



The Impact of the 2007 U.S.-EU Open Skies Air Transport Agreement

by Eugene Alford and
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Overview

On March 2, 2007, the United States and the European Union (EU) concluded a comprehensive air transport agreement with the 27 EU countries. The agreement, which was signed in conjunction with the April 30, 2007, U.S.-EU Summit in Washington, D.C., has tremendous potential for transforming air travel and trade across the Atlantic.

The U.S.-EU economic relationship has contributed to commercial success on both sides of the Atlantic. It has opened investment, promoted trade in goods and services, and enabled the mobility of persons through initiatives such as the Visa Waiver Program. The United States and the EU lead liberalization efforts in the World Trade Organization (WTO), and they continue to work together to remove the remaining economic barriers.

The U.S. aviation relationship with the European Union and the member states, however, has not kept pace with our larger economic and commercial ties. The EU and the United States are the two largest air transport markets in the world. Together they account for more than half of all global scheduled passenger traffic and 71.7 percent of the world's freighter fleet.¹ The European country with which the United States has had the closest relationship overall, the United Kingdom, is the country with which it has had our most restrictive aviation relationship.

The U.S.-EU agreement is thus historic and supports not only aviation liberalization but also the growth of international trade. Aviation plays an important role in driving globalization, enabling trade by bringing businesspeople together, moving high-value, time-critical products, and contributing to the expansion of travel and tourism.

¹ Campbell-Hill Aviation Group, "Commercial Aviation and the American Economy," March 2006.

Open Skies agreements remove regulatory limits on the number of carriers a country may designate, the number of flights, the routes flown, and the type of aircraft an airline may use. Open routing provisions that permit unlimited flights between the parties also allow carriers to continue flights on to third-country markets. While removing barriers to market entry and service, the agreements affirm the critical operations of civil aviation, such as safety and security. The agreements cover operations by scheduled and charter operators, for passenger and all-cargo services.

Key Elements of the U.S.-EU Agreement

The new agreement, which will be provisionally applied beginning March 30, 2008, will extend “Open Skies” principles to 11 EU countries where the United States has had restrictive agreements or none at all, including Greece, Ireland, Spain, and the United Kingdom. The United States and the EU have agreed to begin second-stage negotiations on further liberalization within 60 days of application of the agreement.

Since 1992, U.S. policy has been to conclude Open Skies air services agreements with partners from every region of the world. To date, there are more than 80 such partners, including the 27 countries of the EU (Table 1). The Netherlands was the United States’ first Open Skies partner.

Table 1: Extent of Open Skies Coverage as a Result of the 2007 Agreement

<i>Currently Covered</i>	<i>New</i>
Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, and Sweden	U.K., Bulgaria, Cyprus, Estonia, Ireland, Greece, Hungary, Latvia, Lithuania, Spain, and Slovenia
Number of countries: 16	Number of countries: 11

The new agreement contains these major provisions:

- Open Skies between the United States and the EU and all its 27 member states (see Table 1);
- Broader entry into cooperative marketing arrangements for code sharing, franchising, and leasing;
- Creation of a cooperative joint committee to further airline deregulation;
- Guarantees for U.S. investors to participate as minority shareholders in any majority-EU-owned airline (effectively including minority shares of state-owned firms);
- Investment in U.S. airlines: Restatement of U.S. policy (25 percent legislated cap on

voting equity, 25 percent-minus-one-share regulatory cap on non-voting equity). The United States will consider foreign requests to hold larger shares of non-voting equity, including combinations in which the total of voting and non-voting equity exceeds 50 percent;

- For EU carriers, the ability to route flights between any EU member state and the United States without touching the home country’s “community carriers” (for example, a German Lufthansa flight can go from Paris to the United States, without having to pass through Germany);
- U.S. agreement that purchase by an EU carrier or investor of a controlling share in a carrier (passenger or cargo) from third countries that have Open Skies agreements with the United States—such as Switzerland, Liechtenstein, members of the European Common Aviation Area² (ECAA), Kenya, or African countries—would not jeopardize the acquired airlines’ rights to operate in the United States;
- Authorization for EU carriers (scheduled and charter, passenger and cargo) to carry certain Fly America traffic, except for the Department of Defense; and
- For EU cargo carriers, the ability to route flights between third-party states and the United States without touching the home country, and between the United States and members of the ECAA.

