed means the Administration agrees with the intent of a recommendation and fully expects to implement it, but that detailed analysis is required to ensure successful implementation.
Under Review - Fully Respond in 30 Days means a recommendation requires more time for the Administration to evaluate adequately.
Reject means a recommended action is unnecessary in the Administration's view.

THEME: *AIR TRANSPORTATION SYSTEM EFFICIENCY & TECHNOLOGY*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE – ADDITIONAL WORK NEEDED**	**UNDER REVIEW – FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
GLOBAL POSITIONING SYSTEM	1 Set the goal of changing the air traffic control system to a satellite-based navigation system by 1996, ***integrated with a modernized ATC system*** by the end of 1997.		X			*2*
	2 Accelerate the implementation of GPS and air traffic control modernization through such means as a public-private consortium, designed for expeditious development and implementation of improved technology.		X			*2*
RESTRUCTURING FAA	3 Create an independent federal corporate entity within the Department of Transportation to manage and fund air traffic control and related functions, including system development, procurement and maintenance. Policy control of the air traffic control system and safety oversight should stay with the federal government.		X			*3*
	4 Establish a panel of FAA and industry experts, with the participation of the Department of Defense, which will report in 90 days on the specific structure and method of implementation; and which will draft legislative proposals for creation of the corporate entity.		X			*3*

DRAFT

THEME: *AIR TRANSPORTATION SYSTEM EFFICIENCY & TECHNOLOGY, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE -- ADDITIONAL WORK NEEDED**	**UNDER REVIEW -- FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
RESTRUCTURING FAA, Continued...	5 The following principles should be embodied in the federal corporate entity's implementing act: o Ability of the corporate entity to create and use a predictable, stable source of revenues for operations, maintenance and capital investment; o Ability of the corporate entity to issue long-term bonds for capital purchases; o Removal of current expenditures and revenues from the federal budget in equal amounts for a fiscally neutral effect; o Sufficient management flexibility and compensation to attract and retain high-caliber leadership and staff; o Flexibility to create systems for procurement, staff and budget consistent with best practices in the private sector; o Flexibility in an orderly transfer of operating functions to the reorganized entity; and o Continued air traffic control service to the Defense Department, meeting national security requirements.		X			*3*
OTHER SYSTEM CAPACITY ISSUES	6 FAA review the rule that limits operations at "high density" airports with the aim of either removing these artificial limits or raising them to the highest practicable level consistent with safety requirements. (Washington National Airport's legislated limits would not be affected.)	X				*4*
	7 Congress fully fund system capacity elements -- facilities and equipment; airports; research, engineering and development; and FAA operations -- as long as these remain within the federal budget process.	X				*4*

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THEME: *AIR TRANSPORTATION SYSTEM EFFICIENCY & TECHNOLOGY, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE – ADDITIONAL WORK NEEDED**	**UNDER REVIEW – FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
REGULATORY BURDEN	8 FAA subject regulations to an annual regulatory cost budget – except for emergency regulations needed to eliminate a direct and immediate threat to the traveling public.				X	*5*
	9 Congress and the Department of Transportation be informed of the annual costs their own proposals would impose on the industry.		X			*6*
	10 Congress, the Department of Transportation and FAA more clearly define legislative and regulatory proposals to address problems effectively and efficiently.	X				*7*
	11 Establish an ongoing and independent mechanism to provide objective outside guidance and expertise to FAA to assist in cost/benefit analysis methods and to review cost/benefit disputes.		X			*8*
	12 FAA seek cost impact data from industry early, and industry should provide requested data so the agency can make an informed decision on proceeding with a proposal.	X				*9*
	13 The random drug testing rate be established immediately at 25 percent, which is the rate used for FAA's own safety-related staff, including air traffic controllers. FAA should complete a review within 12 months to reduce the rate to the lowest level possible without reducing the deterrent effect or the statistical reliability of sampling.			X		*10*
	14 New pre-employment alcohol testing rules not be adopted, and any random alcohol testing of airline employees should be at no more than a 10 percent rate.			X		*11*

QUICK REFERENCE...

THEME: *AIR TRANSPORTATION SYSTEM EFFICIENCY & TECHNOLOGY, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	RECOMMENDATION	IMMEDIATELY ACCEPT	ACCEPT PREMISE – ADDITIONAL WORK NEEDED	UNDER REVIEW – FULL RESPONSE IN 30 DAYS	REJECT	*See Page*
REGULATORY BURDEN, Continued...	15 The Department of Transportation and FAA undertake a short-range regulatory review effort in close coordination with industry and interested parties to eliminate or amend existing regulations to reduce regulatory burdens consistent with safety and security considerations.	X				*12*
NOISE	16 Maintain the existing provisions of the 1990 Noise Act which protect the carriers' investment in Stage 3 aircraft by prohibiting enactment of local noise restrictions on Stage 3 aircraft without FAA approval.	X				*13*
	17 The federal government not enact any provision to mandate the replacement, retirement or modification of Stage 3 aircraft for noise purposes.	X				*13*

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QUICK REFERENCE...

THEME: *AIR TRANSPORTATION SYSTEM FINANCIAL STRENGTH*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE -- ADDITIONAL WORK NEEDED**	**UNDER REVIEW -- FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
FURTHERING FINANCIAL STRENGTH	18 A presidentially appointed airline financial advisory committee be created to further the financial health of the airline industry; to review the financial condition of individual airlines composing such industry; and to advise the Secretary of Transportation when an airline's financial condition poses risks to the public or to the industry. The committee should be bipartisan and include senior members from finance, industry and labor.				X	*16*
	19 DOT should monitor and review the financial health of the airlines. If necessary, the Secretary could review a company's business, capital or financial plans with the advisory committee's assistance. The Department should continue to review in advance major changes in an airline's ownership and control (e.g., leveraged buyouts). If there are concerns, the Secretary would raise them directly with the airline's management or board.		X			*17*
	20 If an airline repeatedly fails to heed warnings or concerns of the Secretary, the DOT can exercise its existing authority. New Department of Transportation regulatory authority is not recommended.	X				*18*

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QUICK REFERENCE...

