

**FLYING FRIENDLIER SKIES:
THE EFFECT OF THE 2002 ECJ 'OPEN SKIES' RULING ON EU-US AIR
TRANSPORTATION NEGOTIATIONS – A STUDY IN POLICY CONVERGENCE**

by

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Abstract

The international air transportation industry has historically been a paradox. While the industry enables globalization, historically, the international air transportation regulatory regime has been largely mired in protectionism. This restrictive regime was developed by national actors, who either owned or heavily subsidized their domestic carriers, and guarded their interests very closely, thus insulating the industry from large levels of foreign competition. This paradox of international air transportation continued until the development of convergence in regulatory policy through the 2007 'open skies-plus' air transportation agreement between the United States (US) and the European Union (EU). This thesis examines the developmental process of this agreement as an examination of policy convergence theory, in order identify the explanatory powers leading to the formation of the 'open skies-plus' agreement.

To identify the explanatory powers, a comparative analysis is established, using two historical reference points, t_0 and t_1 , as case studies. This thesis uses two mechanisms for the development of policy convergence, international harmonization and regulatory competition, to identify why the convergence took place at this specific time and why it was set at this specific level of regulation. Using these mechanisms, the 2002 European Court of Justice (ECJ) 'open skies' ruling is identified as the explanatory power for the convergence of policy in this field, and the precedent set by the previous bilateral agreement between the US and the Netherlands is identified as establishing the standards of regulation in the 2007 'open skies-plus' agreement. The thesis concludes with an examination of the prospects for further liberalization of transatlantic air transportation, as well as recommendations for the continued development of the field.

Key words: United States, European Union, Policy Convergence, 'open skies-plus', ECJ, European Community, European Commission, Council of the European Union, Open Aviation Area, Air Transportation Agreement, Chicago Convention, Bermuda II

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List of Abbreviations

American Airlines (AA)
British Airlines (BA)
British Midlands Airways (BMI)
Convention on International Civil Aviation of 1944 (Chicago Convention)
Council of the European Union (Council)
European Civil Aviation Conference (ECAA)
European Commission (Commission)
European Common Aviation Area (ECAA)
European Community (EC)
European Court of Justice (ECJ)
European Union (EU)
International Air Transport Association (IATA)
Open Aviation Area (OAA)
Royal Dutch Airlines (KLM)
United Kingdom of Great Britain and North Ireland (UK)
United States of America (US)
United States Department of Transportation (US DoT)

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Chapter One: Introduction

Historically, the international air transportation industry has been a paradox - while air transportation is a visible enabler of international business, tourism and globalization, the industry itself has been dominated by protective national regulations on cross-border control and competition (Robyn *et al*, 2002). Even before the development of powered flight, national actors began developing a heavily restrictive framework for the regulation of international air transport. This was initially pursued as a means of defense from cross-border military incursion, particularly by the United Kingdom of Great Britain and North Ireland (UK). This soon changed with the development of nationally owned, 'flag carrier'¹ airlines, from which governments developed a stake in the industry, and subsequently acted to protect their interests. In the immediate aftermath of the two World Wars, there were significant attempts, most notably by the United States of America (US), to ease the regulations on the industry, but these were overcome by the desire to maintain national superiority over the ownership and operation of air transportation.

¹ The term flag carrier airline refers to airline companies that were traditionally established and operated by the national government of a state. After the industry was deregulated, many of the 'flag carrier' airlines became privatized, at least partially. Currently, they are the largest airline of a given state, and often carry the name of the state its flag on their airplanes. Examples of such airlines are British Airlines, Air France and Lufthansa.

The restrictive regulatory regime continued until the late-1970s when the US initiated a campaign to liberalize² the industry, the first action of which was the deregulation of their domestic market. This initiated change from the previous restrictive regulatory regime towards a more liberalized international market. The US quickly followed domestic deregulation with a round of renegotiating foreign bilateral agreements, which had great effect on reducing the protectionism in international air transportation. The deregulatory measures launched by the US coincided with a general movement towards liberalization by global political and economic actors during the 1980s, most notably by the Reagan administration in the US and the Thatcher government in the UK. The shift towards liberalization continued with the establishment of a single European aviation market in the early-1990s, greatly opening access and competition for intra-European air transportation. At the same time, the US again renegotiated many of its bilateral agreements with many European countries towards larger levels of liberalization.

Generally, economic liberalization entails lower prices and better products for consumers, increases competition and cost benefits for businesses, and creates more and superior opportunities for employees. The economic benefits of liberalization over the past 30 years have been particularly evident for the international air transportation industry. Between 1987 and 1993, passenger traffic between the US and foreign destinations increased by 47%, largely in part to

² For the purpose of this paper, liberalization will be defined as “the exposure of air transport to *laissez-faire*, or free-market, forces, achieved through the removal of most regulatory controls...permitting carriers to enter and leave markets at will” (Goetz and Graham 2004:270). More specifically, this definition will be expanded to include the removal of nationality-based restrictions on air transportation ownership and operation, as well as removal of regulatory control over fare setting, frequency of flights, destinations, and the ability to enter in code-share alliances.

reduction of international restrictions during this time period (Robyn, Reitzes, Moselle 2002). Growth in air transportation in the US continued. Between 1993 and 1998, combined domestic and international air traffic in the US increased from 93.4 million passengers to 126.1 million (Button and Taylor 2000). Liberalization of the air transportation industry also created economic benefits for cargo services. Between 1990 and 2003, the cost of air cargo transport was nominally reduced by 9% between the US and countries that agreed to liberalizing bilateral agreements, while the volume increased greatly (Micco and Serebrisky 2006, Piermartini and Rousova 2008).

Opening air transportation markets to further competition can also provide large cost benefits to consumers and employees. In 1983, before the conclusion of new bilateral agreement between the UK and the Netherlands, the lowest cost of airfare between Heathrow airport in London and Amsterdam was £83. Two years later, after a liberalizing bilateral agreement was signed, the lowest cost of fare for the same route was £55. This was do to an increase in competition from new carriers, which added 15 more flights on this route, forcing the previous carriers British Airlines (BA) and Royal Dutch Airlines (KLM) to lower their fares. Button and Taylor (2000) show that liberalization can also create large advantages for employees and their local communities. They calculate that by increasing the number of transatlantic destinations served from 3 to 4, 1760 to 2900 new employment opportunities are created for the region, resulting in an economic benefit of up to \$160 million per annum. For larger markets, adding additional destinations show diminished returns, but still provide economic rewards for the

local community. When the number of transatlantic destinations is increased from 20 to 21, around 440 new employment opportunities are created (Button and Taylor 2000).

The liberalization of the air transportation industry can provide benefits for governments, business, employees, and consumers. Because of these benefits, many national and international organizations have advocated on behalf of liberalization³. In the 1980s, the US began the process of liberalization far earlier than their European counterparts, which operated in a fragmented and regulated market. Because of the contrasting regulatory regimes, the US and the Member States of the European Union (EU) carried asymmetric goals towards the standards of liberalization in international air transportation.

In the early 1990s, the EU Member States began to shift towards liberalization with the development of a single European aviation market. Through the 'three packages' of legislation⁴, culminating in 1997, the EU deregulated intra-European air transportation market. During this time, the European Commission (The Commission) sought to gain the right to negotiate a European-level air transportation agreement with the US, which would have to be granted by the Council of the European Union (The Council). Several Member States also renegotiated their bilateral agreements with the US, but at varying levels of liberalization. While many of the protective, nationality-based regulations on air

³ See (US Department of Transportation: 1995); (US Department of Commerce: 2007); (European Commission- Directorate General of Energy and Transport: 2003);(European Commission- Directorate General of Energy and Transport: 2007); (International Air Transport Association: 2006)

⁴ (Council Regulation 3975/87/EEC); (Council Regulation 3976/87/EEC); (Council Directive 87/601/EEC); (Council Decision 87/602/EEC); (Council Regulation 2342/90/EEC); (Council Regulation 2343/90/EEC); (Council Regulation 2344/90/EEC); (Council Regulation 2407/92/EC); (Council Regulation 2408/92/EC)

transportation were being removed, little congruence developed as to the appropriate level of liberalization.

