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INTERNATIONAL AVIATION

DOT Needs Better Data for Monitoring and Decisionmaking

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Mr. Chairman and Members of the Committee:

We are pleased to provide this statement on the Department of Transportation's (DOT) efforts to increase the access of U.S. airlines to foreign markets. The importance of these efforts has increased. In 1994, international operations constituted 27 percent of U.S. airlines' traffic--up from 21 percent in 1980--and this share is expected to grow to 31 percent by 2006. At the request of this and other committees, we have reported on a number of international aviation issues.[1] Our statement draws from this body of work and identifies opportunities that we believe are available for DOT to strengthen its efforts. In summary,

-- DOT's policy goal in negotiating with foreign governments has been to achieve a deregulated environment, referred to as "open skies," in which airlines can fly between countries when they want, where they want, and set fares in response to market forces. However, other countries are concerned that because U.S. airlines are among the world's most efficient, their national carriers will not be able to compete. As a result, DOT has achieved only limited success in key aviation markets. Given that open skies agreements with our major aviation trading partners are not likely in the foreseeable future, DOT will continue to negotiate bilateral agreements that control U.S. airlines' access to foreign markets. Greater access may only be achieved in exchange for increased opportunities for foreign carriers in the U.S. market, as many foreign governments continue to press for such increased opportunities as the quid pro quo for improved access for U.S. airlines. Under such a framework, DOT must be well-positioned to determine the value of access rights that it is trading and to monitor the long-term competitive impacts of its actions.

-- A consistent theme of our work has been that DOT has not collected and analyzed the information necessary to conduct sufficient economic analyses of proposed deals or to keep abreast of changes in the international marketplace. This has occurred because of a lack of emphasis on economic analysis in the past and continuing data problems. In 1991, for example, DOT granted British carriers extensive access to the U.S.

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[1] International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain (GAO/RCED-95-99, Apr. 6, 1995), International Aviation: DOT Needs More Information to Address U.S. Airlines' Problems in Doing-Business Abroad (GAO/RCED-95-24, Nov. 29, 1994), International Aviation: Measures by European Community Could Limit U.S. Airlines' Ability to Compete Abroad (GAO/RCED-93-64, Apr. 26, 1993), and Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines (GAO/RCED-93-7, Dec. 9, 1992).

market via code-sharing.[2] At the time, DOT conducted little economic analysis of code-sharing's value. As a result, British Airways greatly improved its competitive position, and DOT was left with much less leverage to negotiate future agreements to allow U.S. airlines increased access to the British market. Lack of economic analysis has not been confined to the international sector. We noted the same problem in DOT's approval of domestic airline mergers in the 1980s.[3] In addition, we reported in 1994 that DOT was not effectively monitoring the various problems, such as limited access to take-off and landing slots, that U.S. airlines face in doing business at key airports overseas. To its credit, DOT has taken several recent positive steps, including emphasizing the need for economic analysis and creating an office to do this type of analysis. However, several problems, such as insufficient traffic and fare data, persist.

-- While U.S. airlines have increased their international presence, foreign airlines have sought greater access to the U.S. market. These efforts have evolved from pursuing cabotage--the right to fly between points within the United States--to investing in U.S. airlines to the recent proliferation of code-sharing alliances. In 1992, DOT granted one alliance--Northwest/KLM--immunity from U.S. antitrust laws in conjunction with an open skies agreement with the Netherlands. The dramatic success of that alliance has led other alliances to seek such immunity.[4] DOT has not analyzed, however, the value of antitrust immunity or determined whether immunity should be available for other alliances. Although immunity could be a powerful tool in DOT's efforts to obtain open skies, consumers could be negatively affected by losing the protections, such as preventing price fixing among competitors, afforded by antitrust laws.

DOT has made some recent progress in opening foreign markets, such as reaching an accord with Canada that greatly increases U.S. airlines' access to the Canadian market. Nevertheless, DOT faces several challenges, such as negotiating with nations that are often protecting one or two national carriers. By addressing its data needs, DOT would be better positioned to meet these challenges,

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[2]Code-sharing is the practice whereby one airline lists another airline's flights as its own in computer reservation systems, which are used by travel agents to book flights.

