Jiakai Jeremy Chua

Professor Matthew Ramsey

The Heavens were not Free:

Towards Airline Deregulation & Multilateral Open Skies

in the US, EU, & ASEAN Cases

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By
Jiakai Jeremy Chua

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Director of Honors – Matthew Ramsey

Faculty Adviser – David Carlton

Third Reader – Klint Alexander

Content

Introduction

"Cujus est solum, eius est usque ad coelom et ad infernos"

- Accurius, 1182 – 1263

I. US Airline Deregulation: "More", and "More", and "More"?

At the 20th anniversary of America's air transportation deregulation, John E. Robson, Chairman of the Civil Aeronautics Board (CAB) from 1975-77, wrote a heated piece in the 1998 Spring Publication of Cato Magazine about the bureaucratic pressures that he had to confront during his tenure. Robson denounced the CAB's "procedural spaghetti" which prevented the airline industry from growing – and serving its consumers more efficiently. As he most memorably quipped about the strict government oversight which once characterized the aviation sector: "By 1975, the airline industry was like a forty-year old still living at home."[1]

The American airline industry has transformed tremendously since the late 1970s – moving away from the CAB's parent-like and "cumbersome" regulatory processes to a more "free" and autonomous system where market forces rather than government regulators were "arbiters of airline fares and service."[2] For pro-deregulation advocates like Robson, the 1978 Deregulation Act represented an economic and social revolution that allowed for more. More competition meant that the airline industry could expand and

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[1] John E. Robson, "Airline Deregulation: Twenty Years of Success and Counting," Regulation 21, no. 2 (1998): 18, accessed August 1, 2013, object.cato.org/sites/cato.org/files/serials/files/regulation/1998/4/airline2-98.pdf.
[2] Ibid, 17-18.

serve more communities and passengers. More players would equate to more inexpensive airfares. More air services meant more jobs for the airline industry – and the rest of the community.[3] But most importantly of all, the 1978 Deregulation Act would allow air travel to become more accessible for everybody.

At that time, the Heritage Foundation supported Robson's optimistic fistbumping with some concrete numbers. As Adam Thierer wrote in 1998, "The inflation-adjusted 1982 constant dollar yield for airlines has fallen from 12.27 cents in 1978 to 7.92 cents in 1997. This means that airline ticket prices are almost 40 percent lower today than they were in 1978 when the airlines were deregulated."[4] The number of US scheduled airline departures increased 63% from 5 to 8.2 million in the same period. Nearly 600 million people traveled by air in 1997, as opposed to only 250 million passengers 20 years ago.[5] The airline industry was flourishing, consumers were benefitting. The prophecy was slowly proving true: deregulation allowed for more.

Nevertheless, Robson's views appear to contradict the more recent developments in our post-September 11th air transportation world. A little more than a decade after Robson's celebratory article about the "more" with airline deregulation, consumers are apparently seeing less today. The MIT International Center for Air Transportation produced a White Paper which reported that "the United States' 29 largest airports (by 2011 enplanements) lost 8.8% of their yearly scheduled domestic flights between 2007

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[3] As Hoyle and Knowles explain, the "creation of (aviation) transport capacity either directly leads to or supports, in the presence of other factors, an expansion in productive potential of a region," B.S. Hoyle and R.D. Knowles, *Modern Transport Geography* (London: Belhaven, 1992), 14- 15. See also Raguramaran, 239-41.

[4] Adam D. Thierer, "20th Anniversary of Airline Deregulation: Cause For Celebration, Not Re-regulation." *Conservative Policy Research and Analysis*, accessed August 1, 2013, http://www.heritage.org/research/reports/1998/04/20th-anniversary-of-airline-deregulation.

[5] Ibid.

and 2012, compared to a 21.3% reduction in scheduled domestic flights at smaller airports during the same period."[6] Smaller communities bore the brunt of this cutback, with fewer scheduled services to some regional airports, and some others completely losing them altogether. The reductions represent about 1.4 million of yearly scheduled domestic flights in the US air transportation system.[7] Airfares of the affected routes have begun to rise, with the airline companies having no incentive to compete on price points in these markets.

A few days after the announced Delta-Northwest merger in 2008, Micheline Maynard provided some striking economic insight: "After a big industry buildup through the 1990s, more than 100,000 jobs have been lost since the beginning of the decade. Former hub airports like Pittsburgh and St. Louis are now far less busy as hometown airlines have merged with other carriers and their replacements have pulled back service. Fares have fallen, on average, (since 1978) but they often rise when an airline leaves a city."[8] Maynard was spot on in her analysis. Mergers and acquisitions between U.S. airlines have left only 3-4 major legacy carriers in the market today, from as many as 10 major trunk lines that existed before 1978.[9]

II. The Global Fallout: Towards Liberal Skies

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[6]Michael D. Wittman and William S. Swelbar, "Trends and Market Forces Shaping Small Community Air Service in the United States," *MIT*: 3-5, accessed August 1, 2013, http://dspace.mit.edu. dspace.mit.edu/bitstream/handle/1721.1/78844/Trends%20and%20Market%20Forces%20Small%20Community.pdf

[7] Ibid, 5.

[8] Micheline Maynard, "Did Ending Regulation Help Fliers?" *The New York Times*, April 17, 2008, http://www.nytimes.com/2008/04/17/business/17air.html?pagewanted=all&_r=0.

[9] Ibid.

There are many legitimate questions about the pros and cons of deregulation: whether consumer welfare really improved in America, or whether airlines are still profitable enterprises under deregulated market conditions, or whether deregulation actually fulfilled its objective of spurring competition and paring down fares. In fact, the historical and economic materials are diverse and rich for such an interrogation. Yet, there is a much larger and global scope to US air transportation deregulation. What begun as a seemingly isolated economic reform in America's air transport system became a contentious political and social revolution in air transportation worldwide, calling into question the nature, mechanics, and impact of regulation on a decidedly international scale. The 1978 Deregulation Act did not just change the skyscape in America; the rest of the world had to deal with a new status quo which saw the pullback of regulation and herald of competition in (air) transportation policy.

Almost immediately in Europe, the effect of US deregulation on airliners, politicians, and consumers was evident, especially when people saw the once-expensive airfares plummeting within the US and with US Origin-Destination (O-D) points. The disparity between US and European airfares was nearly twelve-fold in some cases.[10] The questions were pertinent: Were the European countries about to adopt a similar economic model in an industry that has been traditionally under intense government purview? Could their own passengers benefit from more competition – and the lower airfares the free market could purportedly bring? How about the airlines themselves – could they survive if the government restrained itself from intervention? As Jurgen Erdmenger,

[10] Gloria Jean Garland, "The American deregulation experience and the use of Article 90 to expedite EEC air transport liberalization," *European Competition Law Review* 7, no. 2 (1986): 193-194.

Director-General of the European Transport Commission in 1983, proclaimed: "The new aviation policy of the Carter administration has its influence on the European scene…the European politician cannot remain indifferent to this growing concern of the European citizen on matters of civil aviation."[11] The marketplace was in turmoil, and action could not longer be stayed.

Nevertheless, the spillover effect of US deregulation did not merely generate economic questions: while there was uncertainty about how fare-setting without government purview in America would affect fares in Europe and elsewhere, a more pertinent question about global power relations and a country's own sovereignty was emerging. How will the countries continue to regulate and negotiate the rights to land for (state-owned) flag and foreign carriers? How should airfares be agreed upon on "fair" and "competitive" bases against foreign competitors, especially now that some airliners have been given free(r) rein in pricing?

What about the political relationship between the states now? What about identity – as a country, or as a political and cultural entity – especially within and without supranational institutions like the European Union (EU) and the Association of South East Nations (ASEAN)? What are the supranational institution's motives in promoting airline liberalization? More importantly, under supranational directive, what becomes of a country's autonomy in deciding who can use its airspaces and airports – and what are the benefits or harms in ceding that power to central control? There would certainly be winners and losers, either way the deregulation momentum trundled outside the US.

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[11] J Erdmenger (DG VII), "A New Dimension to Civil Aviation Through European Economic Intergration", in Wassengergh and Fenema, 36-38. See also Alan P. Dobson, *Globalization and regional integration: the origins, development and impact of the single European aviation market* (London : New York:Routledge, 2007), 28-30.

Accordingly, power relations and supranational politics would define how politicians, airliners, and trade groups supported or advocated against liberalization in the global air transport business; and they define how, if any, liberalization programs would take shape in each country and/or region. As the US and other countries continued to expand their airline networks in the oncoming decades, the trend invariably pointed towards a more liberal airline regime. The EU embarked on an ambitious air transport liberalization plan from 1986-1992; the EU-US Open Skies agreement was signed in 2007 and implemented in 2009. On the other hand, ASEAN has plans of their own: the ASEAN Open Skies are slated to be in place from 2015 onwards, with liberalization and a unified aviation market targeted for 2020.

These are but few of the liberalization and single aviation market agreements that have emerged in the wake of US deregulation. The heavens were certainly not free, and it took a long time to un-cage the skies for a more competitive marketplace. The debates between the two ends of deregulation were fiercely contentious, as the many stakeholders attempted to figure out what a liberal aviation regime meant for them. Nevertheless, in many cases, deregulation was hardly an independent and unilateral decision; countries often had to predicate their decisions on regional political and economic considerations, which were at times beyond their control.

III. Liberal Skies: Subverting The Mercantilist Tradition?

Since the beginning, the air transportation business has been conducted within a complex international web of political, economic, and power relations; this was most

conducive in allowing each country to protect its own interests. However, to understand how this eventually gave way to a more liberal air transportation regime, we need to first begin our story with the Chicago Convention in 1944. As Kenneth Button articulates:

> The Chicago Convention of 1944 confronted the new international potentials of civil aviation and initiated an institutional structure that laid common ground rules for bilateral air service agreements (ASAs) between nationals. The result, however, while providing a formal basis for negotiation, was essentially one of protectionism with pairs of countries agreeing on which airlines could offer services between them, the fares to be changed and, often, how the revenues could be shared.[12]

Namely, the Chicago Convention established the International Air Transport Association (IATA). The organization, in turn, dictated the economic and operational terms and conditions for transboundary air transport and cabotage[13] between any two countries. Thus, IATA is not unlike a "producer's cartel" that is sanctioned by the Chicago party states; its function is to "coordinate tariffs" and set "international airfares at agreed levels."[14] Through a series of yearly IATA conferences, countries would set rates and agree upon capacity restrictions for individual routes between two city pairs. These

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[12] Kenneth Button, "The Impacts of Globalisation on International Air Transport Activity," *Organisation for Economic Co-operation and Development* (2008), 9-10. www.oecd.org/env/transportandenvironment/41373470.pdf (accessed September 15, 2013).

[13] The concept of cabotage stretches back to Roman times, and it was often the feature of a mercantilist trade economy. As W.M. Sheehan explains its background: "For centuries, nations have jealously guarded trade and commerce along their domestic sea routes" through cabotage.[13] Essentially, cabotage disallowed foreign vessels to ply a country's own waters; and in effect, it protected the country's economic and security interests. Today, it is defined as "carriage for remuneration of passengers or goods taken on at one point and discharged at another within the territory of the same state", [13] but its application to passenger aviation continues to hold true to its roots. In fact, countries are unsurprisingly, unwilling to extend cabotage – to sometimes even their closest allies. See also W. M. Sheehan, "Air Cabotage and the Chicago Convention," *Harvard Law Review* 63, no. 7 (May, 1950): 1157, http://www.jstor.org/stable/1335975 (accessed August 1, 2013).

[14] C.J. Redston, "Prospects For Greater Competition Amongst European Community Airlines," *Intereconomics* 20, no. 2 (1985): 2.

became known as Third and Fourth freedom rights, fundamental rights for two countries to begin operations to each other's territories. For the most part, these bilateral agreements (bilaterals) were reciprocal between negotiating governments. Capacity and traffic would be set at 50-50 for the most part. Moreover, cabotage was left out of these agreements: a country would allow only its domestic routes to be served by its own airliners. Fifth freedom rights providing a foreign carrier permission to fly passengers from a second to a third country was also absent from these agreements. Finally, these bilaterals had to be set up individually, one for each O-D city pair between two countries. International scheduled air transportation was thus caught up in an intricate snarl of bilaterals that at once upheld a country's airspace sovereignty and rendered competition from foreign airlines virtually impossible. As Brian Havel put it, the corollary of this Chicago system is such that "all commercial international air transport services are forbidden to the extent that they are permitted."[15]

Nevertheless, the imperative of the Chicago Convention and IATA was not necessarily to uphold mercantilist principles, where "producer interests are privileged" in order to selfishly spur "domestic economic growth or national power."[16] On the one hand, there existed motivations for countries to protect their own airline industries – from fostering a high-risk infant industry to "vague, national objectives of prestige" and security.[17] Moreover, there was also a fear that a completely free-for-all system would permit a monopoly to rise. The United Kingdom, in particular, saw the Chicago

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[15] Brian F. Havel, *Beyond open skies: a new regime for international aviation* (Alphen aan den Rijn [u.a.]: Kluwer, 2009), 103.
[16] Dani Rodrik, "In truth, mercantilism never really went away." *The National*, January 11, 2013, accessed August 1, 2013, www.thenational.ae/business/industry-insights/economics/in-truth-mercantilism-never-really-went-away.
[17] Button, "The Impacts of Globalisation on International Air Transport Activity," 7.

Convention as an avenue to seek "protection against United States dominance."[18] Ergo, the Chicago treaty was a system that provided the rules and structures for two countries to negotiate bilaterals that would ideally benefit both parties and hopefully, the aviation world. Nevertheless, mercantilism was inevitable, when the rate-making machinery fell to the mercy of individual states and the tariff co-ordinating system co-ordinated by IATA. As Randall Lehner put it, "the international air transport regime (became) a rigid and closed system of regulation so that nations can ensure that they get a share of the market that sovereignty… can arguably guarantee."[19]

When the US decided to tamper with the economics of air transportation by embarking on airline deregulation in 1978, it was invariably changing the mechanics of the Chicago system. This subversion may not have been intended to be political in nature – but the extension of economic conditions from one polity to another created market imbalances that governments across the world needed to confront in political ways. For them, the Chicago Convention and IATA system that had allowed the countries to pursue a mercantilist policy was in peril.