The international irregularity of policy continued until 2007, when the US and the EU developed the 'open skies-plus' agreement⁵ for the regulation of air transportation services between the two trading partners. The agreement contains a high-level of liberalization and develops strong congruency to the specific policies for the regulation of the transatlantic industry. Considering the disjointed and heavily regulated environment from which this agreement developed, 'open skies-plus' is a remarkable development for the air transportation industry. My thesis will specifically focus on the developmental process of the 'open skies-plus' agreement in order to identify the factors in the formation of policy convergence in this field, ending the longstanding paradox in the international air transportation industry.

Thesis Statement

In Europe, the 'flag carriers' operated in virtual monopolies within their respective markets. States viewed air transportation operations as public services. Much like other forms of public transportation, air carriers were owned and operated by states, typically at a loss, as a service for to citizenry (O'Reilly and Stone Sweet, 1998). Even before the US market was deregulated, their domestic air transportation carriers operated within a different environment than the carriers in Europe. Multiple carriers operated domestic and international services in the US, and while the market was still heavily regulated, there was some competition,

⁵ I will refer to the 2007 Air Transportation Agreement between the US and the European Union informally as 'open skies-plus', as per the academic naming of the agreement. (Air Transport Agreement between the United States and the Member States of the European Union, 2007)

unlike the monopolies in the European industry. The US government viewed carriers more as private businesses, and was therefore, more receptive to liberalization of the industry.

Beginning in the 1980s, some EU Member States began considering air carriers in this regard, no longer as public service. When the air transportation industry shifted towards privatization, Member States also adjusted the regulatory regime. When air transport became a private business, states changed the regulation of the industry towards the most beneficial regime for the operation of these services. As noted above, increased liberalization has proven to be the most successful regulatory regime available for the operation of air transportation services. After the industry was no longer viewed as a public service, the shift towards liberalization in the Member States was natural.

While the above section offers an examination of the reasons behind liberalization in the air transportation industry, this thesis is not primarily focused on why liberalization developed, but rather how a common regulatory regime was developed in the transatlantic market.

My thesis will examine *why*, after fifty years of attempts to create a European-level air transportation agreement by the Commission and thirty years after the US began the initiative to liberalize the industry, air transportation policies have converged between the EU and the US at a high-level of liberalization in the 2007 'open skies-plus' agreement. I will argue that the 2002 European Court of

Justice (ECJ) ‘open skies’ ruling⁶, and the Council subsequently granting authorization to the Commission to enter into an agreement with the US, was the explanatory power in the development of policy convergence. I will examine two mechanisms for policy convergence, international harmonization and regulatory competition, to demonstrate *how* the convergence took place, and *why* the agreement is set at this specific level of regulation. I will establish a comparative study of two historical reference points, t_0 and t_1 , to demonstrate that during this timeframe the ‘environmental conditions’ remained the same, with the exception of the 2002 ECJ ‘open skies’ ruling and subsequent authority granted to the Commission, thereby isolating this event as the explanatory variable in the development of policy convergence in this field. In this thesis, I will identify the different motives for the actors involved towards liberalization of the transatlantic air transportation industry, but I will primarily focus on the processes that led to the development of policy convergence.

The following Chapter Two: Theoretical Framework will establish the theoretical framework and methodology, under which my thesis argument will be developed. This chapter will include a brief review of the terms and topics included in the literature of policy convergence theory and will examine the mechanisms that can be identified for the development of this theory. Chapter Three: Historical Development of International Air Transportation Regulation will focus largely on the historical development of international air transportation agreements, specifically between the US and Member States of the EU. In order to provide a

⁶ (Joined Cases C-466/98-469/98, C-471/98-472/98, C-475/98-476/98, 2002 ECR I-9427). For the purpose of this thesis, I will refer to these cases as the 2002 ECJ ‘open skies’ ruling.

background of the 'environmental conditions' from which the 'open skies-plus' agreement developed, this thesis will contain a historical analysis of the regulation of international air transportation. This will include the Chicago Convention of 1944⁷, the deregulation of the domestic air transportation markets (the US in 1978 and the EU's 'three packages' in the late-1980s), the numerous attempts by the Commission to gain competency in the air transportation market from the Council, and will conclude with an examination of the 'open skies-plus' agreement.

Chapter Four: International Harmonization and Chapter Five: Regulatory Competition will present the focal point of the convergence argument, specifically an analysis of the two historical reference points between the early-1990's, t_0 , until completion of the 'open skies-plus' agreement in 2007, t_1 . It is within this time frame that the specific mechanisms for convergence developed and can be observed. A comparative analysis of the failed attempts at convergence in the early-1990s, when the mechanisms were not present, to the successful completion of the policy in 2007, will identify how and why the convergence in policy developed. Chapter Four will examine the international harmonization mechanism and Chapter Five will analyze the regulatory competition mechanism. The examination of these two mechanisms will demonstrate how convergence of policy took place in the regulation of air transportation between the US and the EU between the historical reference points t_0 and t_1 .

Chapter Six: Conclusions, Outlook and Recommendations will summarize these arguments and, with these conclusions in mind, assess the future of the

⁷ (Convention on International Civil Aviation, December 1944)

transatlantic air transportation industry. The process of policy convergence between the US and the EU is incomplete, with the two partners in the midst of negotiating a further liberalizing air transportation agreement. This thesis will briefly analyze the significance of such an agreement on the transatlantic air transportation industry, and the urgency in which it is required to be finalized.

Chapter Two: Theoretical Framework

Over the past fifty years there has been an increase of scholarship in the field of policy convergence. Policy convergence is the process in which separate structures continuously develop similarity and likeness in their policies and regulations. While there has been much work recently in this field, there is – ironically - limited convergence in the theoretical study of policy convergence⁸. Echoing Tews (2002), Knill claims that the “empirical and theoretical assessment of policy convergence is generally hampered by the use of different, partially overlapping concepts” (Knill, 2005: 765). Because of this ambiguity I will, for the purpose of this thesis, briefly examine relevant concepts related to policy convergence, and in doing so, will establish a common terminology for coherent analysis of the subject matter.

There are many terms related to policy convergence, of which I will examine the three: policy transfer, policy diffusion and isomorphism. Policy transfer “processes by which knowledge about policy, administrative arrangements, institutions and ideals in one political system (past or present) is used in the development of policies, administrative arrangements, institutions and ideals in another political system” (Dolowitz and Marsh, 2000:5). In this process, new policy types are not developed; instead previously established policy is taken from an independent political system and imitated by a separate system making policy changes. Similar to policy transfer, policy diffusion is defined as “the socially

⁸ See (Heichel *et all*, 2005)

mediated spread of policies across and within political systems, including communication and influence processes which operate both on and within populations of adopters” (Knill, 2005:766). The use of the term diffusion can be linked to its scientific definition, implying the dispersion of an idea or policy throughout a specific international environment. In this process, models of a specific developed policy are diffused throughout separate political systems, creating policies that are similar in nature, but are not exact copies (Kern *et al*, 2005). While policy transfer copies the policies of separate independent political systems, policy diffusion diverges by adapting the models to local circumstances. These two terms are concerned with the process leading to convergence of policy, as opposed to the final outcome. They also describe mechanisms that could, but not necessarily, lead to convergence of policy.

The third related term, isomorphism, is a process that “forces one unit in a population to resemble other units that face the same set of environmental conditions” (DiMaggio and Powell, 1991:66). The term comes from organizational sociology, and is very similar to policy convergence in that it studies the mechanisms causing separate institutions and organizations to resemble each other. The two terms diverge in the focus of the literature studying the two theories. Policy convergence focuses on the changing characteristics of national policy, whereas isomorphism studies are concerned with institutional structures and cultures (Knill, 2005).

These three related terms are essential for understanding the mechanisms of policy convergence theory because they describe some of the ‘environmental

conditions' in which policies could converge with each other on the international level. While these terms relate to policy convergence, they are each separately incomprehensive in their descriptions of the mechanisms of this theory. In the following section, I will further explain the theory of policy convergence and identify the mechanisms described in the literature for its development.

