

Open Skies and Hidden Agendas
***The case of the Open Skies Treaty from the perspective of
strategic behaviour***

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1. Introduction

For many years the transatlantic air traffic between Europe and the USA has been made possible by bilateral treaties which various European countries have entered into individually with the Americans. At this moment (June 2006), every EU member state except for Lithuania, Latvia, Estonia, Cyprus and Slovenia has reached bilateral agreement with the USA on transatlantic air traffic. Ten of them, including the Netherlands, have signed a treaty with scope for market forces. Spain, the UK, Ireland, Greece and Hungary, on the other hand, have tried to resist market forces in the aviation sector and have signed restrictive treaties.

These bilateral aviation treaties have become a common topic of discussion in recent years. The European Commission is fiercely opposed to them, arguing that they stand in the way of a level playing field in Europe. The EC is therefore demanding that they be terminated and replaced by one single treaty which confers equal rights on all airlines in the community. In 2002 the Commission's standpoint was endorsed by the European Court of Justice, when it ruled on an action taken against a number of member states for infringement of Community law (Art. 226 EC Treaty).¹ In the same ruling the Court confirmed the Commission's powers in the matter. When the EC obtained a mandate to negotiate with the USA, also on behalf of the member states, the legal problems seemed to have been solved. The rights and obligations of the EC and the member states were crystal clear.

However, legal coordination does not necessarily spell the end of recalcitrant practices. The aviation sector is complex and dynamic. To begin with, the airlines have considerable economic interests in transatlantic air transport. Secondly, the interests of the air carriers are inscrutably entwined with the interests of member states. And last but not least, the possibilities for individual states to secure their interests and thus the interests of national airlines are subject to the vagaries of international politics and economic power struggles.

This paper discusses the evolution of the Open Skies Treaty (OST) concluded between the EU and the USA on 18 November 2005. The European Commission opened negotiations with the USA in June 2003 with the aim of formulating one Open Skies Treaty to replace all the bilateral treaties which the member states had signed separately with the Americans. The negotiations were arduous and continued for several years. Meantime, there was no certainty that the member states would ratify the treaty. So, what caused this situation? This paper will attempt to answer this question by identifying the actors, the interests, and the interest-securing strategies. These themes will be explored against the background of the perspective of strategic behaviour. What is strategic behaviour and how can it be determined? These questions will be dealt with. By applying four different frameworks for judging the actors, their interests, and their strategies, we will attempt to determine whether behaviour in this case should be regarded as strategic behaviour.

In Section 2 we trace the evolution of bilateral aviation treaties from the Chicago Convention 1944 to the Air Service Agreements. Section 3 addresses the aviation policy in both the USA and the EU and the relationship between the bilateral aviation treaties concluded by EU members. Section 4 concentrates on the deal struck on 18 November 2005. In section 5, we introduce the concept of strategic behaviour and the four different frameworks for judging strategies. Section 6 analyses the negotiation process by identifying the groups of actors, the interests and the interest-securing strategies. Section 7 concludes with several observations from the perspective of strategic behaviour.

2. The evolution of bilateral aviation treaties

2.1 The Chicago Convention

The steady development of aviation in the 1930s and 1940s created a need for a forum where countries could agree on flight routes, frequencies, arrival and departure times, interconnections etc. On 7 December 1944 the Convention on International Civil Aviation (the Chicago Convention) was established. The Chicago Convention sets out regulations on airspace, aircraft registration and safety, and specifies the air travel rights of the signatories. It has been revised several times since its inception. The Chicago Convention paved the way for the establishment of the International Aviation Organization (ICAO) on 4 April 1947, a permanent body that serves the interests of the aviation sector at global level.

The conference which led to the Chicago Convention and the subsequent establishment of the ICAO achieved another important result: the first version of Freedoms of the Air – a standardised set of separate air rights. Freedoms of the Air eased negotiations between states as it prevented misconceptions of the other party's intentions. The convention managed to draw up a multilateral agreement which accorded the first two freedoms, known as the International Air Service Transit Agreement (or the Two Freedoms Agreement), for all signatories. Though it was agreed that the third, fourth and fifth freedoms would be negotiated between the states, the International Air Transport Agreement (or the Five Freedoms Agreement), encompassing the first five freedoms, was also opened for signatories. Several other 'freedoms' have since been added, but they are not officially recognised under international treaty.

The first freedom is the right to overfly a country without landing. The second is the right to stop in a country for refuelling or maintenance on the way to another country without transferring passengers or cargo. The third is the right to carry passengers or cargo from one's own country to another while the fourth is the right to carry passengers or cargo from another country to one's own. Rights under the third and fourth freedom are nearly always granted simultaneously in bilateral agreements between countries. The fifth freedom is the right to carry passengers from one's own country to a second country, and then to a third country. The eighth freedom is the right to carry passengers or cargo within the borders of a foreign country, more commonly referred to as cabotage.