IV. Framing The Project

W.M Sheehan suggested that the Chicago Convention was formulated in a war-tainted atmosphere and that "economic agreements reached under wartime circumstances

[18] L. Welch Pogue, "International Civil Air Transport - Transition Following WWII," *MIT Flight Transportation Laboratory* (1979), 15, dspace.mit.edu/bitstream/handle/1721.1/67930/FTL_R_1979_06.pdf?sequence=1 (accessed August 1, 2013).

[19] Randall D. Lehner, "Protectionism, Prestige, And National Security: The Alliance Against Multilateral Trade in International Air Transport," *Duke Law Journal* 45, no. 2 (1995): 438. http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3299&context=dlj (accessed August 1, 2013).

(were) likely to be unsatisfactory for conditions of peace."[20] Sheehan was accurate to say that the shadow of war had certainly loomed over IATA and the future of bilateral air service agreements. However, was the mercantilist arrangement that emerged with the Chicago system destined then to give way to liberalism? The narrative of global airline deregulation was more than just a contention between mercantilism and liberalism; it was also about dependency and hegemonic stability, about identity and power relations within the region – and with the rest of the world. The legacy of deregulation contained multiple socio-political and economic actors, negotiating for their interests across vastly divergent geo-political conditions for each country and each region. Accordingly, this project is a study of the international political economy behind global air transport liberalization programs. Where and when deregulation took place, and the shape that it took, were without doubt, bound to the politics, power relations, and economics of the region.

Following a three-chapter model, we will seek out the origins, the application, and the impact of airline deregulation in the US, EU, and ASEAN cases. The cases lend themselves well to at once a comparative and chronological analysis of airline deregulation. In the first chapter, we will review the roots of government intervention in America's airline industry and examine the reasons for economic regulation and how these reasons became less compelling over time. In the next chapter, we will investigate how and why the American deregulation experience troubled Europe; we will then explore how the EU reacted to the changes from across the Atlantic over the span of thirty years – from bilateral re-negotiations between the UK and the US, internal liberalization, and to multilateral Open Skies with the US in 2007. We will also explore

[20] Sheehan, "Air Cabotage and the Chicago Convention," 1166.

how the EU's political institutions and its dominant members were imperative in fostering, influencing, and sustaining the liberalization momentum in air transport.

Finally, the last chapter examines the more recent ASEAN case for airline deregulation. We will investigate why and how the member countries finally came together in a sort of diplomatic consensus and compromise to pass and implement their own variation of Open Skies in the region. Through the three cases, we will coax out the heritage of the modern skies. The heavens were not free, and the open skies that we see today certainly came at the price of contentious political, and economic challenges. When Alfred Kahn and Jimmy Carter, the final facilitators of deregulation in the US, argued for the "more" that would come with air transport liberalization, they might not have predicted the more in what meets the global skies today. At best, they could only have advised us to fasten our seat belts, and braced ourselves for a whole new world of flying ahead.

Chapter 1

The Origins & Demise of US Airline Regulation

"Here was an industry small by whatever standards applied, but essential to our national well-being.

Here was an industry carrying out vital functions at pay in many instances less than the cost of rendering the service.

Here was an industry smacking, in many respects, of the traditional public utility but subjected to few of the statutory responsibilities...and enjoying few of the benefits or protective measures usually granted them.

Finally, here was a vital industry threatened with collapse."[21]

- Donald Nyrop, Chairman of the Civil Aeronautics Board (1951-1952)

I. The Status Quo of Nations, The Status Quo of the Skies

After the Chicago Convention was signed on 7 December 1944, the U.S. Assistant Secretary of State and Chairman of the US delegation, Adolf Berle Jr. announced: "As a result of the work of these and many other man, when we leave this Conference, we can say to the world that they can go out and fly their aircraft in peaceful service."[22] In the next fifty years, global air transport flourished under the aegis of the Chicago system. Nevertheless, the Chicago agreement also solidified and formalized an era of state intervention in the industry. Although the Chicago Convention was designed to "promote co-operation...on the basis of equality of opportunity", the opposite had

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[21] United States and Civil Aeronautics Board, *The role of competition in commercial air transportation Report submitted to the Subcommittee on Small Business, United States Senate*, (Washington: U.S. Govt. Print. Off., 1952): 2-3.

[22] ICAO, "1944: The Chicago Conference," *The Postal History of ICAO*, http://www.icao.int/secretariat/PostalHistory/1944_the_chicago_convention.htm (accessed August 1, 2013).

occurred.[23] Countries persisted in drawing up air transport policies along protectionist lines. As a result, the world was left with a global mercantilist system where state interests dictated capacity, routes, and airfares. Competition was thus kept a minimal level.

This was unsurprising. At the end of World War II, the global air transport industry was still in many ways an infant one. A good proportion of the world's antebellum civil fleet had been obliterated in the war, and this very much left the future of commercial passenger aviation uncertain. The entire world had to quickly figure out how to rehabilitate its crippled air transport industry. Paramount were concerns about national security, prestige, and (carrier viability. For the politicians behind this new era of aviation policy, more government intervention was better than none.[24]

The sentiment was especially clear in the Chicago Convention: commercial aviation must remain heavily regulated, and a country should have full autonomy to decide the fate of its own airline industry. Although the US retained much of its aircraft fleet after the war and was an advocate of a liberal skies regime, Adolf Berle Jr. and L. Welch Pogue, the Chairman of the US Civil Aeronautics Board, were forced to return the US to the status quo. Regulation was still needed – to contain US aviation power and to ensure that there was space for other carriers to grow. As Pogue offered in a 1946 MIT report: "It had been known all along that the Chicago Convention would not provide for multilaterally authorized worldwide route." Together with the rest of the world, the US

[23] L. Welch Pogue, "International Civil Air Transport - Transition Following WWII," 13.
[24] Button, "The Impacts of Globalisation on International Air Transport Activity," 8.

had to pursue a highly regulated and protectionist airline transport policy domestically and internationally in alignment with the basic Chicago tenets.[25]

II. Roosevelt's Economic Statesmanship: The Rise of Imperfect Competition

From the inception of US airlines, the US government has had a role to play in fostering, developing, and protecting its own air transport industry. Unlike other countries, the US did not see it necessary to have its own flag carrier; airlines were very much privately owned enterprises. However, the government was far from leaving the industry to its own devices. In 1924, the Kelley Bill established a fundamental public-private framework for the creation and development of an air transport sector through airmail subsidies; the fledging airmail industry would help create a market for passenger traffic.[26] The Kelley Act and later, the 1930 McNary-Watres Act, carved out which routes and at what rates a carrier could operate between two cities through subsidy mechanisms. Between 1926-1929, there was an estimated 1 Billion USD of public money that flooded the industry.[27] The subsidies were in effect an indirect form of economic regulation exercised by the Postmaster-General, a predecessor to the more formal and industry-focused intervention to come.

After a series of tragic aviation accidents which involved black market operators, the Air Commerce Act was passed in May 1926, and it established a formal regulatory

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[25] Ethan Weisman, *Trade in services and imperfect competition: application to international aviation*, (Dordrecht: Kluwer Academic, 1990): 12.

[26] U.S. Centennial of Flight Commission, "Airmail and the Growth of the Airlines," accessed August 1, 2013, http://webarchive.library.unt.edu/eot2008/20080916060900/http://centennialofflight.gov/essay/Government_Role/1930-airmail/POL6.htm

[27] Alan P. Dobson, *FDR and civil aviation: flying strong, flying free*, (New York: Palgrave Macmillan, 2011), 8.

framework to ensure uniform safety rulemaking and certification processes across the industry. Under President Franklin Roosevelt, the 1938 Civil Aeronautics Act took government regulation a step further by establishing the Civil Aeronautics Authority. This legislation imbued the authority with power to regulate airfares and route capacities, above and beyond safety concerns.

In 1940, the Roosevelt administration split the Authority into two: the Civil Aeronautics Administration (CAA) would oversee safety issues, and the Civil Aeronautics Board (CAB) was in charge of regulation on the economic front. Armed with advice from his "Brain Trust", which included the expertise of the aviation lawyer, diplomatic strategist, and economist, Adolf Berle Jr., Roosevelt was convinced that the airline business must conform to the expectations of the "modern corporation". The "modern corporation", as Berle articulated, must "increasingly assume the aspect of economic statesmanship."[28] Accordingly, Roosevelt believed that the government must play an integral role in the continuing development of civil aviation through the CAB, striking a delicate balance between innovation and regulation.

On the other hand, the founding of the CAB was guided in part by the experience of the Great Depression. The free market was to be regarded with some suspicion. As Michael Levine wrote, "In 1938, it appeared to the general public and the Congress that uncontrolled markets did not work very well for the public over the long run...The airline business was relatively new, Congress had little experience with it, and there was reason

[28] Adolf Augustus Berle and Gardiner C. Means, "Book IV: Reorientation of Enterprise," in *The Modern Corporation and Private Property* (New York: Macmillan Co., 1933), 313.

not to apply general skepticism about markets to airlines."[29] Robert Poole and Viggo Butler also explained: "America's fledgling airline industry was hit hard by the Great Depression. As part of a general approach to limit competition and protect firms from failing, commercial aviation was organized essentially as a government supervised cartel."[30] Roosevelt believed that in order to protect the industry and the national interests connected to the sector, the CAB had to play the role of the industry nanny.[31]

Nevertheless, Roosevelt's role in commercial aviation strategy in the US has often been overlooked or misunderstood. His reforms to aviation policy were often enmeshed with administrative ones, leading to contradictions on his positions. In a 2000 interview with aviation historian, Alan Dobson, Pogue remarked "Well, the trouble with Roosevelt on aviation was he just didn't know what he was doing."[32] However, Dobson argued that Roosevelt was guided by principles of competition, and he was committed to pursuing some degree of freedom in the air transport market. Promoting a liberal air regime was "unquestionably a leitmotif in his thinking."[33]

After all, the President was guided by the liberal philosophy outlined in *Mare Liberum* by the Dutch philosopher, Hugo Grotius. Grotius had argued that unlike land, no single country could own the air and the seas. As such, the oceans and the skies should remain free. His treatise was instrumental in shaping the 19th Century freedoms of the seas, and it certainly informed Roosevelt's commercial vision for sea and air transport.

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[29] Michael E. Levine, "Revisionism Revised? Airline Deregulation and the Public Interest," *Law and Contemporary Problems* 44, no. 1 (1981): 191, http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3612&context=lcp (accessed August 1, 2013).
[30] Robert W. Poole Jr. and Viggo Butler, "Airline Deregulation: The Unfinished Revolution," *Regulation* 22, no. 1 (1998): 44-45, http://www.cato.org/sites/cato.org/files/serials/files/regulation/1999/4/airline.pdf (accessed August 1, 2013).
[31] Marc Allen Eisner, *Regulatory politics in transition*, (Baltimore: Johns Hopkins University Press, 1993), 35-37.
[32] Qtd. in Dobson, *FDR and civil aviation: flying strong, flying free*, 3.
[33] Ibid, 5.

However, Roosevelt was also aware of the national and business priorities that jostled for his attention.

He had to proceed with caution. In a January 1939 letter to the National Aviation Forum (NAF), Roosevelt explained the complex dimensions and his concerns about the aviation industry:

> The country's welfare in time of peace and its safety in time of war rest upon the existence of a stabilized aircraft production, an economically and technically sound air transportation system, both domestic and overseas—an adequate supply of well-trained civilian pilots and ground personnel. This new national policy set up by the Congress views American aviation as a special problem requiring special treatment. Aviation is the only form of transportation, which operates in a medium which knows no frontiers but touches alike all countries of the earth.[34]

Aviation was indeed a special problem requiring special attention. For him, the CAB was an agency first and foremost dedicated to "the public interest", established to ensure that civil aviation could develop in tandem with national needs and the growing consumer demand. In addition, the CAB would be the control valve that could turn the country's aviation capacities from commerce towards defense needs. Its founding statement in its clearly reflected his motivations for regulation. Defense and commercial factors certainly informed Roosevelt's vision of the CAB:

> The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense...(and) the

[34] Franklin D. Roosevelt, "Letter to the National Aviation Forum, January 24, 1939, " online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/?pid=15701 (accessed August 1, 2013).

> regulation of air commerce in such manner as to best promote its development and safety.[35]

To this end, the CAB had governance over three factors in the airline business: route capacities, frequency, and pricing. Airlines had to seek the CAB's permission when they desired to begin or cut routes, increase or decrease frequencies and capacities, or change the pricing for specific city-pairs. Moreover, only a single carrier would operate a pair of O-D cities since the CAB sought to prevent duplication of service. Moreover, the CAB was also responsible for disbursing federal subsidies to begin and maintain service in smaller communities. Nevertheless, airlines still had to play within a marketplace, but they were seldom, if never in direct competition with one another. They never had to compete on price points, and they sought to differentiate themselves through their product offerings.

By regulating the various production and consumption factors in commercial air transport, Roosevelt believed that passengers could have more access to flying. As he optimistically offered at the 1940 opening of the Washington DC Airport: "Two years ago not more than a quarter of a million of our people used the airlines and private planes to travel in, that number – the number of citizens at least familiar with the airplane – has doubled and will soon be tripled."[36] The 1938 Civil Aeronautics Act was beginning to show some fruition.

Nevertheless, it would be a mistake to suggest that the CAB was completely

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[35] United States, "Chapter 601: Civil Aeronautics Act of 1938," in *United States statutes at large, containing the laws and concurrent resolutions ... and reorganization plan, amendment to the Constitution, and proclamations* (Washington: United States, 1938): 980.

[36] Franklin D. Roosevelt, "Address at New Washington National Airport, September 28, 1940, online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/index.php?pid=15864&st=airline&st1=airline+deregulation#axzz2fz4ImVCu (accessed August 1, 2013).

opposed to the idea of competition. The CAB was directed to embrace free market principles, but "only to the extent necessary" to maintain the "promotion of adequate, economical, and efficient service by air carriers at reasonable charges."[37] The spirit of Roosevelt's balanced position on the aviation industry was persistent in the CAB regulatory role. In a 1944 speech to Congress, he had proclaimed: "We know that we cannot succeed in building a peaceful world unless we build an economically healthy world."[38] Free market principles were imperative for the aviation industry that Roosevelt sought, but he knew that there were also other national considerations at stake. The consequence was a system of imperfect competition driven by central planning, and in Roosevelt's mind, this middle ground between capitalism and state needs was most astute. The result was his pursuit of the country's stability and prosperity through economic statesmanship, and it was applied vigorously within the ambit of air transport.

