



EU-US Aviation: the importance of reforming cross-border investment

A briefing note from the European Commission

Key takeaway point:

A second stage EU-US agreement containing meaningful reform on cross-border investment is an essential part of any long-term recovery plan for aviation

An industry held back by rules from another era

1. Aviation is one of the most technologically advanced sectors of industry with a central role in the globalization of travel and business. Yet it is still regulated by restrictive rules that remain largely unchanged since the years before commercial passenger flight was a commonplace reality. For example, restrictions limiting foreign ownership of US airlines were first introduced in the 1926 Air Commerce Act, passed 25 years before the first crossing of the Atlantic by a jet plane. **Today, the US retains some of the most restrictive laws on the foreign ownership and operation of airlines in the world, starving its airlines of capital and limiting their options for recovery, growth, and participation in a rapidly globalizing industry.**
2. These rules lead to higher costs and lower employment for airlines, generating unrecoverable losses for consumers, aviation employees, investors and businesses. The original reasoning for the imposition and continuation of these rules has long been forgotten, yet the restrictions remain.
3. US, European and international airline and airport trade associations have all spoken out strongly in support of change. For example, IATA recently wrote to President Obama, stating that *'in order to build a sustainable future, airlines need the same management*

*tools that other businesses take for granted: market access and access to capital*¹. **The industry is clear on the need for change.**

4. Europe has also been an active proponent and practitioner of the modernisation of the sector, taking steps reforming the long-standing restrictions on ownership and control which single out aviation as being almost uniquely undeserving of the benefits of foreign investment. **In Europe, airlines can be owned and controlled by citizens of more than 30 European States**². **Europe is proposing extending this freedom to US airlines and investors on a reciprocal basis, as it recently did with Canada.**
5. The second stage negotiations between the US and EU represent a unique chance to reform an industry in desperate need of a re-think in the way that it operates.

The benefits of change

6. The US and EU concluded a first stage aviation agreement which has delivered significant benefits since its implementation in March 2008. New services and new partnerships have emerged as a result and closer cooperation on key issues between the Governments on both sides has been made possible through the establishment of a Joint Committee and closer working in key areas such as competition and safety.
7. However, it was agreed by both sides that this agreement would be the first in a two-step process. In May 2008, the US and EU commenced negotiations on a second stage agreement. **Europe is proposing as a key outcome of these negotiations the removal of ownership and control restrictions for investors from both sides as well as the waiving of nationality restrictions for airlines from third countries owned by US or European investors and wishing to fly to the US or Europe.**
8. **The potential benefits of these reforms are enormous:**
 - *For the economy.* The US and EU represent the biggest trading relationship in the world and benefit significantly from cross-investment in each others' economies. 60 per cent of the pool of global foreign direct investment is between Europe and the US. In 2007, investment outflows from the EU to the US were 113 billion Euros (compared to 2 billion Euros to China). **US and European aviation is largely excluded from the benefits of this cross-investment. Airlines should be given the same freedoms as almost all other sectors of the economy, in line with the principles of barrier-free markets espoused by the Transatlantic Economic Council (TEC).**
 - *For employment.* Overall the aviation industry is in poor health. Since 2001, US airlines have shed an estimated 150,000 jobs, or more than a quarter of full time employees³. Elsewhere, the removal of ownership and control restrictions and opening up of markets has been shown to generate higher investment, new routes and more

¹ IATA open letter to President-elect Obama, 17 November 2008.

² The 27 Member States of the European Union plus Switzerland, Norway, Iceland and Lichtenstein

³ US Air Transport Association (ATA)

direct services, and the emergence of new business models, with a consequent increase in employment. **An independent study of the impact of the single market in Europe noted that its introduction had helped to double traffic growth, creating 1.4 million jobs⁴. A separate study estimated a 6 per cent growth in employment between 1997 and 2004 in the European airline sector and noted that wages for pilots had increased in line with or in excess of the national average⁵.**

