Association of European Airlines

Speech

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2011: A Year of Many Crossroads and a year to act, not delay

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Ladies and gentlemen,

Thank you for those kind words of introduction. It is a pleasure to be here again in Washington. We have indeed witnessed remarkable developments in recent years, so it is good to see yet once again so many friends that I have known for so many years. It is wonderful that many of you that I can see here today are, thank goodness, still working in and for an aviation industry that is the same, and yet totally different to what it had been only a decade ago.

At first, I wanted to avoid quoting any individual speaker who had addressed the International Aviation Club in the past, but I will. I was particularly moved when noting John Byerly's remarks several months ago here at the IAC; I believe he spoke in October last year.

His vast experience enabled him to deliver a superb overview of past achievements of US aviation and foreign policy in transforming the shape and functioning of international aviation. Thanks to him, Jeff Shane and...here I stop quoting the names of formidable personalities, for fear of not arriving at my conclusion, thanks to the likes of John therefore, aviation has matured, and is more robust in delivering safe, affordable and competitive services sustainably than it would otherwise have been. John referred explicitly and rightly to several individuals, many of whom are in the room here today, who all contributed so much to ensuring that US aviation, but aviation in general would continue to deliver.

As evidently many other speakers, he also alluded to issues still in dire need of attention for the future. I would like to take that one step further, *without* questioning any of the past achievements.
The consolidation in the USA, the successfully concluded cross-border consolidation in Europe, as well as the now concluded second phase EU-US new generation Open Skies Plus Agreement, but also the gradually changing role of ICAO as a negotiator, lead me to believe that the more we experience change, the more we need it.

I have the honour to be the first speaker at this illustrious International Aviation Club in 2011. With that honour comes, I presume, the obligation and privilege to speak about the expectations for this coming year. I shan't disappoint you.

It was the 16th president of the United States who said that the best thing about the future is that it comes only one day at a time.

That definition of 'future' by Abraham Lincoln makes it a lot easier to make forecasts about 2011. Unfortunately for us, we cannot plan for the future one day at a time. We do not have that luxury. We are a fast-moving, dynamic, ever-changing industry that requires substantial long-term planning, from fleets to infrastructure to policy.

A dynamics, a momentum, has been created in the market that calls for new solutions, a new dimension. I suggest that 2011 will indeed be a year of cross roads. If we take the right decisions now, we will be on track for a sustainable recovery of the international aviation sector in the years to come.

If we don't, who knows. But, in my humble view, it is time to do, not delay, to act, not angst and to move ahead, not fall behind.

In the bad old days, the motto for regulators was:
If they (the airlines) move, let's tax them,
If they stop moving, let's subsidize them,
If they continue to move, let's regulate them.

Nowadays, the Future of Aviation Advisory Committee in this country, and the Aviation Platform of the EU Commission, and the Aviation Summit organised by the Belgian Presidency of the European Union a few months ago, to name but a few players, have effectively identified *competitiveness* as the key driver for our future. That is fascinating. On both sides of the Atlantic, financial issues are predominant. On both sides of the Atlantic, high level groups, committees, platforms are addressing competitiveness as an issue in need of political attention. It is fascinating, and it makes 2011 so important.

Let me turn your attention to three issues in particular. I believe that if we do not tackle them, 2011 will have been a year lost. Crossroads yes, but wrong direction.

As Ella Wheeler Wilcox, the great American poet, said:

One ship drives east, and another west
With the self same winds that blow,
'Tis the set of the sails,
And not the gales
That tell us the way to go.

So how do we set the sails? First of all, we address the need for an international level playing field, but not in the sense in which we have used or heard that term before, which was either in the context of one country against another or one region – the EU – versus another – the US. No, I am talking about a truly international, or global level playing field.

You could argue that that is important, but not really urgent. What's the big rush, you might say, with all of the other things on our aviation plates. Consolidation in the US airline sector is well underway. And cross-border consolidation within Europe is gaining momentum – remember that three groups are emerging in Europe, a German-Swiss-Austrian-British-Belgian, a Franco-Dutch, and an Anglo-Spanish. Evidently these developments will impact structures operating on the North-Atlantic; and it appears that the EU-US regulatory framework provides for necessary tools to promote safety and competitiveness in these markets.