THEME: *AIR TRANSPORTATION SYSTEM FINANCIAL STRENGTH, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE – ADDITIONAL WORK NEEDED**	**UNDER REVIEW – FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
BANKRUPTCY	21 Bankruptcy judges be required to make findings, subject to judicial review, for granting an extension of the current 120-day limit and impose an absolute limit of 1 year on the exclusive right of a bankrupt carrier to file a reorganization plan.		X			*19*
	22 [Set] limits on the time period for bankrupt airlines to assume or reject their leases for scarce airport gates. These public assets should not be tied up and underutilized for extensive periods of time to the detriment of surrounding communities and the traveling public.	X				*20*
	23 Allow governmental bodies, such as the PBGC and airports, whose claims are not based on tax liability, to sit on creditors' committees.	X				*21*
	24 Clarify provisions in the bankruptcy code with respect to aircraft leases. Lessor concern about potential impacts of bankruptcy on their leases should be allayed, allowing other airlines to obtain better lease terms for aircraft.	X				*22*
	25 Make the Secretary of Transportation a statutory party to airline bankruptcy proceedings.		X			*23*

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THEME: *AIR TRANSPORTATION SYSTEM FINANCIAL STRENGTH, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE – ADDITIONAL WORK NEEDED**	**UNDER REVIEW – FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
TAX POLICY	26 Amend the AMT so that airlines and other capital intensive industries are not forced to pay taxes at a time they report losses.	X				*24*
	27 Roll back the ticket tax and the cargo waybill tax to their pre-1990 levels of 8 percent and 5 percent respectively.				X	*24*
	28 Reduce the FAA budget allocation from the Trust Fund from 75 percent to 70 percent in recognition of the overpayment by airline users, and the public benefits of aviation.				X	*24*
	29 Exempt airlines from any proposed transportation fuel tax.	X				*24*
	30 [Allow] full deductibility for airline employee per diem payments.				X	*24*
	31 Expenditure of funds on improving facilitation of passengers and cargo arriving in the U.S. should be in rough approximation to the amounts collected in Customs, INS and Agriculture inspection fees.	X				*25*
	32 Rigorously enforce of existing AIP grant assurance language barring diversion of airport revenues to non-airport purposes.	X				*26*
	33 Continue close scrutiny of PFC applications and approval of only those projects which meet the PFC statute's criteria.	X				*27*
	34 When jet fuel prices rise substantially due to war or other national emergency, the President consider releasing crude oil from the [strategic petroleum] reserve as a means of addressing the adverse impact of those price spikes on the airlines and our economy.				X	*28*

QUICK REFERENCE...

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THEME: *AIR TRANSPORTATION SYSTEM FINANCIAL STRENGTH, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	RECOMMENDATION	IMMEDIATELY ACCEPT	ACCEPT PREMISE -- ADDITIONAL WORK NEEDED	UNDER REVIEW -- FULL RESPONSE IN 30 DAYS	REJECT	*See Page*
NEW ENTRANTS	35 The Department of Transportation continue to be receptive to certificating new applicants who can meet the rigorous scrutiny of the Department under its fitness standards.	X				*29*
	36 New carriers be required to meet the same requirements for fitness, operations and maintenance, including Stage 3 fleet requirements, as existing carriers.				X	*30*
ROLE OF THE WORK FORCE	37 Policies which promote the retention and expansion of aviation industry jobs be developed to the extent they are consistent with our international obligations.	X				*31*
	38 The Department of Transportation require acquiring airlines in the purchase of substantial assets or routes to advise DOT of the plans to protect potentially displaced workers.	X				*32*
	39 The airlines and the federal government make a top priority the adoption of policies that encourage a new, cooperative partnership between labor and management.	X				*33*
	40 The Employee Retirement Income Security Act (ERISA) and the appropriate internal revenue code provisions be amended to allow a company to offer its own debt securities to employees as part of a qualified plan.			X		*34*
	41 Amendment of the Internal Revenue Code (Section 415) provisions that limit qualified stock plans to 25 percent of an employee's income in certain cases.			X		*34*
	42 [Allow] deferral of taxes on capital gains on shares sold to employees in public companies if certain conditions are met.			X		*34*

QUICK REFERENCE...

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THEME: *MOVING PEOPLE, PRODUCTS & SERVICES TO MARKETS WHEREVER THEY ARE*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	**RECOMMENDATION**	**IMMEDIATELY ACCEPT**	**ACCEPT PREMISE – ADDITIONAL WORK NEEDED**	**UNDER REVIEW – FULL RESPONSE IN 30 DAYS**	**REJECT**	***See Page***
TOWARD A MULTI-NATIONAL REGIME	43 U.S. negotiating efforts focus on creating a multi-national operating environment for airlines free of discrimination and restrictions.		X			*37*
	44 Liberal, multi-national agreements be negotiated that encompass provisions for passenger and cargo services; charters; cross-border investment and ownership; comparable traffic rights; fifth/sixth freedom traffic rights; fair market access and doing business opportunities; system capacity; government subsidies; and customs and immigration facilities.		X			*37*
SHORT-TERM ISSUES	45 The Federal Aviation Act be amended to allow the U.S. to negotiate bilateral agreements that permit foreign investors to hold up to 49 percent voting equity in U.S. airlines, providing those bilateral agreements are liberal and contain equivalent opportunities for U.S. airlines; the foreign investor is *not* government-owned; there are reciprocal investment rights for U.S. airlines; and the investment will advance the national interest and the development of a liberal global regime for air services.		X			*38*
	46 Enforce current bilateral aviation rights through all means, including renunciation and suspension of privileges and services when violations occur.	X				*39*
	47 Elevate the stature of international air service negotiations and appoint of an ambassador-at-large to lead them; and strengthen the aviation career track at the Department of State to enhance continuity and expertise in the field.		X			*40*

DRAFT

THEME: *MOVING PEOPLE, PRODUCTS & SERVICES TO MARKETS WHEREVER THEY ARE, Continued...*

AIRLINE COMMISSION REPORT			ADMINISTRATION POSITION				
ISSUE		RECOMMENDATION	IMMEDIATELY ACCEPT	ACCEPT PREMISE – ADDITIONAL WORK NEEDED	UNDER REVIEW – FULL RESPONSE IN 30 DAYS	REJECT	*See Page*
SHORT-TERM ISSUES, Continued...	48	Conclude interim agreements liberalizing air cargo and charter services if those agreement support the overall objective of multi-national liberalization.		X			*41*
	49	Avoid the use of unilateral sanctions against international air services unless passenger safety concerns are involved. This would not preclude sanctions for violations of a bilateral agreement.				X	*42*
OTHER INTERNATIONAL AIRLINE ISSUES	50	The U.S. amend the Warsaw Convention by ratifying Montreal Protocols 3 and 4 and approve a supplemental compensation plan.	X				*43*
	51	Protect national security and defense interests by assuring that cross-border investment and ownership do not adversely affect the availability of aircraft for the CRAF program.	X				*44*
AEROSPACE MANUFACTURING	52	Strengthen and expand the coverage of international agreements that contain disciplines on government subsidies and government involvement in aircraft manufacturing projects.	X				*45*
	53	Properly enforce international trade obligations and U.S. trade laws and eliminate subsidies, offsets, purchasing and sourcing incentives and unfair international trading practices.	X				*46*
	54	The Department of Commerce, with the Secretary maintaining full discretion, should use the maximum means available under the GATT to counteract illegal subsidies.	X				*46*

