

## 2 Air transport in crisis\*



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Jeffrey Shane, former Under Secretary for Policy at the US Department of Transportation and President of the triennial Assembly of the ICAO in September 2007 is nowadays a partner at the international law firm of Hogan & Hartson LLP, based at the firm's Washington, DC, headquarters. His practice is focused on regulatory, legislative, transactional, and policy-related matters arising in aviation and other modes of transportation. He was in Paris in October for the World Air Transport Forum where main issues of the future of air transport were to be discussed.

The *Revue de droit des transports* had the great opportunity and honour to meet him, one on one, at Hogan & Hartson's Paris office, Tuesday 28th of October, to talk about issues regarding the impact of the economic crisis on the airline industry, the development of an open aviation area and to talk about environmental issues in developing intermodal transportation.

**Revue de droit des transports :** The financial market turmoil has hit hard on air traffic and many air carriers could face trouble financing planes in the year ahead : how do you see the coming months for the air industry ?

**Jeffrey Shane :** It is difficult to say what the future of the airline industry will be because the magnitude of the crisis has exceeded what we have ever seen before. During the past one or two years, the airline industry has been suffering from the rise of fuel prices and that was considered to be the big crisis. Now, prices of fuel have fallen but ironically this is a bad sign because the demand for energy has dropped too, as a result of a much lower demand for economic activities of all kinds. And the air transport industry is very worried that this downturn is going to be sustained. We're going to see its effects in parts of the world where the air transport industry is often more protected against economic challenges of this kind : in Asia and the Middle East, for example. IATA, as you know, has been putting out a lot of information on this serious downturn and we're only at the beginning. The airlines are now struggling to become more efficient in this huge financial and economic turmoil.

I've just come from Istanbul where IATA hosted a meeting, scheduled long before, where we talked about how liberalization might help the airlines achieve that greater efficiency – a subject that the crisis made even more important. It was not a meeting of the airlines ; even though it was hosted by IATA, the airlines' association ; it was government authorities who sat around the table. Fourteen national delegations and the European Commission were represented there. The principle that we began discussing was the underlying principle of all government regulation which is that there should be a public policy objective that we're trying to achieve. Too often governments do what they do because they have always done it. The policy survives the need they were attempting to address, by which I mean that there are rules prohibiting airlines from flying where they would like to fly, and prohibiting them from having a sustainable model for the air transport industry in the long term.

**« There are national laws everywhere which prohibit the flow of capital across national boundaries »**

The US has probably one of the strictest laws in the air transport sector with a ceiling on 25 % for foreign investment, and even if the foreign investment is under 25 % the government will look closely, because you are not allowed to control an US airline unless you are an US citizen. The airline industry is prevented from accessing the global capital marketplace in the way other industries do every day at a time we are experiencing a serious financial crisis and at a time where air industry is looking to find capital.

**« We need to ask ourselves why we have those rules. Is there a purpose that we are trying to achieve that relates to the public interest ? »**

When the industry was in its infancy, there were many concerns and the issue of citizenship was very sensitive. But that was more than sixty years ago, and we have seen the benefits from the globalization of so many other sectors – telecommunications, for example. And yet we continue to prevent this vital industry, which is the driver of so much international economic activity, from becoming a truly global industry.

That is a very very big issue and I was pleased to see in Istanbul that governments were interested in asking themselves these questions. We did not attempt to achieve any agreement there. The meeting was the beginning of a long, serious conversation. Nobody has achieved this level of liberalization, not even Europe – remember Alitalia – but everybody was prepared to have an open and creative conversation about it. We'll probably have another meeting of the same group sometime in the spring 2009 (no date yet).

The genesis again of the conversation was the airline industry's hopes that it can achieve some greater measure of freedom. That is why IATA called this meeting the « Agenda for Freedom Summit » (it was the official name) and **what was so unusual was to see an industry that is so regulated, begging, pleading with government to deregulate it.**

**RDT :** Opponents of international aviation liberalization argue that it could have an adverse impact in at least three areas : national US security, airline labor, and airline safety. How would you answer them ?

**Jeffrey Shane :** We had a very specific effort when I was still in government to liberalize the restrictions on foreign investment in

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the airline industry. It failed because the Congress was opposed. Even the Department of Defense was not opposed to this element of deregulation. As the person in charge of the Department of Transportation's policy office, I went to see my friends at the Defense Department and it was not very long before they understood that there was absolutely nothing in our proposal that would have an adverse impact on their ability to use the airlines to supplement their capacity. They approved it. There is not any national security justification for the kind of rules that are in place. We have foreign investment in other industries that are just as strategically important as air transport: automobile manufacturing, electronics, technology, financial services. We don't have a rule to prevent foreign investment in those industries; we do have a process to ensure there is no threat to our national security from any foreign investment.

**« In air industry, we have a rule, not a process : foreigners are not allowed to invest more than a certain amount. It simply does not make any sense in 2008 »**

About safety, nobody has ever suggested changing any aspect of our regulation of safety in a more globalized aviation market. We can have a global capital marketplace for airlines with secure rules for safety, no doubt, because we will never have flags of convenience like we have in shipping.

About labor, nobody can pretend that liberalization when it began, in the late seventies in the US and later in other countries, had no adverse impact on labor. It did. When you're transitioning from a completely regulated industry to a competitive industry, it is a shock, no question. But for the most part it has happened, and liberalization will continue. Every country that has deregulated shows the same consequences: many many more jobs in the industry than before. But I do understand the controversy regarding labor.