2.2 Air Service Agreements

As the Chicago Convention sets out only a few basic principles of international aviation law, the details need to be fleshed out in bilateral treaties, known as Air Service Agreements, which regulate the supply of air transport services. As a result, countless ASAs are currently in force which, literally, guide the air traffic on a global scale. The content of these ASAs can vary widely. Freedoms of the Air can be embedded in the treaty in line with the wishes of the parties. Some ASAs protect markets, while others allow scope for competition (the latter category is relatively small). The states try to allocate the transport rights granted to their airlines on the basis of *equal exchange of economic benefits*, i.e. *quid pro quo*. The key role played by ASAs in commercial civil aviation is illustrated by the fact that, at this moment, each EU member state has, on average, 60-70 ASAs with other countries.²

3. Aviation policy

3.1 Deregulation in the USA

At the end of the 1970s the US Government decided that it would no longer intervene in the aviation sector. It launched an extensive deregulation programme designed to give the market space to develop. Countless anti-competition regulations were scrapped. This dramatic change brought an end to a period of intensive government participation, largely via the Civil Aviation Board. For example, airlines had to charge CAB-approved fares and fly CAB-approved routes. Even the frequency and the type of aircraft had to be CAB-approved. After being more or less straitjacketed, US airlines were now free to compete. As a result, they were able to develop business acumen at an early stage, which – as became clear later – gave them a head-start over their European rivals.

3.2 Gradual phase-out of bilateralism in Europe

In the early 1980s, after the wave of deregulation in the USA, competition in the aviation sector was added to the European agenda, as a result of the obligations that the signatories to the EC Treaty has assumed with regard to the realisation of a single transport market. In 1986 it was decided that the European aviation market would be liberalised in phases.

The single market has been in existence since 1 April 1997. Each airline with an EU licence is free to operate national and international routes within the Community. Under Regulation 2407/92, issued by the Council of Ministers on 23 July 1992, the member states are obliged to grant an operating licence to each European airline that meets the fixed criteria.³ Pricing is addressed by Regulation 2409/92, also issued by the Council of Ministers on 23 July 1992.⁴ The thrust of this regulation is that the rates for air transport services provided within the Community must be determined by market forces.

3.3 The EU member states and their bilateral Air Service Agreements with the US: bilaterals and Open Skies Agreements

Strictly speaking, there are two types of bilateral Air Service Agreements between EU member states and the USA: the traditional restrictive bilaterals and the free, modern Open Skies Agreements. The traditional bilaterals establish a tightly regulated market in which the power of the airline industry is heavily curtailed by, for example, stipulated prices and flight frequencies for each route. The Open Skies Agreements, which establish a market with scope for competition, have become increasingly popular in recent years. The degree of liberalisation varies from one agreement to another. Since 1992, the USA has signed Open Skies Agreements with 15 of the 25 EU countries.

Table 1 shows the member states with a traditional bilateral agreement with the US and the member states with an Open Skies Agreement.

EU members with a traditional bilateral agreement with the US	Spain, United Kingdom, Ireland, Greece, Hungary
EU members with an Open Skies Agreement with the US	Portugal, France, Luxembourg, the Netherlands, Belgium, Germany, Denmark, Sweden, Finland, Poland, Czech Republic, Slovakia, Austria, Italy, Malta
EU members with no agreement with the US	Cyprus, Lithuania, Latvia, Estonia, Slovenia

Table 1: Air Service Agreements between EU member states and the US

Table 2 shows the main differences between a bilateral agreement and an Open Skies Agreement.

Type of agreement	Service provider	Service frequency	Fares	Extended traffic right
Traditional bilateral agreement	Restrictions on which airlines can operate	Restrictions on which markets airlines may serve Restrictions on the number of flights that can be flown	Restrictions on pricing	Restrictions on operations to and from additional countries
Open Skies Agreement	No restrictions	No restrictions	No restrictions	No restrictions

Table 2: Differences between bilateral and Open Skies Agreement (source: www.gao.gov)

With the establishment of the internal market in 1997, the European Commission felt that bilateral aviation treaties – both traditional and Open Skies – were no longer desirable. The multifarious conditions were not only creating a tangled web of rules and regulations; they were also – and most importantly – causing inequality between EC airlines.

One particularly sharp thorn in the flesh of the EC was treaties that allow only national airlines to offer transport services between two countries, thereby excluding foreign competition. The term ‘national airlines’ is understood as airlines which are owned and controlled by subjects of the two states who are signatory to the treaty. The Commission takes the view that advantages like these can seriously undermine the market. It means that:

- EC airlines which are majority-owned by parties from outside the member state have no access to international routes to and from that state;
- EC airlines which are officially registered in one member state and have a base in another member state cannot utilise their EC Treaty rights to operate international routes from both states;
- Mergers and takeovers whereby EC airlines become involved with international networks are virtually impossible;
- It is extremely difficult to develop Community airlines with multi-hub systems, such as those operated by US airlines.

Article 234 of the EC Treaty regulates the relationship between EU law and agreements between member states and third parties. The starting point is that the EC Treaty leaves intact any agreement that was entered into before the EC Treaty came into force, unless the agreement is irreconcilable with the EC Treaty. In the latter case the member state is obliged to use all appropriate means to solve the problem as soon as possible.