Benefits of the Agreement

Benefits for Industry

Press reports and public statements by EU spokesmen estimate the value of the agreement at approximately \$12 billion annually in economic benefit to the transatlantic airline and related industries.³ The agreement is also expected to add 80,000 new jobs. The EU estimates are reportedly drawn from a Brattle Group study concluded in 2002. State Department representatives have indicated they broadly agree with those figures, which are also consistent with a more recent study by the InterVISTAS consulting group, funded in part by Boeing and the tourism industry.⁴

² EU Member States plus Norway, Iceland, Croatia, Macedonia, Albania, Bosnia and Herzegovina, the UNMIK (Kosovo representative), Serbia, Montenegro, Switzerland, and Liechtenstein.

³ Brattle Group, “The Impact of an EU-US Open Aviation Area,” December 2002.

⁴ InterVISTAS-ga2, “The Economic Impact of Air Service Liberalization” p. 5.

Creating a more reliable, efficient air transport system increases worldwide productivity by reducing distances between manufacturers, suppliers, and customers; and improves supply chain efficiencies by enabling firms to operate lean, just-in-time, manufacturing processes.⁵ Increased passenger and cargo traffic create further indirect and catalytic economic benefits to local economies. Worldwide airfreight services carry 40 percent of trade by value.

U.S. businesses depend on an efficient air transport system. According to industry studies, businesses surveyed report that 25 percent of their sales are dependent on air transport. In some sectors, such as information technology, approximately 40 percent of sales are dependent on air transport. Additionally, 70 percent of businesses report a key benefit of air transport services is that it enables business to reach a broader market. These firms report that an efficient air transport system is vitally important to their business efficiency and ability to reduce costs.⁶

Eleven of 27 EU states did not have Open Skies agreements with the United States. With the agreement there will be an additional 26 million potential passengers in EU markets that do not currently benefit from Open Skies—a 34 percent larger market than today.⁷

To the extent the agreement generates productivity gains and increased competition, it will generate lower airfares, new direct jobs, greater consumer choice, growth in aircraft and computer businesses, and foreign direct investment in surrounding airports with new traffic. It will also act as a catalyst, stimulating other economic benefits. Industry analysts estimate that these gains would result in increases to total passenger traffic of up to 39 million as well as increases in cargo of up to 170,000 tons.⁸ The U.S.-EU agreement may also encourage other countries to liberalize further and open their markets. For example, Canada has already announced its intention to negotiate an Open Skies agreement with the EU, and the United States is looking for further market openings with China and Japan.

⁵ International Air Transport Association (IATA), “Airline Network Benefits: Measuring the Additional Benefits Generated by Airline Networks for Economic Development,” January 2006, p. 13.

⁶ IATA, *Ibid.*, p. 5; Air Transport Action Group, “The Economic and Social Benefits of Air Transport,” 2006, p. 2.

⁷ Booz Allen Hamilton, “The Economic Impacts of an Open Aviation Area between the EU and the US,” (London, England, January 2007), p. vi.

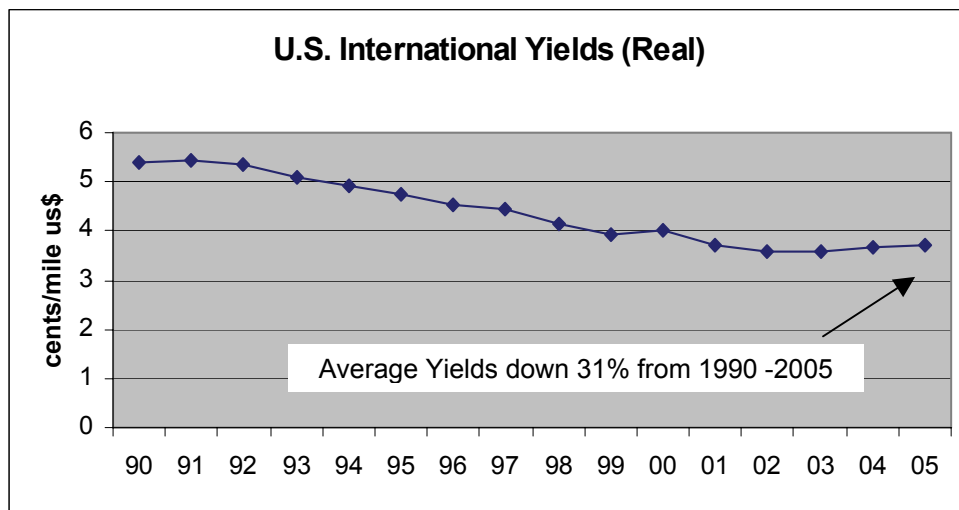
⁸ *Ibid.*, pp. viii–ix.