DRAFT

THEME: *MOVING PEOPLE, PRODUCTS & SERVICES TO MARKETS WHEREVER THEY ARE, Continued...*

AIRLINE COMMISSION REPORT		ADMINISTRATION POSITION				
ISSUE	RECOMMENDATION	IMMEDIATELY ACCEPT	ACCEPT PREMISE – ADDITIONAL WORK NEEDED	UNDER REVIEW – FULL RESPONSE IN 30 DAYS	REJECT	*See Page*
AEROSPACE MANUFACTURING, Continued...	55 Adopt explicit goals and devise policies to encourage domestic and international cooperation among airframe, component and engine manufacturers in order to increase their ability to attract sufficient investment capital to support new product development, manufacture and marketing of new products.		X			*47*
	56 Increase Export-Import Bank funding levels and lending authority for large and small aircraft to the extent necessary to provide parity in financing for U.S. manufacturers compared with their foreign competitors.			X		*48*
	57 Increase efforts to harmonize international standards for the manufacture and initial certification of aircraft and encourage further cooperation between U.S. and foreign certification and inspection agencies.	X				*49*
	58 Avoid placing unilateral sanctions on manufacturers' export of aerospace products unless those sanctions are necessary to protect the national security.				X	*50*
GENERAL AVIATION AIRCRAFT PRODUCTION	59 Enact a statute of repose for general aviation aircraft which would limit the liability of manufacturers of these aircraft to 15 years from the date of manufacture.	X				*51*
ASSURING SERVICE TO SMALL COMMUNITIES	60 Develop policies which encourage service to small communities.	X				*52*
	61 Maintain the federal Essential Air Service program at sufficient levels to serve its legislated purpose.	X				*53*

THE WHITE HOUSE

July 9, 1993

Dear Bob,

Thank you for your recent letter and the materials in relation to European practices in relation to U.S. airline business. I along with my staff will carefully study the information.

Sincerely,

Carol H. Rasco

AmericanAirlines

Mike S. –
Pls. review. I've
sent a simple courtesy
ack. CHR

June 28, 1993

Bob
R.L. CRANDALL
CHAIRMAN AND PRESIDENT

The Honorable Carol H. Rasco
Assistant to the President for
Domestic Policy
Domestic Policy Council
Executive Office of the President
Washington, D.C. 20500

Dear Carol:

On June 22, 1993, The Wall Street Journal carried an important story concerning the present debate within Europe over its "lack of competitiveness in relation to the U.S.". A copy is attached.

The article noted that the U.S. is now ranked second in terms of global competitiveness by the Geneva-based World Economic Forum, trailing only Japan. The story also canvassed the forces in Europe, and especially those in France, which were pushing "to create a 'fortress Europe' closed to imports".

The U.S. airline business has long been the victim of exclusionary practices by European flag carriers and the governments which own and subsidize most of them. Unfortunately, the intensity of the efforts to protect European airlines from competition by more efficient U.S. carriers is increasing.

We have attached briefing materials concerning the threats to U.S. carriers in Europe. These materials focus on the renewed efforts by European carriers -- led by Air France -- to deny U.S. airlines the right to market their sophisticated airline computer reservations systems in Europe.

The "high-tech" CRS industry was created in the United States in the late 1970s, and U.S. systems are acknowledged to be the global leaders in this business. U.S. CRS companies can contribute positively to the U.S. balance of trade and generate important employment opportunities for America's workers. These opportunities are in jeopardy, however, because certain European airlines and their governments have formed an alliance whose purpose is to use the process of unification in Europe to raise new barriers to U.S. CRS systems.

We hope you will take a few moments to review the enclosed materials. Should you or your staff have any questions, feel free to contact Ed Faberman, Vice President-Federal Affairs, at our Washington office at (202) 857-4221.

Very truly yours,

Attachments

INTERN

EC, Its Competitiveness Waning, Argues Over Trimming Safety Net

By CHARLES GOLDSMITH
And PETER GUMBEL
Staff Reporters of THE WALL STREET JOURNAL

COPENHAGEN – The European Community began an agonizing debate over its lack of competitiveness in relation to the U.S. and Japan.

But there are no politically easy solutions in sight. In fact, the opening day of a two-day summit of EC leaders showcased once again the community's fundamental divisions over economic policy, and especially over whether Europe's extensive system of social protection handicaps it with onerous costs.

Britain, for example, used the debate for a frontal attack on the "folly" of stringent EC labor rules, while Denmark rejected any emulation of a "U.S. model" as an invitation to "societal problems, crime and hopelessness." While Germany's chancellor, Helmut Kohl, advocated open markets and longer working hours, French President Francois Mitterrand raged at what he called "unfair competition" from low-cost producers, especially in Asia, and stressed the need for a united EC front against the U.S. in world trade talks.

Putting Science to Work

Washington should dole out its $76 billion R&D budget according to evaluations of the competitiveness of U.S. science, the National Academy of Sciences recommended. See article on page B4.

In an eagerly awaited presentation, the EC Commission president, Jacques Delors, unveiled an eight-part plan to spark economic revival in Europe. The French Socialist steered clear of any radical rethinking of Europe's social welfare system as some industrialists have urged. His plan focused instead on increased spending on research and development, enhanced transportation and telecommunications networks (with annual spending of at least $35 billion), educational reforms, and job training or placement schemes designed to boost labor flexibility.

His chart-laden speech also called for new taxes on "scarce natural resources" as a way to reduce "excessive taxes on labor" and increase Europe's competitiveness. Beyond the EC's immediate economic crisis, which includes projections of a 0.5% decline in output this year and 12% unemployment in 1994, Mr. Delors said Europe's long-term structural problems are equally pressing.