As the member states were unwilling to terminate these lucrative bilaterals, the Commission had no choice but to initiate actions for infringement of Community law by member states under Article 226 of the EC Treaty. In a decision of 5 November 2002 the European Court of Justice ruled unequivocally that the nationality conditions in the agreements constitute an infringement of the freedom of establishment principle.⁵ In the same decision the Court ruled that the Community alone is empowered to regulate aviation issues with third countries which (might) have implications for the development of the European market. After receiving a negotiation mandate from the Council of Ministers in June 2003, the European Commission opened negotiations in October of the same year on the creation of a common aviation area with the US. The agenda included terms to liberalise the EU-US market and to remove foreign investment restrictions on airlines operating between the EU and US.

4. The Open Aviation Agreement of 18 November 2005

4.1 Growth market

Political support for a transatlantic common aviation area has grown over the years, primarily because it is slowly beginning to dawn on people that the transatlantic air transport market has huge potential. Transatlantic air transport is booming business for US and European airlines and by far the most promising foreign market. In recent years the transatlantic market in passenger transport burgeoned from 28 million passengers a year in 1990 to over 51 million by 2000 – and the figures are still rising. Another strong reason is that people have also realised that in a bilateral system the

potential of the market remains untapped. In all probability, an EU-block open skies agreement with the US will lower transatlantic airfares and generate a positive spin-off for trade, tourism and cultural exchange.

4.2 Fits and starts

On 25 June 2003, the EU and US agreed to open negotiations on a community-wide ASA. The first round of talks was held in Washington DC on 1 and 2 October 2003. It was already clear at this early stage that the path to an agreement would be long and arduous. Though progress was made on questions like ground handling and computer reservation systems, the talks became deadlocked on the question of ownership rules. The main sticking points were:

- Granting rights to EU carriers to offer services in the US (cabotage);
- The EU demand that the US scrap the 'Fly American' rule for US government employees and armed forces;
- The level of foreign investment (Goeteyn & Soames 2005, p. 23).

The EC's trump card in the negotiations was access to London Heathrow, the EU's busiest airport for transatlantic flights. (Goeteyn & Soames 2005, p. 23). At that time, under the Bermuda 2 Agreement, only four airlines were licensed to fly between Heathrow and the US: Virgin Atlantic and British Airways from the UK and United Airlines and American Airlines from the US (BBC News, 1 October 2003).

The negotiations resumed in Washington from 17 to 20 February 2004. At that moment, the US proposal offered unlimited fifth freedom rights in the EU for all American passenger and cargo airlines, but it denied European airlines access to the US domestic market (TCM, 12 February 2004). In a speech on 6 April 2004, the US Transport Secretary, Norman Mineta, repeated in no uncertain terms that cabotage was a no-go area for European carriers in the US and that it was most unlikely that the US would accept a foreign investment level higher than 49 percent (Goeteyn & Soames 2005, p. 23).

The negotiations suffered another heavy blow when the EU Transport Council rejected a proposal on 10 and 11 June 2004. The Transport Council, notably Britain, argued that the US had not made enough concessions. At that moment, after almost a year of negotiations between the European Commission and the United States, a draft agreement lay on the table. This agreement managed to reconcile the EU-US deal with Community Law by removing all discrimination between EU airlines, thus affording them equal opportunities to fly on any transatlantic route between the EU and the US. However, the Transport Council was not happy with the concessions and continued to maintain that the EU airlines should get better access to the American domestic market (European Commission Press Release, 20 July 2004 IP/04/967; Gow 2005).

The proposal that was rejected in June 2004 included, for the first time, US recognition of the concept of the 'EU carrier' – a gesture which the US saw as more than generous. In general, bilateral Air Service Agreements, including Open Skies Agreements, give the airlines of each party the right to operate air services from any point in one country to any point in the other country. This 'nationality clause'

prevented EU air carriers from doing what every US carrier was able to do, i.e. fly from any point in the United States to any point in the EU, apart from a few exceptions such as Heathrow. It is the nationality clause that the European Court of Justice deemed incompatible with the EC Treaty. According to the US, recognition of the concept of EU carrier would generate a great many benefits for the European airlines, as they would no longer be subject to nationality restrictions. Hence, from that moment on, every EU carrier could fly from any city in the EU to the United States. In exchange, the US wanted to retain the rights under existing ASAs and to extend them to EU countries with which it had (as yet) no bilateral agreement (United States Embassy in London, 17 October 2005). These countries are listed in Table 1. The British felt that increased US access to Heathrow was too high a price, particularly as the Americans were not prepared to open the US domestic market (White 2005).

A move by European Commission on 20 July 2004 significantly stepped up the pressure on the EU and the US to reach an Open Skies Agreement. On that date the Commission formally called upon eight EU member states to terminate their bilateral aviation agreements with the US in response to the ruling by the European Court of Justice in November 2002. According to the Commission, this action would not have any direct consequences for the airlines, as these bilateral agreements were subject to 12 months' notice and left enough time for the US and the EU to arrive at an open skies deal. But the US and the airlines were not so sure that the EC's action would have no adverse effects. The Secretary General of the Association of European Airlines (AEA) said: 'Once termination of the agreements becomes effective, airlines will have no legal certainty; capacity planning and pricing will be subject to governmental ad hoc approval' (Euractiv, 22 July 2004).