But, as I said, my first point is not on EU-US competitiveness, it is *global* competitiveness. This is an issue square on for Europe today, and it will become an issue for the US and Canada tomorrow, and then Asia, and South America, and Oceania, and Africa. And here is why.

We, on either side of the Atlantic, are conditioned to thinking of ourselves – the US and European carriers – as pre-eminent in global aviation terms. We look forward, naturally, based on the past. And yet, both reality and perceptions are moving on, as we continue to look in the rear view mirror and believe that tomorrow will be like yesterday.

After a conference I attended recently in Munich, I spoke to the waitress in a restaurant who told me she would go on vacation to Thailand. I asked which airline she would fly on, thinking of my member airlines, of course. She replied that her first choice was "evidently" Emirates.

"Evidently"? Well, in case the news passed you by, in 2009 Emirates became the world's largest international airline, in passenger-km terms. For a large proportion of European travellers, it offers a one-stop transfer product to all the major Asian, Australasian and African destinations. And it is growing, massively. Its CEO is on record as saying that its planned fleet of 90 A380 superjumbos could be increased to 120 if stand capacity were available at its Dubai hub. And, I suspect, for the reasons that I explain in a minute, Dubai will certainly accommodate Emirates' need for yet further capacity on the ground.

Now – in case you're not aware – the United Arab Emirates has two main commercial centres, the other being Abu Dhabi, just 75 miles away. Each has its own airline with global aspirations – the Abu Dhabi carrier is Etihad, smaller than Emirates but growing more quickly.

These airlines are owned by their respective governments, and operated as an instrument of national strategy (if 'national' is the right word within this regional rivalry), and they are integrated vertically across commerce, tourism and foreign policy – as our Canadian friends have recently discovered. For them, the airlines are just a part – a tool – of this vertically-integrated economic chain.

But the phenomenon is not restricted to the United Arab Emirates. Just up the desert highway about 230 miles from Dubai and 185 miles from Abu Dhabi is the city-state of Qatar, whose airline also has global aspirations, and is – you guessed it – growing massively.

These three airlines have more wide-body seats on order than the entire US industry has in its current fleet. *[I'll pause to let you reflect on that – the total longhaul lift capability of Delta plus United plus American plus Continental plus US Airways doesn't match up to the order book of just these three Gulf airlines]*. 425 brand-new longhaul aircraft in the next five years – where will they fly? The answer, of course, has to be everywhere. Looking to the West of the Gulf hubs, we can expect further saturation of Europe, but also increased penetration of the US market. And Canada. To the East, the emerging economic superpowers of India and China are obvious candidates, but so, too, are other Asian countries – Japan, Korea, Thailand, Singapore, Malaysia, Indonesia, Vietnam, and so on. And, then there's Australia and New Zealand. And South America. You get the picture.

Here I ask: Does growth of this magnitude really make sense?

After all, the population of Dubai is just 2.3 million people, about the size of Pittsburgh and smaller than Baltimore. Qatar, at 1.4 million, is smaller than Providence, Rhode Island's metropolitan population, and Abu Dhabi, at just under 900,000, is about the size of Fresno, California or Tulsa, Oklahoma. So, again, I ask "does growth of this magnitude make sense?" I am sorry to confuse you so early after lunch, but the answer is a clear yes, and no. But, who am I kidding? This is Washington, where lawyers and lobbyists – I know that's most of you – make your living taking both sides or moving between them, so "yes and no" makes perfect sense in this city and this crowd.

The "Yes" answer is that, yes, it does make sense even for a region with, in global terms, a limited population size, to invest heavily into infrastructure, if the investments generate a sufficient return. And evidently, the Emirates of the Gulf region are satisfied with the value-added created by their investments or believe that in the long-run these investments will generate macro-economic, vertically-integrated returns of the magnitude sufficient to warrant the investment.

But does it make sense for airlines and travellers worldwide if three carriers – two of which have never made a profit – collectively commit 100 billion dollars to transforming the aviation map of the world?

I do not know the answer, but the situation makes me uneasy. I am not paranoid, although this is an accusation frequently used when Europeans speak out about Gulf carrier expansion. Make no mistake – these airlines are efficient, they have extremely low unit costs yet deliver consistently high service quality. They have clarity of vision and decisiveness of action. They also have the full and enthusiastic support of their domestic political institutions.