Policy Convergence

The consensus definition of policy convergence is “the tendency for societies to grow more alike, and to develop similarities in structures, process, and performances” (Kerr, 1983:3). In defining policy convergence, Drezner (2001) retains Kerr’s phrase, but substitutes societies with policies. This is a more accurate illustration of the modern state of the literature on the term, in which many scholars examine specific policies cross-nationally as examples of convergence between political systems. Most scholarship on convergence focuses on cross-national policies, with the majority of the studies focusing on either environmental agreements⁹ or the control of capital flows¹⁰. As mentioned above, the literature on policy convergence theory is spread across many disciplines, and as a result, there has been problems in merging the scholarly work and clearly defined theory building. Recently many scholars have written articles reviewing the literature and attempting to succinctly define the theory¹¹, but none have been completely successful in doing so. Because there is little convergence in the field, I will rely on

⁹ (Drezner 2001, 2005); (Lenschow *et al*, 2005); (Kern *et al*, 2000)

¹⁰ (Simmons and Elkins, 2004); (Drezner, 2005)

¹¹ (Bennett, 1991); (Holzinger and Knill, 2005); (Heichel *et al*, 2005); (Drezner 2001, 2005); (Knill, 2005)

all of the authors mentioned above to define the theory and mechanisms of policy convergence.

Bennett (1991) claims that the study of convergence should be seen as the process of policies becoming more similar, as opposed a study of the developed states of being alike. Because of this, the recommended approach to theory is comparative analysis of case studies, as opposed to statistical analysis, which would be better suited for studies of the outcomes of the policy. Bennett stresses the importance of focusing on the policy content, the rules, regulations, laws and formalities of the policy, and the policy instruments, the mechanisms available in the institution to apply and enforce the policy, as the research dimensions for policy convergence (Bennett, 1991). In this thesis, I will follow Bennett's design of research dimensions, as it most aptly fits a comparative case-study model and allows for focus on the process of convergence, as opposed to analyzing the outcomes of a developed policy. I will examine the 2002 ECJ 'open skies' ruling and subsequent action by the Council of the EU granting the European Commission competency to negotiate in this field and the previous bilateral agreements between the US and the EU Member States as the policy content. I will also examine the influence of EU law and the single market initiatives of the EU as the policy instruments in this analysis of the 'open skies-plus' policy.

Heichel *et all* (2005: 829) claim that "by definition, convergence means the development of policy similarity over time". Therefore, when establishing reference points for case-studies, one of the "most decisive of which is time." Convergence research cannot solely infer that policies are alike, it must first recognize that they

were once dissimilar, and that policies did merge with each other over a specific time-frame, in order to prove that convergence did occur (*Ibid*). The comparison of established specific time reference points is essential to the proof of convergence in policy between clearly identified, independent political systems. The time-frame for the comparative case studies can be noted as t_0 , the 'before' historical reference point, and t_1 , the 'after' historical reference point. Comparing t_0 with t_1 will show that convergence took place over this period, and the explanatory powers for which can be identified within this time frame. The recommended 'medium time-frame' for reference points is fifteen to twenty years (*Ibid*).

For the purpose of this thesis, the t_0 historical reference point will be the negotiation of bilateral agreements of the early 1990s, and the t_1 historical reference point will be the culmination of the 2007 'open skies-plus' air transportation agreement. A comparative analysis of these two case studies will demonstrate that policy convergence did take place in the air transportation industry between the US and the EU. The convergence of policy can be identified through an examination of the mechanisms that led to the 'open skies-plus' agreement. The following section identifies the mechanisms discussed in the literature that can lead to policy convergence.

Mechanisms for Policy Convergence

There are many mechanisms observable in the international community that can be used to describe the process in which policy convergence takes place. They can be grouped into three categories: elite networking, international harmonization and regulatory competition (Holzinger and Knill, 2005).

Emulation

The term 'elite networking' refers to how policies are determined within 'epistemic communities'¹², and are characterized by governments examining at the policies of others with their community, and using the information in varied manners to make conclusions about their own policies. One of the processes in this category that could lead towards policy convergence is emulation. Emulation is very similar to policy transfer and can be defined as the intentional borrowing or copying by one political system of a policy from another and adopting it as their own. Emulation implies the voluntary and intentional direct copying of a specific policy (Bennett, 1991). In emulation, principals of a policy are taken from a separate system and are slightly changed by a system to hopefully improve on them. Holzinger and Knill (2005) link emulation to two other mechanisms under the elite-networking category. 'Lesson-drawing' is when governments refer to a specific environment of policies and pick and choose parts of different policies that suit them best. 'International policy promotion' is when international institutions promote or advocate a specific policy, but do not force adherence to it through methods of coercion. The elite networking mechanism is useful in defining many of the developments of policy convergence, but does not properly describe the factors leading to the 'open skies-plus' agreement examined in this thesis.

¹² Drezner defines epistemic communities as "a network of policy experts who share common principled beliefs over ends, causal beliefs over means, and common standards of accruing and testing new knowledge" (Drezner, 2001:63).

International Harmonization and Regulatory Competition

The second mechanism for policy convergence, international harmonization, is defined as a process “that leads to cross-national convergence if the involved countries comply with uniform legal obligations defined in supranational law” (Holzinger and Knill, 2005:781). This mechanism requires specific policy developed out of international communities, in which the member states are legally required to adopt the policy or regulation. When an international institution develops policy with strong enforcement capability over its members, there is likely to be a strong degree of convergence towards this policy. In this thesis, the international harmonization mechanism will be used to describe the process in which European-level governance was granted competency to negotiate a foreign air transportation agreement with the US, resulting in the ‘open skies-plus’ agreement. In Chapter Four: International Harmonization, this mechanism, the process towards granting EU competency, and the establishment of policy convergence in this field will be further developed and analyzed.

The third mechanism for policy convergence, regulatory competition contends that when states are faced with economic pressures in international trade, they will adjust their regulatory standards to be more similar, and therefore, more properly equipped for international competition (Holzinger and Knill, 2005). States converge on a cross-national policy in order to avoid loss of their share in a particular market to international competitors. In regulatory competition, it is likely that the level of regulation will be set at the standards of the most laissez-faire country (Drezner, 2001). The regulatory competition mechanism helps describe

why states develop similar policies for international trade, and how the regulations in this policy are set at specific levels of liberalization. For the purpose of this thesis, I will use this mechanism to establish explanations for how and why policy convergence developed between the US and the EU. Chapter Five: Regulatory Competition will contain a more in-depth discussion of this mechanism and will then continue with an examination of how regulatory competition can describe the development of policy convergence in the 'open skies-plus' agreement.

Chapter Three: Historical Development of International Air Transportation Regulation

The following chapter will focus on the historical development of international air transportation regulation and will demonstrate the 'environmental conditions' under which the 'open skies-plus' agreement between the US and the EU developed. This chapter will focus on the beginnings of international air transportation regulation, the deregulation of domestic markets in the US and the EU, the attempts by the Commission to gain external trade negotiation competency from the Council, and will conclude with an analysis of the 'open skies-plus' agreement.

Beginnings of Regulation and the Chicago-Bermuda Regime

The regulation of international air transportation has historically been dominated by strong governmental protection of national interests. Beginning in 1880, thirty years before the Wright Brothers and Bleriot, various international organizations have attempted to adopt rules for the governance of aviation (Jönsson, 1987). In 1910, delegates from eighteen European countries met in Paris to convene the first major conference on international air code. During the Paris Conference, two diverging principles to the regulation of the industry emerged. The French and German delegation argued in favor of extensive freedom of flight, whereas the British delegation supported national sovereignty over air. The Conference suspended with no major international agreements, and did not reconvene before the outbreak of World War I. Instead, the British Aerial

Navigation Act of 1911¹³ established precedent for national protection and sovereignty over its airspace in Europe. Soon thereafter, England, France and Germany all created prohibited air transportation zones in their border regions. With the beginning of World War I in 1914, European countries closed off their air boundaries to foreign air transportation.

After the war ended, the international community discussed the regulation of civil aviation at the Paris Convention of 1919, as part of the overall peace talks. The Convention created the principle of unrestricted state sovereignty, meaning the state has the ultimate authority over the regulation of its airspace. This created the system of bilateral agreements between states that has remained the decision-making procedure for the regulation of the air transport (Jönsson, 1987). Bilateral agreements have developed under the model of reciprocity, in which agreeing states grant equivalent aviation rights to each other's airspace. The 'horse trading' that took place during these bilateral agreements created an extremely restricted transatlantic market, which was not resolved until after the end of World War II. It is also worth noting that although the US and the Soviet Union were not signatures to the Treaty of Versailles, and also therefore to the accords of the Paris Convention, they still operated under the same principles of national sovereignty and bilateral agreements as the international community.

