

international passengers traveling to or from U.S. interior cities use domestic services for some portion of their international journey. Code sharing should increase competition among domestic carriers to carry those passengers on the domestic segment of their international journey.

Although we expect the expansion of cooperative arrangements to be largely beneficial, there may be some negative effects. The greater traffic access of participants may give them considerable competitive muscle, and we may need to watch for harmful effects on competition. In addition, cooperative arrangements may affect the availability of civil aircraft to meet emergency airlift requirements. Our national defense establishment relies on U.S. civil aircraft committed to the Civil Reserve Air Fleet program to respond to worldwide crises. As set forth in our National Airlift Policy, the global mobility needs of our national defense establishment, and ensuring that the nation's defense air transportation needs are met during peace and contingency operations, are important considerations.

Global systems and the growing use of code sharing may put significant competitive pressure on carriers whose strategy does not include participation in such systems or in code-sharing alliances, or whose options to participate may be limited due to the lack of potential partners. Such carriers will have to develop other commercial responses to compete effectively. We expect these pressures and responses to lead to a restructuring of service and airlines, similar to the U.S. domestic experience in the 1980s. Overall, cities and consumers will probably enjoy improved service and access to the international transportation system, although some cities may have fewer or less convenient service options in some markets than they have today. Similarly, although some airlines will grow and prosper, others will not. Moreover, we recognize that the balance of benefits in any particular alliance will depend on the specific structure of that arrangement between the partners. Overall, this evolution should expand the level and quality of international air service for consumers.

Code-sharing arrangements are designed to address the preference of passengers and shippers for on-line service from beginning to end through coordinated scheduling, baggage- and cargo-handling, and other elements of single-carrier service. However, innovative service products, such as code sharing, can only respond to consumer preferences accurately, and

thereby enable the marketplace to function efficiently, if consumers make choices based on full information. Therefore, we must ensure that airlines give consumers clear information about the characteristics of their service product, and that consumers can distinguish between code sharing and other forms of service.

In addition to the two types of global networks (sole-carrier systems and joint carrier systems), there will continue to be a role for air services outside of global networks. The U.S. experience with deregulation indicates that—absent legal barriers to entry—specialized competitors will enter the market and discipline the pricing and service behavior of the larger network operators. The introduction of technologically advanced aircraft such as the B-767, the MD-11 and the B-777 make direct service on longer or thinner routes economically viable. Moreover, airlines can viably serve heavily traveled routes with point-to-point service.

In short, as indicated by our domestic experience, a variety of service forms—global networks with carriers participating either as the sole provider or as participant in a joint network, and regional niche carriers—can exist in the international aviation market and the competition among these services will enhance consumer benefits through efficient operations and low fares. Thus, our international aviation strategy should provide opportunities for all of these forms of service so that we realize the benefits from maximum competition among them.

Our airlines are well positioned to be primary participants in all aspects of the future global marketplace. In recent years, our largest domestic carriers have become our primary international carriers, replacing specialized international operators. After operating in a deregulated domestic market for more than 15 years, our carriers have developed operating efficiencies that give them a cost advantage over their major foreign competitors. Moreover, the financial positions of our carriers are improving due to their cost-cutting measures and improving economic conditions. Coupled with their cost efficiencies, their improving financial status will further enhance their competitive capabilities. Over time, however, trends toward privatization and increased productivity of major foreign competitors may affect the current cost advantage U.S. airlines enjoy. We must try to provide our carriers with the flexible rights and economic environment that will enable them to respond to the dynamics of the marketplace.

Intergovernment Aviation Relations

International air services between two nations have traditionally been conducted pursuant to bilateral agreements. The U.S. National Commission to Ensure a Strong Competitive Airline Industry and the European Union's Comité des Sages for Air Transport have both recognized that the bilateral system is limited in its ability to encompass the broad, multinational market access required by the new global operating systems. Consequently, progress in developing global networks has been and will be extremely fragmented and may preclude or limit the development of efficient operations. We must consider alternative forums for international aviation negotiations and agreements in which we can obtain the necessary broad access rights. We should examine the feasibility of achieving multilateral air service agreements among trading partners. Although such negotiations may be more complex and difficult because of the number of parties involved, they should be undertaken when they present a reasonable prospect for further liberalization.

Moreover, some governments are taking steps to enhance their airlines' positions both by restricting the development of new, competitive services and by trying to overcome, through government fiat, their carriers' cost disadvantages that make it difficult for them to compete against U.S. airlines in a free market. These efforts underlie many of the disputes we face in international negotiations today.

Such countries are responding to the highly competitive integrated and global air transportation market, in which their airlines may not be fully prepared to compete. Most foreign airlines are only beginning to adapt to the more competitive operating environment through such mechanisms as streamlining costs and realigning their operations to achieve greater productivity and operating economies. For state-owned airlines, privatization is an important initial step as it will lead those airlines to develop cost-efficient operations and, in the longer term, to expand their markets. These governments also may be reacting to the U.S. airlines' recent operating successes in the international aviation market, which are largely attributable to the U.S. airlines' productivity and competitive gains.

Some national governments continue to give their national airlines financial aid. Some also distort the marketplace by permitting their national airlines to maintain ground-handling and other