Specific benefits accrue to the air services sector under the new agreement:

- A unified set of rules governing air services arrangements across the EU, replacing multiple national-level air services agreements for passenger and air cargo routes served by U.S. operators;
- Potential simplification of the existing passenger and cargo operating relationships, including competition-law issues, in the non-Open Skies EU countries, helping to rationalize the industry further (for example, more choices in partnership or co-branding relationships, broader selection of passenger and cargo hubs) and improved operational efficiency; and
- Unrestricted access to the UK, and especially London’s Heathrow Airport, the busiest point in the EU and currently limited to American and United among U.S. airlines.

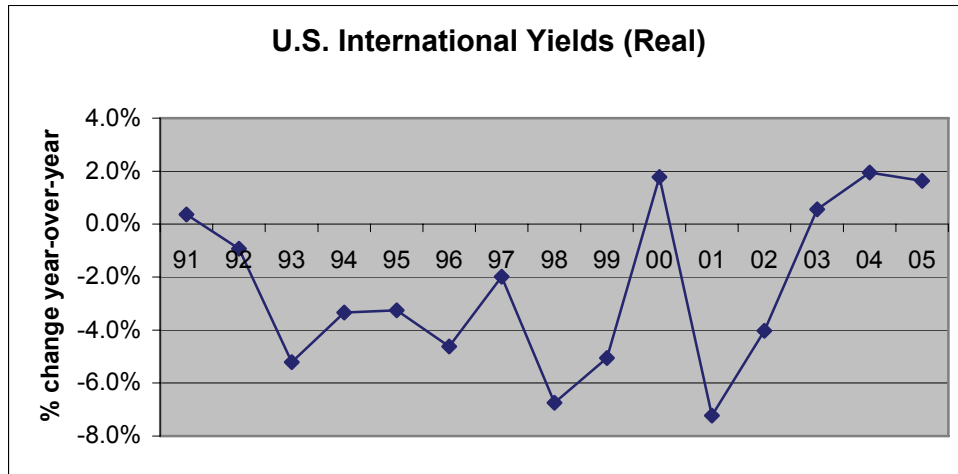
Open Skies commenced in 1992 with the U.S.-Netherlands agreement. The yield charts in Figures 1 and 2 show the average real yields declined, over the period 1990 through 2005, for international passengers on U.S. carriers. Contributors to the decrease in yields were lower average fares (due to competition) and longer haul routes.

Figure 1



Sources: U.S. Department of Commerce, Office of Travel and Tourism; Air Transport Association.

Figure 2



Sources: U.S. Department of Commerce, Office of Travel and Tourism; Air Transport Association.

The principal U.S. gains would include the benefits of adding new flights and U.S. carriers on the U.S.-UK routes through Heathrow, plus any net new flights. Although the total traffic and revenue figures for the western EU members will remain much larger than those in the new Eastern European EU members, the traffic and revenue growth rates among the new members are generally higher and offer significant opportunity. Other gains would be multiplier effects from tourism and other industries linked to air travel.

The agreement also facilitates improved cooperation between airlines through deeper alliances. According to Booz Allen Hamilton, “Closer alliances that do not undermine the competitiveness of markets would allow airlines to coordinate prices and schedules in order to reduce costs and thus reduce fares.”