In November 1944, delegations from 54 nations convened the Convention on International Civil Aviation, which has become known as the Chicago Convention, to decide the future of air transportation after the end of World War II. The US entered

¹³ (Aerial Navigation Act, 1911)

the Chicago Convention with the intention of abandoning the principle of national sovereignty of air transportation in favor of 'open skies'. At the opening of the Chicago Convention, President Roosevelt asserted:

Let us rather, in full acknowledgement of the sovereign rights of all nations and the legal equality of all peoples, work together in order that the skies of the world can be exploited by man for all mankind (Sampson 1984, 66).

While the US argued in favor of ending national control of the skies, the international community rejected this assertion, and decided to further affirm the system of national sovereignty and bilateral agreements in the Chicago Convention (*Ibid*).

Beyond the reaffirmation of the previous regulatory regimes of the Paris Convention, Chicago marked the establishment of the eight 'freedoms of air':

- The *first freedom* grants the right for an aircraft to land in foreign territory for technical or safety purposes
- The *second freedom* allows for an aircraft to land in foreign territory for technical or safety purposes.
- The *third freedom* is the right to transport passengers and cargo from one's home country to foreign territory.
- The *fourth freedom* awards the right to carry passengers and cargo from a foreign country to one's own. The third and fourth freedoms are typically granted simultaneously.
- The *fifth freedom* grants the privilege to carry passengers and cargo from one's home country to a second, and then on to a third country.
- The *sixth freedom* allows for the transport of passengers and cargo from a second country to a third, by stopping in the home country. For example, an Asian carrier is able to offer transportation from Europe to North America by making an intermediate connection in their home country.
- The *seventh freedom* is the right to operate service between a second and third country, without making a connection to the home country.
- The *eighth freedom*, also called cabotage, grants the right to conduct air transportation between destinations within only one, single foreign country. (Bartlik, 2007; Doganis, 2001; Jönsson, 1987)

The first two freedoms, considered 'technical freedoms', were granted by the Chicago Convention to all signatory countries, which is considered to be the greatest

improvement over the Paris regime. States were therefore allowed civil aircraft to fly over foreign territory, without the need to enter into a bilateral agreement with them, allowing for the opening of many new routes (Jönsson, 1987). While universally granting the first two freedoms was a step forward in terms of opening the skies, the failure of the Chicago Convention to ensure further 'freedoms of air' secured the nationally protective system.

After the Chicago Convention, the US and European countries, led by the UK, still held diverging objectives for the regulation of international air transportation. The US advocated for freedom of the air traffic rights, whereas the UK favored strong governmental control over the regulation of air transportation. The two powers compromised in the 1946 Bermuda agreement¹⁴, which defined the philosophy for other bilateral agreements worldwide (Lawton, 1999). The principles of the agreement were very restrictive: exact routes between the two countries were to be negotiated in the bilateral agreement, and each government was granted the right to control which specific carriers were allowed to operate these routes; the frequency of flights and the capacity of airplanes was left up to the air transportation operators, but the governments retained the power to intervene on behalf of their national interests; and the International Air Transport Association¹⁵ (IATA) would hold negotiations between the air carriers to determine the fares (Jönsson, 1987).

¹⁴ (Air Transportation Agreement between the United Kingdom of Great Britain and North Ireland and the United States of America, 1946)

¹⁵ The International Air Transport Association, established in 1945, is an industry trade group of international air carriers that helps develop and organize the setting of fares.

The compromise that was developed in the Bermuda Agreement greatly favored the negotiating position of the UK. The only provisions of the agreement allowing for market forces - the ability to set frequency and capacity of flights - were often overruled by national legislation. The provisions allowed for governmental intervention, and the European states “never accepted the flexibility of the Bermuda Agreement: they insisted on fixing frequencies and fares rigidly” (Sampson, 1984:92). The Bermuda Agreement did grant third and fourth freedoms to both trade partners, but the UK did not agree to US demands for extensive fifth freedom rights. Granting such rights would be negotiated on a country-by-country basis in supplementary agreements (Zacher and Sutton, 1996). The precedent setting Bermuda Agreement made for an extensively regulated international air transportation market, heavily influenced by national protection of their interests. The US and UK set the international standard for bilateral agreements that made for more closed markets in the industry for the decades that followed.

From the Bermuda Regime to ‘Open Skies’

In the first years of the Council, discussions were held as to the possibility and means of creating regional co-operation in the air transportation industry (Sochor, 1991). In 1954, the European Civil Aviation Conference (ECAC), a regional consultative organization for the industry, was established. The push for the European-level control of the regional air transportation was included in the establishment of the European Community (EC) in 1957. Under Article 80(2) of the

Treaty Establishing the European Community (Treaty of Rome)¹⁶, “the Council may, acting by a qualified majority, decide whether, to what extent, and by what procedure appropriate provisions may be laid down for sea and air transport”. This Article gave the Council large abilities to enact European-level regulations. In 1964, the Commission attempted to expand on this provision in an effort to create a common transport policy for both sea and air transportation (Lawton, 1999). In the end, the Council did not accept the Commission’s plan because there was little backing from the national governments for granting European level competency (Sampson, 1985). For the following 25 years, the Commission sought to develop common European air transportation policies, but very little substantial progress occurred.

In 1977, the US and the UK negotiated a second bilateral agreement known as ‘Bermuda II.’ The British government believed that the previous agreement had become disadvantageous to their carriers, in relation to their US counterparts. The US had negotiated supplemental agreements to the original Bermuda agreement with the UK, granting their carriers fifth freedom rights to carry passengers from London Heathrow to most major European destinations. The ‘Bermuda II’ agreement rolled back many of the fifth freedom rights for US carriers, while at the same time, created new routes for British carriers to US cities. The agreement also restricted the access to Heathrow Airport to two US carries, limited the number of US cities eligible for non-stop service to Heathrow and Gatwick airports, and “effectively disallowed pro-competitive pricing initiatives” (Robyn *et all*, 2002).

¹⁶ (Treaty Establishing the European Economic Community, 1957)

Many in the US considered 'Bermuda II' to be more restrictive than the previous agreement (Jönsson, 1987).

In 1978, the US, partly in response to the provisions of 'Bermuda II', established the position of liberalization for air transportation, beginning with the deregulation of their domestic market. President Jimmy Carter announced the primary objective should be "to move toward a truly competitive system", one in which "market forces should be the main determinate of the variety, quality and price of air services" (Jönsson, 1987:36). The deregulation of the domestic US market was the first major step towards the liberalization of the international air transportation industry.

In the first half of the 1980's, the US and the UK became the leaders in a global trend towards general economic liberalization. During this time, the EC initiated development towards the creation of a Single Market. In 1984, the UK and the Netherlands negotiated a new bilateral agreement that effectively liberalized air transportation between the two countries. This agreement was a breakthrough for the European market, and initiated renegotiation of other bilateral agreements between European countries (Doganis, 2001). By the end of 1985, the UK had negotiated new air service agreements with Germany, Luxembourg, France, Belgium, Switzerland and Ireland. Not all of these agreements were as liberalizing as the agreement with the Netherlands, but they reduced many of the restrictions that national actors had enacted on the industry. While the UK became an initiator of liberalization in the European market, they, like the rest of the European

countries, remained protective of their national interests in transatlantic relations and did not renegotiate with the US at this time.

Until the mid-1980's, European institutions had been largely inconsequential and uninvolved in the development of air transportation agreements, but with the movement towards deregulation and the creation of a Single European Market, the Commission began to have an increasingly influential role (Lawton, 1999). In 1987, the Council agreed to the first of 'three packages' that would lead to the deregulation of the internal European aviation market. The most important provision of the 'first package'¹⁷ was the inclusion of air transportation into the competency of the EC (Bartlik, 2007). As previously noted, Article 80(2) of the Treaty of Rome grants the Council the discretion to decide whether it desires to act in the fields of air and sea transportation, and the ability to decide what the "appropriate provisions" for such actions would be. Until this time, the Council had largely resisted exerting itself in the field of air transportation. The 'second package' of legislation¹⁸, passed in 1990, further liberalizing the market. The Council decreased regulations on fares and the frequency of flights between Member States. It also granted full third and fourth freedom rights to all members of the EC, and allowed for partial fifth freedom rights.