The EC Commission is expected to prepare a white paper outlining policy initiatives to boost competitiveness in time for the December summit of EC leaders in Brussels, their next regularly scheduled meeting, or even before.

Fears of declining European competitiveness were reinforced by a new report that graphically illustrates how the most efficient EC economy, Germany, is on the wane. In the Geneva-based World Economic Forum's annual ranking of 22 industrialized and 15 newly industrialized countries, Germany has fallen to No. 5 from No. 2 in overall competitiveness. It has been surpassed by the U.S., Denmark and Switzerland, which now rank No. 2, No. 3, and No. 4, respectively. Japan is still No. 1 despite slipping in certain measures such as executive optimism, internationalization and confidence in government.

In his speech, Mr. Delors cited the debate a decade ago over "Eurosclerosis," the fear that Europe's economies had become so rigid they no longer functioned properly. He drew a parallel between the coming white paper and the one in 1985 that launched the EC's single market program after the early 1980s recession.

But there are important differences in the two initiatives: The 1985 program was based on a package of nearly 300 measures proposed in Brussels, while EC leaders say new steps to boost growth must be generated in national capitals, with the Brussels-based commission as coordinator.

EC leaders generally gave Mr. Delors's presentation a polite but lukewarm reception, acknowledging that the problems are deep-seated and not conducive to miracle cures at Copenhagen.

"This is an in-between summit," said the Dutch prime minister, Ruud Lubbers, "a preparatory summit for Brussels." Another official described the Delors address as "professorial" rather than inspiring. Britain, which has enjoyed better relations with Mr. Delors under John Major's leadership than under that of his predecessor, Margaret Thatcher, made clear it was unimpressed by Mr. Delors's plan for Europe's renewal.

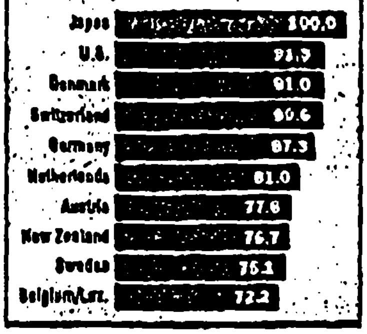
"What plan?" a senior British official said dismissively. "He made eight points. I don't think we really see those as pointing the way to reducing unemployment in the community in any meaningful way," because the EC's competitive disadvantage isn't effectively confronted.

In his address to other EC leaders, Mr. Major said EC unemployment stems largely from rigid employment markets and high nonwage labor costs such as social benefits, and he stressed that those problems are fueled by meddling EC measures including those regulating part-time work or limiting the workweek to 48 hours. He called for a new policy requiring the commission to analyze the impact on competitiveness of any new proposals affecting industry or employment.

Mr. Major said EC manufacturing labor costs rose by 4% a year in the 1980s compared with a 1% increase in the U.S. and no increase at all in Japan, so average manufacturing labor costs are now 20% higher in the EC than in the U.S. or Japan. He bemoaned the fact that the U.S. economy created four times as many new jobs in the 1980s as did the EC economy, even though economic growth was roughly equivalent. Such results, he said, are at least partly blamed on the social costs of European labor policies.

World Competitiveness

The world's 10 most competitive nations as ranked in the annual survey of the World Economic Forum



The Danish foreign minister, Niels Helveg Petersen, dismissed any suggestion that the community could emerge from recession through wholesale dismantling of social protection policies. "We don't see a way through this crisis by increasing insecurity," he said. "I wouldn't advocate anything that resembles the U.S. model. In the U.S. we are seeing severe defects, social problems, crime and hopelessness in large urban areas. It's not something we should be encouraged to do. It's not the way to go."

One of the most potentially divisive economic issues, the future of the world trade talks under the General Agreement on Tariffs and Trade, was also aired yesterday. France is trying to persuade its EC partners to oppose a U.S.-EC accord on agriculture agreed upon last year in Washington. French officials are reporting some success, but they have been horrified by a recent German and U.S. agreement not to enforce sanctions against each other's telecommunications industries.

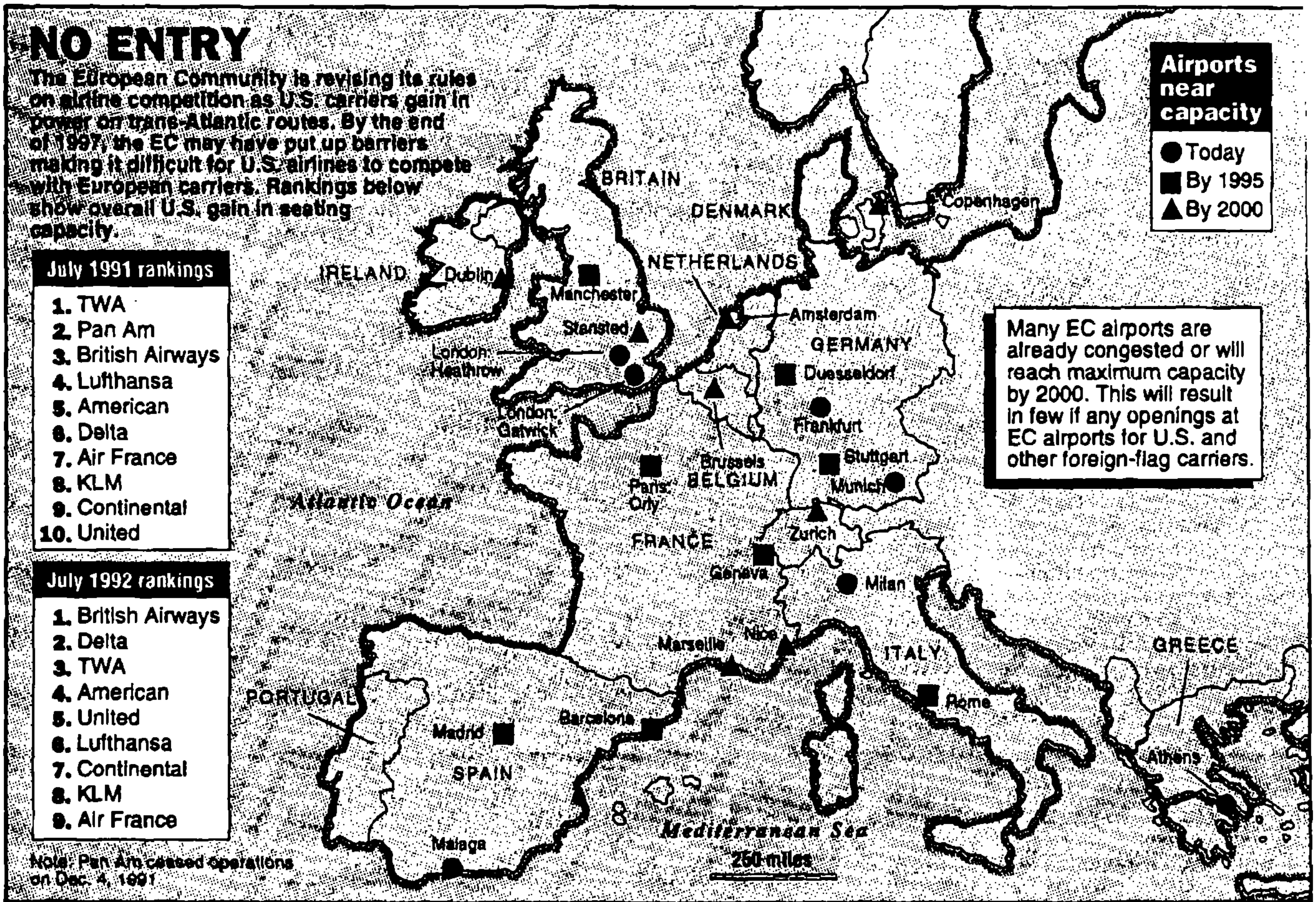
French President Mitterrand made a strong plea in the summit for unambiguous solidarity among the EC nations in dealing with the U.S. And, while insisting that "I am not a protectionist," he also called for strict enforcement of the principle of giving preference to EC producers.