[3]Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

[4]The antitrust laws prohibit contracts and agreements that restrain trade. This would include agreements between competitors to set prices.

monitor the long-term competitive impacts of its decisions, and address such difficult issues as valuing access rights and antitrust immunity.

THOROUGH ECONOMIC ANALYSIS NECESSARY FOR EFFECTIVE NEGOTIATIONS

Since the early 1980s, U.S. passenger airlines and cargo carriers have increasingly turned to the international marketplace for new growth opportunities. Unlike the deregulated U.S. domestic market, however, international markets are heavily regulated by bilateral agreements between nations. As of June 1995, the United States was a party to 72 such agreements. Under this framework, two countries negotiate the air services between them and award their airlines the right to offer those services. In general, bilateral agreements define (1) which routes can be served between the countries and to third countries; (2) whether the fares airlines charge need government approval; and in some cases (3) how frequently flights can be offered and (4) how many airlines from each country can fly the routes.

The extent to which new international opportunities are available to U.S. airlines depends largely on the efforts of DOT to remove these bilateral restrictions. Over the last decade, DOT has achieved mixed results. The agency has reached agreements with numerous countries that reduce or eliminate the restrictions.[5] However, the major U.S. aviation trading partners, including the United Kingdom, Germany, and Japan, have maintained--and in some cases added--extensive limitations on U.S. airlines' access to their airports or ability to continue to cities in other countries. Others, including France and Thailand, have renounced their accords with the United States. These countries have taken these actions principally to protect their national carriers from competition with U.S. airlines, which often have much lower operating costs. The European Union, for example, found that the operating costs of major European airlines were about 50 percent higher than the costs of major U.S. airlines in 1992.

Because of the increasing demand for international travel, the mixed success of DOT at eliminating bilateral restrictions, and the relative maturity of the U.S. domestic market after several years of rapid expansion following deregulation, growth in the number of passengers flying internationally on U.S. airlines greatly outpaced domestic growth between 1987 and 1993. (See fig. 1.) This trend did not hold true in 1994, in part because of the domestic economic recovery and the leveling off of U.S. airlines' international growth. In part to overcome the restrictive framework that impedes

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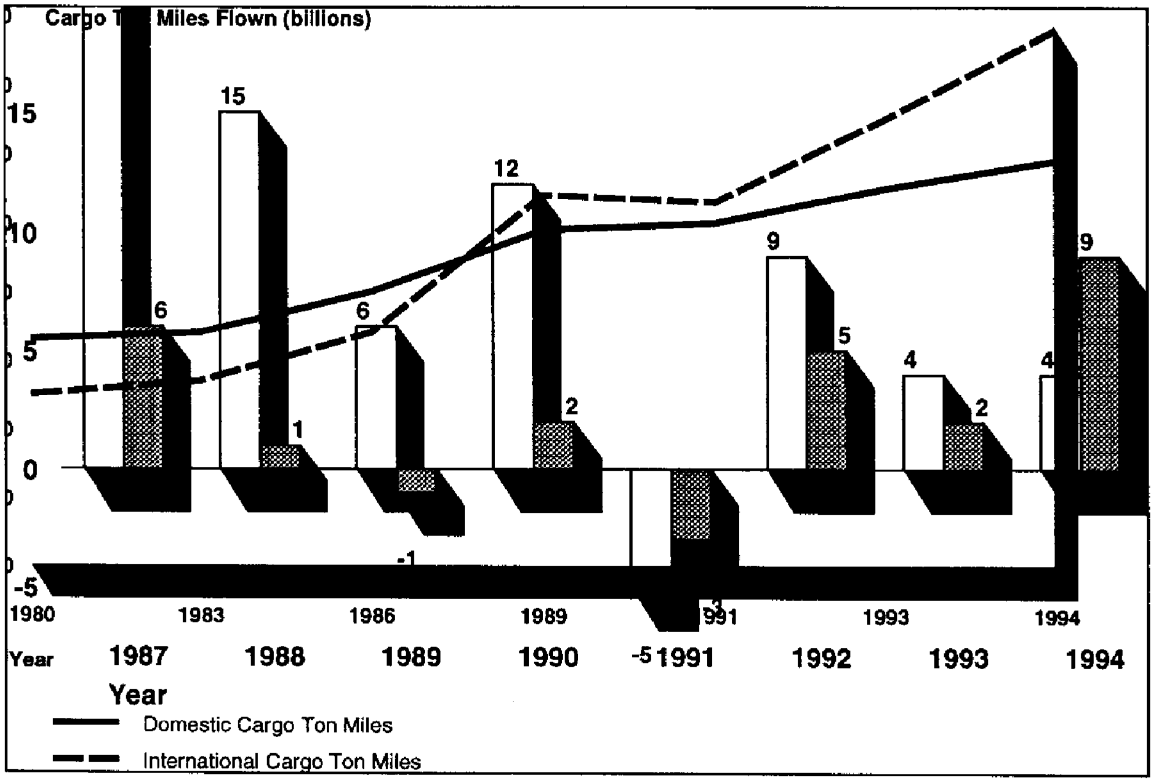
[5]These countries include Austria, Belgium, Canada, Denmark, Finland, Iceland, Israel, Jamaica, Korea, Luxembourg, the Netherlands, Norway, Singapore, Sweden, and Switzerland.