My point is this: In a market of double-digit growth, airlines that have long-haul aircraft fleets which dwarf those of their international competitors are being driven by a policy which is not compatible with that of the US and Europe, or, I suspect, Australia, China, Japan, Canada, Mexico, Brazil, Chile, Korea and so on. You get the picture.

How does a European or US airline compete in the short-, medium and long-term? Or, a Canadian, Japanese, Australian, Brazilian carrier compete?

In the short term, the answer could be to ask governments to prevent additional market access. But stalling growth opportunities for airlines is not synonymous for “another year gained”; it is tantamount to “another year lost”. The purpose of an aviation policy cannot consist of intervening in commercial airline decisions. The purpose of regulatory activity must be to provide for safety, of course, but also to address imbalances, divergences of policies, and distortions to competition.

So the answer is ensuring that the governmental policies converge. That should <u>not</u> be done by imposing one’s own policies extraterritorially.

In the good old days, the US would impose their *security* policy, including all forms of Emergency Amendments, on non-US carriers with the formidable argument that they don’t have to fly to the US if they don’t want to.

The EU in turn are beginning to apply an *environmental* policy extraterritorially with the equally strange argument that paying *European* governments for CO2 certificates will help *developing* countries invest into environmentally-friendly technology. As one Asian friend said pointedly: they are replacing US imperialism by EU imperialism.

So if regulatory provisions should not be imposed extraterritorially, the framework for a level playing field should be negotiated. Not only *bilaterally*, as between the EU and the US, but *multilaterally*, to cover global competitiveness. The aviation forum for that is ICAO.

Last year, we celebrated the 60th anniversary of ICAO. Is this the age of retirement for ICAO? After all, cross-border acquisitions were not possible, and the EU-US Open Skies Plus was not developed *because* of the Chicago Convention, but *despite* the 1944 Convention. Or is ICAO, at 60, the new 40, as those of us fast approaching that age, would like to think of it?

Is ICAO the way forward? I believe so. Despite the criticism that ICAO has not adapted to the requirements of a modern economic globalised market, I believe ICAO has the potential to become our solution-provider. If ICAO can become a negotiator on behalf of aviation on a global environmental scheme, a de facto State of the UNFCCC, why can ICAO not also become a negotiator with the World Trade Organisation. The WTO has clear processes to deal with capacity dumping in other trade sectors. Why cannot ICAO negotiate a mechanism to deal with capacity dumping in the field of aviation?

I have lost you now, right? I can see you grumbling that the instruments we developed in the past were more than adequate to deal with any challenge. So what’s so special?

It is the dimensions that come with globally operating airlines.

True, it has been quite a while since anyone in the airline industry mentioned capacity dumping as an issue. The issues of overcapacity scheduling by one airline have disappeared from the political radar screen, as we have entered an era where airlines have been privatised and must act as private entities and not part of any government bureau, policy, or macro, nationalistic economic motive or agenda. But, the spectre of an airline as part of a government vertically-integrated design operating to all corners of the world forces us to reconsider the issue of capacity dumping.

Having ICAO negotiate a mechanism to deal with capacity dumping in the field of aviation would give the industry a globally agreed procedure to address and, in case of need, resolve the issue globally, without resorting to unilateral actions or power-plays.

Ladies and gentlemen, I strongly believe we need to change the way we look at the challenges aviation faces. In Europe the railway sector has sought to argue that ultra-long highway trucks should not be certified because they are such an efficient competitor against the railways. What a logic! I could accept any argument except that one.

But likewise, we cannot, and will not argue that efficient competitors from abroad should be prevented from competing in our sector on the mere grounds that they are efficient; however, the corollary to that is the need for a framework to address possible distortions generated by global carriers operating in a global economic market, but subjected to divergent governmental policies.

This is linked to my second point. Another international phenomenon, the environmental challenge, can only be dealt with adequately at a global level.

Regional and national measures by definition create distortions because they cannot address the global dimensions. The progress achieved at ICAO at the last Assembly, although in itself highly commendable, has not resolved the problems we all face with the EU ETS. So what is the Association of European Airlines doing about that? Good question, next question!

Technically, the EU has adopted a Directive which is being applied into national law by all European Member States, thereby impacting all airlines flying to, from and within the European Union. Right?

Yes and no. Take the de minimis rule. ICAO favoured adopting that principle. The EU ETS has its own, carrier-based and not country-based de minimis rule, the idea of both ICAO and the EU being to home in on the big guys.