The 'third package'¹⁹ was the final set of liberalizing provisions, culminating in the deregulation of the European air transportation market. Full fifth freedom rights were granted to all European carriers, and all remaining constraints on

¹⁷ (Council Regulation 3975/87/EEC); (Council Regulation 3976/87/EEC); (Council Directive 87/601/EEC); (Council Decision 87/602/EEC)

¹⁸ (Council Regulation 2342/90/EEC); (Council Regulation 2343/90/EEC); (Council Regulation 2344/90/EEC)

¹⁹ (Council Regulation 2407/92/EC); (Council Regulation 2408/92/EC)

frequency and capacity were to be removed. This package also established the eighth freedom, or 'true cabotage'²⁰, was to be gradually introduced and become active by 1997. The extensive control over the setting of fares would also be eliminated by 1996, after which, carriers would only be required to publish fares 24 hours before they become effective. The establishment of these three packages created a unique environment in Europe. While air transportation operations between Member States are still classified as international travel, the carriers function as though they are operating completely within a single domestic, national market (*Ibid*).

Beyond the liberalization of operating procedures for European carriers, the 'third package' introduced two important measures ending nationality-based rules. First, restrictions upon cross-national ownership of air carriers were removed²¹. This is an important and often disregarded step in this process, noting the shift from an industry dominated nationally owned and operated airlines to one that has removed regulations on ownership and opens itself up the European market. Second, the 'third package' removed the exemptions from EC competition laws available for the air transportation industry. This helped further institute the competency of the ECJ over the industry. The establishment of these provisions and implicit induction of the ECJ competency into the field of air transportation became an essential development leading to the 'open skies-plus' agreement with the US.

²⁰ 'true cabotage' is the right to conduct air transportation between destinations within only one, single foreign country without making a stop in the home country of the air carrier (Bartlik, 2007)

²¹ (Council Regulation 2408/92/EC)

In the early 1990's, the US began to renegotiate their bilateral agreements with Member States. The first of these new 'open skies'- framework agreements was established between the US and the Netherlands in 1992²². This agreement created competition between the Member States in their separate negotiations with the US. The goals of the Member States diverged greatly, with many of the larger countries favoring less liberalizing measures than the principles agreed upon in the bilateral between the Netherlands and the US (Doganis, 2001). Perceiving that the opportunity to negotiate a European-level air transportation agreement with the US was beginning to fade, the Commission strongly asserted its dissent to the wave of new bilateral agreements being negotiated by the Member States.

In 1995, Transport Commissioner Neil Kinnock wrote to the six Member States who were in negotiation with the US, and asked them not to sign any further bilateral agreements. He argued that by negotiating from a common European policy, they would be coming from a better bargaining position, and would therefore develop and more favorable agreement. Kinnock threatened to pursue legal action against these Member States; Austria, Belgium, Denmark, Finland, Luxemburg and Sweden, if they signed new agreements with the US (Meurnier, 2003). Nevertheless, these six Member States did sign bilateral agreements in 1995.

The Commission held the opinion that the bilateral agreements with the US were in violation of the Member States' obligations to the Treaty of Rome (Bartlik, 2007). In 1998, the Commission brought this charge against eight Member States²³

²² (Air Transport Agreement between the United States of America and the Kingdom of the Netherlands, 1992)

²³ Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Sweden and the UK

to the ECJ, and argued that they alone had the power to enter into foreign air transportation agreements with the US. In November 2002, the ECJ 'open skies' ruling concluded that the bilateral agreements with the US were contradictory to EU competition laws. This created a void in the air transportation agreements between the US and the Member States. In 2003, the Council intervened and authorized the Commission to begin negotiations with the US on behalf of the Member States. These negotiations concluded with the 'open skies-plus' agreement in 2007.

The 2007 'Open Skies-Plus' Agreement

On April 18th 2007, the US and the EU formally concluded negotiations with the signing of the 'open skies-plus' air transportation agreement. The agreement is the culmination of four years of negotiations between the two trade partners, and takes the place of sixty years' worth of bilateral agreements between the US and the 27 Member States of the EU. 'Open skies-plus' came into effect on March 30th 2008, and will go great measures to promote "significant economic benefits for America and Europe" (US Department of State, 2007). The agreement was modeled after the 'open skies' framework used in the previous bilateral agreements that the US had signed with 16 of the Member States²⁴. The agreement will eliminate most of the regulations on air transportation operations between the US and the European Common Aviation Area (ECAA)²⁵. Previous to the agreement, transatlantic air transportation accounted for more than half of all international traffic. 50 million

²⁴ Austria, Belgium, Czech Republic, Denmark, France, Finland, Germany, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Sweden all had 'open skies' agreements with the US prior to the implementation of this agreement in 2008.

²⁵ The European Common Aviation Area is defined as the 27 Member States of the EU, plus Albania, Bosnia-Herzegovina, Croatia, Iceland, Kosovo, Norway and the former Yugoslav Republic of Macedonia. The Gibraltar Airport is excluded from the ECAA.

passengers, on 400 daily flights, went between the EU and the US in 2007 (*Ibid*). The agreement intends to greatly increase the volume of traffic through liberalization of the air transportation market. Over the next five years, the agreement is projected to add an increase of 25 million passengers, which would result in around 12 billion dollars of economic benefits, and approximately 80,000 new job opportunities will be created in the US and the EU (EU-US Open Skies Air Transportation Agreement Q and A, 2008).

The 'open skies-plus' agreement grants several rights to both trading partners and removes many of the previous restrictions on the transatlantic air transportation operations. The agreement affords third and fourth freedom rights to all air carriers within the US and the ECAA. Air carriers are allowed to fly between any point within these two areas, without any restrictions on pricing, frequency or capacity. This provision creates new markets for US and EU carriers. Previous to the implementation of 'open skies-plus', the US did not have an agreement with several newer Member States, such as Bulgaria, Cyprus, Estonia, Latvia, Lithuania and Slovenia.

This provision also removes the regulations preventing entrance for US carriers into the largest transatlantic European market, London-Heathrow Airport. In 2006, 40% of the total EU-US air transportation traffic was between the US and the UK, with the largest gateway being Heathrow (Buyck, 2008). Previous to the agreement, only two carriers from each the US (American and United Airlines) and the UK (BA and Virgin Atlantic) were allowed to fly between Heathrow and specific US cities. These carriers were also limited by regulations on frequency, capacity and

pricing of their operations. The 'open skies-plus' agreement opens access to the Heathrow market. Since the implementation of the agreement, there are already 18 more daily flights from US cities to Heathrow, an increase of 20% (EU-US Open Skies Air Transportation Agreement Q and A, 2008). The private market is now able to decide the direction of air transportation between the US and UK. Currently, there is strong competition for entrance into the Heathrow market, Alitalia recently sold three of its Heathrow slots for a total of €92 million (Buyck, 2008). While previous air transportation agreements were completed on the national level, a European-level agreement with the US grants carriers from all the Member States equal access to the Heathrow market. Air France now offers service from Heathrow to six US cities, while BA has begun operations from Paris to New York.

The 'open skies-plus' agreement also grants full 'fifth freedom' rights to the US and EU Member States. This provision will allow for carriers to continue flights beyond the transatlantic air transportation area. Previous to the agreement, fifth freedom rights were negotiated on a limited basis, in which the two negotiating countries would decide which specific third countries they would allow access to. Under 'Bermuda II', carriers were not allowed to continue transatlantic flights to several commercially important destinations: namely, China, France, Hong Kong, Italy, Japan and Spain (Robyn *et al*, 2002). Through this agreement, access to all third-countries is now available, particularly the increasingly commercially important destinations in Asia.