On 21 and 22 March 2005, the EU Transport Commissioner Jacques Barrot was due to visit Washington to relaunch the open skies negotiations. Following its action in July 2004, and prior to this visit, the EC instructed twelve EU member states to terminate their bilateral agreements with the US (Euractiv, 17 March 2005). The pressure on the US and the EU to reach agreement was raised again in a joint letter sent by the associations of EU and US airports (ACI Europe and ACI North America) to the EU and US administrations, urging EU Commissioner Jacques Barrot, and US Transport Secretary, Norman Y. Mineta, to make progress on EU-US air service negotiations. The ACIs wrote that an agreement would deliver huge economic benefits for both the airports and the communities they serve by increasing business, tourism, investment and jobs (ACI Europe, 21 March 2005).

The negotiations were re-opened in Brussels on 17 October 2005. Three days earlier, on 14 October, the Deputy Secretary of State for Transport at the Bureau of Economic and Business Affairs, John Byerly, delivered a conference speech in which he made a number of statements about the status of the open skies negotiations. He stressed the need for progress: "The negotiations this fall are the last clear chance to achieve an historic breakthrough in transatlantic aviation before storm clouds gather on the European legal horizon in 2006." He repeated, amongst others, that the US was still prepared to accept the concept of the EU carrier. Perhaps more interesting were his comments on the issue of ownership and control: "The possible expansion of opportunities for foreign participation in the US airline industry is, from my perspective, an issue that we Americans must examine based on whether it makes

sense for us, balancing the clear advantages of increased access to capital and business know-how against concerns about safety, security, and the essential role that US carriers play in the national defence.” Even more important was his comment on ownership and control: “The Administration is aware of the keen interest of European parties in this issue. What is important, however, is to emphasize that this issue is being considered by the Administration on its own merits and cannot be linked to air services negotiations” (Byerly, 14 October 2005). What Byerly, in effect, did was to exclude ownership and control from the negotiations on an EU-US open skies agreement. Finally, Byerly said that he was hopeful that a first step agreement could be reached, not necessarily at the meeting in the week of 17 October 2005, but during the talks that were planned for mid-November 2005 in Washington (United States Embassy in London, 17 October 2005).

On 3 November 2005, in the run-up to the next round of negotiations scheduled for 14 - 18 November 2005 in Washington, the US Department of Transportation (US DOT) submitted proposals on the deregulation of foreign ownership of US-domiciled airlines. DOT proposed easing the restrictions on overseas investment in US airlines, giving foreign investors more input in marketing, routing and fleet planning (Crawley 2005). The proposal did not ease restrictions on foreign ownership – foreigners would not be allowed to own more than 25 percent of the shares in a United States carrier – but the interpretation of the rules of control would be relaxed. As long as American citizens remained in charge of safety and other key aspects of airline operations, foreigners would be allowed control (Sunday Times, 6 November 2005).

This proposal ran into a barrage of criticism in both the US and the EU. Some felt that it went too far while others felt that it did not go far enough. The US trades unions argued that it gave too much scope for foreign control over the domestic airline industry and that such a proposal should be approved by Congress and not introduced via a change in the regulations. The proposal also proved highly controversial among British airlines. BA and Virgin complained that it did not go far enough and took the view that a true open skies agreement would abandon all ownership and control restrictions. BMI, a British rival of BA and Virgin, responded by saying that BA and Virgin were simply protecting their own privileged positions (Sunday Times, 6 November 2005).

The next round of negotiations went ahead as planned on 14 – 18 November 2005. On 18 November the negotiators announced that a tentative agreement had been reached. The deal, which still needed approval by the EU Council of Transport Ministers on 5 December, was conditional on the outcome of the rulemaking process initiated by US DOT to expand opportunities for foreign citizens to invest and participate in the management of US air carriers (Euractiv, 21 December 2005).

If approved, the tentative agreement of 18 November 2005 would authorise every EU and US airline:

- To fly between every city in the EU and every city in the US;
- To operate without restrictions on the number of flights, the aircraft type, or the routes, including unlimited rights to fly beyond the EU and US to points in third countries;
- To set fares freely in accordance with market demand;

- To enter into cooperative agreements with other airlines, including code-sharing and leasing.

The agreement, if approved, would come into force at the end of October 2006. It was said that the agreement marked the first step towards opening markets and enhancing cooperation. The EU and US had agreed to begin a second stage of negotiations within sixty days of application of the Agreement (U.S. Mission to the EU, 21 November 2005).

The tentative agreement met with fierce criticism from many quarters. Various airlines and trades unions in the US feared the impact of an increase in foreign competition and threatened to take legal action to block it. The US Congress also raised objections, particularly against the DOT proposal to give foreign investors greater control without seeking official approval. Some members of Congress expressed concern that giving foreign nationals more power in the managerial decisions of airlines could pose a risk to national defence and security. The Chairman of British Airways, Martin Broughton, described the result of the negotiations as a “disappointment”. The agreement also meant that the lucrative market between Heathrow and the US, which was operated by BA, Virgin Atlantic, American Airlines and United Airlines, would be opened up to dozens of carriers. BA, the dominant carrier at Heathrow, was therefore fiercely opposed to the proposal. Broughton also pointed out that the agreement would not give EU carriers cabotage rights for the US domestic market. And, EU carriers would still be denied access to the segment of the US market controlled by the Fly America programme. Fly America holds no less than one fifth of the US market.