- *For consumers.* The removal of unjustified economic regulation has been shown to be universally good for consumers. In Europe, consumers have been clear beneficiaries of the removal of ownership restrictions and the subsequent improvement in competition. Airlines have been quick to seize the opportunities created by a relaxation of ownership and control restrictions, providing additional choice to passengers and shippers. **Since the introduction of a barrier-free single market, Europe has witnessed significant change in the level of competition, with the number of cross-border routes more than doubling and the number of routes with more than two competitors increasing by 400 per cent.**
- *For airlines.* Airlines such as Virgin America and JetBlue in the US have benefited from the injection of transatlantic minority investment, allowing them to start new services and hire additional employees. Yet, their future potential remains limited by ceilings on the amounts that such investors can invest. **The ability to merge and invest across borders has been critical in strengthening the financial and competitive position of a number of companies (e.g. KLM-Air France and Lufthansa-Swiss). Cross-border flows of capital have strengthened many airlines and helped others to avoid bankruptcy, to the benefit of airlines, employees, airports and the local regions they serve.**

9. Access to new sources of investment and finance is vitally important in the current economic climate, which has had a major impact on the aviation industry.

Freeing up the industry to help itself

10. The forthcoming second stage negotiations offer a unique opportunity to change things for the better.

11. By relaxing the investment rules for the two biggest aviation markets in the world encompassing 60 per cent of global aviation, an agreement would allow airlines the freedom to structure their industry more sensibly. It would place US and European airlines in a strong position compared to other global competitors.

12. European law allows the European Community to grant favorable treatment to US aviation investors where specifically permitted in an international agreement. **Europe recognizes that removing restrictions for investors in US airlines is less straightforward, requiring a change to current US law, namely the Federal Aviation**

⁴ Intervistas Consultancy (2007) The Economic Impact of Air Service Liberalisation

⁵ Ecorys (2007) Social Developments in the Air Transport Sector

Act of 1958 (as re-enacted in the Airline Deregulation Act 1978). Exactly how this might be achieved is of course be up to the US Administration and Congress to decide. However, the modernization of those rules could be effected very simply.

13. Concerns have been expressed on both sides of the Atlantic about the possible impact of such reforms in the areas of security and labour relations. Europe has already been proactive in taking steps to develop debate on these issues and seek solutions. For example, it hosted a "Labour Forum" involving key figures from airlines, labour interests, academia and Government in Washington in December 2008, and is planning a follow up event in June this year. And the EU and its member states continue to cooperate very closely with the US on aviation security issues. **Europe is ready further to discuss these concerns and, if necessary, to explore the possible inclusion of safeguards on national security and labour in a second stage agreement.**

14. **The need for change is clear. The aviation industry faces a crisis that is exacerbated by out-dated and unnecessary restrictions on cross-border investment. Governments need to grant airlines the freedom to work out their own solutions.**

TECHNICAL ANNEX: Europe's proposals for a second stage EU-US aviation agreement

The issues for discussion in negotiations on a second stage is set out in Article 21 of the first stage agreement. The European detailed its position on each of these issues in the first two rounds of negotiations on a second stage agreement in May and September 2008:

'(a) - Further liberalization of traffic rights'. Europe is offering a full reciprocal exchange of full **7th freedom rights** for all passenger and cargo services to and from the other side, as well as the reciprocal granting of **cabotage** rights for both sides.

'(b) additional foreign investment opportunities'. Europe is offering the full reciprocal exchange of **investment freedoms** to US investors, which would allow citizens from the US to take control of European airlines in over 27 countries. In addition, Europe is proposing that investors from both sides have the chance to **openly invest in third country airlines** (subject to the laws of those countries) without fear of them losing the right to fly to Europe or the US.

'(c) effect of environmental measures and infrastructure constraints on the exercise of traffic rights'. Europe is open to the consideration of proposals from the US in this area, particularly in the area of **night-noise regulation**.

'(d) further access to Government-financed air transportation'. Europe considers that the discriminatory treatment of airlines as required under the "**Fly America**" policy does not fit with the principles upon which the first stage agreement is based. Reform of this outdated law should be central to any second stage agreement.

and

'(e) provision of aircraft with crew'. In line with the principle of removing constraints on cabotage services for both sides, Europe is proposing that airlines from both sides have the right to **provide aircraft with crew** in the territory of the other party.