Mr. Mitterrand's stance worries other EC nations, especially Britain, the Netherlands and Germany, who note that in times of recession France is tempted to create a "fortress Europe" closed to imports.

The Washington Times

June 24, 1993

MONEY



Source: U.S. General Accounting Office

Map by Paul Compton / The Washington Times

EC barriers expected to restrict access of U.S. airlines to Europe

By David Field
THE WASHINGTON TIMES

U.S. efforts to keep aloft its international airline industry may face a vast and impenetrable barrier in the new restrictions the European Community is putting up around the continent — the favored destination for U.S. vacationers.

The United States is now involved in separate and sometimes minor skirmishes with France, Germany, Japan, Canada and, until last week, Australia, but the European Community's rules on competition by foreign-flag carriers threaten a full-scale battle: They may keep out U.S. lines while allowing the growth of European giants, say aviation industry experts and congressional authorities.

About 30 million passengers fly between U.S. airports and European nations each year, and trans-Atlantic routes have become the single greatest source of revenue for U.S. airlines.

By 1997, when it begins negotiating collective air rights for its member nations, the EC will have erected a wall around the dozen members of the trading bloc. The rules will curtail the powers of individual nations in such areas as landing rights pacts — for example, no single member of the EC will be able to cut itself a separate, special deal with the United States.

"Current and proposed measures could limit U.S. airlines' ability to compete in the EC," Kenneth M. Mead, the transportation issues director for the General Accounting Office, told Congress in a recent report.

Common Market airlines include big brand-name players such as Europe's most profitable line, British Airways, as well as Air France, KLM and smaller lines such as Olympic (Greece), Sabena (Belgium), Iberia (Spain) and TAP (Portugal).

The EC's latest rules, adopted in Jan-

see EUROPE, page C3

EUROPE

From page C1

uary and already in effect, say that only EC airlines may introduce fares that are lower than existing levels, meaning no wealthy, passenger-hungry outsider like United or Delta airlines could come in and start a fare war that would draw in EC lines.

Except for British Airways, EC carriers are state-supported to some degree, and few are known as fare slashers.

Another rule holds that only EC carriers may introduce "new products." Although the rules don't define this term, most analysts think it refers to features such as innovative frequent-flier promotions, hotel and car rental tie-ins and other attractions to business fliers. European carriers have lagged behind the U.S. competition in crafting these marketing weapons.

For the major U.S. carriers such as American, Delta and United airlines, which spent more than $1.4 billion to buy up trans-Atlantic routes from foundering but still flying Trans World Airlines and from now-defunct Pan American World Airways, the stakes are high.

The U.S.-Europe market is the single largest source of revenue for U.S. airlines' international operations. Of a total $16.8 billion in revenues on international routes, 44 percent came on trans-Atlantic routes, the most important of which are those between U.S. and European cities.

Some carriers depend on summer travel to and from Europe to put enough cash in their coffers to carry them through the cold and customerless winter months.

From 1980 to 1990, U.S.-Europe traffic carried by U.S. airlines grew by 103 percent, twice the rate of domestic growth of 55 percent. Although this growth has slowed since the recession, trans-Atlantic flights are still vital elements in the U.S. lines' long-term survival strategy.

The stakes are high for the European carriers as well. Larger EC carriers like Lufthansa or Air France concentrate most of their resources on international operations, Avitas, the Reston-based airline research and consulting firm, found.

Fewer than half of British Airways' flights are within Europe, according to a recent Avitas study. For other EC lines, the ratio is similar: Alitalia flies 47 percent of its routes between Europe and other continents, 40 percent within Europe and only 13 percent at home.

Mr. Mead of the GAO believes that the EC rules barring non-EC carriers from offering lower fares and the rules restricting access to landing and takeoff slots at crowded European airports both "discriminate against non-EC airlines."

Congestion problems at the older European airports that limit the number of planes that can land or take off per hour "will make it difficult for U.S. airlines to obtain additional [landing] slots, which could constrain the growth of U.S. airlines' service to the EC," Mr. Mead said.

As Europe moves toward privatizing its state-owned airlines, companies like Air France, Lufthansa and a revitalized Alitalia are likely to become tough competitors.

EC rules that claim veto power over proposed mergers and acquisitions by U.S. and other foreign carriers — a power the U.S. Transportation Department does not recognize — may also work against American-flag carriers. If in the future, U.S. lines see attractive acquisitions in Europe, the EC could block the deals.

This is not to say that Europe has all the advantages.

Many analysts and U.S. officials privately concede that the U.S.-Germany and U.S.-France treaties favor U.S. carriers by giving them unequaled freedoms on pricing and on the number of seats they may offer.

Air France Chairman Bernard Attali has accused U.S. carriers of "dumping," of scheduling more flights with larger planes than the market demands and then selling tickets below cost, to the disadvantage of Air France.