OK, so the carrier operating two weekly frequencies from, say Latin America to one destination in, say, Spain, is a negligible entity in terms of environmental impact. So, the same amount of emissions from the European carrier flying the other two weekly frequencies on the same route to Latin America is....also negligible?

Or take another seemingly irrelevant technical detail: If schemes *equivalent* to the EU ETS are implemented by non-European governments, their non-European carriers would not pay twice, but only into the non-European scheme. They would certainly do so if their non-European government applies its scheme to and from its country. Can European carriers opt into that non-European scheme and sell the certificates they no longer need?

We have yet to be convinced that the EU ETS will be non-distortive. Moreover, cap-and-trade measures only make sense if they impact positively the environmental bottom line. Will the EU ETS benefit the environment? A cap-and-trade system, applied *globally* in an *open* scheme, would. A *regional* scheme, to be applied internationally to mobile emitters, would not.

European *finance ministers* will be the beneficiaries of complex auctioning processes, not the global *environment.*

Credit is due to IATA and Giovanni Bisignani for having rallied the entire global aviation sector around objectives for emissions reduction. ICAO recently endorsed broadly the same vision for emissions reduction in the mid- and long-term. These goals are predicated on the insight that the environment will benefit from technological progress and improvements to infrastructure.

Now that is something we can learn from the Gulf states: investments into infrastructure are investments into the future. In this country, the Future of Aviation Advisory Committee has done an excellent job in providing out-of-the-box thinking and developing several highly pertinent recommendations. From an outsider's perspective this should make it easier for the Administration to propose some form of public funding for NextGen equipage for example. The underlying logic, that a satellite-based system is a next generation infrastructure and should therefore be funded publicly, is I believe, spot-on. But I can imagine that in the current political climate, it will be an uphill battle to generate enthusiasm for any form of spending.
If it is any consolation, the situation in Europe is significantly more complex. As you know, in Europe, we need not only our next generation technology, SESAR, which must for the same reason be a public-private partnership, but a European re-organisation of the air space, a Single Sky as opposed to a set of 27 national ones. The good news is that political will was shown, a Second Single Package adopted to set deadlines for implementation of the Single Sky, and the creation of the 9 Functional Air Space Blocks which would replace the national systems. A month ago, an intergovernmental agreement was signed to actually create the biggest central European FAB involving France, Germany the Benelux countries and Switzerland.

The question is will they walk their talk. Labour in some countries has yet to be convinced that this is the way forward to secure competitiveness and thus employment. And the EU is evidently facing severe issues in the Euro zone which easily and quickly can, and have, changed political priorities for the foreseeable future.

It is absolutely imperative that the aviation sector on both sides of the Atlantic secures a consistently upheld understanding that investments into infrastructure and technology are investments into the future. And, I hasten to add, the SESAR and NextGen systems should be inter-operable.

Several institutions, the FAA, Euro control, NavCanada, ACI, aircraft manufacturers and airlines have all individually publicly highlighted the significant environmental gains that technological progress on the ATC systems, and research into biofuels, will generate in terms of saved CO2 emissions. This is not just PR of individual providers or companies. Taken together, this is a global sector which demonstrates what it is doing to reduce its impact on the environment. And that aviation is not a *low-tech* industry which needs market based mechanisms to force it to offset its inevitable and growing CO2 emissions; it is a *high tech* industry that has decoupled emissions growth from traffic growth, and is successfully decreasing emissions growth through investments into technological progress.

Another reason why 2011 is the year of crossroads. If austerity measures and environmental dogmatism swing the development, we run the serious risk of losing a window of opportunity to secure progress achieved so far.

In the course of this year, AEA will build upon the recommendations from the Aviation Summit in Bruges last year, and upon the Aviation Platform to at least find ways of avoiding trade conflicts resulting from an extraterritorially-imposed EU ETS.

This leads me to my third point. In 2011 we need firstly, as I mentioned, to deal with the distortive impact governmental *aviation* policies can have on trade; secondly, deal with the distortive impact governmental *environmental* policies can have on aviation; but thirdly, 2011 is the year in which governments should turn their attention to aviation value chain issues, as opposed to airline issues.