U.S. all-cargo carriers stand to benefit at least as much as combination carriers. A 2004 Government Accountability Office (GAO) report on transatlantic aviation noted that “similar to the increase in passenger service, cargo service also experienced a significant increase in volume and operations since the inception of Open Skies agreements.”⁹

Significant investments have been made by U.S. cargo carriers in hubs to serve not only the European market, but to connect the European market to the global market. U.S.

⁹ U.S. Government Accountability Office, “Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets,” report no. GAO-04-835 (Washington, D.C., July 2004).

cargo carriers have built these international hubs into operations similar to domestic hubs, to carry high-value express cargo. Restrictions on fifth freedom¹⁰ operations in certain European markets under existing bilateral agreements have limited the ability of U.S. cargo airlines with European hubs from fully exploiting their investments. With the U.S.-EU air transport agreement, there will be no restrictions on fifth freedom flights within or beyond the EU, facilitating service, in particular, between London Stansted (London's preferred cargo airport) and the FedEx hub at Paris Charles de Gaulle and the UPS hub at Cologne.

For those cargo carriers without existing European hubs, the new agreement provides the opportunity to develop a hub at any airport in the EU, based on purely commercial considerations. Some U.S. cargo carriers have built business plans that involve leasing aircraft with crew, so-called "wet-leasing," that the agreement explicitly facilitates.

Cargo services are further promoted through the guarantee of access to customs facilities and processing, choices for ground-handling, and the use of surface transportation in connection with flights. Through these provisions, cargo carriers have the ability to control cargo from the point of pick-up to the final destination. Cargo carriers can provide a higher value-added service to customers through faster delivery.

International air transport services benefit a long list of manufacturers, service providers, labor, and the general economy through a multiplier effect that spreads across communities adjacent to airports and into regional areas. Hotels, car rentals, restaurants and other tourism services providers are necessary services to meet the needs of business and leisure travelers. Greater shipping options through all-cargo and belly cargo (on combination/passenger aircraft) increases competition, lowering shipping costs, and potentially brings new markets on line.

U.S. airports show continued growth in enplanements (Table 2). According to Federal Aviation Administration (FAA) passenger boarding and all cargo data, Hartsfield-Jackson Atlanta International Airport, the United States' busiest airport, grew 3.11 percent in 2005, to 42.4 million passengers. The other top 10 U.S. airports showed growth in enplanements ranging from 0.06 percent for Dallas/Fort Worth International

¹⁰ The "fifth freedom of the air" is "the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State (also known as a Fifth Freedom Right)." See ICAO Web site, www.icao.int/icao/en/trivia/freedoms_air.htm.

to 9.87 percent for George Bush Intercontinental/Houston. On the cargo side, Ted Stevens Anchorage International, Memphis International, and Louisville International–Standiford Field, the top three cargo airports in the United States, showed growth of 5.28, 5.15, and 4.62 percent respectively, in 2005 (Table 3).

Table 2: Enplanements and Growth Rates for Top U.S. Passenger Airports, 2005

<i>Airport</i>	<i>Enplanements (millions)</i>	<i>Growth rate (percent)</i>
Hartsfield-Jackson Atlanta International	42.4	3.11
Chicago O'Hare International	36.7	1.72
Los Angeles International	29.3	1.55
Dallas/Fort Worth International	28.1	0.06
McCarran International	21.4	7.32
Denver international	20.8	1.93
Phoenix Sky Harbor International	20.3	5.07
John F. Kennedy International	20.3	9.0
George Bush Intercontinental/Houston	19.0	9.87
Minneapolis-St. Paul International/Wold-Chamberlain	18.0	2.80

Source: Federal Aviation Administration, Passenger Boarding and All Cargo Data, Calendar Year 2005.

Table 3: Landed Weights and Growth Rates for Top U.S. Cargo Airports, 2005

<i>Airport</i>	<i>Landed weight (billion lbs.)</i>	<i>Growth rate</i>
Ted Stevens Anchorage International	20.7	5.28
Memphis International	18.7	5.15
Louisville International-Standiford Field	9.2	4.62
Miami International	7.1	3.71
Los Angeles International	5.9	(4.43)

Source: Federal Aviation Administration, Passenger Boarding and All Cargo Data, Calendar Year 2005.