**RDT :** Beside deregulation, the development of alliances (Star Alliance, Skyteam, Oneworld) shows the tendency for the companies to search for synergies, but can't we see in such Alliances a way for these companies to avoid anti-trust regulation laws ?

**Jeffrey Shane :** Very good question. Alliances are a second-best approach to do what companies are doing in other sectors every day. They need to have immunity from the antitrust laws in order to replicate the globalized approach enjoyed by other businesses. **The real issue is not whether the members of alliances are allowed to coordinate their prices, product quality, and so on ; the question is whether or not that alliance is competing with any other alliance.** What we did when we created the Open Skies policy in the early 90's was open the market for the first time in air transport. Every alliance knows that every market it serves, and this is the prerequisite to getting antitrust immunity, can be entered by anybody else at any time; this what economists have called in English « contestability. » It was very consciously done. And I think it is a good balance. It is a good thing that government relies on the market.

**RDT :** Since March the 30th, air transport between the EU and the US has undergone significant changes but it is still a step, and negotiations are now aimed at issues like facilitating foreign investment (we've talked about that), favoring wet leasing, opening cabotage. According to you, what would be the success factors for these further negotiations ?

**Jeffrey Shane :** It is a big challenge. And it is difficult to predict what the political landscape will be after our national elections. But I think that it is important to look at the first round, which was a big step, even if – I know it – the EU negotiators were disappointed. We tried hard to deliver more, but it was not the Bush Administration which refused it, it was the legislature. **Still, we need to recognize that this Agreement facilitated compliance for the first time with the Treaty of Rome and that is important.** It starts to replicate the kind of open market in Europe that the US has enjoyed for a long time, because we're one country. This is going to be a slow process of transitioning to European carriers rather than national carriers, and that is very

exciting. It will bring a lot of competition as European carrier begin to challenge each other. I'm very hopeful that, regardless of the politics in Washington, the second round will be a success because the US and the EU will be a template, the model for the rest of the world.

**RDT :** A year ago the French Government launched a vast program favoring alternative modes of transportation to minimize truck traffic and put the stress on sustainable development. Do you in the US face the same questions and what kind of programs has the government developed ?

**Jeffrey Shane :** This matter has been a central part of our policy for a long time. Apart from the environment, we see too much congestion in the surface modes today, and we must find a way to address that. Rail cargo has a lower carbon footprint than trucks, and we have a program under the US Maritime Administration, which is part of our Department of Transportation, called « Marine Highways. » I know that the EU is far ahead of the US in this sector. US has an important impediment in this sector which is the cabotage law and the foreign investment restriction. I speak here of domestic marine transport, not international, where we have the same kinds of restrictions we have in the airline industry. So the efficiency of short sea shipping is not as available as it could be. Personally, I would say that we do not take advantage of this mode as much as we could.

On the highway system itself we're looking closely at effective ways of pricing the use of transportation assets. Truckers themselves are interested in it, as strange as that may seem. They would pay tolls if they find efficiency in it, if they can deliver on time on highways less congested with traffic. Every few years we have to rewrite our transportation law and in January the new administration will begin to write a new law. My hope is that in September 2009, when the Congress will have to vote on this new law, they will look closely at the tools which could make transport more efficient today.

As for the environment, I see a lot more movement in this area and economic incentives are going to be more powerful than before. You can make the transportation system more efficient reducing its carbon footprint. A lot of people don't like the rebuy idea of pure taxes like taxing carbon. People who are compelled to pay don't know what happens to the money once they have paid. They want to be sure that the proceeds of such taxes are going to be used to improve technology. Taxes don't give them this assurance.

**« The strong preference among such critics is for a trading regime rather than tax regime »**

There is also a big question about US air carriers being covered by the EU's Emissions Trading Scheme (ETS). It is very controversial, not only in the US but also all around the world. Nobody wants to have a trading scheme imposed by someone else without mutual agreement. I was the president of the Assembly at the ICAO one year ago, and the European ETS aroused great opposition. Indeed, ICAO adopted a resolution that urged all states to seek such mutual agreement before attempting to impose an ETS unilaterally. Predictably, the EU delegation formally announced a reservation regarding that provision.

**RDT :** Could you tell me some words about the Personal Name Record program ?

**Jeffrey Shane :** Well, the Passenger Name Record (PNR) was not in my Department; it was handled by the Department of Homeland Security. It is a very important program for ensuring security not only for air transport but for our societies. I know it is controversial mostly because of privacy requirements in Europe, as well as in the US. But there are ways to ensure that information is protected for going in the wrong places. PNRs are a part of a very larger strategy which relies far more on intelligence than on looking in bags.

**RDT :** In conclusion, what kind of benefit can Open Skies agreements bring to consumers, and, besides the economic crisis, are you optimistic ?

**Jeffrey Shane :** What we want is a system that reduces the « pain » that people have to experience as they go through the

process of air travel. We fully understand that there is a security imperative out of there. Passengers complain about that, but security has been good and there have been a lot of improvements. **The interesting thing, for all the reasons I have explained, is that despite our Open Skies agreements, we still do not have an open market today for airlines. We should allow the airlines to be more creative and reducing regulations even further will help to do so.**

**RDT :** Thank you very much, Mr Shane, it is a great honour for the Journal to meet you today.

**Jeffrey Shane :** It was a pleasure for me. And congratulations on this publication !

Comments collected by Valérie MAYER-BLIMONT

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