In 2004, the European legislative process gave birth to a regulatory monster called the Denied Boarding Compensation Regulation. The main thrust was to penalise airlines for miscalculating the number of expected no-shows. In a *regulated* world, you would expect regulators to regulate market behaviour. If there is a political will to do so in a *liberalised* environment, so be it, as long as it is done in a way the market understands. But if you need courts to figure out what was meant in the law, something went wrong. And a lot went wrong with the EU DBC Regulation.

Its ambiguous wording gave rise to the notion that it provided passenger rights under all circumstances, even exceptional circumstances. If the flight is cancelled for reasons beyond the control of the airline, the passenger can expect the airline to cover the cost of care whilst it is rerouting the passenger to his/her final destination. If the entire air space is closed and there is no possibility to reroute, the Regulation foresees no limits to the cost or duration of the care. Airlines did their utmost to satisfy the claims of the 10 million passengers which could not reach their final destination during the air space closure in Europe, but many carriers were confused as to how to apply a Regulation for a situation for which it had not been designed.

Clearly, the closure of the entire European airspace is exceptional, but that was supposed to have been the purpose of regulating “exceptional circumstances”.

Europe recently witnessed the extraordinary phenomenon sometimes referred to as snow; and some airports were also surprised by ice in winter. Really? Surprised?

Because aircraft cannot land or take off under such adverse circumstances, these are “extraordinary”. But are they as extraordinary for airports? If the airlines are to be held *accountable* for *unpredictable* events like volcanic ash – which they should not be – then airports should be held accountable for *predictable* events like snow and ice. Again, it appears to me that clarifications are called for - clarifications of the liabilities of the service providers to the airlines, but also in the interest of the travelling public.

It is simply not reasonable to lead the traveller to believe that the aircraft operator is always liable, irrespective of the irregularity. Aviation has developed into a complex system, in which the elements of the aviation value chain are inter-dependent. This is not adequately reflected in current legislation on either side of the Atlantic.

Whether we like it or not, consumer rights have become an issue. Just as carriers are entitled to have assurances that a regulatory framework is applied globally to address distortions, so are consumers entitled to know what their rights are. And the rights are not dependent upon the direction of the flight they are taking. However, no one wants a regulatory frenzy on either side of the Atlantic, or anywhere else, to define what the market cannot, but should deliver for the customer.

What is called for is an understanding of the functioning of the value chain. Airlines are part of a complex service system, the elements of which are inter-dependent, which makes the system fragile, and which requires a clear definition of liabilities of all parties concerned. Airlines are only as efficient as the system lets them. Governments must see the “big picture” and address inefficiencies of the value chain if airlines are to deliver on consumer satisfaction.

If anyone can see the big picture, it is the USA. No one in Europe seriously believes that any state or airline, certainly not the Gulf carriers, could undermine the traditional and indisputable ability of the USA to assume leadership to master any challenge. In the aviation sector the USA has certainly been in the driver’s seat and successfully modernised aviation.

My point today is that in light of the dimensions of globalised economic and financial developments, together with the gravitational shifts of growth and traffic to Asia, we need to think out of the box as to what this global aviation village needs if it is to function sustainably.

In the context of competition policy and environmental issues, I mentioned the need to review the role of ICAO as a global regulatory body for a globally oriented aviation sector. But we believe the engine for further change lies in the EU-US Agreement.

We all know that in order to achieve the advantage of legal and regulatory stability of the 2nd Phase of the EU-US Agreement, many discussions were not led, and conclusions not drawn; the achievable was achieved.

But as we see the global aviation development knocking on our EU-US door, EU-US leadership will be required to take a broader view of what lies ahead, and, yes, resume a fresh review of ownership and control restrictions. I recognise that different camps are re-evaluating this complex issue as we speak. But it does seem to me that the new structures that are emerging on the North Atlantic will be turning to stabilise their operations by securing the interest of financial and/or strategic investors. But essentially the issue on the table is whether, in the dimensions of cross-border mega carrier conglomerates, a 24.9% ownership clause of voting rights is still appropriate.

But, to end with the beginning in mind, 2011 will be, barring further extraordinary crises, a year of economic growth and recovery for many regions, even Europe. However, that recovery is fragile.

Let me conclude my remarks, as I began them, by quoting another famous American poet, Robert Frost:

Two roads diverged in a wood, and I—
I took the one less travelled by,
And that has made all the difference

Ladies and Gentlemen, in 2011, we, too, must take the road less travelled. And that should make all the difference in securing a stable, prosperous, sound global aviation environment for all of us.

Thank you.

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