A 2006 study on the economic impact of air services liberalization funded by a broad manufacturing and services industry coalition found that “significant evidence [exists] that supports the generally accepted ‘conventional wisdom’ that liberalization of air services between countries generates significant additional opportunities for consumers,

shippers, and the numerous direct and indirect entities and individuals affected by such liberalization.”¹¹

The same study noted that “Growing evidence indicates that new air services can lead to changes in the underlying structure of the regional economy by creating new capabilities, and forming a different set of transactor expectations. These reactions can literally create new industries in a region, and allow the area to compete for economic opportunities throughout the world.”¹²

The study also observes that while the relationship of liberalized air services in a market and enhanced activity in the market’s broader economy—what the study calls “catalytic impacts”—are the most difficult to quantify, substantial anecdotal evidence exists to support these linkages.

A study on the impact of one daily Boeing 747-400 passenger service to San Francisco International Airport (SFO) from the Asia-Pacific market highlights the significant, far-reaching economic impact of an international service.¹³ Table 4 offers a summary of the economic impact of air services liberalization.

Table 4: Economic Impact of Air Services Liberalization, 2004

	<i>Airport</i>	<i>Visitor Industry</i>	<i>Total</i>
Jobs (direct/induced/indirect)	210	346	556
Personal income (in millions)	\$18.1	\$8.8	\$26.9
Business revenues (in millions)	\$23.9	\$8.6	\$32.5
State and local taxes (in millions)	\$1.9	\$1.9	\$3.8

Source: John C. Martin Associates.

Benefits for Consumers

The increased scope for commercial decisions, rather than regulatory-driven ones, in the industry benefits consumers and operators alike and translates into new operational flexibility in routing, choice of partners and alliances, and setting rates that could improve airlines’ operating efficiency and increases consumer choice. Aer Lingus has announced it will begin service in October 2007 to Orlando, Florida, a strong U.S.

¹¹ InterVISTAS-ga2, “The Economic Impact of Air Service Liberalization,” 2006, pp. 10–11.

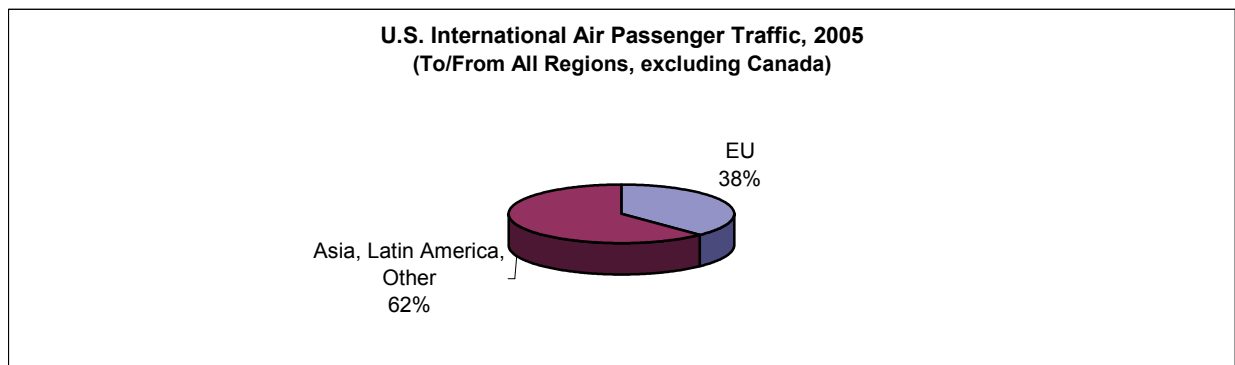
¹² Ibid., p. 11.

¹³ “International Traffic: Yesterday, Today and tomorrow,” presented February 27, 2007, from a study by John C. Martin Associates, 2005.

tourism destination.¹⁴ Virgin Atlantic’s announcement that it may serve six new EU destinations direct to the United States will create healthy competition in the market and benefit consumers. U.S. airlines have also indicated interest in new routes available through the Open Skies agreement. Ultimately, the regulatory process for applying for new routes will provide a concrete indication of growth. This market-oriented competition will benefit consumers through increased choice and, potentially, lower costs.