III. The Way the Sky Cookie Crumbles: Re-affirming the "Public Interest" in a Changing World

At the swearing in of John Robson as Chairman of the CAB on April 25th 1975, President Gerald Ford was already well aware that the airline industry was in trouble. In his speech, he indicated that the CAB must re-think its purpose in order to keep up with its original 1938 mandate to protect the "public interest". As Ford explained,

It is my judgment that the American airline industry is one of the very best… It

[37] United States, "Chapter 601: Civil Aeronautics Act of 1938," in *United States statutes at large, containing the laws and concurrent resolutions ... and reorganization plan, amendment to the Constitution, and proclamations*, 980.

[38] Franklin D. Roosevelt, "Message to Congress on the Trade Agreements Act, March 26, 1945," online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/?pid=16597 (accessed August 1, 2013).

> seems to me, however, that as we try to achieve the most efficient commercial airline service in this country at the lowest possible cost, we do have to have an organization such as the CAB… and of course, the CAB must not neglect the environment, energy, and a raft of other important matters that are in the public interest.[39]

As early as 1952, there were calls by deregulation advocates to examine the dearth of competition in the industry. At that time however, there was little evidence that the consumers were anyhow disadvantaged.[40] The CAB had argued that positive effects of competition on consumer welfare, if any, were often far outweighed by national interests.[41] Nevertheless, the CAB in the 1970s was quickly falling out of touch with Roosevelt's original vision. The aviation skyscape, technology capacities, economic conditions, and political priorities of the US were rapidly changing.

After World War II, technological advances took flying to the next frontier. Airlines were optimistically making larger capital investments for the future. There was an industry trend to procure progressively bigger and more powerful planes. Between 1946-60, there was a rapid evolution from the pre-war 21-seater unpressurized short-range planes to the piston-era equipment such as Douglas DC-4s, DC-6s, and DC-7s and the Lockheed Constellations, which could seat between 40-60 passengers as well as fly twice the speed and range of its predecessors.

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[39] Gerald R. Ford, "Remarks at the Swearing In of John E. Robson as Chairman of the Civil Aeronautics Board, April 21, 1975, " Online by Gerhard Peters and John T. Woolley, *The American Presidency Project.* http://www.presidency.ucsb.edu/ws/?pid=4854 (accessed August 1, 2013).

[40]United States and Civil Aeronautics Board, *The role of competition in commercial air transportation Report submitted to the Subcommittee on Small Business, United States Senate*, (Washington: U.S. Govt. Print. Off., 1952): 10-12.

[41] United States and Civil Aeronautics Board, "Letter of Transmittal," in *The role of competition in commercial air transportation Report submitted to the Subcommittee on Small Business, United States Senate*, (Washington: U.S. Govt. Print. Off., 1952): Iii.

The following decade saw piston-era planes give way to the advent of the 100-170-seater turbojet and turbofan aircraft, which could cruise at nearly 575mph and fly twice the range of a piston-era Martin 202. During the same time, wide-bodies which featured two aisles also slowly became commonplace. The most visible technological marvel in the aviation space came with the rise of the jumbo jet. The Boeing 747, nicknamed the Queen of the Skies, could carry "an unprecedented payload and more than 250 passengers on her missions."[42]

As airliners acquired these bigger planes, they soon realized that they had too many seats, and too few passengers. Frank Spencer indicates, "By 1973, wide-bodies supplied over 30 percent of the available seat-miles but only 45 percent of the seats were utilized."[43] Moreover, the advancement of aircraft technology did not necessarily equate to operational savings for the airline. Size carried its own costs, in fuel and maintenance expenditure. For one, the Boeing 747 models were massive fuel guzzlers, having higher fuel burn rates/seat mile than some of their narrow-body counterparts. Furthermore, airlines were not used to the new costs of possessing aircraft such as the jumbo jet: direct maintenance costs on a Boeing 707 was traditionally about 11 USD/Hour as opposed to 65 USD/Hour on the 747.[44] Finally, the industry was confronted by the 1973 energy crisis – which saw fuel prices furiously escalate by nearly 70%, raising costs of operations significantly.[45]

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[42] Frank A. Spencer, "Technology, Economics, and Corporate Strategy in US Air Transportation, 1946-73," *Business History Conference* 7, no. 2 (1978): 11, http://www.thebhc.org/publications/BEHprint/v007/p0011-p0028.pdf (accessed August 1, 2013).
[43] Spencer, "Technology, Economics, and Corporate Strategy in US Air Transportation, 1946-73," 26.
[44] Ibid, 26.
[45] Daniel Yergin, *The prize: the epic quest for oil, money, and power*, (New York: Simon & Schuster, 1991): 587.

In Poole and Butler's opinions, a good part of the US airlines' overcapacity and financial problems was a product of mismanagement. As they indicated, "the ability to pass on costs via CAB-approved fares allowed inefficient work rules and expensive management practices to proliferate. Thus, the advent of deregulation found airlines with too many large aircraft, too many non-economic routes, and work rules that would prove unsustainable in competitive markets."[46] Whichever way airfares went, costs were rarely the concern of the airline company. The CAB controlled the fares to ensure profitability, or at the very least, sustainability for the routes the airline served. This artificially inflated airfares for consumers. An extraordinary complacency thus developed within the airlines' business structures, and the CAB fed its appetite. A Time Magazine article pointed out in 1975:

> For nearly two decades, the nation's airlines have tried to fill empty seats on their cavernous jets primarily by catering to the air traveler's palate rather than his pocketbook. They have wined and dined him with increasingly elaborate soup-to-nuts meal services and, while offering a variety of excursion rates, raised regular fares more than 40 times since the jets began flying in the U.S. in 1958.[47]

Politically, the sentiment was also slowly changing. The economic recession of the 70s warranted a review of the regulatory regime within transportation. As Senator Edward Kennedy pointed out in 1975, "In the transportation area alone, studies have estimated the cost to the public of Federal regulation to be $8 to $16 billion each year. That is an unacceptable cost at any price...(and) unacceptable under our present

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[46] Poole and Butler, "Airline Deregulation," 1-3.
[47] "AIRLINES: The Frill Is Gone." *TIME.com*, Last modified April 21, 1975, http://www.time.com/time/magazine/article/0,9171,917349,00.html#ixzz2M8aN8d4y (accessed August 1, 2013).

economic conditions."[48] On the other hand, there were also growing signs of "defects" in the Civil Aeronautics Board brand of regulation. At the 1975 White House Conference on Domestic and Economic Affairs, President Ford cited the examples of California and Texas, where "fares of nonregulated interstate carriers are as much as 40-percent lower than those controlled by the CAB. "[49]

Furthermore, the CAB had been mired in scandals where charges of impropriety were levied against its senior officials. The most prominent involved the suicide of the CAB's Director of Enforcement, William Gingery. Prior to his death, he leaked a note, which provided details of improper campaign contributions by airlines and the industry relationships that compromised the CAB's objectivity.[50] Moreover, Gingery provided evidence that the CAB had also issued an unofficial moratorium in awarding routes and operating licenses to new players in an attempt order to protect favored existing players. Between 1969 and 1975, there were more than 80 applications from prospective operators. None were approved.[51] Attempts were made by CAB officials to suppress evidence of this moratorium. Nevertheless, a hearing before a Senate judiciary committee led by Senators Edward Kennedy and James Eastland in 1975 revealed that the CAB had

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[48] United States, *Oversight of Civil Aeronautics Board practices and procedures: hearings before the Subcommittee on Administrative Practice and Procedure of the Committee on the Judiciary, United States Senate, Ninety-fourth Congress, first session...* (Washington: U.S. Govt. Print. Off., 1975).

[49]Gerald R. Ford, "Remarks at the White House Conference on Domestic and Economic Affairs in Concord, New Hampshire, April 18, 1975," online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/index.php?pid=4845&st=civil+aeronautics+board&st1=#axzz2fz4ImVCu (accessed August 1, 2013).

[50] "Suicide Note Left by CAB Official Alleges Cover-Up," *The Palm Beach Post (West Palm Beach)*, March 5, 1975, http://news.google.com/newspapers?nid=1964&dat=19750305&id=JZxUAAAAIBAJ&sjid=gjsNAAAAIBAJ&pg=6524,1575402 (accessed August 1, 2013).

[51] Jimmy Carter, "Airline Industry Regulation Message to the Congress, March 4, 1977," online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/?pid=7113#axzz2h30FkQpv (accessed August 1, 2013).

broken its commitment to public interest by unjustifiably stifling competition.[52] Charges of criminal breach of trust against its Chairman then, Robert Timm was dropped, once Timm agreed to resign.[53] At this point however, the CAB had lost its political credibility.

The most striking blow to the CAB emerged in the aforementioned 1975 hearings, which were designed to study the relevance of the organization. The hearings ultimately found that "the cost of [the CAB's] regulation is always passed on to the consumer. And that cost is astronomical."[54] Stephen Breyer, who worked on Kennedy's staff, provided a more dramatic and succinct summary of the 1975 proceedings:

> A woman, who had been picketing, entered the committee room and said, "Senator Kennedy, why are you having hearings on airlines? I've never been able to fly."
>
> And the Senator replied, "That's why I'm having the hearings!"[55]

The ignorance and apathy of the woman's word in Breyer's anecdote, if nothing else, demonstrated the shortcomings of the agency. The CAB had failed so miserably in its commitment to the public interest, that flying was out of the question for everyday Americans such as her. At the conclusion of the hearings, Kennedy and Ford realized that the current regulatory regime would prove too heavy a burden for the public to carry into the future. They formed an alliance that strengthened the deregulation cause.

In appointing Robson to Chairman of the CAB, the Ford administration was keen

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[52] United States, *Oversight of Civil Aeronautics Board.*

[53] "Furor in CAB: Timm aims fire at Ford's staff," *Spokesman-Review (Spokane, WA)*, December 24, 1975, http://news.google.com/newspapers?nid=1314&dat=19751224&id=FfBLAAAAIBAJ&sjid=c-0DAAAAIBAJ&pg=7200,3175640 (accessed August 1, 2013).

[54] United States, *Oversight of Civil Aeronautics Board.*

[55] Stephen G. Breyer, "Working on the Staff of Senator Ted Kennedy," *Legislation and Public Policy* 14 (2011): 609, http://dev.nyujlpp.org/wp-content/uploads/2012/10/The-Honorable-Stephen-G.-Breyer-Working-on-the-Staff-of-Senator-Ted-Kennedy.pdf.

on examining the effects of competition on airlines and re-affirming the integrity of the CAB. While the imperative for roping in Robson was not specifically deregulation, it was an open secret that the Ford administration had wanted the Robson to explore moving away from the existing CAB regime. As Robson quipped, "Now I can't tell you that somebody in the Ford administration didn't think that [deregulation] was what I would do, but nobody talked to me about it."[56]

After all, Robson had two distinct qualities that made him the ideal candidate for rehabilitating the CAB's tainted reputation and leading the transformations within the agency. Firstly, he had "no background in the airline industry."[57] He came in with fresh eyes, and was less prone to the regulatory capture and tunnel vision that the CAB had developed over the years. On the other hand, Robson was what Thomas Petzinger called a "loose cannon" and the Ford administration understood that they needed just that – an audacious changemaker who had the gumption and intelligence to seed deregulation in the industry. Almost immediately, Robson went about implementing unprecedented discount or "peanut" fares – despite the opposition within the CAB and a great proportion of the airline industry. His experiments set the stage for deregulation.

Finally, Gerald Ford, in particular, was concerned about the America's position in the world's aviation sector. In a 1976 speech about the US' aviation policy, he indicated: "Historically, the United States has had a leadership role in the development of international air transport and intends to continue in that role."[58] He had believed that the

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[56] Qtd. in Andrew Downer Crain, "Deregulation," in *The Ford presidency: a history*, (Jefferson, N.C.: McFarland & Co., 2009), 206-207.
[57] Thomas Petzinger, *Hard landing: the epic contest for power and profits that plunged the airlines into chaos*, (New York: Times Business, 1995), 42-3.
[58] Gerald R. Ford, "Statement on International Air Transportation Policy, September 8, 1976," online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/?pid=6316#axzz2fz4ImVCu (accessed August 1, 2013).

Department of Transportation (DOT) and the CAB must re-think the country's position on air transport regulation in order for airlines to stay competitive and provide lower fares to consumers. This would also allow America to cement its aviation power, a proposition that Pogue and Welch could not entertain in 1944 due to the international pressure they had to confront during their time. For America to take the lead in the industry, the administration Ford believed that a competitive playing field must firstly be instituted. Domestic deregulation must first begin to take place. However, while Ford was a fierce advocate of airline liberalization, it was only with Jimmy Carter that full-fledged deregulation actually took place.

IV. The 1978 Deregulation Act & Beyond

In his maiden speech to Congress on 4 March 1977, President Jimmy Carter went on to affirm his commitment to free market solutions for what he and his administration had perceived as industrial inefficiencies in the airline business:

> One of my administration's major goals is to free the American people from the burden of over-regulation. As a first step toward our shared goal of a more efficient less burdensome Federal government, I urge the Congress to reduce Federal regulation of the domestic commercial airline industry.[59]

Carter thought that the CAB had essentially strayed from its initial mission of protecting the consumer. Following in the footsteps of Ford, he began rectifying the problems in the regulatory regime.

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[59] Jimmy Carter, "Airline Industry Regulation Message to the Congress, March 4, 1977," online by Gerhard Peters and John T. Woolley, *The American President Project.* http://www.presidency.ucsb.edu/ws/?pid=7113#axzz2h30FkQpv (accessed August 1, 2013).

After announcing his intent to Congress to pursue airline deregulation, Carter went on to appoint Alfred E. Kahn to head the CAB. The political stage had already been set up for revolution by President Ford, Senator Kennedy, and the CAB chairman John Robson. On one side, Ford and Kennedy represented the Republican and Democratic political consensus for deregulation, while John Robson was the capable administrator and policymaker who was in the process of modernizing and preparing the CAB for changes to come. Yet, Robson was not the leader that Carter needed for his deregulation ambitions. Robson had preferred to wait for congressional action, and Carter wanted a more formidable and aggressive momentum for deregulation.

What the Carter administration needed, was an economist who had a track record of success in deregulation. In the 1975 hearings, Ted Kennedy had asked Kahn if an economist would do the CAB "any good". With a charming smile, Kahn responded, "Why I think it would be marvelous."[60] Kennedy knew that only an economist could imbue the deregulation momentum with the credibility of which politicians were often found wanting. Moreover, the Cornell professor was also experienced as a "practitioner of regulation" during his tenure as Chairman of the New York State Public Services Commission.[61] Kahn was roped in from his study of trucking and telecommunications deregulation to pursue the prospects of airline deregulation, and he was armed with the experience that Carter needed to push deregulation through.

