



Air service agreements between the UK and the US - Government response

The Department presented written and oral evidence to the Committee in April and June respectively. These introductory paragraphs bring the Committee up to date with subsequent developments.

As the Committee is aware, the UK and US resumed their negotiations on 56 July in Washington, when further progress was made on the text of a revised Air Services Agreement. Recognising that progress towards a final agreement was difficult when the UK's largest carrier, British Airways, was in the middle of significant discussions with KLM, the two sides agreed that further talks should be held in the autumn, when the outcome of these discussions would be known.

On 21 September BA and KLM announced that talks had broken down. With no UK carrier in a position to apply to the competition authorities in the US, UK and EU for approval of an alliance with full and fair access to and especially in the US market, it was agreed by both sides that the prospects for rapid progress at resumed talks was slim. The talks scheduled for 1820 October have therefore been deferred. We would expect them to be rescheduled for later this year or early in 2001.

On 2 October, the EU Council of Ministers tabled a questionnaire on the need for reform of airport slot allocation, and the form any new system should take. The Department has consulted on the questionnaire.

(a) We hope that our inquiry, both through the process of taking and publishing evidence from witnesses from both sides of the negotiations, and by publishing the conclusions and recommendations contained in this Report, has prompted and will prompt fresh thinking from all those involved in the bilateral air service negotiations (paragraph 5).

The Government welcomes this report. The evidence presented to the Committee from across the spectrum of interest, and the Committee's commentary on that evidence, is comprehensive. The Government notes that, whilst all the witnesses and the Committee support the drive towards full liberalisation of the UK/US aviation market, the Report illustrates the wide range of views, sometimes conflicting, on the best way to achieve that outcome.

(b) The Government's priority should be to benefit the economy as a whole, rather than individual airlines (paragraph 71).

(c) The United Kingdom, however, is in a different position to other European nations, in that we have two trans-Atlantic carriers already, and another domestic airline has said that it is willing and able to enter the market. We recommend that the Government ensure that any deal offer equal opportunities to Virgin

Atlantic and British Midland as well as to British Airways (paragraph 73).

(d)Under Bermuda II there are already far more air services between the United Kingdom and the United States than between any other European nation and the US, almost 40 per cent of passengers to the US fly from or via the United Kingdom, and from London, if not from Heathrow, it is possible to fly to more points in the United States than from any other European city. Moreover, British airlines have been extremely successful under Bermuda II, not only out-performing their US rivals on most routes to the United States, but also attracting more passengers from 'behind' London than US carriers attract from 'behind' gateway airports in the United States. This leads us to two conclusions. First, the Government should be alive to the fact that some of those who have been successful under the current regime may try to ensure that Bermuda II is retained, perhaps by seeking in exchange for a more liberal regime concessions that the United States refuses to give, or that the United Kingdom cannot offer. Second, given the strong position the United Kingdom currently enjoys, the Government should be extremely careful to ensure that a new agreement will bring substantial benefits to the United Kingdom's airlines and consumers, and to the economy as a whole, and that, if access to Heathrow for US carriers is liberalised, significant reciprocal benefits in the shape of access to the US domestic market for both passenger and all-cargo British carriers such as full wet-leasing rights are obtained (paragraph 78).

The Government has always sought to balance the interests of UK airlines, airport operators, consumers (both of passenger and cargo services), the regions and the wider UK economy, and will continue to do so. In the interests of balance between UK and US interests, the UK will continue to press for full wet-leasing rights within the US domestic market.

In considering the interests of individual airlines, the Government's aim is to ensure that they all should have the right to compete on fair terms on air services to the US, without restriction as to frequency of service or airport of operation. Nevertheless, it is a simple statement of fact that BA is our largest airline, in terms of route network and employment; and that must be given due weight when considering the balance of interests.

(e)The United States has proved to be intransigent about its domestic legislation relating to cabotage, airline ownership and Fly America. The current proposal to accept a more liberal air services agreement in return for permitting alliances between airlines in order to allow United Kingdom airlines to gain access to the US domestic market may lead to a deal in the short term, but such a deal should include a clear timetable for the lifting of US restrictions on cabotage and airline ownership, and of the Fly America policy (paragraph 72).