It is important to note that this agreement applies to the transport of passengers and cargo. Many US cargo carriers were particularly disadvantaged by

the previous agreements. FedEx, for example, was forced to operate out of Stansted Airport in London since they were not allowed access to Heathrow for their transatlantic transportation of cargo. Because they were not granted 'fifth freedom' rights under 'Bermuda II', FedEx was also not allowed to fly this cargo from London to their European hub in Paris. Transportation of this cargo had to be done via train or bus, or by contracting a EU carrier to fly the cargo (Robyn *et al*, 2002). The 'open skies-plus' agreement also grants seventh freedom rights to cargo carriers. This means that companies are allowed to provide service from either the EU or US to third-party countries, without being required to make a stop in their home country. Through eliminating the regulations of the previous bilateral agreements, air carriers are able to freely decide how best to organize their operations.

'Open skies'-framework agreements contain the provisions previously discussed in this section: unlimited third, fourth and fifth freedom rights, and removal of controls on frequency, capacity and pricing, as well as the ability to enter into code-share agreements with foreign air carriers, which will be discussed below. The 'plus' portion of the agreement between the EU and the US refers to the reduction of the 'nationality clauses' on ownership. Under the 'open skies-plus' agreement, EU nationals are allowed to purchase majority stakes in US airlines, as long as they do not control more than 25% of the voting equity. US carriers are allowed to purchase up to 49.9%, or '50% minus-one', of EU airlines, and are allowed to have up to 49.9% of the voting equity of that carrier. These provisions accentuate a large transition over the past few decades from an industry that was dominated by nationally owned, 'flag-carrier' airlines to one that allows for foreign,

private ownership of these same airlines. Recently, the German airline Lufthansa has purchased 19% of the low cost US carrier, Jet Blue (Michaels and Carey, 2007). Such cross-national investment and ownership is likely to increase in the years following the implementation of the agreement. UK entrepreneur Richard Branson, owner of Virgin Airlines, has expressed interest in starting a low-cost US airline. Under this agreement, Branson would be allowed to start his own airline and operate it as a US company, as long as he does not control more than 25% of the voting stock (*Ibid*).

The 'open skies-plus' agreement also includes provisions for foreign airlines to apply for immunity from anti-trust laws in the US, so that they can freely enter into code-share agreements with US carriers. A code-share agreement is a marketing strategy between two foreign airlines, where one's airline code is marketed on a flight operated by another company. This allows air carriers to cooperate by selling tickets for connecting flights operated by partner airlines to their consumers, which greatly increases their access to international markets. The largest examples of such code-share agreements are the Star Alliance, which includes United Airlines, US Airways, Swiss Airlines, Lufthansa, Air Canada and BMI; and the SkyTeam alliance, which includes KLM, Air France, Alitalia, Delta, and Northwest. Recently, the SkyTeam alliance has applied to the US Department of Transportation (US DoT) for anti-trust immunity, in order to fully include their most recent addition, Delta, to the partnership.

Code-sharing is another example of the reduction of the 'nationality clause' in air transportation, and has been received in Europe as another example in the

transference of power to the supranational level. Pierre-Henri Gourgeon, President and COO of Air France, said that the 'open skies-plus' agreement, "confirms that we were right to take the risk of purchasing the Dutch company while not being Dutch", referring to the merger of Air France and KLM in 2004. "We bet that with time, the only question of ownership would be European", and that it is the "European nationality" that is emerging in the control of the transatlantic air transportation market with the US (Buyck, 2008).

The final major provisions of the 'open skies-plus' agreement are related to the development of further liberalization between the EU and US. The two trade partners established the EU-US Joint Committee to monitor the implementation of the 'open skies-plus' agreement and to ensure regulatory cooperation. The Committee is mandated to meet at least once a year to discuss and mediate issues arising from the 'open skies-plus' agreement. In May 2008, the EU and US began negotiations for a second-stage, further liberalizing air transportation agreement. The EU holds the objective in these negotiations of creating an Open Aviation Area (OAA) between the US and the EU.

An OAA amounts to "a free trade zone in air transport encompassing not just transatlantic operations, but operations within the European Union and the United States as well" (Robyn *et al*, 2002:58). This means that all of the eight freedoms of air established in 1944. The remaining restrictions regarding ownership of foreign airlines would also likely be removed. This would result in the creation of essentially one transatlantic air transportation market, in which carriers, regardless

of their European or US ownership, would operate in either area as if it were their domestic market.

Because this would involve the dissolution of national control remaining over the air transportation industry, there has already been resistance to the progression of such an agreement. The UK, the leading European critic of the 'open skies-plus' agreement, and the US Congress have both expressed contention with such an agreement (EU, US Launch Second Round of 'Open Skies' Talks, 2008). While the detractors from an OAA may be difficult to overcome in negotiations, the 'open skies-plus' agreement carries a provision that ensures a further liberalizing agreement will be met. The two parties are required to develop a second-stage agreement, or significant progress towards one, by November 2010, and if such an accord is not reached, each party reserves the right to suspend the provisions granted in the initial 'open skies-plus' agreement. The EU has threatened to take such action if they are not satisfied with the progress of negotiations with the US.

In terms of liberalization and cross-national policy convergence, the 'open skies-plus' agreement is a remarkable achievement. The principals of regulation and national protection of the industry dates back to before international air transportation was even technologically possible. The agreement removes many of these nationality-based restrictions, and opens transatlantic air transportation to market forces. The following chapter will analyze the 2002 ECJ 'open skies' ruling, and the subsequent measures by the Council granting the Commission the right to enter into negotiations with the US, as an example of the international harmonization mechanism for policy convergence.

Chapter 4: International Harmonization

The previous chapter established the ‘environmental conditions’ from which the 2007 ‘open skies-plus’ agreement was developed, and concluded with an analysis of the provisions of the agreement. The following chapter will demonstrate why the US and the EU converged on air transportation policy at this time. This will be done through an examination of the international harmonization mechanism, which will identify the 2002 ECJ ‘open skies’ ruling and the subsequent regulations by the Council granting the Commission the right to enter into negotiations on behalf of the EU as the explanatory variable in the development of policy convergence.

International Harmonization Mechanism

As previously discussed, in the international harmonization mechanism for policy convergence, cross-national convergence is developed through international legal obligations, which participatory states are legally required to adopt. For the purpose of this thesis, harmonization refers to “a specific outcome of international co-operation, namely to constellations in which national governments are legally required to adopt similar policies and programs as part of their obligations as members of international institutions” (Holzinger and Knill, 2005:781-782). The obligation for states member to an international institution to adopt homogenous policies can be more properly described as ‘uniformity’, as opposed to harmonization. While these two terms are similar, uniformity describes a more ‘top-down’ approach to policy formation, whereas harmonization could be used to

describe 'bottom-up' development of policy. While uniformity could be more properly suited for discussion of this form of policy convergence, for the purpose of this thesis, the term international harmonization will be used as a reflection of the literature in the field.

Two basic conditions must exist for the international harmonization mechanism to be implemented: the national government must first be a member of an international or supranational organization, and this organization must carry strong levels of competency to enforce its obligations on their members. If these two conditions are met, then the degree of convergence through this mechanism varies depending on two further factors. First, the measure of specificity in the international law or regulation carries strong influence on the degree of policy convergence. The more specific and defined the parameters and scope of the law are, the higher the level of convergence will result out of this mechanism. Second, the ability of the international organization to enforce compliance with obligations resulting from the law or regulation on its members affects the level of convergence. When the international organization has strong enforcement capabilities for its actions on its members, there will likely be a high degree of convergence in policy.

With strong specificity of a law or regulation and the ability to enforce their obligations, the level of policy convergence caused by the international harmonization mechanism will be high and tend towards total harmonization (*Ibid*). The following chapter will examine the 2002 ECJ 'open skies' ruling²⁶ as an example of the international harmonization mechanism described above. The chapter will

²⁶ See footnote on page 11

develop the argument that this ruling was the explanatory power leading towards policy convergence in the transatlantic air transportation market between the EU and the US by exhibiting a comparative analysis of the previously described historical reference points, t_0 and t_1 . It will identify the variables and 'environmental conditions' present at t_0 , and will demonstrate that these same variables remained present immediately previous to t_1 . With these variables influencing the transatlantic air transportation, limited policy convergence took place. At t_1 , the 'environmental conditions' remained unchanged; except for the induction of this ECJ ruling and its implications on the Member States into the transatlantic air transportation negotiations, thereby isolating it as the explanatory power.