such growth, U.S. airlines have increasingly entered into code-sharing alliances with foreign airlines.[6] (App. I lists alliances approved by DOT as of June 30, 1995.) U.S. cargo carriers have also experienced rapid international growth. (See fig. 2.)

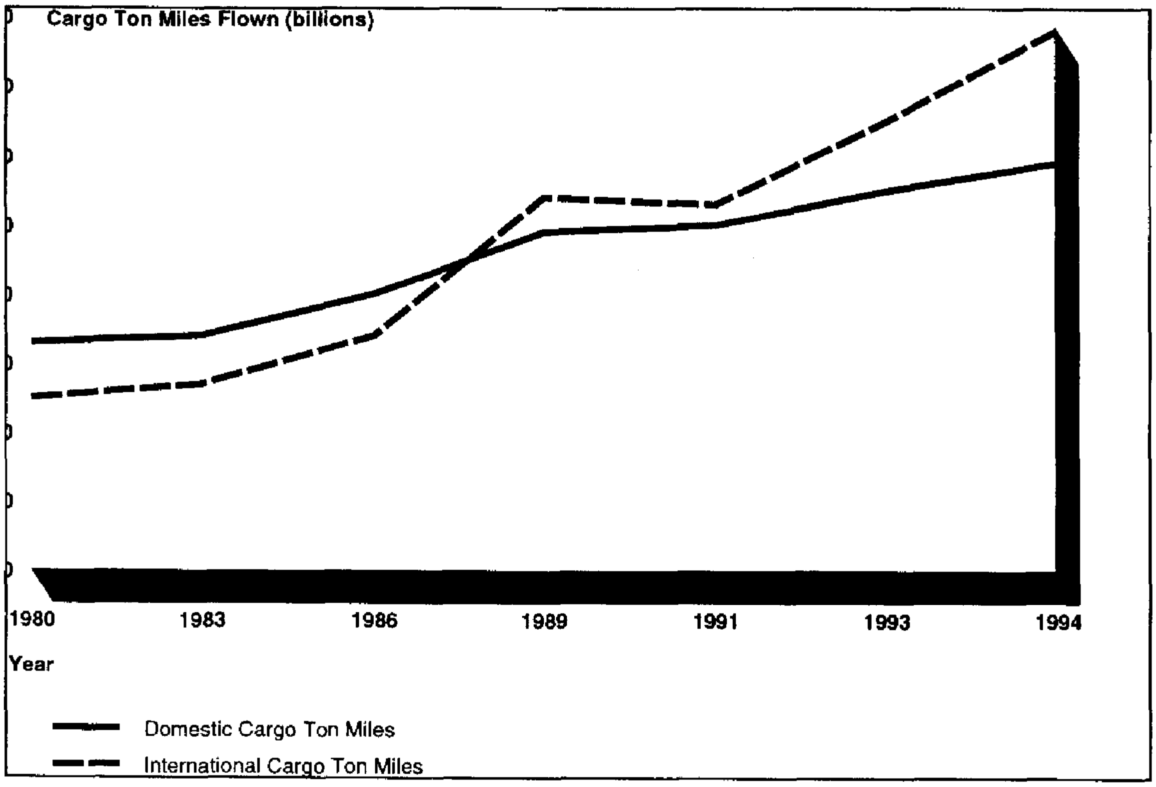
Figure 1: Growth in U.S. Scheduled Airlines' International and Domestic Passenger Traffic, 1987-94



Source: Air Transport Association.