For the major U.S. and European carriers, the most important international market has traditionally been the trans-Atlantic market. Figures 4 and 5 show the importance of EU passenger traffic as a share of total U.S. international traffic and the share of U.S.-EU traffic governed by Open Skies agreements. The significance of the UK market is clear in Figure 3, but enormous traffic volumes already flow under the existing arrangements.

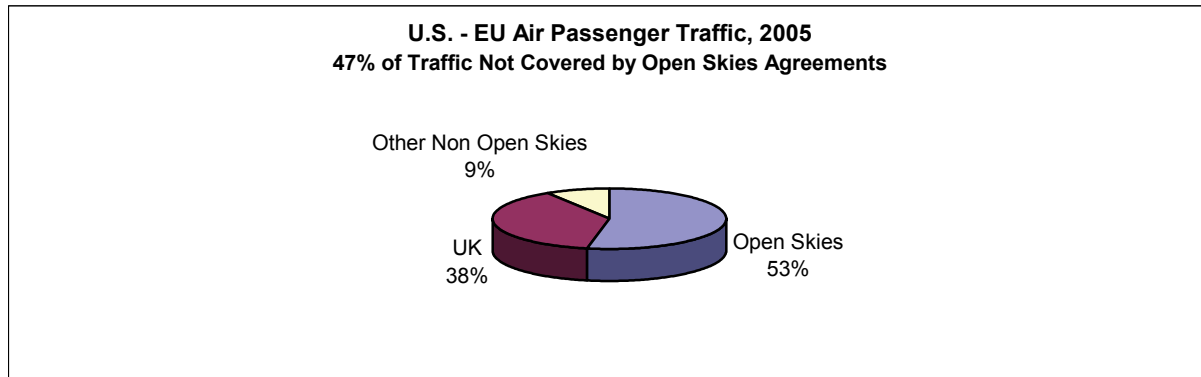
Figure 3



Source: U.S. Department of Commerce, Office of Travel and Tourism Industries.

¹⁴ *Aviation Daily*, March 26, 2007.

Figure 4



Source: U.S. Department of Commerce, Office of Travel and Tourism Industries

Benefits for the Travel and Tourism Sector

European visitors account for nearly a third (29 percent) of all U.S. travel and tourism-related exports—spending more than \$31 billion in the United States in 2006, higher than Asia and Oceania (28 percent) and the Western Hemisphere (24 percent).

Table 5: Forecast of U.S.–EU Travel, 2006–2010

<i>thousands</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>Percent Change, 2006–2010</i>
US to EU	17,060	17,331	17,816	18,368	18,920	11 percent
EU TO US	9,521	10,053	10,576	11,215	12,031	26 percent

Source: Office of Travel and Tourism Industries (Global Insight).