His point raises the central challenge facing all airlines serving Europe, regardless of their homeland — the problem of supply and demand. The simple fact is that the demand for air travel exceeds the physical supply of landing room, runways and airport capacity.

Mr. Mead and others say that the problem of congestion and resulting flight limits will likely be the most difficult of all. "Nearly all major European airports are subject to slot controls" or limits on the number of operations per hour, he said.

By contrast, only four U.S. airports, Washington National, New York La Guardia and Kennedy International and Chicago O'Hare International, have similar slot rules.

The International Air Transport Association predicted in a recent study that 16 of 27 major European airports will be unable to accommodate the expected levels of traffic by the year 2000 without major upgrades, both in runways and terminals, and in air traffic control.

Among these are the two largest European hubs, London Heathrow and Frankfurt International, as well as airports in Milan, Italy; Madrid; Athens; and even Munich, the only new European facility in the last 18 years.

As Europe moves toward privatizing its state-owned airlines, companies like Air France, Lufthansa and a revitalized Alitalia are likely to become tough competitors.

Even more formidable could be multinational carriers such as the four-way union now forming among SAS Scandinavian Airlines System, KLM Royal Dutch Airlines, Austrian Airlines and Swissair.

Another alliance is possible among Lufthansa, Olympic and TAP. This four-way deal draws in some non-EC members (Switzerland is not in, and only one of the three SAS backers, Denmark, is), and EC airline alliances even farther afield in regions such as Asia are also likely.

THE EUROPEAN SINGLE MARKET -- THREATS TO U.S. AIR CARRIERS' ABILITY TO COMPETE

Prepared by American Airlines, Inc.
June 1993

THE EUROPEAN SINGLE MARKET -- THREATS TO U.S. AIR CARRIERS' ABILITY TO COMPETE

As the European Community moves closer to becoming a unified trading bloc, there is a growing threat that European airlines will use the process of unification to raise new barriers to competition from their U.S. counterparts, and make the EC a less, and not a more, competitive market.

As one of the principal U.S. flag carriers to Europe, American Airlines has experienced firsthand tactics by European airlines -- nearly all of which are owned by their governments -- to impair our ability to compete in the Community.

Attached is a briefing paper which discusses longstanding -- but recently redoubled -- efforts by European carriers to deny U.S. airlines the right to market their highly sophisticated airline computer reservations systems (CRSs) in the Community. The CRS business is one in which U.S. airlines are the world leaders and can contribute positively to the U.S. balance of trade, if given the opportunity to compete fairly.

We have also enclosed a six-page Executive Summary of the United States General Accounting Office (GAO) report entitled "Measures By European Community Could Limit U.S. Airlines' Ability To Compete Abroad", which was published in April 1993.

At page four, the GAO concludes that "...current and proposed measures could limit U.S. airlines' ability to compete in the EC." U.S. carriers have already been the victims of discriminatory treatment in such areas as the allocation of takeoff and landing rights and the ability to introduce new fares; restrictions on CRS and other matters seem likely to follow.

This U.S. government report confirms what U.S. airlines have both feared and experienced. The U.S. must watch vigilantly to prevent European carriers, and their sponsor states, from excluding U.S. carriers from their protected markets.

Prepared by American Airlines, Inc.
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CAMPAIGN BY EUROPEAN AIRLINES AND THEIR GOVERNMENTS TO EXCLUDE FROM EUROPE SUPERIOR U.S. COMPUTER RESERVATIONS SYSTEMS

European airlines have banded together to persuade the European Commission to make last-minute changes to rules governing the operation of airline computer reservations systems (CRSs), which the Commission has been considering for over a year. These changes would prevent U.S. airlines from independently marketing their state-of-the-art systems. This is the most recent in a long series of measures to exclude U.S. airlines and their superior technology from the European market.

The United States must demonstrate to European governments that it will not tolerate the misuse of the European Community's regulatory procedures to bar competition from U.S. companies.

Background

Compared to U.S. international airlines, European carriers -- which have always been sheltered by their governments from competition -- are quite inefficient. Recognizing that U.S. airlines, and U.S. CRSs, are superior to their own, European carriers and the governments which own them have embarked on a fierce campaign to hamstring the ability of U.S. airlines to compete in Europe. This campaign is being waged on several fronts. For example, most European airlines are actively cajoling their governments to demand from the U.S. bilateral air services agreements which will predetermine their market share. Simultaneously, they have been demanding, and getting, huge subsidies from their owning governments.

In 1992, Iberia was the beneficiary of a huge $1.3 billion grant from the Spanish government, and Air France has received approvals to obtain at least $1 billion in state aid over the next three years. These enormous sums are used to fund the day-to-day operation of these airlines. This puts U.S. carriers, which must compete with these state-funded enterprises, at a huge disadvantage in a business where the margins have always been razor-thin.

There is, however, no more egregious example of European governments intervening to coddle European carriers from competition than in the sphere of CRS.

Travel agencies use CRSs to make reservations for airlines, hotels, rental cars and tours. CRSs in the U.S., by law, have been neutral since 1984, and carry complete information on the publicly filed schedules and fares of all airlines offering service on a route. By ensuring that U.S. travel agencies can offer consumers nearly perfect information on all travel options, CRSs have fostered intense competition in the U.S. airline business. In the U.S., four systems compete vigorously based on price, service, and technology.

U.S. airlines created the CRS industry in the mid-to-late 1970s, and U.S. systems -- spurred by intense competition here -- are acknowledged as the global CRS leaders. Over the past decade, whenever a foreign airline has sought to upgrade or replace an antiquated system, it has turned to U.S. expertise and U.S. technology. Today, U.S. vendors do business around the globe. SABRE, American's CRS, has established a presence in over 60 countries worldwide and has done quite well when given a chance to compete fairly on the merits. Thus, in Canada, SABRE has achieved a market share of over 40% -- contributing positively to the U.S. trade account with that country.

Systematic Efforts by European Interests to Expel U.S. CRSs from that Continent

Ever since U.S. CRS systems first began their attempts to crack the stranglehold that European airlines have on the CRS market there, these U.S. CRSs have been the victim of the very exclusionary practices of European airlines and the governments that own them. American began selling SABRE in Europe in 1986. We recognized that SABRE was far ahead of the European systems and that this created great opportunity. The reaction from the various European airlines was swift and severe.