The Government agrees that US protection of its domestic market is inimical to full liberalisation and will continue to impress upon the US the benefits of competition in a free market, even if, in the interim, some agreement short of full liberalisation is reached. The Government notes that the removal of some of these anti-competitive measures but not necessarily Fly America would require domestic legislation within the US. However, the Government has seen no evidence yet of steps being taken in this direction, nor of any political will to take them. The US Government maintains at present that it is unable to commit itself to legislate on the grounds that it would be difficult to get Congress to accept legislation that it might regard as contrary to US commercial interests.

(f) We agree that any deal reached between the two countries should be, as is intended, phased in as competition authorities on both sides of the Atlantic grant airlines the ability to reach alliance agreements with one another. We further recommend that the Government ensure that liberal rights of access to Heathrow are rescinded if alliance agreements cannot be reached within a reasonably short timescale, and thus United Kingdom airlines prove unable to access the US domestic market (paragraph 74).

The Government see it as central to any agreement that access for US carriers to Heathrow should be matched by effective access for UK carriers to the US domestic market. At the present time, neither British Airways, the UK's largest carrier, nor any other UK airline has applied for anti-trust immunity to the US DOT, or sought Art. 81(3) approval from the UK and EU competition authorities. Until such applications are made, the competition implications cannot be predicted.

(g) We recommend that as part of any deal made now in advance of the removal of restrictions on cabotage and airline ownership the United Kingdom should ensure that the regulations governing wet-leasing into the United States be brought into line with those in this country. To do so will not allow British carriers to access the US market directly, but it will at least allow them to benefit from the size and strength of the market (paragraph 75).

(h) Liberalising fifth freedom rights for all-cargo services will undoubtedly bring benefits to the United Kingdom in the shape of increased employment and lower costs for exporters. Such a measure should therefore be considered as a possible basis for a preliminary deal in advance of a wider air services agreement between the two countries. However, we are concerned that domestic all-cargo carriers will not benefit from the grant of fifth freedom rights beyond the United States in the same way that US carriers will from operating to points beyond the United Kingdom. We therefore recommend that the Government should offer to liberalise 'cargo fifths' in return for an agreement that the United States will enable British all-cargo and charter carriers to benefit from the US market through wet-leasing (paragraph 76).

The Government agrees that the US rules prohibiting the wet leasing of non-US aircraft within their domestic market are anti-competitive and protectionist, and it will continue to press the US to rescind those rules. However, it would require US legislation to allow wet leasing by UK airlines in a form which is commercially attractive to potential US lessees, and so this could not be delivered in an early preliminary deal. In our recent informal discussions with the US we offered a deal very close to that recommended by the Committee liberalisation of the all-cargo market by summer 2002 provided that, by that time, the US Government had legislated to allow UK airlines to wet-lease to US airlines to the same extent as US carriers (such as Atlas Air) currently wet-lease to UK airlines. The US Government said that they were not interested in such a deal. The Government notes that US carriers are permitted wet lease into the UK domestic market, subject to certain constraints imposed by EU Regulations.

The Government agrees that a strong and competitive air cargo sector is in the interests of UK businesses, and an expansion in that sector may bring increased employment opportunities. The Government also agrees with the Committee's implication that a deal which confers disproportionate advantages to one side only cannot be considered as fair.

(i) We recommend that the Government seek to improve the position of charter airlines either as part of the air services agreement between the two countries, or as part of a preliminary deal in advance of a full agreement, so that their permits to operate services to and beyond the United States are agreed either for a lengthy period or permanently, allowing them to plan future services and investments (paragraph 77).

The Government will work to improve the position of charter carriers under any revised air services agreement, in particular, to provide assurance that they will be able to operate two-centre holidays involving stops in both the US and the Caribbean. However, the Government is unaware of any aeronautical authority in the world which grants permits on a permanent basis.

(j) It is unfortunate that the granting of fifth freedom rights to Singapore Airlines to operate services from the United Kingdom to the United States continues to be delayed by the fact that the bilateral air service negotiations have not yet been concluded. We therefore recommend that the Government consider granting such rights to the airline in advance of the conclusion of its talks with the United States (paragraph 80).

During talks in January the Government offered transatlantic fifth freedom rights to Singapore from all points in the United Kingdom apart from Heathrow and Gatwick as part of a wider liberalisation of our bilateral air services arrangements. This offer was refused. We continue to believe that it would not be appropriate for us to offer transatlantic rights to Singapore whilst a UK carrier which wishes to do so is unable to operate on transatlantic routes from Heathrow.