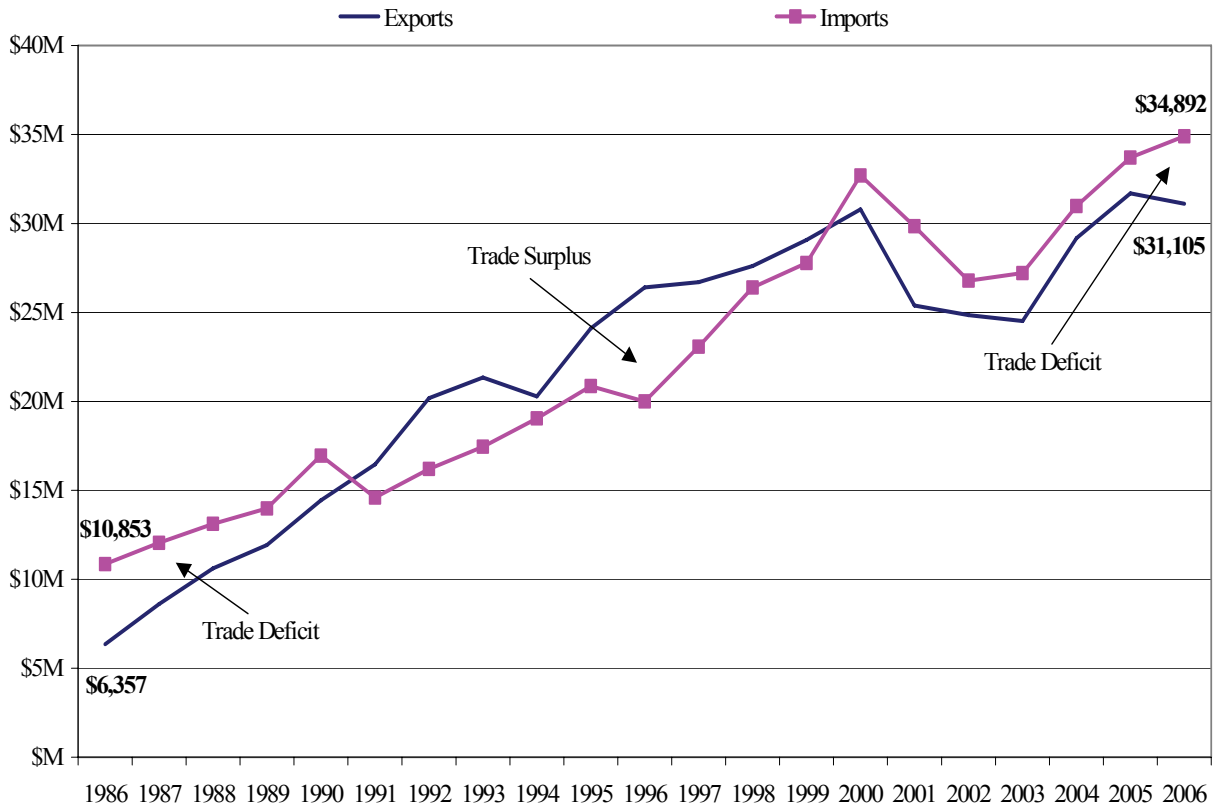
Assessments of passenger volumes for selected U.S.-EU markets, prior to and following bilateral Open Skies agreements, demonstrate there is a positive impact from these agreements. Forecast growth is shown in Table 5. Open Skies agreements offer a substantive opportunity for governments to facilitate increased traveler flows between the United States and partner countries. In 2006 alone, travel to the U.S. increased by nearly 4 percent over 2005 for all 75 Open Skies markets.

Both U.S. and European airlines have benefited from air services liberalization. Due to the greater number of U.S. travelers who fly to Europe on European carriers compared to the lesser numbers of European travelers to the United States traveling on U.S. airlines, the United States has recorded a trade deficit in passenger fares. Since 2000,

the passenger fares deficit has created an overall travel and tourism trade deficit with the European Union (Figure 5).

Figure 5

**U.S. Travel and Tourism Exports/Imports 1986-2006
(European Union)**



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

As liberalization in air services is made, there is evidence of how new service can stimulate new traffic as seen in the growth of point-to-point traffic. For example, one-year traffic jumped 146.4 percent between Vancouver, British Columbia, and Phoenix, Arizona, after adoption of the 1995 U.S.-Canada transborder air services agreement. Similarly, travel between Toronto and Minneapolis, Minnesota, jumped 55.3 percent in the first year after the U.S.-Canada agreement. Even with the highly restrictive U.S.-UK air services agreement, a further liberalization in 1995 expanded service to Manchester,

Birmingham, and Glasgow. Additionally, new trans-Atlantic gateways developed in Bristol, Edinburgh, and Belfast.¹⁵

Conclusion

The historic, comprehensive U.S.-EU air transport agreement substantially liberalizes our aviation market and brings it closer to trade and investment patterns in the broader U.S.-EU relationship. It provides key benefits across the board for the air services sector, consumers, businesses who rely on express delivery services, commercial air travel and tourism. The agreement provides the base upon which airlines and others can build for a future of closer integration through alliances and investment, and the expansion of their routes both across the Atlantic and globally. The joint commitment on the part of the United States and the European Union to launch second-stage negotiations in 2008 holds open the possibilities for even greater commercial opportunities in the future.

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¹⁵ InterVISTAS-ga2 “The Economic Impact of Air Services Liberalization.”