In most European nations, the flag carrier dominates the national airline market. It provides the bulk of the international service from that country and also supplies, either directly or through an affiliated carrier, most domestic service as well. Consequently, travel agency users of CRSs are absolutely dependent on the ability to use whatever CRS they select to sell transportation on the local flag airline. Recognizing this, European airlines decided to undermine the marketability of SABRE in their homelands by withholding either flight or price information, or the right to book reservations, from SABRE, even though they had gladly allowed SABRE to sell their seats for them in the United States.

This tactic erected nearly insurmountable barriers to the European market. In response to a series of complaints filed by American Airlines and others, the U.S. DOT made it abundantly clear that such treatment of U.S. systems by European airlines constituted a violation of U.S. carriers' rights under the bilateral aviation agreements.

It has become apparent, however, that European airlines will only abandon these abusive tactics when confronted with the prospects of real and immediate sanctions from the U.S. and, even then, will do so only temporarily.

In mid-1993, under pressure from the U.S., Air France and Iberia agreed to provide flight information to SABRE. However, less than five weeks later, those airlines (together with Alitalia) led a change in tactics by European carriers. On June 7, 1993, the governments of these state-owned airlines successfully blocked European Community adoption of new CRS rules. The purpose of the new regulations was to halt, once and for all, many of the anti-competitive acts targeted at U.S. systems. Now, those governments have launched an intense effort to pressure the European Commission to adopt new technical requirements which would make it impossible for the only independent U.S. systems doing business in Europe to continue operating there.

Specifically, this confederation of European airlines is pushing for a requirement that all CRSs be "dehosted". In simple terms, "dehosting" means that a CRS may not share common computer hardware and software with the computer reservations system used by the personnel of an airline. These European airlines allege that such sharing of facilities confers unfair benefits on the airline that owns the system. After a thorough and extensive review, the U.S. DOT in September 1992, rejected suggestions that "dehosting" was warranted. Following a similar, lengthy inquiry, the European Commission issued proposed new rules in September 1992, which likewise dismissed calls for "dehosting" as insupportable.

SABRE and the other major U.S. systems had their origins many years ago in the internal reservations systems of U.S. airlines. Today, U.S. CRSs enjoy great economies of scope and scale because they share equipment, software and databases with the internal reservations systems of dozens of airlines. Having lived under nearly ten years of DOT regulation, U.S. CRSs have been carefully designed to ensure that all carriers are treated equally. It was this fact which caused the U.S. and European governments previously to decide that "dehosting", which is enormously expensive, was entirely unjustified.

Simply put, U.S. CRSs operate like automated teller machines. They may be owned and operated by one company, and achieve efficiencies through the sharing of computer resources with that company, but they operate as neutral clearinghouses, providing users the full, transparent ability to deal with multiple suppliers.

The European systems do not enjoy these economies of scale and scope. In 1987, European airlines formed two CRS consortia for the express purpose of checking the advance of U.S. systems. One is called Amadeus (owned principally by Air France, Lufthansa, and Iberia) and the other is called Galileo (owned principally by British Airways, KLM, Swissair, and Alitalia). Both consortia were forced to build new systems from scratch because none of the parent carriers' internal systems was sufficiently sophisticated to serve as the core system.

In early 1993, Amadeus finally completed the implementation of its new system, which it claims is "dehosted". Based on the limited data which it has made available, the accuracy of this claim is doubtful. Despite that fact, Amadeus and its owning carriers are now spearheading the attempt to include in the European rules a ban on doing business in the Community for systems which are not "dehosted". The European carriers fully understand that U.S. systems -- which unlike their European counterparts are not directly or indirectly subsidized by the government -- cannot justify this enormous, unnecessary expenditure and will simply be forced to abandon Europe. That is their long-held goal.

Conclusion

The United States cannot tolerate this misuse of the regulatory processes of the European Community to thwart the entry of superior U.S. products. Failing to take determined and forceful action would simply encourage other airlines in Asia and Latin America to emulate these tactics. Additionally, such a failure by the United States would also encourage the European Community to adopt protectionist measures in other aviation matters and, indeed, in other high-tech industries where the Europeans recognize the superiority of U.S. products. In short, the price of not standing up to European trade barriers in CRS would be high for both American companies and American workers.

6/22/93

Executive Summary

Purpose

With nearly 30 million passengers flying to and from Europe annually, transatlantic service is the largest international market for U.S. airlines. The European nations that are the principal destinations for U.S. airlines are members of the European Economic Community (EC), which is changing the way the individual aviation markets of its member nations are regulated. The Senate Committee on Commerce, Science, and Transportation and its Subcommittee on Aviation asked GAO to describe and assess (1) changes to air transport regulation that have been undertaken by the EC; (2) the effect of those changes on competition in the European air travel market; and (3) the implications of those changes for U.S. airlines, including the possibility of granting cabotage rights to a unified EC, which would allow EC airlines to provide air service between points in the United States in exchange for allowing U.S. airlines to serve additional routes within the EC.

Background

The EC was created in 1957 by the Treaty of Rome to facilitate economic growth in Western Europe and to enable European countries to compete better in world markets. The EC's membership includes Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. In 1986, these countries passed the Single European Act, which set the end of 1992 as the target date for creating a single European market for exchanging services (including air transport services), goods, labor, and capital. The EC Commission, the primary executive institution of the EC, is responsible for implementing the 1986 act, including the provisions concerning air transport.

International aviation is controlled by bilateral air service agreements in addition to national laws and regulations. These agreements can address issues including routes, fares, and the amount and frequency of service between two countries. The United States has a bilateral air service agreement with each EC country.

Results in Brief

Since 1987, the EC has been phasing in measures that reduce the ability of individual countries to control airlines' pricing and access to markets and the amount and frequency of service offered on routes within the Community. With these measures, the Community has made modest progress in giving EC airlines increased freedom to respond to market forces, but it has not yet created a single air transport market or significantly enhanced real competition. Some member countries still want to protect their airlines from competition and have delayed until 1997 or beyond some necessary changes, such as allowing airlines of any EC country to operate on routes within other EC countries.

Measures adopted in 1987 and 1990 did not lead to an increase in competition from new airlines entering the market or to lower airfares, and because the third set of measures was not implemented until January 1993, it is too soon to assess their effect. Instead, mergers and acquisitions may be leading to less competition in the EC aviation market. These activities may result in the EC market being dominated by as few as three major airlines that will be in a stronger position to challenge U.S. airlines.