With deregulation's political and economic bases covered and with the CAB poised for an economic revolution in the airline industry, the rise of Kahn to the CAB's chairmanship marked the beginning of end to the old regulatory regime in the domestic

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[60] Alfred E. Kahn, testimony, *Oversight of Civil Aeronautics Board.*
[61] Ibid.

airline industry. When Kahn took office, he allowed Robson's "peanut" fare wars to wage on; in fact, he encouraged them further by removing restrictions on capacities and frequencies and extending the "peanut" fares to the entire US aviation market. He also lifted the CAB's unofficial moratorium on allowing new airlines into the playing field. At the same time, he was fiercely advocating for dismantling the CAB apparatus entirely. Competition was now ushered into the airline industry, and the Carter administration was committed to have it stay.

With virtually no resistance from the house and the senate, the Deregulation Act[62] was passed into law the next year. As such, the CAB would no longer determine airfares, capacities, routes, and frequencies. The Deregulation Act was also accompanied by the Sunset Act, which arranged for CAB's demise over the next 6 years. Kahn was thorough in his quest to eradicate the entire instrument of US economic regulation in the aviation sector. He compared it to scrambling eggs that could no longer be unscrambled. As he revealed in a 1980 panel discussion with the American Enterprise Institute: "It would be the measure of my success at the CAB that there be nothing there when I left."[63]

While deregulation might seem contained only within the US at first, the new skyscape invariably became a political and economic instrument that inevitably affected other countries' aviation markets and political commitments to the Chicago Convention. As President Ford indicated earlier in his 1976 Statement on International Air Transport Policy, "Regulatory regimes imposed by governments should not stifle the industry's flexibility to respond to this demand, nor should they remove incentives to keep costs

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[62] United States, *Federal Aviation Act of 1958: revised April 1, 1981 (includes Public Law 95-504 - October 24, 1978 and Public law 96-192 - February 15, 1980)*. Rev. Apr. 1, 1981. ed., (Washington, D.C.: Civil Aeronautics Board, 1982).

[63] Alfred E. Kahn, *American Enterprise Institute: Studies in Government Regulation*, a *conversation,* April 3,1980.

low."[64] Ford was heralding a new aviation order, one that was guided by competitive forces – and it was a new status quo the world has never seen before.

In the next few years, Europe would be attempting to respond to the economic and political pressures of competing with the new US aviation regime. Deregulation had disrupted the global Chicago system in significant ways. While the US advocates of deregulation in its early years never really quite foresaw how a domestic policy could be used to create such a global impact, the new status quo in the airline industry certainly allowed America to establish a leadership position and hegemonic dominance over air transport markets in Europe – mostly by design, rather than by coincidence.

[64] Office of the White House Secretary, "Statement of the President", (September 8, 1976). http://www.fordlibrarymuseum.gov/library/document/0248/whpr19760908-016.pdf.

Chapter 2

The EU Aviation Story: From Protectionism to Multilateral Open Skies

"It is, however, evident that any true progress towards an aeropolitical Europe goes hand in hand with an advance of the community towards political unity."

- Altiero Spinelli, 28 October 1974 [65]

I. Cognitive Dissonance: The Impact from across the Atlantic

"In the eyes of many, European air transport is in need of a radical overhaul. Air services and airlines are bombarded constantly with complaints by consumer groups and others about what are seen as route protection, fare fixing, and outrageously high prices. Scarcely a month passes without the publication of yet another report criticizing...airline operations."[66] These were the introductory words of a 1986 report from The Economist Intelligence Unit, and they were certainly instructive of the public dissatisfaction with the air transport industry in Europe. While the average European consumer would not be as knowledgeable about the divergent political, economic, and business challenges that confronted the industry, he or she was probably aware of the financial dissonances which the deregulation experience in America generated from across the Atlantic ocean.

After all, the European consumer was paying about $353 to fly 734 miles from Brussels to Rome. On the other hand, he could jump on an American carrier to fly nearly

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[65] University of Pittsburgh, "Extracts from Mr. Spinelli's Speech to the AECMA," (October 28, 1974) Archive of European Integration (AEI), aei.pitt.edu/13011/1/13011.pdf (accessed August 1, 2013).

[66] Stephen Wheatcroft and Geoffrey Lipman, "Air Transport in a Competitive European Market: Problems, Prospects and Strategies", *The Economist Intelligence Unit: Travel and Tourism Report No. 3,* (London: EIU, 1986)

5000 miles from San Francisco to Brussels at only $149 on a nearly unrestricted ticket.[67] Within the US, a passenger could expect to fly about 2500 transcontinental miles from New York to San Francisco at about $199 in 1986 terms.[68] After nearly a decade of US deregulation, the economic differences between deregulated and regulated markets were increasingly stark. Even then, political action was invariably tractor-like, and carriers themselves resisted any attempt to move into any form of liberal skies, fearful that they might lose their monopolies Chicago gave them.[69]

In his study of historical air fares prior to deregulation in Europe, Maho Kawagoe proposed two factors for the higher airfares European consumers were experiencing in the 1980s: higher cost performance of the European airlines and structural strictness of the air transport market in Europe. [70] Not unlike American carriers before 1978, European airliners operated under a firm system of regulated fares, single airline designation, and tight capacity agreements on market access. It was unsurprising then, that the European airlines were facing parallel problems as their American counterparts from a decade ago. On the one hand, airlines found themselves frustrated with the inability to expand freely into other markets, and new bilaterals were often complex diplomatic challenges for the home government. Moreover, airlines were competing on frills rather than price points. This, in turn, made cost efficiency less of a priority for the firm.

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[67] Gloria Garland, "The American Deregulation Experience and the Use of Article 90 to Expedite EEC Air Transport Liberalisation," *European Competition Law Review,* 7 (1986): 193-4.
[68] Ibid, 193.
[69] J Erdmenger (DG VII), "A New Dimension to Civil Aviation Through European Economic Intergration", in Wassengergh and Fenema, 36-52. See also Alan Dobson, 28-30.
[70] Maho Kawagoe, "Air Transport Deregulation in the EU: Study from the Europeanization Perspective" (Paper for Presentation at the IPSA RC-3 Symposium on "European Integration between the Past and the Present" Hokkaido University, Sapporo, Japan 6 September 2008), 3. http://eprints.lib.hokudai.ac.jp/dspace/bitstream/2115/43684/1/2_161-180.pdf.

These were the common arguments for pro-deregulation advocates. For them, the historical turning point for commercial aviation was seen with Carter's deregulation program. The airliners in America were beginning to reform their business practices in the new aviation climate. Competition was ushered in the form of new business practices, introduced by the deluge of new players who plunged into the airline industry. New city pairs were approved, and new communities were being served. The hub-spoke network became commonplace. The low-cost carrier model based on Texas Southwest Airlines was becoming popular. Subsequently, costs and airfares began to plummet. Advocates believed that if Europe took the policy plunge with North America, the consumers could stand to benefit.

Nevertheless, it took the European Economic Community (EEC) nearly a decade from America's example to move forward with airline deregulation in the region. It took another 20 years before the European Union (EU) eventually signed the multilateral open skies agreement with the US in 2007. The questions that emerge here are quite intriguing. Why was the region caught up with a lengthy process to deregulate? What and who were the catalysts for the change in direction? After the EEC undertook the First Liberalisation Package (First Package) for airline deregulation in 1987, what changed to align the EU with multilateral open skies?

Before the 1992 Maastricht Treaty which brought together the EU, the Inner Six countries, which included Belgium, France, West Germany, Italy, the Netherlands, and Luxemburg, formed the EEC through 1957 Treaty of Rome. Rome had proposed for balanced economic growth within the region, and it sought to create a common market of goods, workers, services and capital within the EEC's member states. For the most part,

this common market would embrace uniform competition rules. At the signing of Rome, the EEC had envisioned a Common Transport Policy (CTP) for the region. According to Alan Dobson, the CTP "was essential for opening up the inward-looking, state-centric transport systems of the Member States and for promoting cohesion, economic mobility and the reality of a single European market."[71]

Nevertheless, the EEC's Council of Ministers was reluctant to tackle the problem of a missing CTP. It was not until 1985 that the EEC managed to produce a White Paper that articulated a direction for the CTP. Even then, the 1985 White Paper "Completing the Internal Market" only mentioned the CTP in passing and the follow-up action was minimal. As Liana Giorgi and Michael Schmidt pointed out: "Despite the (treaty's) explicit commitment to removing barriers to competition and supporting free market access, the European transport policy did not amount to much between 1957 and 1985... Transport policy during this time continued to be primarily national."[72] The want of trans-boundary co-operation and dialogue on transport essentially scuttled plans for a common transport policy within the region. After all, transportation was an extremely sensitive national infrastructure. There were a lot of political challenges in aligning a country's national transport policies with a larger supranational institution. Naturally, aviation would prove more delicate to bring under the community rules.

Moreover, how the terms of Rome and the proposed CTP could apply to the aviation sector was even made more complex by an exception clause in the EEC's founding document. As Article 84 of the Rome Treaty indicated: "The provisions of this

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[71] Dobson, 3-4

[72] Liana Giorgi and Michael Schmidt, "European Transport Policy – A Historical and Forward Looking Perspective," *German Policy Studies* 2, no. 4 (2002): 1-19, accessed August 1, 2013, http://www.spaef.com/file.php?id=864.

title shall apply to transport by rail, road, and inland waterways."[73] Air transportation was essentially left out of the wording in the original Rome treaty. Therefore, the standard procedure for the EEC to deal with air transportation was to consider aviation outside the purview of the Treaty of Rome. This meant that the common market and competition rules, which were initially outlined in Rome, would not apply within the aviation sector by this technicality. As Jacqueline O' LiCalzi pointed out,

> The legislative vacuum that has existed since the Community's inception thirty years ago has permitted the air transport sector to develop unconstrained by competitive pressures and insulated from the normal consequences of commercial inefficiency.[74]

Consequently, governance over air transport and its various infrastructure would remain within the purview and discretion of individual countries. Nevertheless, in order for the European countries to formulate community laws in the aviation sector, they would need to alter the coverage of Article 84.

Finally, while the US airlines were historically owned, maintained, and operated by private interests, the governments in Europe had taken measured stakes in many of their airlines since their inceptions. The member states had no political, financial, and business incentive to break from the status quo of strict regulation. A liberal aviation regime meant that these countries would no longer be able to afford their flag carriers economic protection from the wilderness of competition; it would serve to demolish the monopoly that these state-owned airlines traditionally enjoyed.

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[73] Treaty of Rome (1957), 30. http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf; Refer to European Commission. *The Rome, Maastricht and Amsterdam treaties: the treaty on European Union (the Treaty of Rome) and the treaty establishing the European Community (the Treaty of Maastricht), amended by the Treaty of Amsterdam: comparative texts.* 1999 ed., 1st ed. Belgium: Euroconfidentiel, 1999.

[74] Jacqueline O' LiCalzi, "Competition and Deregulation: Nouvelles Frontieres for the EEC Air Transport Industry?" *Fordham International Law Journal* 10, no. 4 (1986): 841-56, 843.

Table 1: The percentage of capital held by Member States in the main EC scheduled airlines in 1979[75]

Air France	98.80
Air Inter	49.90
Alitalia	99.00
British Airways	100.00
KLM	78.00
Aer Lingus	100.00
Lufthansa	82.16
Luxair	25.57
Sabena	100.00

In a 1994 Comite des Sages on Air Transport report to the European Commission, Chairman Herman de Croo summarized the reasons behind the reluctance in pursuing deregulation of the aviation sector:

> In its early days as an infant industry, air transport depended on state support. It developed as a highly protected area of national economies, an integral part of government policy…states exercised their right of sovereignty over airspace and their privilege to set up national carriers. Almost regularly, these carriers were used by governments as an instrument to promote their 'own' aeronautical industry, or foreign political links or domestic employment – all without regard to the economic implications or commercial significance.[76]

Part by default and part by design, the system had rendered competition scarce in the European aviation market. Nevertheless, the world of commercial airliners was quickly changing after 1978. In order to compete with the new economic paradigm of American

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[75] Qtd. in BULL. EUR. COMM. Supp. 35 (May 1979). See also Leah E. Clifton, Comment, Introducing Competition to the European Economic Community Airline Industry, 15 CAL. W. INT'L L.J. 364, 365 n.7 (1985); and, Paul Stephen Dempsey, European Aviation Regulation: Flying Through the Liberalization Labyrinth, 15 B.C. Int'l & Comp. L. Rev. 311 (1992), http://lawdigitalcommons.bc.edu/iclr/vol15/iss2/4.

[76] Qtd. in European Commission, "Commissioner Mautes Receives Report of Comites de Sages on Air Transport", IP/94/54, (February 2, 1994). http://europa.eu/rapid/press-release_IP-94-54_en.htm

airliners, politicians were seriously contemplating deregulation in Europe. However, the countries in the community first needed to review the Chicago system, the community rules of the EU, and the future of each respective nation's political and economic stakes in the airline business.

II. Bermuda II: One Step Backward and a Leap Forward

The 1944 Chicago Convention had allowed each country to decide and control its own agenda as it pertained to the aviation sector. Following the conference at Chicago, the Bermuda agreement signed in 1946 between the US and UK was held up as the high watermark of bilateral commercial aviation agreements. This served as the template for the thousands of bilaterals across the world today. On the other hand, Bermuda also came to indicate the tension between America's desires for more liberal skies and Europe's post-war desire for regulation, self-determination, and economic self-interest in the global aviation market. To this end, the United States agreed that IATA would have the primary responsibility for establishing fares on international routes, subject to the approval of the governments affected by IATA fare decisions. The United Kingdom allowed designated airlines from each country the freedom to determine capacity and frequency of service.[77] According to Seth Warner, "Bermuda I represented a compromise between the liberal American and the restrictive British ideologies that had conflicted at the Chicago Conference."[78]

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[77] Ibid.

[78] Seth Warner, "Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Noncitizens in Second Class". *The American University Law Review.* 43, no. 1 (1993): 279-80.