(k) Reform of European regulation EC95/93, which governs the allocation of slots at airports such as Heathrow and Gatwick, is imperative, particularly if a new air services agreement liberalises access to Heathrow. The Government should review 'grandfather rights' over slots, make clear instead that slots are "community assets", and establish a system whereby slots are allocated to airlines for a defined period of time. The Government should also support amendments which put in place a transparent means by which airlines can trade slots with one another, whether or not such a system involves secondary trading. Such measures will make access to Heathrow and Gatwick for new operators more straightforward, and will therefore encourage competition. However, steps should also be taken to protect regional and other short-haul services, and we welcome the Government's intention to support amendments to the regulation which will achieve that aim (paragraph 89).

The Commission has been developing suggestions for revision of EC 95/93. The Government has made suggestions to the Commission about the form that such a revision might take, including the view expressed in A New Deal for Transport that any revised regulation should make greater recognition of the importance of maintaining services from peripheral regional airports into the key hub airports. The Government is preparing a response to a series of questions relating to the underlying principles of revision, including the need or scope for greater use of market mechanisms in slot allocation, posed by the Commission. In doing so, it is in discussion with the airport and airline industry. It will let the Committee have a copy of that response in due course.

(l) We are disappointed to note that publication of a document setting out the Government's aviation policy still seems to be a long way off. Without a clear statement of Government policy and a commitment to investment in runways and terminal facilities, the current lack of capacity at Heathrow and Gatwick, and the potential increase in 'mixed-mode' activities there, which is likely to be exacerbated by a new liberal air services agreement between the United Kingdom and the United States, will not be permanently addressed (paragraph 91).

The forthcoming White Paper on air transport will need to take account of the Government's decision on a fifth terminal at Heathrow. It cannot therefore be published immediately. The Government also wants to consult widely in producing the White Paper. There will be several steps leading up to its production: a consultation document on national policy issues; a set of regional consultation documents examining air

service and capacity issues in each region; and a separate consultation on issues in the south east and east of England, which will include an examination of preferred options for new runway development in the region. Responses to these consultation documents will form a crucial input into the preparation of a comprehensive White Paper that will provide a framework for the future development of the aviation industry in the UK.

(m) We are concerned that the uncertainty caused by the current round of talks between airlines about possible mergers will lead to a lengthy delay in the conclusion of negotiations over air service agreements between the United Kingdom and the United States. For that reason we urge the two Governments in the interim to reach a preliminary deal about those areas of common interest not affected by airline mergers: the charter market and matters relating to all-cargo carriers. We also urge both Governments to recognise that bilateral negotiations will prove increasingly difficult, if not irrelevant, if, as seems likely, airlines merge and form closely-co-operating alliances. However, it is clear that the instigation of multi-lateral rather than bilateral negotiations would have a considerable impact on the economic and consumer interests of the United Kingdom. We therefore recommend that the Government urgently investigate the effect that moving to multi-lateral negotiations would have on the economic and political rights and interests of the United Kingdom (paragraph 94).

Whilst the Government accepts that the breakdown of BA's discussions with KLM will have been disappointing to the two airlines concerned, the decision was entirely theirs to make. Furthermore, it must be for BA to decide its future strategy with regard to alliances and consolidation. We expect them to make decisions in the near future.

Officials discussed the consequences of the breakdown of discussions with the US in October. The two sides considered a possible interim deal but could not agree a balanced exchange on passenger services. As previously stated, the UK is willing to liberalise the all-cargo market provided that the US Government legislates to allow UK airlines to wet-lease to US airlines in their domestic market. The US Government has rejected this proposal. We shall therefore continue to pursue full liberalisation.

As the breakdown of the proposed BA/KLM merger illustrates, the trend towards consolidation in the airline industry is constrained by the current regulatory system. One factor in the breakdown was reportedly the difficulties posed by the ownership and control restrictions that are a fundamental part of the bilateral system. Although there is some pressure for change, there are a number of unresolved problems. These were illustrated recently by the cautious approach taken by most World Trade Organisation (WTO) members at the recent first meeting to review the scope of application of the General Agreement on Trade in Services (GATS) to air transport. Negotiations on traffic rights at a true multilateral level are therefore some way off. However, the Government will continue to assess the likely impacts of various options in consultation with interested parties in developing future policy.

(n) Whilst we recognise that the creation of a trans-Atlantic Common Aviation Area would be desirable, we agree with the Government that the European Commission should only be given a mandate to negotiate with the United States when it becomes clear that a Common Aviation Area is achievable, and that its creation is in our best interests (paragraph 99).

Government welcomes the Committee's support.

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