The EC's measures have focused on EC airlines operating within the Community and have had little direct effect on U.S. airlines. However, U.S. airlines' ability to compete in the EC could be limited by some measures, such as a prohibition against non-EC airlines' introducing low-fare initiatives on routes between EC countries. In addition, some EC governments are trying to restrict U.S. airlines' services to their countries as they renegotiate their bilateral air service agreements with the United States. To improve aviation relations with the EC countries, the Department of Transportation (DOT) has undertaken several initiatives, such as offering these countries the opportunity to establish agreements that could ease restrictions on their airlines' access to the United States. However, the EC Commission has proposed limiting the ability of individual governments to establish less restrictive agreements with the United States. The Commission has also proposed gaining the authority to negotiate multilateral agreements on behalf of all of its members after 1998. But as long as some EC members oppose this proposal, aviation relations between the United States and EC countries will continue to be governed by bilateral agreements.

Cabotage is currently prohibited in the United States. Attempts to legalize cabotage would face strong opposition in this country because of concerns that this air service could be detrimental to U.S. airline workers. Even if cabotage were legalized and the EC were able to negotiate as a bloc with the United States, both the EC and U.S. aviation markets present constraints to significantly expanding service, such as difficulties in obtaining access to EC airports and the high cost of establishing competitive service in U.S. markets.

Principal Findings

EC Proceeding More Slowly Than Hoped in Liberalizing Air Transport

The EC adopted measures in December 1987 and July 1990 that modestly reduced the regulation of EC airlines. The 1990 measures were replaced by measures that went into effect on January 1, 1993. The 1990 measures widened the range of fares that were exempt from governments' review and allowed airlines operating scheduled flights to match the fares of low-price charter airlines in an effort to lower airfares in the EC. To increase the number of airlines competing on most routes within the EC, the measures also allowed a route to be served by more than one airline from a single country and gave EC airlines the right to carry traffic between their home country and other EC countries.

The 1993 measures have aimed at further liberalizing the EC air transport market by removing many remaining restrictions on fares, on access to markets, and on the amount and frequency of service. But because these measures have been implemented so recently, it is too soon to know what their ultimate effect will be. Even with the 1993 measures, though, EC members retain significant control over their domestic air travel markets. For example, member states may restrict access to their markets if they believe that competition by airlines from other nations has seriously damaged their national airlines financially. Furthermore, EC countries do not all agree on limiting the subsidies some governments give to their airlines—assistance that provides an advantage to those airlines by artificially lowering their financing costs. The EC has no timetable for dealing with this issue.

EC Air Travel Market May Become Less Competitive

EC officials hoped their measures would lead to increased competition from new airlines entering the market, which, in turn, would lead to lower fares. This has not happened as a result of the first two phases of liberalization. Several independent charter airlines, such as Air Europe and TEA, tried to move into the market for scheduled service but failed because they were unable to compete successfully with established EC airlines.

Three major EC airlines—Air France, British Airways, and Lufthansa—have been consolidating their positions in the EC market through mergers, acquisitions, investments, and marketing alliances. These activities may impede competition in the EC market, because partners are not likely to compete directly with each other, and may result in the EC market eventually being dominated by as few as three major airlines. These activities will also help EC airlines to expand their global route networks and could make them more competitive with U.S. airlines in the transatlantic market.

Liberalization Measures Could Limit U.S. Airlines' Ability to Compete in the EC

Although the first two sets of measures have had little direct effect on U.S. airlines, current and proposed measures could limit U.S. airlines' ability to compete in the EC. In January 1993, the EC adopted rules to redistribute takeoff and landing slots at congested EC airports in an effort to open up markets to additional airlines. Although the new rules appear to be nondiscriminatory, they do discriminate against non-EC airlines and will make it difficult for U.S. airlines to obtain additional slots, which could constrain the growth of U.S. airlines' service to the EC. In addition, the EC's measures prohibit U.S. and other non-EC airlines from introducing fares lower than existing ones on routes within the Community.

American, Delta, and United have been improving their competitive positions in the EC by acquiring routes and operations from Pan Am and TWA. The German and French governments, in response to these actions and in an effort to improve their airlines' competitive positions before the 1993 measures took effect, have tried to restrict U.S. airlines' access to their countries as they renegotiated their bilateral agreements with the United States.

DOT hopes that its initiatives to liberalize and improve aviation relations with EC countries will improve U.S. airlines' access to European markets. DOT has offered, among other things, all EC countries the opportunity to establish "open skies" agreements, which would give EC airlines unrestricted access to routes between their home country and the United States in exchange for permitting U.S. airlines free access to their markets. Only the Netherlands had accepted the offer as of February 1993. The EC Commission has proposed limiting the ability of individual EC countries to adopt open skies agreements or similar agreements with non-EC countries. The proposal, which is opposed by some EC countries, would also give the Commission the authority to negotiate aviation agreements for the 12 member countries after 1998. If enacted, the proposal could lead to a single aviation agreement replacing the existing bilateral agreements between individual EC countries and the United States.

Granting cabotage rights to EC airlines is not likely in the near future. Attempts to legalize cabotage would face strong opposition from U.S. airline unions because they believe that cabotage could ultimately result in lost jobs for their members. Furthermore, it would be difficult for U.S. airlines to significantly expand service in the EC because of ground and air congestion in the Community's aviation system. In addition, because of the large investment needed to establish competitive service in the United States, investing in or obtaining an ownership stake in a U.S. airline may be more important to some EC airlines than cabotage. With an ownership stake in a U.S. airline, a foreign airline gains access to the domestic route network of the U.S. airline and avoids the high cost of developing independent service in the U.S. market.

Recommendations

This report reviewed the activities of an international organization, the EC, and was not intended to make recommendations to it. Rather, the report is intended to provide the Congress with an overview of recent and emerging aviation events in the EC that have significant implications for U.S. airlines. International operations are important for the industry's financial well-being and are the subject of ongoing bilateral negotiations with EC countries.

Agency Comments

GAO met with the Assistant Director for Negotiations from DOT's Office of International Aviation and the Director of the State Department's Office of Aviation Programs and Policy to discuss the contents of a draft of this report. The officials agreed with the facts presented but noted that competition in the EC air travel market will probably increase as a result of the January 1993 measures and that some of GAO's conclusions may be premature. In response to these comments, the report now indicates that the first two sets of liberalization measures have not increased competition or lowered airfares in the EC and that it is too early to assess the results of the third set of measures. As agreed with the requesters' offices, GAO did not obtain written agency comments on the draft report.