However, the situation began to shift in the 1970s. As a result of losing its Asian and Caribbean colonies and the nationally mandated mergers between the original UK carriers in the Bermuda agreement, the UK was left only with British Airways (BA) on the prized UK-US transatlantic routes. Its hands were tied. The 1944 Bermuda agreement prevented new players from entering the market, and this inadvertently allowed the US to dominate. Moreover, the UK was especially concerned about Freddie Laker's Laker Airways. Laker had found itself unable to secure approval from the US authorities for its proposed low-cost Skytrain service in the London Stanstead-New York market, and the UK government was determined to help Laker and another carrier, British Caledonian, access the US-UK market.[79]

By early 1974, the UK became the only Western European country, other than Portugal, which was carrying significantly less than 50% share of the transatlantic traffic on its flag carrier. As the Secretary of State for Trade, Edmund Dell was perturbed by the traffic and revenue imbalance, and he set out to spearhead the re-negotiations of Bermuda I in 1976. Dell was unashamed about the UK's commercial interests. As he explained in parliament, "Our proposals (will) undoubtedly cause difficulties for the United States, because we wish for a better share of the revenue that arises in air transport involving our two countries."[80]

Dell and his team were focused on procuring more restrictive capacity controls and tighter regulatory powers (in favor of the British) over scheduled services in the

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[79] HC Deb 14 February 1977 vol 926 cc28-32.
http://hansard.millbanksystems.com/commons/1977/feb/14/laker-airways-skytrain-1#S5CV0926P0_19770214_HOC_175

[80] HC Deb 14 February 1977 vol 926 cc14-6
http://hansard.millbanksystems.com/commons/1977/feb/14/civil-aviation-bermuda-agreement#S5CV0926P0_19770214_HOC_89

Bermuda re-negotiation. They were determined to secure a "full-scale intergovernmental treaty" that would,

1) allow Laker and BCal to begin service across the Atlantic,

2) restrict access to a congested Heathrow Airport,

3) negotiate the Concorde entry's to New York's John F. Kennedy airport,

4) and limit cabotage and Fifth Freedom rights for US carriers.[81]

To rally domestic support, Dell was spectacularly religious about his intentions. He did not mince his words to the London Chamber of Commerce on 28 February 1977, "We need capacity to avoid waste. We need balanced routes…we need a better opportunity for British airlines within the international air transport system."[82] Naturally, his espousal of a "better opportunity" for its home carriers fell within the traditional mercantilist approach that the British and other European countries had taken since Chicago.

At first, the Carter administration was reluctant in yielding to Dell's demands for more regulation. After all, the US was more inclined for a more liberal aviation regime. However, Dell and his team possessed an uncompromising style, and they had made an aggressive play at the beginning of the negotiations by serving the Ford administration a one-year notice in June 1976 for terminating Bermuda I. They knew that the US side had

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[81] Flight International, "Britain to end Bermuda Agreement", *Flight Global,* (3 July 1976), 3.
[82] Qtd. in *Flight, (19 March 1977)* 508. See also Dobson, *FFOC,* 128.

much more to lose should it let Bermuda talks collapse, since it was carrying more traffic and revenue. As the one-year window neared expiry in June 1977 and just as Carter was elected to office, the US rushed to sign Bermuda II without gaining many concessions. The new treaty saw the US lose many of its original bilateral privileges, including city-pairs and its original triple designations. Even then, the US negotiators identified and accepted the long-term advantages in approving Bermuda II.

Firstly, Bermuda II allowed the two countries discretion in setting airfares without a formal package as dictated by IATA, as long as the fares were set above cost. The US recognized the benefits of having low-cost carriers like Laker Airways as part of the new arrangements; it would raise the level of competition and dampen prices further on the transatlantic routes. Removing the CAB's power on fare control however was inadequate to promote competitive ratemaking practices in the international sphere. Bermuda II's loophole provided Carter administration's impetus to go after what the US had perceived as international fare fixing in IATA.[83] On 9 June 1978, the US issued a 'Show Cause Order' (SCO) that demanded IATA demonstrate its relevance to public interest.[84] In less than three months, IATA announced that carrier participation in the packaged fare setting was to become optional and procedures were to become more flexible. The SCO proceedings were dropped and anti-trust immunity returned to IATA.[85]

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[83] "Open Skies and Flights of Fancy", *The Economist,* (October 2, 2012). http://www.economist.com/node/2099875?story_id=E1_NDJJRSV&source=login_payBarrier (accessed August 1, 2013).

[84] CAB Order 78-6-78, June 12 1978. See also, Dobson, FFOC, 154-5.

[85] As Marvin Cohen, Kahn's successor articulated: "The board was impressed with the support given to the new IATA mechanism not only by many witnesses who are familiar with the industry, but also by our own Departments of Transportation and State and other foreign government leaders who support the precompetitive politics of the United States…Diplomatic considerations are primary reasons for our decision to extend (antitrust) immunity to the new IATA." Dobson, 155-6.

Secondly, the US rigorously leveraged the momentum built with Bermuda II to pursue renegotiation of bilaterals with other countries. This was in hopes of bearing down on the UK to return to the negotiating table without souring the relationship.[86] For one, the Netherlands who "had shown a willingness to be helpful to the Americans during the Bermuda II talks" was invited in March 1978 to negotiate a new protocol that would allow the Dutch more access to the US markets, 5th freedom traffic rights, flexible pricing and capacity controls, and charter memoranda. In turn, the Dutch-US bilaterals generated a new boilerplate for US-Europe bilateral agreements that allowed countries to decide on tariffs with less of the strict formalities established by IATA.

The beginnings of competition were showing from across the Atlantic. Slowly but surely, the Chicago paradigms that were in place for thirty years were slowly being dismantled post-Bermuda II and it was important for the changes yet to come in Europe.

III. The French Seaman & New Frontiers: Expanding Article 84's Coverage

At the 1974 Symposium on Air Transport in Europe, the Industry Affairs Director of BCal, H.C. Brilliant, expressed: "The creation of the European Community has not itself altered the environment in which air transport perforce operates, but it may have introduced a new dimension yet fully to be evaluated."[87] He could not have been more prophetic. The Rome treaty was for the most part silent on the application of common market rules to air and sea transport. While the Article 84 indicated: "the provisions of

[86] Alfred Kahn quipped that this was to "stick it to the Brits.Qtd. in Dobson, 161.
[87] H.C. Brilliant, "An Airline's View of the Opportunities and Obligations of the European Economic Community," *Symposium on Air Transport in Europe,* (London: Royal Aeronautical Society, 16 January 1974).

the Title (IV) shall (only) apply to transport by rail, road and inland waterway,"[88]there was a technical loophole for the European Community to apply Rome to the excluded industries. Such an undertaking, however, must come from consensus and compromise, as the latter clause of Article 84 that the EC council "may, acting unanimously, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport."[89]

It was in the spirit of the second clause that the European Commission had invited the French government to re-examine its 1926 Code du Travail Maritime in March 1974. The Maritime law imposed that a "proportion of crew of any (French-registered) ship as is laid down by order of the Minister for the Merchant Fleet must be French nationals."[90] More specifically, the code "reserve(d), subject to special exemptions, employments on the bridge, in the engine room and in the wireless room on French vessels to persons of French nationality, and general employment…is limited in the ratio of three French to one non-French."[91] This quota system was clearly in breach of Rome's Articles 48 and 49, which were designed to prevent discrimination based on nationality between workers of the Member States as it pertained to employment, remuneration and other conditions of work and employment, as well as to the "right of such workers to move freely within the Community in order to pursue activities as employed persons." [92]

The French claimed that Article 84 exempted community interference. Moreover, it argued that the EC had no legal standing to bring about a case against the country's

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[88] Treaty of Rome (25 March 1957), 28-33. http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf
[89] Ibid, 33.
[90] Commission of the European Communities v French Republic (1974) 167/73, 361.
[91] qtd. In Ibid, 361.
[92] Regulation (EEC) No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31968R1612:EN:HTML

labor laws.[93] The EC disagreed and it filed a suit with the Court of Justice (ECJ) against the French government. The ECJ ruled in favor of the Commission, and ordered the French to withdraw the quota system from the Code du Travail Maritime. As the ECJ articulated in its judgment:

> Far from excluding the application of the Treaty to these (maritime) matters, it provides only that the special provisions of the Title relating to transport shall not automatically apply to them…so long as the Council has not decided otherwise. It thus follows that the application of Articles 48 to 51 to the sphere of sea transport is not optional but obligatory for Member States.[94]

The case was a complex intersection of labor and maritime law. Firstly, it established and confirmed the EC's powers to enforce the community terms of the Rome treaty on labor matters in member states. As long as the business practices within member nations were in contravention of Rome, there was cause for action. Secondly, the judgment in the French Seaman case also served to resolve part of the technical exclusion in Article 84 by expanding Rome's coverage to the maritime industry.

It was only in 1984 that the European community had a clearer answer to how air transportation would be covered under Article 84. The French Civil Aviation Authority (CAA) found Nouvelles Frontieres, a travel agency, in breach of its tariff codes when the latter began selling discounted air tickets that were not submitted to the CAA approval. However, the tribunal de police was reluctant to begin criminal proceedings against the travel agency. Uncertain about the legality of the CAA's allegations, the tribunal asked the ECJ for a judgment on the compatibility of the CAA code with the Rome treaty.[95]

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[93] Commission v French Republic (1974) 167/73, 368.
[94] Ibid, 372.
[95] Ministere Public v Lucas Asjes and others, Andrew Gray and others, Andrew Gray and others, Jacques Maillot and others and Leo Ludwig and others (1984), 1459. See also, 1466-72. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61984CJ0209:EN:PDF

The French government once again invoked Article 84 to exempt the CAA codes from community interference, but the ECJ referred back to its judgment in the French Seaman case.[96] It was not up to the individual country, but to the EC to decide whether Rome applied to the excluded industries. For the first time however, the ECJ patently expressed that Article 84 did not preclude air transport from common market laws under Rome.

More interestingly, was the other part of the ECJ judgment, which dealt with the intersections of the Chicago Convention and community rules. The French had tried to pursue a secondary non locus standi argument against community interference since the Nouvelles Frontieres case dealt with international civil aviation. It sought refuge under Article 6 of the Chicago Convention, which protected the independence and sovereignty of each signatory country in aviation matters. Under the terms of Article 6, each country had full rights to impose tariffs within the ambit of its bilaterals. However, the ECJ ruled that Chicago Convention and community rules were not mutually exclusive:

> The French Government points out that the French legislation and rules at issue in the main proceedings were adopted in the international context described above. However it has not claimed that the said international agreements obliged the Member States which signed them not to respect the competition rules in the EEC Treaty.

Accordingly, the coverage of Article 84 of the Rome Treaty was expanded with the ECJ decisions in the French Seaman and the Nouvelles Frontieres cases. Pursuing deregulation predicated on releasing the control valves of rate-fixing mechanisms. Firstly, the original IATA that was established in 1944 needed to move away from imposing tariffs through its packaged system. The US aviation authorities, in favor of more

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[96] Ibid, 1466.

competition in the global airline marketplace, leveraged Bermuda II to secure a new IATA regime conducive to market forces setting price points. Secondly, the European Community needed to lay down the foundations of competition within the aviation sector by placing it under the rules of the Rome treaty. Not only did the French Seaman and Nouvelles Frontieres cases return air transportation explicitly to the EEC's ambit, they also shifted the power from individual countries over air transport to the supranational institution by placing the importance of community rules beside the Chicago convention.

IV. The Dutch & British Alliance: Towards Competition & a Common Transport Policy for Aviation

The 1980s saw shifting economic philosophies and alliances between member states. With Margaret Thatcher's rise to power, the UK had begun changing its position on regulation. Her government began on an aggressive campaign to privatize its national industries and apply free market solutions to the economy. The UK's air transport sector was not spared. In 1980, the UK's CAA embarked on domestic deregulation, akin to the 1978 program which Kahn's CAB galvanized.[97] With the 1980 Civil Aviation Act, the CAA also permitted competition on routes within the UK's colonies. In a famous radical move that aligned with the new momentum in the metropole, John Nott, Dell's successor, opened up the Hong Kong – London route to BA, BCal, and Cathay Pacific (CX) with no restrictions on fares, frequencies, and capacities.[98] Nott recognized from the American

[97] George K. Yarrow, "Airline Deregulation and Privitization in the UK," Economic and Social Research Institute: 57, http://www.esri.go.jp/jp/archive/bun/bun150/bun143c.pdf. See also, Civil Aviation Act (1980).
[98] Adam Thomson, *High Risk: The politics of the* Air, (London: Sidgwick & Jackson, 1990), 378.

experience that enhanced access to more aviation markets would be conducive to both the airliners and consumers. Although Thatcher's government was mostly Eurosceptic, Nott knew that a more competitive aviation skyscape globally could only be heralded with the EEC's revised stance on Rome – and sought to influence the EEC towards liberal skies.

On the other hand, the Dutch government was also showing signs of energetically embracing competition in the aviation sector. After all, the Dutch was critical of the UK and US Bermuda renegotiations in 1978. For its show of support, it was the first country to sign a new generation of bilateral arrangements with the US that allowed for flexible capacities and pricings on designated city pairs. Nott knew that the CAA could count on its Dutch counterparts when pursuing its new aviation policy in Europe. In 1984, the UK signed an agreement with the Netherlands, which was similar in nature to the 1978 US-Dutch deal. The Dutch government was also actively reducing its stake in its flag carrier, KLM; by 1985, its investment constituted less than 58% of the company.[99] Alan Dobson explained: "Unlike the other EEC member countries, the UK and Netherlands were the most receptive to the idea of liberalization. Both countries had developed their main international airports as gateways to and from Europe and they wanted better access to foreign passenger markets."[100]It was in this spirit that the Dutch and British became the de facto advocates of aviation deregulation within the community, and they were inclined to strategically leverage their political positions within EEC institutions to steer community-wide changes.[101]

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[99] Martin Staniland, *Government birds: air transport and the state in Western Europe,* (Lanham, Md.:Rowman & Littlefield Publishers, 2003), 224.
[100] Dobson, 28-30.
[101] Wayne Sandholtz and Alec Stone Sweet, *European integration and supranational governance.* (Oxford: Oxford University Press, 1998), 177-178.

In 1982, Piet Dankert, who had been elected President of the European Parliament in January the same year, represented the Netherlands' interest in transport liberalization. Once in office, he took action to tackle the missing CPT. As he wrote to the Council of the European Communities on 21 September 1982:

> I have the honour to inform you that the European Parliament...(has) set in motion the procedure against the Council under Article 175 of the Treaty establishing the European Economic Community, as the Council has, in breach of the Treaty, failed to determine...the framework of a common transport policy within which the objectives of the Treaty may be pursued.[102]

Despite pressures on the various institutions of the EEC, there still was a lack of progress on the CTP. Before leaving office in 1984, Dankert brought the missing CTP matter to the ECJ. After all, there was no stronger avenue than the EEC's enforcement channels to create community-wide changes.