Virgin Atlantic also complained that US carriers wanted access to Heathrow, but were not prepared to do anything in return: “The effect would be to allow US airlines unrestricted access to Europe while barring European carriers from operating within the US”. The tentative agreement of 18 November 2005 did, however, get support from France. It would get rid of the nationality clause (see above) which denied European airlines US landing rights if they merged. The nationality clause had already led to fragmentation and inefficiency in the European industry. At that time, France desperately wanted US approval for the merger between Air France and KLM and for alliances with North West and Delta. The agreement was also supported by most of the other EU member states, so the UK found itself increasingly out on a limb by insisting that opening up Heathrow to all US and EU airlines had to be accompanied by genuine liberalisation. The future of the negotiations now depended on what would be decided in Washington on the issue of foreign ownership of US carriers (Daily Tribune, 2005; US Mission to the EU, 25 April 2006; Webster, 2005; White 2005).

On 3 May 2006, US DOT issued a revised proposal, largely in response to the criticism from Congress. On the basis of the original DOT proposal, foreign investors would be allowed to enter deals with US airlines, which would empower them to take operational decisions on, for instance, carrier rates and routes. On the basis of the revised proposal, US citizens with voting stock in an airline or who sat on its board would be able to veto any decision made by non-US stockholders or their representatives. The revised proposal would also lend weight to the demand that US citizens have full control over all policies and decisions relating to safety, security and national defence. Under the current regulations, foreign investors could exert no

influence on any operations of a US airline in which they invest. According to the proposal of 3 May, the majority US investors could delegate some commercial decisions to foreign investors, such as which routes to fly and which aircraft to buy and sell. The proposal of 3 May also allowed foreign investors to hold up to 49 percent of the equity in a US airline even though they could control no more than 25 percent of the voting rights (US Mission to the EU, 4 May 2006; US Mission to the EU, 9 May 2006; Euractiv, 12 May 2006).

The US Congress had 60 days to consider the revised DOT proposal. At first, it met with strong criticism from Democrats and Republicans alike. The greatest fear was that US safety, security, or national defence might be compromised. Some senators also expressed concern that foreign investors might decide to halt low-profit services to rural areas of the US, such as Montana. Even if the proposal gets through Congress, the question of EU approval is still far from certain. The decision is scheduled to be taken at a meeting of the EU transport ministers in October 2006. Daniel Calleja, Director at the EC Transport Directorate, has said that he could not prejudge the decision of the EU transport ministers and pointed out that the ministers will approve the deal if the new rule is clear, meaningful, and legally safe. One crucial element in the Council's decision is whether the European companies are actually given more scope to invest in US airlines (US Mission to the EU, 9 May 2006; Euractiv, 12 May 2006).

5. *The perspective of strategic behaviour*

The concept of strategic behaviour originates in economic theory. More in particular, it has its origin in economic theories such as game theory, rational choice, and public choice (cf., Von Neumann and Morgenstern 1944). These theories assume that actors in an interdependent setting will anticipate and react to the behaviour of other actors in order to maximize their individual utility. According to these theories, the behaviour of these actors is rational. In other words, actors are believed to know what the possible alternatives are and to be able to predict and understand the behaviour of other actors (Ten Heuvelhof et al. 2003; Ten Heuvelhof et al. 2004).

However, if we try to judge behaviour in an empirical setting, it turns out that the reality of actor behaviour is not as clear-cut as suggested by these economic theories. The social reality is ambiguous in various ways. Actors usually do not have complete information and they are often not able to judge correctly the behaviour of other actors. In addition to this concept of *bounded rationality* (as was introduced by Simon), a framework for judging strategic behaviour should also include the concept of *opportunism*. Actors can often be unreliable in their interactions with other actors, which means that they may break an agreement, if the agreement does not coincide with their interests. Another concept that should be taken into account when trying to determine strategic behaviour is that of *information asymmetry* between actors. Finally, an important characteristic of strategic behaviour is that there will often be a discrepancy between the opinions and motivations that are presented by actors *front stage* and their 'true' *back stage* opinions. Again, the problem is that it is hard to provide evidence of these back stage opinions and intentions that are underlying the front stage behaviour (Ten Heuvelhof et al. 2003; Ten Heuvelhof et al. 2004). Actors may for instance intentionally interpret legal rules in their own advantage or they may be selective in the information that they provide to other actors. Another possible

demonstration of strategic behaviour is that actors adjust the prices of their products on the basis of the market power of other actors. As the number of competitors decreases, the prices increase. A final example of strategic behaviour relates to the strategic use of bottleneck facilities. For instance, the owner of a public utility network may take advantage of his position by demanding high tariffs from potential competitors that want to access the network (Ten Heuvelhof et al. 2003).