[6]Code-sharing alliances between U.S. and foreign airlines require DOT's approval and reapproval on a periodic basis.

Figure 2: Total Cargo Ton Miles Flown Internationally and Domestically by U.S. Carriers, 1980-94



Source: Air Transport Association.

Because most major U.S. aviation trading partners have blocked DOT's efforts to achieve open skies, new opportunities for U.S. airlines will still have to be obtained by DOT in exchange for increased opportunities by foreign carriers in the U.S. market. In such a quid pro quo environment, it is essential for DOT to know the value of what it is obtaining, what it is giving up, and what the effect of a proposed deal will be on consumers. Underestimating the benefits received by foreign airlines, for example, could lead DOT to accept less for U.S. airlines than the foreign government might be willing to concede. Similarly, given the importance of international operations to the bottom-lines of U.S. airlines--for example, 60 percent of United Airlines' $513 million operating profit in 1994 came from operations to and from the Asia/Pacific region--such economic analysis is necessary to fully understand the potential impact of proposed deals on various U.S. airlines.

DOT NEEDS BETTER DATA TO PERFORM SOUND ECONOMIC ANALYSES AND KEEP ABREAST OF CHANGES IN THE INTERNATIONAL ENVIRONMENT

Our work over the past few years indicates that DOT has not collected nor analyzed the information necessary to conduct sufficient economic analysis of proposed deals that revise bilateral agreements or to monitor the changing competitive conditions in the international marketplace. This has occurred largely because of several data limitations as well as the fact that DOT in the past placed little value on conducting economic analysis prior to key negotiations. As a result, DOT's negotiators have been at a disadvantage compared to their foreign counterparts, who are often representing one or two carriers and who have extensive access to their carriers' data as well as to much of DOT's data. Likewise, DOT has not been well-positioned to monitor and resolve the variety of continuously arising problems that U.S. airlines face doing business overseas.

Our April 1995 report on the growing number of code-sharing alliances between U.S. and foreign airlines outlined how DOT's past deemphasis on economic analysis and insufficient data on code-sharing has hindered DOT's ability to negotiate as well as monitor the impacts of its actions on consumers. In 1991, for example, DOT gave British carriers extensive access to the U.S. market through code-sharing in exchange for substituting American and United for TWA and Pan Am as the two U.S. carriers allowed to serve London's Heathrow Airport. Many U.S. airline representatives have criticized the deal because they believe the value of the code-sharing rights granted to British carriers (1) outweighs the value of allowing the substitution of two U.S. airlines to serve Heathrow and (2) contrasts greatly with the severe restrictions on U.S. airlines' access to Heathrow. DOT conducted little analysis of the value of code-sharing prior to concluding this deal, while we found that the British were analyzing the potential benefit of code-sharing as early as March 1989. DOT's weakness in this area is similar to the agency's lack of analysis prior to approving domestic mergers in the 1980s.

Several data limitations with respect to code-sharing continue to handicap DOT. For example, the data reported by U.S. airlines to DOT from a sample of their tickets do not identify passengers who traveled on code-share flights and, in some cases, which airline actually operated a code-share flight. Likewise, because foreign airlines are not required to report data from a sample of their tickets involving travel to or from the United States, DOT lacks data on code-share flights operated solely by foreign carriers. DOT analysts told us that this limitation prevents them from completely (1) analyzing shifts in traffic from U.S. to foreign carriers caused by code-sharing or (2) determining the extent to which code-sharing benefits foreign airlines. Thus, DOT is limited in the extent to which it can accurately value access rights that it grants to foreign governments. In addition, the agency cannot determine the effect of code-sharing on fares. Because of these limitations, we recommended, among other things, that DOT collect data from foreign airlines on their code-share traffic. In its review of code-sharing for DOT, a consultant reached similar conclusions, emphasizing that

". . . if DOT wants to monitor the effects of international code-sharing on airlines and consumers, it should consider expanding the reporting requirements for code-sharing operations, particularly those of foreign carriers . . . it is strongly suggested that DOT consider the possibility of obtaining ticketing information from foreign carriers. . . ."[7]