The ECJ came to conclude in May 1985 that the Council had failed to ensure the freedom to provide services and eliminate discrimination in the sphere of international transport.[103] A month after the ECJ decision, the EEC heads of states agreed in their Milan summit to establish a free market in the sphere of transportation as part of the integration process. The Single European Act (SEA) was beginning to taking root here. The matter of common market principles for transport was followed up with the European Council meeting three months later, where the Council agreed to the abolition

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[102] Qtd. in "Judgment of the Court", European Parliament v Council of the European Communities (1985), 1559. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61983CJ0013:EN:PDF

[103] Ibid, "Judgment of the Court", European Parliament v Council of the European Communities (1985), 1603.

of competitive restrictions.[104] A Common Transport Policy was in essence being built into the SEA. Moreover, the Nouvelles Frontieres ruling meant that the European community could no longer deny Rome's legitimacy in the air transport space.

The twin Dutch and British presidencies of the Council of the European Union in 1985 ensured that transport would be set in the SEA's common market agenda, and air transportation would be included in the policy-making. Finally, Lord Arthur Cockfield, who was a fierce advocate for reform in the UK's CAA and for Europe's common market rules in civil aviation was appointed the internal commissioner of the Jacques Delors Commission in 1985. He was a major driving force of Europe's market integration, and was responsible for making sure that the SEA would apply to air transport.[105] With the pieces in place, it was only a matter of time before the airline industry was deregulated in favor of a competitive single aviation market.

V. Singularity: Creating and Leveraging The Common Aviation Market for the EU-US Open Skies Agreement

In many ways, the 1986 Single European Act was the final and most important catalyst that opened up the possibilities of a single aviation market in which Rome's competition rules would apply. The SEA articulated that transportation was fundamental to the EEC integration process, and it embraced air transport as part of the political and economic re-structuring of a new EEC community. In essence, it was an evolution and

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[104] Charles McKay, "The common transport policy of the EEC", *Intereconomics* 22, no.6 (1987): 290-296, http://dx.doi.org/10.1007/BF02933171 (accessed August 1, 2013).

[105] Eppink, Derk-Jan; Ian Connerty (translator) (2007). *Life of a European Mandarin: Inside the Commission*, (Tielt, Belgium: Lannoo, 2007), 20–7, 31

application of the original Rome Treaty to community transport politics. As such, the enhanced access to more passenger markets that the UK and the Netherlands had hoped for was in their hands. Competition was coming to town, and it was fairly difficult for community members to challenge the changing landscape since it was an institutional directive. Against vast opposition from member states who clearly sought to protect their controlling interests in their own flag carriers, the UK and the Netherlands had astutely relied on supranational authority and structures, international economic pressure, and the right opportune moments to encourage the deregulation momentum along.

From 1986 to 1992, the Single European Aviation Market (SEAM) was achieved with three liberalization packages under the SEA. The EEC took consideration of the 2nd Civil Aviation Memorandum to execute much of the deregulation process. According to the Memorandum, the Transport Commission of the EC had asserted that there were growing incompatibilities with Rome and provided recommendations for creating the SEAM with competitive rules.[106] It also noted that while the US deregulation experience introduced a larger degree of consumer choice and pushed down airfares rather considerably, an "evolutionary" approach must be adopted for Europe.[107] This caveat was sensible, since a shock therapy deregulation program modeled after the US case would have destabilized the disparate and uneven air transport markets across Europe. The economic fall-out could have been devastating.

With the First Package in 1986, member states could eschew IATA-packaged tariffs and were able to approve discount fares between routes as long as "they (were)

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[106] Commission of The European Communities, *Civil Aviation Memorandum No 2: Progress towards the development of a Community air transport policy*, (15 March 1984), 17. (Henceafter known as Memorandum II). http://aei.pitt.edu/5374/1/5374.pdf

[107] Memorandum II, 27.

reasonably related to the long-term fully allocated costs" of the carrier and not less than 45% of the full economy fare.[108] The traditional 50-50 traffic and revenue sharing were no longer obligatory. New entrants were able to enter the market.[109] Furthermore, single designation rule was demolished, allowing a country to permit as many airlines as it desired on any city pairs. In order to prevent cartels from forming externally and ensure fair play among the carriers, the EEC was also sage to ensure that computer reservations systems (CRS) and airport slot allocation rules would be neutral and fairly applied across national airlines – with no one single country able to dominate and control the above mechanisms.[110]

Following in the ethos of the First Package where liberalization was pursued with caution, the Second Package in 1990 introduced fifth freedom rights for member states, as long as it remained less than 50% of a carrier's overall route offerings and that third and fourth freedom rights already existed. Discounted fares without requiring approval were permitted under the stipulation that they were not less than 30% of the full economy fare. However, the Commission stopped short of full cabotage rights, the privilege to operate between two points within a member state.

It was only with the third phase of liberalization in 1992 that the aviation market actually came together and "a substantially liberalised internal Community market was achieved."[111] Key features of Third Liberalization Package included a free pricing regime with no additional stipulations for discounted fares and "ex post double disapproval" for flexible fares; open market access – the right to fly between any two points in different

[108] EEC, Council Directive 87/601.
[109] EEC, Council Decision 87/602.
[110] EEC, Commission Regulation 2671188.
[111] Louis Butcher, "Aviation: European liberalisation, 1986-2002," *House of Commons Library* (13 May 2010), 5-6.

community states; and domestic cabotage only as an extension of "international" service eg. Frankfurt-Manchester-London as long as it constituted less than 50% of the available seats. [112]

Furthermore, not unlike the ruling in the French Seaman case, directives in the Third Package also indicated that national provisions in a member state's bilaterals would be dissonant with the terms of the Rome Treaty. Finally, the Third Package also transferred powers of negotiating Open Skies agreements with from member states to the EEC. With the implementation of the Third Package, the SEAM was thus complete. The Chicago Convention and the protectionist fronts that the system once afforded countries have now been irrevocably broken down in the new Open Skies paradigm within the European community. Yet, Europe's aviation market was now tied together like never before, and the implications for having a SEAM were only beginning to emerge.

While Europe was experiencing a transformation of its airline industry through the Three Liberalization Packages, the US was embarking on an aggressive re-positioning of its aviation strategy between 1992-1996. When President Bill Clinton came into office, he assembled a team of strategic traders who sought to open up markets previously closed to the US. The international cargo and passenger aviation markets were two of the most fundamental and important ones targeted for reform. In the next five years, Clinton's US Secretary of Transportation, Frederico Pena, led the Department of Transportation (DOT) to negotiate more competitive and liberal aviation agreements successfully with 41

[112] George Yarrow, "Airline Deregulation and Privatization in the UK," 62.

nations.[113] The motivation was to allow the US to continue to lead in the airline industry, while opening up other trade avenues with the other country. As Pena explained the US strategy:

> Every time we expand competition in international airline services, the market grows substantially, transportation for travelers and shippers improves, and commerce increases between the United States and its trading partners. Our strategy is to expand services and competition wherever possible. Our challenge is to provide the opportunity for U.S. airlines to develop those services in the most efficient and productive manner possible without government constraints that inhibit the full development of the aviation market.[114]

The US' chosen instrument for its new international aviation policy was the Open Skies agreement, which were designed to demolish designations, allow flexible fare pricing structures, and open up all cities short of cabotage to service. The Netherlands was the first to sign the Open Skies in 1992, and other EU countries began to follow suit, not desiring to lose out on a piece of the transatlantic pie. As Kenneth Button pointed out, "The US effectively developed and spread its Open Skies strategies by stimulating beggar-thy-neighbor policies in Europe."[115]

Nevertheless, the new-generation Open Skies agreement retained restrictions on national provisions, which stipulated that airlines operating to the US had to be owned

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[113] Randolph E. Schmid, "Pena Moves to Energy Post," The Washington Post, http://www.washingtonpost.com/wp-srv/national/longterm/inaug/players/pena.htm (accessed August 1, 2013).
[114] Frederico Pena, "U.S. is fighting for open skies" Journal of Commerce, April 16, 1996 http://www.usembassy-israel.org.il/publish/press/trade/archive/april/bk1_4-18.htm
[115] Kenneth Button, "The Impact of US-EU "Open Skies" Agreement on Airline Market Structures and Airline Networks", *Journal of Air Transport Management* 15, no. 2 (2009), 62.

substantially by the signatory country. This was in contradiction of the SEAM rules. The signatory EU member states of the individual Open Skies agreements had technically disallowed the other member states from participating. On 5 December 2002, the ECJ ruled that the Open Skies nations Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany had contravened community rules. The decision, which was predicated on the clause on the ownership and control of airlines, found that the United States had, in principle, "under an obligation to grant the rights provided for in the agreements to carriers controlled by the Member State with which it has concluded the agreement and (was) entitled to refuse those rights to carriers controlled by other Member States which are established in that Member State." [116]

However, this would have constituted a case of discrimination by excluding air carriers of other member states from the benefit of national treatment in the host member state.[117] The ECJ decision was clear in stating that the national ownership and control provisions in the US-member state bilaterals violated a central treaty principle of freedom of establishment of corporations, in that they provide for the designation only of airlines subject to the ownership and control of the signatory state or its nationals. According to the right of establishment rules in the SEAM, the signatory states essentially denied the

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[116]European Court of Justice, Press & Information Division. "PRESS RELEASE No 89/02: Judgments in Cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98/ *Commission* v *United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany. http://curia.europa.eu/en/actu/communiques/cp02/aff/cp0289en.htm*

[117] Ibid.

right of airlines of the other 14 Member States to receive national treatment at their hands.[118]

In addition, the shadow of Nouvelles Frontieres case continued to hang over the ECJ decision here. Although the Chicago Convention technigcally protected a country's right to negotiate its own bilaterals, the ECJ ruled in 1985 that the EEC rules could take precedence. Furthermore, since the Third Package had allowed the EEC to negotiate on behalf of the member states in Open Skies-type agreements, the solution was to allow the EU to secure an Open Skies policy with the US as a whole. Furthermore, what facilitated the momentum was that the airliners on both sides of the Atlantic were on board. More specifically, the Association of European Airlines (AEA) had proposed a Transatlantic Common Aviation Area (TCAA) in 1995 and it invariably had an impact on the psychology of transatlantic deregulation on the EU policymakers.[119] The AEA believed that the institution of the EU and the SEAM would be instrumental in securing the TCAA.

On the other hand, the US was keen on using the US-EU deal to gain access to markets unavailable to them and free up US landing restrictions at the coveted London Heathrow airport.[120] The support for the US-EU arrangement was now only subject to negotiations. The negotiations came and went. The US-EU Open Skies talks were concluded and signed in 2007 and implemented in stages between 2008 and 2010. The agreement was essentially an expanded version of singular Open Skies agreements the

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[118] Armand de Maestral, "The Consequences of the European Court of Justice's 'Open Skies' Decisions", *Business Briefings: Aviation Strategies Challenges* & Opportunities of liberalization. http://www.touchbriefings.com/pdf/12/avia031_p_mestral.pdf

[119] Association of European Airlines, "Open Skies: the EU□US Air Transport Agreement," 1-3. http://files.aea.be/News/News020408.pdf

[120] GAO, Transatlantic aviation: Effects of Easing Restrictions on U.S.-European Markets, (Washington D.C.: U.S. Government Accountability Office, 2004), http://www.gao.gov/new.items/d04835.pdf.

US had with individual member states, except that it now applied to the entire EU community. The rules of competition were now in place between the two biggest aviation markets in the world.

After more than half a century following Chicago, the heavens were now free and open within and between the two communities. The process took a great deal of political and economic maneuvering, and the European institutions certainly encouraged and facilitated the deregulation programs in the community. The advocates were resourceful and they took advantage of the geopolitical infrastructures and supranational power to spur on their deregulation programs. Nevertheless, the liberalization story did not just end here with the US-EU Open Skies. The deregulation momentum continued to spread across the world, except for very different reasons and in very different ways.

Chapter 3

ASEAN: Coming Together in the Skies

I. The Changing Skyscape Globally

The emergence of the US-EU Open Skies agreement marked an unprecedented liberal aviation regime that spanned an array of nations across two continents. Since the inception of the Chicago system, countries were inclined only to sign exclusive bilaterals that covered two countries. When the SEAM was finally formed in the EU after the 1992 Third Liberalization Package, it essentially threw the Chicago system on its head. What the world had understood as sovereignty of the skies – "Cujus est solum, eius est usque ad coelom et ad infernos" – buckled away to multilateral freedoms of the heavens within the EU community. The US-EU Open Skies agreement took the SEAM one step further to demolish national lines across two separate markets, in favor of creating a competitive skyscape globally. The traditional mercantilist system that allowed individual countries to protect their national carriers for was in the process of being wiped away.

Nevertheless, while US and EU traffic only accounted for 40% of the global aviation market, the Open Skies campaign which began with Clinton's administration invariably had an impact on what the rest of the world thought about deregulating their aviation sector. Australia and New Zealand signed their versions of the Single Aviation Market and Open Skies agreements in 1996 and 2000 respectively.[121] Singapore,

[121] B: New Zealand Minister of Foreign Affairs and Trade, "Memorandum of Understanding on Open Skies between Australia and New Zealand" (2000), http://www.mfat.govt.nz/downloads/foreign-

Malaysia, and Brunei signed their Open Skies agreements with the US in 1997, and other countries in South-East Asia like Thailand and Philippines followed suit soon after.[122] Even then, for the next decade, the Association of South East Asian Nations (ASEAN) as a community could not yet adjust to the new Open Skies paradigm, in spite of existing in a Free Trade Area (FTA) environment. It was only in 2007 that a provisional ASEAN Open Skies treaty was signed, but it still lacked the full cabotage rights and national ownership provision waivers that the EU SEAM members enjoyed.

The reluctance of ASEAN member states to deregulate their airline industries as a community was not so different from their EU counterparts: the ASEAN governments owned substantial stakes in their national carriers since their inceptions. Furthermore, individual members also had their peculiar concerns about diplomatic and trade issues within and without the region that threw uncertainty to plans for a single aviation market. Not least of all, the ASEAN community operated within a passive-aggressive political space, with its members often preferring to engage with each other through unique non-interference and non-confrontational modes dubbed "the ASEAN way". Achieving Open Skies would need to be the product of consensus and compromise at the supranational level, and this would prove challenging for the community. With the aim of drawing out some similarities with the EU SEAM, US-EU, and US deregulation cases, the final chapter of our airline liberalization narrative explores the motivations and problems of

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relations/australia/mou-open-skies-australia.pdf. See also, Ministers representing the Governments of Australia and New Zealand, November 20, 2000, Memorandum of Understanding on Open Skies Between Australia and New Zealand, New Zealand Ministry of Foreign Affairs and Trade, http://www.mfat.govt.nz/downloads/foreign-relations/australia/mou-open-skies-australia.pdf.