Since it is hard to establish the motives and intentions underlying the behaviour of actors, Ten Heuvelhof et al. (2004) have developed a framework to judge actor behaviour from four different perspectives. If behaviour would be considered to be strategic from all four perspectives, then the conclusion on the basis of this framework would be that we are dealing with strategic behaviour. The four perspectives are the following:

- *The journalist:* A journalist will evaluate whether behaviour should be characterized as morally ambiguous. Journalists will usually be inclined to judge behaviour relatively easily as strategic and, consequently, undesirable.
- *The judge:* A judge will assess whether behaviour should be qualified as unlawful. Since it is often very difficult to establish whether a certain practice is unlawful, a judge will be less inclined to decide that we are dealing with strategic behaviour.
- *The business analyst:* For a business analyst, strategic behaviour will up to a large extent be regarded as optimal behaviour from the point of view of the enterprise, for instance behaviour aimed at reaching a higher efficiency rate. In other words, strategic behaviour largely coincides with ‘healthy’ business behaviour. However, if strategic behaviour threatens to harm the reputation of a business as a result of legal intervention or media attention, then the business analyst will no longer put this behaviour on the same level as healthy business behaviour and he will qualify it as strategic behaviour.
- *The policy analyst:* When judging actor behaviour, a policy analyst will try to determine whether the interests of consumers or citizens are at stake as a result of the behaviour. Policy analysts will often evaluate behaviour from a welfare theoretical point of view. For instance, a policy analyst will try to determine whether competition has been reduced or consumer choice has decreased as a result of the behaviour.

In section 7, we will apply these four perspectives to the process of negotiations on the Open Skies Treaty.

6. Analysis of the negotiation process

6.1 The Americans

The American negotiators had huge interests to defend. Air transport plays a crucial role in the US economy and consists for a large part of transatlantic air traffic. Great Britain is one of the main overseas markets for US carriers (Button, 1998).

Since 1980 the US Department of Transportation has been actively seeking to conclude bilateral open skies agreements. Bilateral agreements are generally regarded as restrictive and geared primarily to protecting the national air carriers. They also prevent the realisation of full hub-and-spoke systems, making for inefficiency in the current arrangements. Hub-and-spoke systems lower the costs by exploiting

economies of scale. They benefit both the airlines and the passengers, who can profit from lower fares and a larger choice of services (Button, 1998).

The US signed its first open skies agreement with the Netherlands. When the US negotiated bilateral agreements with EU countries, it employed a 'divide and rule' strategy. It began by entering liberal bilateral agreements with countries that were amenable to them, such as the Netherlands and Belgium. The idea was that these agreements would lead to greater competition, higher capacity, and lower fares on transatlantic flights between the US and Amsterdam or Brussels. This would then put pressure on more mercantilist countries, such as the UK, France, Germany and Italy, to strike a more liberal deal with the US, as they might otherwise lose customers to airports in other countries (Stober, 2003; Staniland, 1996).

DOT often used the carrot-and-stick approach to entice countries into bilateral open skies agreements. In other words, it offered them incentives. One much-used incentive was antitrust immunity for international alliances. Antitrust immunity for international alliances has often been conditional on the signing of an open skies agreement with the United States. Thus the open skies agreement between the US and the Netherlands preceded antitrust immunity for the alliance between Northwest and KLM Royal Dutch Airlines. Antitrust immunity is extremely important to carriers. It not only guarantees non-interference by governments, it also prevents private antitrust actions (Stober 2003).

The Americans were intent on gaining access to Heathrow throughout the negotiations on the Open Skies Agreement. Heathrow had been at the centre of a bitter and long-running trade dispute between the US and Britain ever since 1976. The many business travellers and the strategic position of Heathrow between the US and Europe make for important economic interests around the airport (Sunday Times, 6 November 2005). At present, only four airlines (British Airways and Virgin Atlantic from the United Kingdom and United and American Airlines from the United States) are licensed to operate flights between Heathrow and the US, even though this is one of the most lucrative aviation routes in the world (Sunday Times, 6 November 2005). So, a lot of rich pickings are being enjoyed by just a few recipients.

Another important issue for the Americans is access to the US domestic market. During the negotiations the Americans were strongly opposed to cabotage rights for EU carriers in the US domestic market and to more relaxed regulations on foreign ownership of US airlines. The Americans make considerable use of lack of reciprocity as an argument against opening the domestic market. The US refuses to grant cabotage rights for its domestic market because there is no prospect of a reciprocal agreement that would give US carriers the similar access to foreign markets. With a 25 percent share of the global aviation market, the Americans are in no hurry to respond to the EU's demand for cabotage. According to the Americans, flying domestic US routes would be highly profitable for EU carriers, but flying short-distance domestic EU routes would not be commercially viable for US carriers (Euractiv, 22 July 2004). Cabotage rights in the US market have proven a huge obstacle in the negotiations.

A second argument against opening the domestic market that was frequently raised by the Americans is national safety. The US DOT proposals on foreign ownership of US

airlines ran into considerable opposition from Congress. Congressmen were afraid that an increase in the influence of foreign investors would have an adverse effect on safety. This is why Byerly, in his speech of 14 October 2005, re-emphasised that the Americans wanted to separate the issue of ownership and control from the negotiations on a US-EU Open Skies Agreement. Nonetheless, the EU has now made approval of the tentative open skies agreement conditional upon the US proposals on foreign ownership of American carriers.