This chapter will use the methodology defined above to demonstrate that this ruling is an example of the international harmonization mechanism. It will close with an examination of the specificity of the ECJ 'open skies' ruling and the subsequent package of measures by the Council, as well as how the capability of the EU to enforce its laws led to the large degree of policy convergence present in the 'open skies-plus' agreement.

'Open Skies' Framework Agreements (t_0)

During the process of deregulating the domestic US market, the Carter administration developed new policies towards international air transport operations, with the priorities of eliminating restrictions on pricing and capacity, and creating more flexibility for carriers to decide which routes they will operate. This mandate for liberalization in 1978 called for the US to renegotiate their existing

bilateral agreements (Doganis, 2001). The first of these new 'open market' agreements was between the US and the Netherlands in 1983, and was quickly followed by agreements with Belgium and Germany in 1984 (*Ibid*). These agreements reduced restrictions of capacity, and discouraged tariffs, while also allowing for greater market access to destinations in each country. The renegotiation of these transatlantic agreements initiated a similar movement between European countries to conclude more liberalizing bilateral agreements with each other. As previously noted, this process ended with the introduction of European-level control over the internal air transportation industry through the implementation of the 'three packages' of deregulation.

In 1992, the US developed the position that the 'open market' bilateral agreements negotiated with some Member States in the late-1970s did not go far enough in liberalizing air transportation, and began a campaign for 'open skies'. 'Open skies'- framework agreements are characterized by a few key elements: open route access from any point in either of the agreeing countries, unlimited fifth freedom rights, removal of control over frequency or capacity. The US Open Skies Initiative was announced in March 1992, with the goal of developing bilateral agreements containing the key elements outlined above (Oum, 1998). The Initiative began two months before the passing of the third and final air transportation liberalization package in the EU.

The US was strongly in favor of liberalizing transatlantic air transportation, but was weary of the possible effects of the 'three packages' could have on this goal. They feared that the creation of the Single European Market would result in a

'Fortress Europe' mentality towards external air transportation agreements. Such a development would likely discourage the Member States from granting the US full 'fifth freedom' rights, and could therefore prevent opening of the market (Chang *et al*, 2004). In order to guard against this possibility, the US swiftly negotiated an 'open skies'- framework bilateral agreement with the Netherlands in 1992. In 1995, six other Member States²⁷ followed the Netherlands by negotiating similar agreements.

While the US was renegotiating its bilateral agreements with several of the Member States, the Commission was hoping to use the development of the single European transportation market to enter into foreign trade negotiations with the US. But the Commission still lacked the necessary mandate from the Council. The US maintained the goal of opening up the transatlantic market for its air transportation industry, and was receptive to the prospect of European-level agreement, but was unwilling to negotiate with the relatively powerless Commission. The Commission held extremely limited powers in this field, and the US was only interested in negotiating matters resulting in 'hard rights' (*Ibid*).

It is worth noting the interests of the airline business sector during this time-period. Historically, the US and EU Member States concluded agreements that were strongly dictated by the concerns of their domestic carriers (Lobbenberg, 1994). Operating in by far the largest domestic aviation market, the carriers in the US were better suited to take advantage of transatlantic air transportation liberalization. The US carriers were more equipped to support low fares and pricing wars on

²⁷ Austria, Belgium, Denmark, Finland, Luxembourg, Sweden

transatlantic routes because international operations accounted for a smaller proportion of their total revenue than their European counterparts (*Ibid*). Also, liberalization of the restrictions on capacity would prove to be more beneficial for American carriers.

The political decisions made by Member States were more closely aligned with the business interests than in the US, primarily because most of the international carriers were either owned or largely subsidized by the national governments. There were two primary approaches to the regulation of the transatlantic market at the time, characterized by the UK and the Netherlands. The UK operated in a situation unique from the rest of Europe. Approximately 40% of the traffic between the US and EU was through the UK in the early-1990s, more than twice the percentage of the next highest country, Germany (*Ibid*). The UK also had negotiated a very restrictive bilateral agreement with the US, the aforementioned 'Bermuda II' agreement. Because the UK held such a high percentage of the EU market share, they were able to negotiate an agreement with the US that, through its restrictions and regulations, created a competitive advantage for their domestic carriers (Chang *et all*, 2004).

Carriers in the Netherlands, like many other smaller Member States, were heavily dependant on transatlantic operations. KLM relied on operations to and from the US for 32% of their overall revenue in 1991 (Lobbenberg, 1994). Because of this, the Dutch government was largely receptive to liberalization with the US. The US carriers were also searching for other gateways into the European market to circumvent the 'Bermuda II' agreement with the UK. The Netherlands offered one

such gateway. In their 1992 agreement, the US and the Netherlands granted each other unrestricted fifth freedoms rights. This provision thereby opens up the rest of Europe for American carriers beyond just the Netherlands, while at the same time, increases the access to the domestic market in the US for Dutch carriers.

In the following five years, six more Member States²⁸ signed 'open skies'-framework agreements with the US, while at the same time, the Commission tried to gain competency to negotiate a European-level agreement. During the time period between t_0 and t_1 , the 'environmental conditions' in the transatlantic aviation private market remained the same, with many of the Member States pushing for liberalization and the UK advocating for the continuation of its comparatively restrictive policies. However, there was no progress made towards a new agreement negotiated by the Commission. In summation, while the two trade partners shared common goals in the early-1990s, they were unable to develop coordinated policy.

The ECJ 'open skies' ruling in 2002, at time t_1 , implemented the international harmonization mechanism for policy convergence described above, and a new European-level agreement was swiftly developed between the Commission and the US.

The 2002 ECJ 'Open Skies' Ruling

Since the development of European-level governance, the Commission had requested the Council to grant them authorization to enter in foreign negotiations. Under Article 133(3) of the Treaty of Rome, "where agreements with one or more

²⁸ Czech Republic, France, Germany, Italy, Poland, and Portugal

States or international organizations need to be negotiated, the Commission shall make recommendations to the Council, which shall authorize the Commission to open the necessary negotiations". The Treaty in Article 80(2) also states that, "the Council may, acting by a qualified majority, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport". These two Articles explicitly allow for the Council to grant far reaching foreign trade negotiation powers to the Commission, specifically in the areas of sea and air transport. The Commission had long requested the Council to grant them authority to enter in foreign negotiations, but was denied, including requests in 1990 and 1992.

As previously noted, Transport Commissioner Neil Kinnock wrote to six Member States, and asked them to negotiate new bilateral agreements with the US. Nonetheless, all of the six Member States signed 'open skies'-framework agreements with the US between June and September of 1995. The Commission, frustrated by the Council continued denial of their requests for competency in foreign negotiations and their inability to convince Member States to wait for Council authorization before renegotiating their own agreements, brought actions against eight Member States²⁹ before the ECJ in 1998, under Article 226³⁰ of the Treaty of Rome.

²⁹ The eight Member States originally included in this case were the UK, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, and Germany. The Netherlands was later added to the case, upon their insistence to provide solidarity with the charged Member States.

³⁰ Article 226 states if the Commission considers that a Member State has failed to fulfill an obligation under this Treaty, they can bring the matter before the European Court of Justice.

In these cases, the Commission charged eight Member States with violating their obligations to the EC under the Treaty of Rome in their bilateral agreements with the US. The Commission developed three main arguments against the Member States. First, that the ‘three packages’ of legislation had established a common internal European aviation market, and that the Member States were thereafter disallowed from entering into new bilateral agreements. The Commission argued that since the enactment of these legislative measures, they alone had the right to negotiate foreign trade agreements in the air transportation sector (Joined Cases C-466-475/98; Hoffmeister, 2004). Second, the Commission claimed that the bilateral agreement contained clauses that prevented common competition between Member States. Third, the Commission claimed that these eight countries had violated Article 43 of the Treaty, the right of establishment, because of the nationality clauses for ownership and operation of airlines in the ‘open skies’ bilateral agreements (Joined Cases C-466-475/98; Bartlik, 2007).