In addition, we reported in 1994 that the challenges that DOT faces--such as balancing the competing interests of several U.S. airlines and addressing an increasing workload with declining resource and staffing levels--are complicated by a variety of continuously arising problems that U.S. passenger and cargo airlines face at airports in Europe and the Asia/Pacific region. These problems include limited access to take-off and landing slots, inadequate facilities, and restrictions on their ability to perform such "ground-handling" services as passenger check-in and baggage handling. At numerous European airports, for example, only the national carrier and/or airport authority can provide ground-handling services, thereby raising U.S. and other airlines' costs.[8] At Amsterdam's Schiphol Airport, ground-handling service fees declined by about 25 percent after such a ground-handling provision was eliminated in 1993, and competition for services was introduced. We found that because it does not periodically collect and analyze information on these problems, DOT cannot determine whether certain problems are pervasive in different countries, document whether they are increasing in number, make the most effective use of its limited resources to address these problems, or enter bilateral negotiations as well prepared as it could be.

FOLLOW-THROUGH ON DOT'S RECENT INITIATIVES NECESSARY TO MEET CHALLENGES OF EMERGING ISSUES

Since late last year, DOT has taken action to address some of these weaknesses. In November 1994, the agency issued an international policy statement that committed DOT to heightening the emphasis that it gives to economic analysis. Also in November 1994, DOT, acknowledging that it needed to greatly improve its analytical capabilities and better prepare U.S. negotiators, created a new office whose sole responsibility is to carry out such analyses. Likewise, responding to one of our recommendations, DOT recently began collecting information on U.S. airlines' doing-business problems and has established a data base so that the agency can systematically monitor those problems and better

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[7]A Study of International Airline Code-Sharing, Gellman Research Associates, Inc. (Dec. 1994).

[8]In response to airlines' complaints, the European Union is developing guidelines on competition in ground-handling and has drafted a consultation paper on the topic.

facilitate their resolution. In addition to these initiatives, the agency concluded several successful negotiations. DOT signed an agreement with Canada in February 1995 that expanded opportunities for U.S. airlines to Canada and increased competition and lowered fares in such markets as Washington, D.C.-Montreal. DOT also signed open skies accords in June 1995 with nine smaller European nations.[9]

The success of its initiatives, however, will depend on effective follow-through and ensuring that the new office has the resources needed to fulfill its mission. The data shortcomings that we identified in our code-sharing report remain. Although DOT has asked the three U.S. airlines--Northwest, United, and USAir--that are in the largest code-sharing alliances with foreign airlines to file special reports on their code-share traffic, this request does not address our concerns because it (1) will provide data on only three, albeit the three largest, of the 50 code-sharing alliances now in existence and (2) does not provide information on code-share traffic in which only a foreign airline's aircraft is used. In addition, DOT's request does not require U.S. airlines that code-share with foreign airlines to identify the actual operator of a code-share flight. Finally, according to representatives from the three affected U.S. airlines, it is unfair to impose a reporting requirement on them that is not imposed on the rest of the industry.

By promptly addressing these shortcomings, DOT would be better positioned to address emerging, complex issues that arise from the constantly changing competitive conditions in the international marketplace. Antitrust immunity for code-sharing alliances is one such issue. While U.S. airlines have increased their international presence, foreign airlines' desire for greater access to the U.S. market has intensified. Foreign airlines' efforts to secure such improved access have evolved from seeking cabotage rights to investing in U.S. airlines that are in financial difficulty to code-sharing. In 1992, DOT granted one alliance--Northwest/KLM--immunity from U.S. antitrust laws. The dramatic success of the Northwest/KLM alliance has led other alliances to seek such immunity. Our discussions with U.S. and foreign airline representatives indicate that the number of such requests will greatly increase over the next few years.