In the proposal that the EU Transport Council rejected in June 2004, the US had, for the first time, recognised the concept of the 'EU carrier'. The Americans presented this as a strong concession, arguing that the EU airlines could profit enormously from this recognition as it would enable them to fly to the US from any airport in the European Union. They also claimed that recognition of the EU carrier and the subsequent abandonment of the nationality clause would promote consolidation in the EU airline industry. In exchange, the US wanted better access to Heathrow. The proposal was thrown out by the EU. The British government, under pressure from British Airways and Virgin Atlantic, found access to Heathrow far too high a price, especially as the US was not prepared to grant cabotage rights for its domestic market.

6.2 *The Europeans*

Important interests were also at stake for the European Union in the negotiations. The EU desperately wanted access to the US domestic market, which accounts for over 25 percent of global air travel. So, it fought for cabotage rights in the US domestic market and more supple regulations on foreign ownership of American carriers. However, several EU countries are faced with an inefficient aviation industry which enjoys a large measure of government protection. These countries are less keen to engage in too liberal an agreement with the US. The American carriers are, as a whole, much more efficient than the European carriers. Indeed, the overall operating costs per air traffic mile in 1992 for the EU carriers were 48 percent higher than those of the major US carriers (Button 1998).

Both the US and the EU argue that there is no level playing field. The EU negotiators claim that the US enjoys *de facto* cabotage in the EU. As in the US, the EU does not allow non-EU investors to acquire a controlling interest in an EU carrier. Moreover, the EU member states do not grant cabotage rights to non-EU carriers. Thanks to liberal bilateral agreements signed with a majority of EU member states, however, US carriers can use their 'beyond' rights to offer services between a number of EU cities. Hence, the US carriers can enjoy a limited form of cabotage within the EU market (Button 1998). Another bone of contention for the EU negotiators is the Fly America Program, which demands that U.S. government employees, contractors and military fly by US carriers. The Fly America Program controls one fifth of the US market.

A much-used strategy employed by European airlines to gain – albeit indirect – access to the US market is to enter alliances with American carriers. This accounts for the steep rise in the number of alliances in recent years. Alliances enable airlines to operate more efficiently and more profitably (Button 1998; Staniland 1996). As mentioned above, the US has cleverly exploited this development by linking antitrust immunity to a willingness to enter open skies agreements.

The UK and the UK airlines are key players on the EU side. Approximately 40 percent of transatlantic air traffic originates in England (Gow 2005). Access to London Heathrow has been the Commission's own carrot-and-stick to persuade the US to enter into an ASA with the EU (Goeteyn & Soames 2005). BA and Virgin Atlantic, the only two airlines licensed to fly between Heathrow and the US, are vigorously opposed to extending access to Heathrow. Both airlines derive a large part of their revenue from transatlantic flights and maintain that the Americans should offer a lot more than just recognition of the concept of the EU carrier. BA and Virgin Atlantic are in favour of a far more radical – 'truly open skies' – agreement with the US.

British Airways has yet another interest in 'truly open skies', which also came into play during the negotiations of 2005. BA had made no secret of its interest in Iberia, the Spanish airline in which it already owned a nine percent stake. A truly open skies agreement would probably make it a lot easier to strike a deal in this area. And, BA could make use of an open skies agreement to press its claims for anti-trust immunity for its alliance with American Airlines. It might even breathe new life into its long-held merger plans with American Airlines (Sunday Times 2005).

Not all British airlines shared the standpoint of BA and Virgin Atlantic. BMI, a British competitor, owned around 14 percent of the available take-off and landing slots at Heathrow at the time of the negotiations in 2005. If these slots could be used for flights to the USA, they would soar in value. So, BMI resisted the extension of access to Heathrow and accused BA and Virgin Atlantic of pursuing their own interests (Sunday Times 2005).

6.3 Actors, interests, and strategies for securing interests

The above information is summarised in Table 3 according to the actors, the interests, and the interest-securing strategies.

Actor	Interest	Strategy for securing interest
European Commission	The achievement of a level playing field in Europe	Legal action against member states at the European Court of Justice Forcing member states to terminate their bilaterals Obtaining a negotiation mandate from member states Sign Open Skies Treaty with USA
EU member states	Unlimited access to the US market	Acquisition of cabotage rights Relaxation of foreign investment regulations Relaxation of foreign ownership and control regulations Abandonment of Fly American Program Link approval for OST with US proposals on foreign ownership and control Standpoint that US already has <i>de facto</i> cabotage rights in EU
British Airways & Virgin Atlantic	Protect position at Heathrow Strategic alliances with US carriers Alliance with Iberia	Reject US proposals because they do not truly open up markets Obtain antitrust immunity USA OST
EU carriers	Unlimited access to US market	Obtain cabotage rights Relaxation of foreign investment regulations Relaxation of foreign ownership and control regulations Abandonment of Fly American Program Strategic alliances with US carriers
Trades Unions, EU & US	Job security	Reject market forces
US Negotiators	Access to Heathrow Protection of national airline industry Reject claims for cabotage rights	Recognition 'EU carrier' No cabotage rights Arguments: safety, security and national defence (?) Lack of reciprocity
US DOT	Protect national market	Conclude bilateral agreements ('divide and rule'; 'carrot-and-stick') Separate approval OST and US proposals in connection with foreign ownership and control