[122] US Department of State, "Open Skies Partners," August 19, 2013, Bureau of Economic and Business Affairs, http://www.state.gov/e/eb/rls/othr/ata/114805.htm, (accessed August 19, 2013).
B: US Department of State, "Open Skies Partners." August 19, 2013. Bureau of Economic and Business Affairs. http://www.state.gov/e/eb/rls/othr/ata/114805.htm, (accessed August 19, 2013).

the ASEAN member states and their complex climb towards multilateral Open Skies in the region.

II. Growing Markets: The Undeniable Deregulation Momentum in Asia-Pacific

The ASEAN community had two advantages in its pursuit of an Open Skies policy within the region. Firstly, it could build upon the lessons that history brought to the table. Benefits that the authorities saw with the US and EU cases were instrumental in driving the Open Skies momentum. For one, the no-frills airline business models, which became popular after deregulation in the West, were becoming everyday realities in the region from 2000. To the ASEAN member states, the growing prevalence of Low-Cost Carriers (LCCs) served to underscore the importance and need for creating wider and more liberal airline access in the region to support the flourishing ASEAN and Asia-Pacific markets.

Between 2000 and 2004, the ASEAN region saw a booming LCC skyscape, at once the product of deregulated domestic markets, relaxed rules for forming airlines, and Open Skies-type bilaterals signed between ASEAN member states. Thailand was first of the ASEAN community to deregulate its domestic market in 2000, allowing private low-cost operators to compete with its national airline, Thai Airways (TG), on interior routes. Indonesia followed suit the same year; after the policy was passed, the country saw 12

new LCCs spring up in the domestic sphere.[123] In 2003, confronted with pressures from the burgeoning regional LCC market, Singapore established an Air Traffic Rights Committee (ATRC) to re-allocate some of the government's international air traffic rights to newly formed LCCs Valuair (VF) and Tigerair (TR) in a bid to jumpstart its own LCC industry in ASEAN.[124]

Since Singapore's aviation market was exclusively international, its airline liberalization interests could only be served by creating external deregulated regimes. Singapore signed an Open Skies agreement with Thailand and Brunei in 2004, allowing an unprecedented degree of market access for the signatory parties.[125] The resulting growth of LCCs in Asia was spectacular. As Airbus CEO, John Leahy, reported with enthusiasm at the 2004 Singapore Airshow:

> Last year Asian budget carriers flew an average 1,800 kilometres (1,118 miles) per flight to 576 airports, up from 2001 when they averaged 700 kilometres to 48 airports... If you put that together, you can see a growth rate compounding of almost 40 percent a year.[126]

Secondly ASEAN economy presented remarkable potential for air traffic expansion. In 2012, the International Monetary Fund indicated that other than China, the combined

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[123] Airline Business, "Deregulation sparks Thai start-ups," *Flight Global*, (October 1, 2000,) http://www.flightglobal.com/news/articles/deregulation-sparks-thai-start-ups--121006/.
[124] AFP and Bloomberg, "Singapore gives air-traffic rights," *Taipei* Times, October 4, 2003, http://www.taipeitimes.com/News/biz/archives/2003/10/04/2003070372.
[125] Siew Yean Tham, "ASEAN Open Skies and the Implications for Airport Development Strategy in Malaysia," Working Paper 119, ADB Institute, (October 2008), 5, http://www.adbi.org/working-paper/2008/11/04/2736.asean.open.skies.airport.development.strategy.malaysia/.
[126] Martin Abbugao, "AFP: Open skies, budget travel: Asian airlines soar," *Google News*, (February 6, 2010), http://www.google.com/hostednews/afp/article/ALeqM5gTtqtDG6RZEn6TLPibi8nhR4TUFg.

ASEAN region represented the highest annual GDP growth projections at 7.3-7.9%.[127] As the community became wealthier and more populous, air travel demand for business and leisure would continue to swell. The implications for both the traditional and LCC airline industries were clear. Moreover, this LCC growth area became even more compelling with the inclusion of the North and South Asian markets. As Eric Bellman predicted in a 2011 Wall Street Journal article,

> The battle for frequent frugal fliers in Asia—home to more than four billion people and the world's fastest-growing economies—is expected to keep rates low and traffic growth high in the region and possibly decide the leading global airlines of the future. In the five years to 2014, the number of people flying in Asia will rise by 360 million to one billion.[128]

Accordingly, wider and more liberal access to the ASEAN's aviation markets was a much sought-after commodity that clearly aligned with the region's explosive growth projections. While individual member states in ASEAN continued to negotiate bilaterals to stimulate and/or keep up with further growth, regional deregulation appeared to be the logical progression. Nevertheless, the way forward was a challenging one, with its fair share of political and economic difficulties.

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[127] "Summary of World Output," table, World Economic Outlook 2012, *International Monetary Fund*, April 2012, Table A1, 189-90, http://www.imf.org/external/pubs/ft/weo/2012/01/pdf/tables.pdf.
[128] Eric Bellman, "Competition Takes Off in Asia's Budget-Airline Market," *The Wall Street Journal,* (July 22, 2011), http://online.wsj.com/news/articles/SB10001424052702304567604576453651762471330.

III. Consensus and Compromises: Inside The "ASEAN Way"

While ASEAN and the EU have similar beginnings as economic and trade bodies, ASEAN has been less focused on political integration. Traditionally, the notion of a Single ASEAN was a problematic one. Member states preferred to maintain their own sovereignty to seeking a community-oriented identity. "The principles of the independence, sovereignty, equality, territorial integrity, non-interference, and national identity of all nations"[129] was thus the blueprint for engagement in the region, but this political process has often resulted in a degree of inaction or ineffective policy action. Consequently, scholars and diplomats have readily, and sometimes, derisively dubbed this diplomatic process as the "ASEAN way".

In defining the "ASEAN Way", Nikolas Busse outlined the key norms in the ASEAN consultative process: "They include the principle of seeking agreement and harmony, the principle of sensitivity, politeness, non-confrontation and agreeability, the principle of quiet, private and elitist diplomacy versus public washing of dirty linen, and the principle of being non-Cartesian, non-legalistic."[130] Accordingly, ASEAN lacked the supranational oversight and dispute settlement bodies that the EEC had established in its inception. Moreover, many of the agreements within ASEAN provided a technical opt-out clause for members, creating leeway to the community policy. The ASEAN system was designed to facilitate collaboration and consensus building, not confrontation or

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[129] ASEAN, Bali Declaration on ASEAN Community in a Global Community of Nations, (17 November 2011), 3, http://www.preventionweb.net/files/23664_baliconcordiii28readyforsignature29.pdf.
[130] Nikolas Busse, "Constructivism and Southeast Asian Security," *The Pacific Review* 12, No.1 (1999): 47-55. 47-8.

enforcement.

Furthermore, the community was mostly focused on creating and maintaing economic ties within the region. Naturally, ASEAN was inclined to avoid political questions, which were unfortunately in the nature of air service bilaterals. ASEAN's most notable economic policies related to trade, and they revolved around the creation of the ASEAN Free Trade Area (AFTA), which was implemented in the form of a Common Effective Preferential Tariff Scheme (CEPT) in 1992.[131] Moreover, when it came to trade dispute settlements, ASEAN would defer to the procedures and institutions of the World Trade Organization (WTO), in which only Myanmar was not a member as of 2013.[132] In its essence, the "ASEAN Way" was a diplomatic status quo that entailed not stepping on another's toes, and it invariably came from a recognition that ASEAN economic and political structures were extremely heterogeneous. Member states featured different stages of economic development, membership status at WTO, dependence on imports/exports, and economic commitments to other trade bodies. Moreover, the investment regimes and attitudes towards government transparency were also divergent. This uneven landscape and rules for engagement made for an intricate political alliance in ASEAN.

When it came to aviation markets, the airlines and airports were structured very differently owing to the geographical makeups. For example, the city-state of Singapore served only international destinations through Changi, while its counterparts had varying

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[131] ASEAN, Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area, (28 January 2002), http://wits.worldbank.org/GPTAD/PDF/archive/ASEAN.pdf.
[132] As of 2013, only Myanmar is not a member. Vietnam ascended in 2007, and Myanmar in 2013. J. Michael Finger, *GATT's Influence on regional arrangements*, (Cambridge: Cambridge University Press, 1993), 141-142, http://www.unige.ch/ses/ecopo/demelo/Cdrom/RIA/Readings/dm_ch5.pdf.

levels of domestic airline networks. It was unsurprising that member states thought that multilateral Open Skies would prove problematic when they were exchanging all their interior points for one single destination in a country such as Singapore. The idea of Open Skies had its potential stable of winners and losers, and the member states sought to execute their negotiations in the "ASEAN Way" for what they thought to be their best interests.

IV. Contractual Consensus: Seeking an ASEAN Single Aviation Market

On December 1995 at the Fifth Summit in Bangkok, ASEAN Leaders made the unprecedented move in deciding to include the development of an Open Skies Policy as an area of cooperation in the Plan of Action for Transport and Communications slated for 1994-1996. However, they were uncertain what this liberal aviation regime could mean for them and they called for a more detailed study into the "Development of Multimodal Transport and Trade Facilitation and Improvement of Air Space Management in ASEAN."[133]

It was the first time that ASEAN was concerned about aviation in the community. For the most part, this was a product of the 1992 Singapore Declaration, which was the first commitment of its kind in ASEAN to "further enhance regional cooperation to

[133] ASEAN, Plan of Action for Transport and Communications, (15 December 1995), http://www.asean.org/communities/asean-economic-community/item/asean-plan-of-action-in-transport-and-communications-1994-1996.

provide safe, efficient and innovative transportation."[134] Peter Forsyth pointed out that having more transport policy links in ASEAN was "in line with the goal of achieving greater economic integration"[135] and this sentiment emerged as the CEPT and the AFTA came into effect in 1992. The Plan of Action was followed in 1996 by a high-level discussion in Bali, Indonesia with the ASEAN Transport Ministers (ATM). At the Bali meeting, the ATMs agreed to a conceivable action plan and pursue the development of a competitive air services policy, which they saw as a potential "gradual step towards an Open Sky Policy in ASEAN."[136] Even then, ASEAN members were aware of the imperatives of transport as part of their own nation-building apparatus. They sought "to promote interconnectivity and interoperability of national networks and access, taking particular account of the need to link islands, land locked, and peripheral regions with the national and global economies."[137] A mechanism to coordinate and supervise cooperation projects and activities in the transport sector was high on the list for the community.

At the 1997 ASEAN summit, the ATMs made a commitment that to "further accelerate the growth of business and foreign investments, tourism and trade… a regional competitive environment in international air transport within ASEAN shall be developed and promoted, with no restrictions in frequency, capacity and aircraft type for point-to-

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[134] Qtd. in Ibid.
[135] Peter Forsyth, John King, Cherry Lyn Rodolfo, and Keith Trace, *Preparing ASEAN For Open Sky: AADCP Regional Economic Policy Support Facility research report 02/008: final report*, (Hawthorn: Regional Economic Policy Support Facility, 2004): 130-1.
[136] Ibid, 132.
[137] ASEAN, Joint Press Release For The First ASEAN Transport Ministers Meeting Bali, (17-19 March 1996). http://www.asean.org/communities/asean-economic-community/item/ministerial-understanding-on-asean-cooperation-in-transportation

point services."[138] The ATMs cautioned that the competitive regime must also be based on the progressive, orderly and safeguarded change in international air transport regulations on the basis of fair and equal opportunity for all member countries.[139] With this notion in mind, the ATMs were astute to take a similar "evolutionary" approach as the EU had to liberalization. However, the policy did not take shape immediately.

While the intention was to pursue regional Open Skies, it was not until the 2001 ATM meeting held in Kuala Lumpur, Malaysia, that solidified ASEAN's aspirations for Open Skies. Part of the delay was the 1997 Asian Financial Crisis, which threw plans off for the regional Open Skies arrangement. By the early 2000s, the economic environment had transformed tremendously. For many of the member states, national industries were privatized. Deregulation of the aviation markets had been implemented or was already on the horizons. As part of extending the AFTA into the skies at the Kuala Lumpur meeting, the ATMs endorsed "the offers in the liberalization of air and maritime transport sectors for incorporation into the Protocol to Implement under the ASEAN Framework Agreement on Services (AFAS)."[140]

Two years later at Yangon, the ATMs came together to produce a Roadmap for Integration of ASEAN (RIA) for ASEAN Competitive Air Services Policy."[141] As part of the roadmap, ASEAN adopted the Multilateral Agreement on Air Services (MAAS) in

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[138] ASEAN, Integrated Implementation Programme for the ASEAN Plan of Action in Transport and Communications, (1997). http://www.asean.org/news/item/integrated-implementation-programme-for-the-asean-plan-of-action-in-transport-and-communications-1997.

[139] Ibid.

[140] ASEAN, *Joint Press Statement Seventh ASEAN Transport Ministers Meeting* (25-26 October 2001), http://www.asean.org/news/item/joint-press-statement-seventh-asean-transport-ministers-meeting-25-26-october-2001-kuala-lumpur-malaysia.

[141] ASEAN, *ASEAN Transport Action Plan 2005-2010*, http://www.asean.org/news/item/asean-transport-action-plan-2005-2010, accessed August 16, 2013.

2009 – and in the following year, the Multilateral Agreement on the Full Liberalization of Passenger Air Services (MALFPS). The first agreement granted third and fourth freedom rights to ASEAN carriers into the region's capital cities, and it was signed and ratified by all member states except Indonesia and the Philippines. Indonesia's and the Philippines' opt-out of the MALFPS meant that their capitals, Jakarta and Manila, remained excluded from the liberalizing movement.