However, DOT has yet to determine, in light of the Northwest/KLM experience, the value of antitrust immunity or whether immunity should be potentially available for other alliances in markets that allow for significantly increased access for U.S. airlines. DOT granted Northwest and KLM immunity in 1992 in conjunction with the open skies accord with the Netherlands and

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[9]The nine smaller European nations are Austria, Belgium, Denmark, Finland, Iceland, Luxembourg, Norway, Sweden, and Switzerland.

in the hopes that the major European aviation trading partners would follow suit in seeking open skies. They did not. Many representatives of U.S. and foreign airlines and foreign government officials expressed to us their strong concern about the competitive impacts of allowing only one alliance to have antitrust immunity, which allows partners to, among other things, jointly set fares without fear of legal reprisal. Many, though, expressed interest in obtaining immunity for their alliance. Noting these sentiments, several U.S. airline representatives maintained that the success of the Northwest/KLM alliance presented DOT with a new "carrot" in its efforts to obtain open skies. Nevertheless, others objected to such an approach, stating that U.S. antitrust laws protect consumers and prevent anticompetitive behavior; therefore, they continued, it does not make sense to remove these protections in the hopes of increasing competition. In our code-sharing report, we recommended that DOT more fully examine these issues, analyze the value of antitrust immunity, and determine if the United States should use immunity as a carrot to obtain open skies.

CONCLUSIONS

By emphasizing the importance of economic analysis, establishing a new office dedicated to such analysis, and creating a formal system to track U.S. airlines' doing-business problems overseas, DOT is headed in the right direction. However, to effectively pursue deals that benefit the U.S. airline industry and consumers, DOT negotiators will need the support of thorough analysis by the new economic office. Because of the data shortcomings that we have identified, the new office is limited in the extent to which it can value proposed exchanges of traffic rights and code-share rights as well as factor in such related variables as antitrust immunity. By addressing these shortcomings, DOT will be better able to more effectively negotiate increased access for U.S. airlines to foreign markets, equitably accommodate the competing interests of U.S. airlines, and track the impact of its deals to revise current agreements--as well as such trends as code-sharing--on competition and fares.

CODE-SHARING ALLIANCES BETWEEN U.S. AND FOREIGN AIRLINES APPROVED BY DOT, AS OF JUNE 30, 1995

U.S. airline	Foreign airline partner(s)	Year approved
Air L.A.	Aeromexico	1993
America West	Aeromexico	1992
American Airlines	Air New Zealand*** Airbremen GmBH*** British Midland Cathay Pacific*** Canadian Airlines China Airways Gulf Air Lufthansa*** Malev Hungarian*** Qantas South African Airways Transwede Airways	1991 1990 1993 1990 1995 1994 1994 1991 1989 1990 1992 1994
Carnival	AeroPeru Iberia LADECO Linea Aerea Nacional Chile	1995 1993 1995 1992
Challenge Air Cargo	Lufthansa	1992
Continental Airlines	AirBC Alitalia Air Canada Air Nova Air Ontario*** Ansett New Zealand*** Scandinavian Airlines Systems	1994 1994 1995 1994 1993 1992 1991
Delta Air Lines	Aeroflot Aeromexico Austrian Airlines Malev Hungarian Sabena Singapore Airlines Swissair Transportes Aeroes Portugueses Varig Virgin Atlantic	1991 1994 1994 1991 1993 1992 1993 1994 1994 1995
Hawaiian Airlines	Japan Air Lines***	1992

Midwest Express	Virgin Atlantic	1992
Northwest Airlines	Air UK Limited Ansett Australia*** Asiana KLM	1994 1992 1994 1991
Pan Am	Ardia Airways*** Malev Hungarian***	1990 1988
TWA	China Airlines*** Gulf Air*** Malev Hungarian*** Philippine Airlines	1990 1988 1989 1991
United Airlines	ALM Antillean Airlines Ansett Australia Ansett New Zealand British Airways*** British Midland Cayman Airways Emirites Air Lufthansa National Airlines Chile, S.A. Transbrasil Transportes Aeromar	1993 1992 1993 1987 1992 1994 1993 1994 1994 1993 1994
USAir	Alitalia All Nippon Airways British Airways Cayman Airways Compania Mexicana de Aviacion LADECO*** Qantas	1991 1992 1993 1992 1994 1991 1994

Notes: 1. "Year approved" represents the year in which DOT approved the first code-share arrangement of an alliance. Alliances often entail subsequent DOT approvals of arrangements to code-share more flights to additional cities.

2. *** denotes that alliance has been terminated by the carriers involved.

Source: DOT.

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