Table 3: Actors, interests and strategies

As the table shows, the actors have different and sometimes contradictory interests. Mutual dependence makes cooperation necessary. Without the US, no OST; without OST no access to Heathrow for the Americans. For the privileged airlines, BA and Virgin, the issue is complicated: on the one hand, they have nothing to gain from an OST, because it would mean losing Heathrow; on the other hand, an OST would make it easier to enter strategic alliances with European or American partners. The former interest appears to be infinitely more important than the latter. After all, an advantage in one market is always better than no advantage at all. It may therefore be assumed that British interests have formed the main obstacle in bringing the negotiations to a successful conclusion. The other EU member states have far less to lose from an OST, especially if they already have a liberal agreement with the US. What is most likely to tip the balance for them is if they stand to benefit from an OST, particularly if they also get access to the US domestic market – a prospect not included in the draft OST which is currently on the table. Seen from this light, it is doubtful whether the draft agreement will make it. What is more, the demands for more relaxed foreign ownership and control regulations are a bad omen. Given the standpoint adopted by Congress, it is unlikely that the Americans will wholeheartedly consent. The heightened state of alert in the country will do nothing to help things along.

It is now a matter of waiting for the response to the revised American proposal on foreign ownership of American carriers and the decision of the EU Transport Council in October of this year.

7. Observations from the perspective of strategic behaviour

The first perspective on strategic behaviour that was presented in section 5 was that of the *journalist*. The journalist will try to determine whether we are dealing with morally ambiguous behaviour. In the case of the OST negotiations, the behaviour of several actors could be regarded as morally ambiguous. For instance, the American use of the argument of national safety as a reason for not opening the US domestic market could be characterised as morally ambiguous. The fact that both the EU as well as the US are claiming that they are facing a lack of reciprocity could also be judged as morally ambiguous. Both parties are trying to present their attitude and concessions in the negotiation process as highly accommodating. This is for instance the case with the recognition by the Americans of the concept of the EU carrier, which is presented by the US as highly beneficial to the EU.

The next perspective on strategic behaviour is that of the *judge*. As was mentioned in section 5, it can be very difficult for a judge to establish that we are dealing with unlawful behaviour. In the case of open skies, the European Court of Justice did rule that the nationality conditions in the bilateral agreements constituted an infringement of the freedom of establishment principle. On the basis of the EU Treaty, Member States are supposed to endeavour to modify agreements that do not correspond to the intention of the European Commission to establish a European common market. However, it is very hard to determine whether a Member State is actually making a serious effort. An interesting issue from the perspective of the judge is also the reliance of the US on the national security argument for not allowing access to the domestic market. Even though it might be clear that international trade is

hindered, it is hard to oppose the argument from the legal point of view. An institution such as the WTO would also have a hard time to prove that national security is an unlawful argument in this case.

The *business analyst* will usually say that strategic behaviour and ‘normal’ business behaviour are highly connected. For instance, the fact that BA and Virgin Atlantic claim that their reason for opposing the results of the negotiations is that they are in favor of a more radical, more far-reaching OST is very understandable from the viewpoint of a business analyst. It is quite clear that BA and Virgin Atlantic are merely protecting their main interest, which is to maintain their favourable position regarding Heathrow. In other words, they are simply defending the interests of their businesses. The fact that they try to pressure the British government to reject the US proposals does not mean that their behaviour will be qualified as strategic by a business analyst. The fact that many European airlines have entered into alliances with American carriers in order to obtain indirect access to the US market is even less likely to be characterised as strategic behaviour by a business analyst. All in all, the behaviour of the various actors in this case would probably not be qualified as strategic behaviour from the perspective of a business analyst.

The final perspective that was presented in section 5 was that of the *policy analyst*. As discussed above, bilateral agreements are preventing the realisation of a worldwide airline market and full hub-and-spoke systems, which makes the current system rather inefficient. It can be argued that one Open Skies Treaty would result in more fierce competition, more economies of scale for air carriers, lower fares for consumers, and a higher variety of choice for consumers. Consequently, from the perspective of the policy analyst, the behaviour of the actors in this case would most probably be regarded as strategic behaviour.

Arguably, three out of four perspectives suggest that the actors in this case are displaying strategic behaviour. However, from the perspective of the business analyst, the behaviour would not be characterised as strategic. All in all, it cannot be determined unequivocally that the behaviour of the various actors in the negotiations on an Open Skies Treaty should be qualified as strategic behaviour.

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² COM (2002) 649, p. 4.

³ Official Journal of the European Union 1992, L 240/1.

⁴ Official Journal of the European Union 1992, L 240/15.

⁵ 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 versus United Kingdom, Denmark, Sweden, Finland, Belgium, Luxemburg, Austria, Germany.