The latter agreement, the MALFPS, which was designed to provide third and fourth freedom access to other cities, was signed and ratified the same year, with target for implementation in 2015. This MALFPS saw even fewer adherents – Indonesia, Brunei, Laos and Cambodia have elected not to accept it. The Philippines, on the other hand, accepted this agreement to open up access to its secondary cities, even while keeping Manila restricted.[142] Both agreements stopped short of cabotage rights, which would have allowed carriers to serve two separate markets outside their country of registration.[143]

At the ASEAN Economic Symposium held on 12 December 2012, Professor Alan Tan expressed: "When the media refers to (ASEAN) Open Skies, it is misleading… Seventh Freedom rights and Cabotage are not even on the table!"[144] Nevertheless, the state of regional Open Skies has come a long way since the ASEAN governments took the first steps in deregulating their own internal markets and contemplating the notion of a single aviation market. With the ratification of the multilateral agreements, the ATMs

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[142] CAPA, "ASEAN's Single Aviation Market: Many Miles To Go," (*CAPA:* March 13, 2013). http://centreforaviation.com/analysis/aseans-single-aviation-market-many-miles-to-go-100831.
[143] ASEAN, ASEAN Multilateral Agreement on Air Services, (May 20 2009), 13-4, http://cil.nus.edu.sg/rp/pdf/2009%20ASEAN%20Multilateral%20Agreement%20on%20Air%20Services-pdf.pdf.
[144] Qtd. in ASEAN, *ASEAN Economic Symposium*, December 12 2012. http://www.youtube.com/watch?v=cko970UjpcM.

adopted the Implementation Framework of the Single Aviation Market in 2011, and slated 2015 and 2020 for execution of the MAAS and MALFPS.

On the supranational level, ASEAN has achieved a partial Single Aviation Market (SAM), and member states have essentially brokered the rights to the market that could support the region's growth. This was done through consensus-building and opt-out processes that would still allow the agreement to take form. It was a show of the "ASEAN way" at work. Even then, the largest aviation market (Indonesia) was still out of the bounds to the community. The single market that ASEAN had envisioned back in 1995 had not been attained in practice.

V. The Practical Compromise: Partial SAM, Joint Ventures, and Seeking Other Liberal Aviation Markets

During the consensus-building process between 2003 and 2005 in ASEAN, Indonesia began to back away from the notion of liberalization. They went as far as to block foreign LCCs from accessing their Surabaya, Denpasar, Jakarta, and Medan markets.[145] A large part of their reluctance for a more liberal aviation regime came from a desire to protect their national carriers and their domestic markets. As Alan Tan offered an example,

> Singapore is seen as offering only one point...On the other hand, a country like Indonesia has 250 million people and tens, if not hundreds, of cities that foreign

[145] Scott Rochfort, "Jakarta slams door on Jetstar," *Sydney Morning Herald*, (March 26, 2005), http://www.smh.com.au/news/Business/Jakarta-slams-door-on-Jetstar/2005/03/25/1111692625053.html.

> airlines can fly into. They do not therefore see the logic of exchanging all points in Indonesia for all points in Singapore."[146]

Despite having a deregulated internal market and a robust LCC landscape, Indonesia was fearful that the proliferation of foreign LCCs under an ASEAN Open Skies regime would be inimical to its national interest. In 2005, Indonesian Transport Minister, M Radjasa, had expressed that the ASEAN Open Skies policy could "cause the collapse of a number of Indonesian carriers, resulting in substantial financial losses to the Country."[147]

The Philippines government put forth a similar argument, but they were also equally concerned about the possibility of unfair competition resulting from state aid to national carriers. It felt that both the ASEAN MASS and MALFPS did not do enough to address this potential problem. As Rey Gamboa explained the Philippines' position,

> Care must be taken to keep relationships with their own airlines on a transparent basis and to avoid granting subsidies to their national flag carriers, thereby creating an uneven playing field.[148]

Furthermore, major Filipino airports also suffered similar problems as their Indonesian counterparts: congestion. In 2013, Indonesia's Jakarta airport was already operating at twice its design capacity. Despite having undergone expansion and renovations, the airport will still exceed capacity again in 2015.[149]

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[146] Alan Tan, Qtd. in Karamjit Kaur, "Indonesia Throws a Wrench in ASEAN's Open-skies Policy," *China Post*, (May 9, 2010), http://www.chinapost.com.tw/commentary/the-china-post/special-to-the-chinapost/2010/05/09/255723/Indonesia-throws.htm.

[147] Qtd. in Bali Discover News, "Indonesia Says 'No' to Open Skies with Singapore," *Bali Discover* Tours, (May 18, 2005), http://www.balidiscovery.com/messages/message.asp?Id=2559.

[148] Rey Gamboa, "Are we ready for ASEAN open skies?" *The Philippine Star*, May 16, 2011, http://www.philstar.com/business/686152/are-we-ready-asean-open-skies.

[149] http://www.thejakartaglobe.com/blogs/indonesias-stance-towards-asean-open-skies/.

Nevertheless, since both countries still desired a share of the ASEAN aviation pie, they were willing to compromise on a partial Open Skies policy. In 2012, the Indonesian Ministry of Transport's Directorate General agreed to open up 29 international gateways progressively, beginning with its four major cities of Jakarta, Denpasar, Surabaya, and Medan airports in 2015, before lifting restrictions on access to its other 25 international points. Such a strategy was designed to protect the country's less popular domestic cities from competition so that current operators stood at better chance of survival on them. The Philippines went the other direction, agreeing to open up its secondary airports to ease up congestion at the main Manila airport, before contemplating a full-fledged liberal skies arrangement within ASEAN.[150] This, in essence, resulted in a partial single aviation market.

On the other hand, traditional and LCC operators from outside of Indonesia and the Philippines who sought to procure access to new markets continued to have options for establishing joint ventures, which would have allowed them to circumvent substantial ownership and national provision requirements. For example, when Malaysia-based Air Asia created Thai Air Asia as a joint venture with Thai ShinCorp in 2004, it effectively received the bilateral rights that Thailand had. This was a loophole that member states were often willing to offer the foreign carriers; it was an investment in the country and it benefited the country's domestic LCC industry. Other notable cases include, Singapore's ValuAir, which was co-owned by Australia's Qantas, which had invested about S$50mn for 49.9% stake in the airline in 2003.[151]

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[150] CAPA, "ASEAN's Single Aviation Market: Many Miles To Go", (CAPA: March 13, 2013). http://centreforaviation.com/analysis/aseans-single-aviation-market-many-miles-to-go-100831.

[151] Mahani Zainal-Abidin, Wan Khatina Wan Mohd Nawawi, and Sazalina Kamaruddin, *Strategic Directions for ASEAN Airlines in a Globalizaing World: Ownership Rules and Investment Issues: AADCP*

Finally, ASEAN also understood that although Indonesia constituted a massive market, it was not the only viable aviation market that members could tackle. At its initial stages, advocates of the ASEAN SAM had envisioned that the Open Skies policy would enable the community to negotiate an Open Skies regime with a larger market like China as a trade bloc. It would certainly have imbued ASEAN with more substantial bargaining power. However, the deal could not be attained without the complete participation of all ASEAN member states.

Individually, China signed its Open Skies with Thailand in 2004, and it was looking to expand its access to the rest of the ASEAN economy. China was not a member of ASEAN, but it was a dialogue partner and it was in a prime position to negotiate for access. On the ASEAN side, the community foresaw that not all member states would be on board with the proposal of regional Open Skies. It had to turn its eye on other valuable markets. Since ASEAN had been developing a FTA with its dialogue partner since 2002, it took the opportunity to extend the FTA with China to the heavens between them. In particular, Singapore, Brunei, and Thailand, on account of their 2004 multilateral skies agreement between themselves led the charge. In 2010, the ASEAN-China Open Skies policy was signed and ratified, scheduled for implementation in 2015.[152] Similar to the intra-ASEAN agreement, there was an opt-out mechanism for member states that saw no benefits of being part of the agreement. Naturally, Indonesia and the Philippines elected

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Regional Economic Policy Support Facility research report 04/008: Revised final report, (Hawthorn: Regional Economic Policy Support Facility, 2005): 16-7. http://www.aadcp2.org/uploads/user/6/PDF/REPSF/04-008-FinalOwnership.pdf.

[152] ASEAN-China Air Transport Agreement, http://www.asean.org/archive/transport/Air%20Transport%20Agreement%20between%20ASEAN+China.pdf.

to steer clear of the policy once again – and they have showed little to no signs of relenting.

The "ASEAN Way" proved to be an effective negotiation process that certainly helped the community gain the SAM that it had sought. Although the liberal aviation regime was an extension of the community's AFTA agreement, it was still viable without the full participation of the ASEAN members. Securing Open Skies in the community was a challenging task – since not necessarily all member states were advocates for regional deregulation and a single aviation market. Due to the unique institution of the "ASEAN Way", the member states managed to draw consensus building together with more practical side-solutions for pursuing multilateral Open Skies.

Conclusion

The three cases of deregulation and liberalization in the airline industry have shown themselves to be fascinating analyses in public policy-making for the aviation sector. In the history of creating a more liberal aviation regime, countries often had to take into account the political and economic conditions of their surroundings; decisions were not made in isolation. For a period of time, the mercantilist tradition that emerged out of Chicago allowed countries to have control over their aviation infrastructure. But the changing and more connected world slowly dismantled the Chicago system, in favor of a competitive skyscape that was purportedly more consumer-friendly. Eventually, the protectionist sentiments gave way because countries came together in either community-directed initiative or a compromise to drive liberalization. The process was challenging, and how Open Skies ensued was practically a matter of creative diplomatic engagement within the EU and ASEAN region at the right opportune moments. It underscored the power relations, hegemonies, and political positions – and that there were winners and losers, some more clear than the others.

Nevertheless, we began with the US case. The US deregulation experience was not so much an economic experiment as it was a calculated response to a changing world. The Ford and Carter administrations were dealing with an economic crisis and a CAB that was very quickly falling out of favor with the public. Roosevelt's directive to the CAB to serve the "public interest" was fading away from the CAB actual policies in the 1970s; with its fair share of scandals, the CAB was also a source of embarrassment

politically. Moreover, airfares were deterring travelers from stepping on an airplane – while airlines themselves struggled with operating profitably in the face of a rapidly changing aviation environment.

For the most part, with little precedence of large-scale deregulation, its advocates needed to be ferociously brave and politically astute. Fortunately, the US liberalization story found some formidable actors in Ford, Robson, Kahn and Kennedy, spread like narrative butter across two generations of political, legal, economic power play. Not least of all, these actors were deeply concerned about consumer welfare and the development of the airline industry. In particular, Ford was intent on helping the US airline industry lead in the aviation world. Accordingly, these personalities lent considerable weight to a sage alliance that searched for and found the imperatives for deregulation, crossing party lines to create a consensus that made deregulation possible. Yet, the impact of the US deregulation program was not just confined to the country. Fares plummeted not just in the US. The new status quo was slowly aligning with Ford's vision of a US-influenced aviation skyscape.

On the other side of the Atlantic, the European advocates for deregulation were limited to the UK and the Netherlands in the early 1980s. Nevertheless, the EEC member states were certainly shaken up by the fiscal impact from the US deregulation experience when consumers were able to purchase fares on America carriers at nearly three times lower than European carriers. Even then, the mechanics for deregulation in EU emerged not so much from an economic consideration than it was a legal one, not least, coming from the ECJ itself. The most pertinent question for member states was whether the terms of Rome Treaty should and must apply to aviation. The ECJ judged that the Treaty of

Rome covered air transport, and it was as important to adhere to Rome as it was the Chicago Convention. By expanding the coverage to air transport in Article 84 of Rome, the ECJ provided a game-changer to the liberalization momentum. In addition, the UK and the Netherlands were strategically leveraging their political influence within the EEC to push deregulation through. The convergence of the changing political conditions and strong liberalization evangelists was imperative in the process.

During the liberalization process of the 1980s, the ECJ asserted that governments could not practice preferential treatment with the Third Package, which jeopardized the individual Open Skies arrangements member states would sign with the US in the 1990s. The result was the 2007 EU-US Open Skies arrangement. To the credit of the American diplomatic negotiators, they were also strategic with the European nations when it came airline liberalization. Firstly, while the US had recognized in 1978 that the Bermuda II agreement was a step in the wrong direction for competition, they were unfazed. Instead, they used Bermuda II negotiations to dismantle and transform IATA tariff coordination structures and to open up a new generation of liberal bilaterals to the EEC member states. When the SEAM was fully implemented by the end of 1993, the US was equally poised to capitalize on community rules for wider access to the EU market through the Open Skies agreements.

Accordingly, the US-EU Open Skies could not have been brokered without first waiting for and influencing the political and economic integration of the EU. The EEC institutions saw transport as a major building block of its integrated European identity and the creation of a Common Market through the 1986 Single European Act allowed the European member states to come together in a way never before. Supranational directive

effectively trumped the individual country's desire to protect its own industries. The US-EU cases essentially underscored the political, legal, and supranational frameworks in promoting liberalization and coaxing Open Skies. Furthermore, the cases highlighted how when countries like the UK, US, and the Netherlands proactively promoted deregulation, they were quintessentially advocating from an advantage and they sought to expand their aviation advantage through demolishing the protectionist bulwark.

Finally, the ASEAN case demonstrated the principles of consensus, compromise, and non-interference. The community was in many ways in favor of liberalization in the hopes of fostering business, trade, and tourism links. To an extent, economic integration was also high on the list for ASEAN. Not unlike the EU, the ASEAN member states were also aware that the US shock therapy transformation on the market would be inimical to the long-term development of its aviation industry. They were inclined to adopt roadmaps and implementation programs in its traditionally consultative-driven process. This process certainly took a longer time, but it operated within ASEAN's unofficial rules of non-confrontation and diplomacy. Even so, member states were able to compromise by turning to an opt-out mechanism, especially when they recognized that not all markets in ASEAN were created equal. Naturally, countries that would lose out were given the choice to stay out of the agreement, whereas the EU was subject to supranational control. In essence, member states employed the "ASEAN way" to carefully but decisively drive the liberalization process, turning to a more friendly and polite negotiating process which still effectively created a new liberal aviation regime and allowed member states to decide the destinies of their own airline industries.

In conclusion, the three different cases demonstrated different internal dynamics, and they shaped liberalization programs that were unique to each region. The divergent time frames afforded each of the cases growing wisdom as liberalization gained steam; ASEAN appeared to have taken the cautionary tales of the US and EU deregulation cases in its stride. Nevertheless, the power relations within and between the regions dominated the nature of negotiations. The imperatives, execution, and mechanisms of deregulation were not so much the result of moving from mercantilism to liberalism – it was the need to respond to their immediate political and economic environments. As other regions continue to liberalize their airline industries today, they might need to take a leaf from the three cases in international political economy.

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