The Commission’s first claim to the ECJ stating that they owned the sole right to negotiate foreign air transportation agreements, was backed by a previous decision by the Court, the so-called ‘1/76’ principal. The ‘1/76 principal’ is developed out of an opinion of the Court in 1976³¹, which states that the EC can be granted the right to conclude an international agreement on behalf of the Member States, but the “agreement must be necessary to attain the objectives of the Treaty and those objectives must not be attainable by merely introducing autonomous common rules” (Hoffmeister, 2004:567). The Court ruled that the ‘1/76’ principle

³¹ (Opinion 1/76, ECR 741)

was not valid in this case, because the Council could simply adopt legislation for a common foreign trade agreement, removing the need to enact this principle. This ruling was a disappointment for the Commission, who had hoped that they could use this principle to get around the Council and directly gain competency over negotiation of foreign air transportation agreements through the ECJ.

The second claim made by the Commission involved the 'ERTA principle'³², which states that once the EC enacts a legislation or rule, Member States cannot interact with nonmember countries in a way that could change or negate those rules (Case 22/70; Hoffmeister, 2004). The ECJ ruled that Commission legislation contained no provisions directly governing the regulation and granting of traffic rights between Member States and non-Community states. But, they found that the Commission had adopted rules regulating fares and rates, use of computer reservation systems, and allocation of airport slots for air transportation services between the EC and non-EC territories (Joined Cases C-466-475/98; Bartlik, 2007). The ECJ ruled that if any bilateral agreement contained clauses regarding fares and rates, computer systems, or the allocation of airline slots, than the responsible Member State is in violation of the Treaty. 'Open skies'- framework agreements involve some, if not all, of these three provisions.

The final argument made by the Commission pertained to the equal rights granted to nationals of any Member State for establishment in all Member States. The Commission charged that the Member States were in violation of Article 43 of the Treaty because their agreements with the US contained restrictions on

³² (Commission v Council, ECR 22/70)

ownership, based upon nationality. The Commission claimed the ownership clauses were discriminatory to nationals of Member States not involved in the bilateral agreement, and were therefore in violation of the right of establishment. The ECJ found that the ownership of a EC airline is not vested solely for the nationals of the carrier's Member States; it is vested in the nationals of all Member States of the EC (Joined Cases C-466-475/98; Abeyratne, 2003). Therefore, any agreement that places preferential clauses for one nationality over another is in violation of Article 43 of the Treaty.

The result of the ECJ 'open skies' ruling is the invalidation of the 'open skies'-framework bilateral agreements. While the ECJ denied granting the Commission's request for the right to negotiate foreign trade agreements, they effectively disallowed the Member States from entering into 'open skies'-framework agreements. While the ECJ ruling did not explicitly allow the Commission to enter into foreign air transportation negotiations, they effectively forced the Council into granting them this right.

Council Authorization and Implementation of the Mechanism (t₁)

On June 5th, 2003, the Council authorized the Commission to begin air transportation trade negotiations with the US, exactly eight months after the ECJ 'open skies' ruling. The Council authorized the Commission to begin negotiations in three different regards: first, to enter into negotiations with the US in the field of air transportation, with the specific goal of developing an OAA³³ (European Commission Press Release, 2003); second, the Council authorized the Commission

³³ Open Aviation Area, see page 38

to open negotiations with all other third-party countries to replace their existing bilateral agreements with Member States; third, to replace restrictions based on nationality in previous agreements (Wassenbach, 2003).

In the international harmonization mechanism for policy convergence, the level of convergence depends on the specificity of the law or regulation and the ability for the international organization to enforce the measures. The provisions of this 'package' are very brief, concise and specific. The Commission was specifically granted authorization to negotiate an air transportation agreement with the US, which they had been seeking for decades, and this mandate contained specific guidelines for the provisions to be developed in the agreement, the eventual establishment of an OAA. The decisions made by European-level governance also have strong enforcement capabilities. The 'Van Gend en Loos case'³⁴ establishes the direct effect of EU laws, regulations, decisions and directives on the Member States. There is also supremacy of EU law over the Member States, established in the 'Costa v ENEL case'³⁵. In regards to the ECJ 'open skies' ruling and subsequent Council authorization 'package', the specificity and enforcement capability were extremely high, which is evidenced by the expedited development of a new agreement.

On April 18th 2007, at historical reference point t_1 , the 'open skies-plus' air transportation agreement was agreed upon by the US and EU, resulting in large degrees of policy convergence. In between t_0 and t_1 , the 'environmental conditions' in the transatlantic air transportation remained the same. The US and many smaller Member States, specifically the Netherlands, were still largely in favor of

³⁴ (Van Gend en Loos v Netherlands, Case C-26/62)

³⁵ (Flaminio Costa v. ENEL, Case 6/64)

liberalization. The UK also remained largely against redeveloping the industry, preferring to continue operations under the 'Bermuda II' agreement. Air carriers on both sides of the Atlantic, namely KLM and United, continued steady support for liberalization of the industry. The lone variable that changed in between t_0 and t_1 was the ECJ 'open skies' ruling and subsequent Council authorization. Using the methodological framework of the international harmonization mechanism developed above, the 2002 ECJ 'open skies' ruling and the following regulations by the Council are identified as the explanatory power in the development of policy coordination between the US and the EU.

Chapter 5: Regulatory Competition

Through the use of the international harmonization mechanism, the 2002 ECJ 'open skies' ruling and mandate granted to the Commission by the Council is identified as the explanatory power in the development of policy convergence in transatlantic air transportation. While the international harmonization mechanism develops the explanatory power for the convergence of policy, it is unable to identify which factors caused the degree of regulation to be set at the specific level found in the 2007 'open skies-plus' agreement. The following chapter will examine a second mechanism of policy convergence, regulatory competition, in order to identify how the EU and US converged on policy at a specific level of regulation. This will be demonstrated through an analysis of the previous bilateral agreements between the US and several Member States.

Regulatory Competition Mechanism

Under the regulatory competition mechanism, "countries adjust policy instruments and regulatory standards in order to cope with competitive pressures emerging from international economic integration" (Holzinger and Knill, 2005:789). Drezner (2001) theorizes that national actors will converge on a specific policy when the costs of adjustment are overcome by the potential loss of income, trade, or capital that would result from not adopting the policy. When there is an established, international standard, convergence towards this policy is very simple, national actors are forced to decide whether to adopt the regulations, or be left behind in international trade for this sector. However, when there is no consensus

internationally towards one specific policy, the prospects for convergence become much more varied. In order to examine these scenarios for policy convergence, Drezner (2005) establishes a dichotomy. He argues that national governments are the “primary actors in global governance” (Drezner, 2005: 843) and that each government is separated from another by their relative power. According to Drezner, there are only two ‘great powers’ in the modern global economy, the US and the EU. When the ‘great powers’ agree on a specific policy area, there will be high levels of international convergence to this position. When the ‘great powers’ fail to agree, there will be limited policy convergence, which will be followed by regulatory competition, generating congruence at ‘multiple policy nodes’.

The dichotomy established by Drezner (2005) is exemplified in transatlantic air transportation negotiations. At the historical reference point t_0 , the ‘great powers’ failed to agree on a common policy for the regulation of the industry. This resulted in regulatory competition between the Member States in their separate negotiations of bilateral agreements with the US. When the ‘great powers’ did eventually agree on a policy, at historical reference point t_1 , the result was a large degree of policy convergence.

In the previous chapter, the ECJ ‘open skies’ ruling and following regulations were identified as the explanatory power for the policy convergence, exemplifying the international harmonization mechanism. These findings of the previous chapter are supported by theorized result of when the ‘great powers’ agree, with both conclusions suggesting large degrees of policy convergence. Also, since the deregulation of their domestic market in 1978, the US been steadfastly committed to

liberalization, while at the same time, the Member States of the EU have held different levels of commitment to liberalization. Because the causes for liberalization in the US have already been established, the following chapter will include an asymmetric analysis of the two 'great powers', focusing more on the causes of liberalization within the EU.

While the international harmonization mechanism and Drezner's 'great powers' dichotomy explain why convergence of policy did develop between the US and the EU, they fail to explain how the level of regulation was determined. After the Commission was unable to obtain Council authorization in the early-1990s, the 'great powers' failed to agree. This resulted in regulatory competition between the Member States as they renegotiated their bilateral agreements with the US. The regulatory competition resulted some convergence of policy at 'multiple policy nodes'. When the 'great powers' did subsequently agree, the result was policy convergence. Drezner (2001) argues that in regulatory competition, when policy convergence does eventually take place, it is likely that the level of regulation will be set at the standards of the most laissez-faire country. This assertion is evidenced in the 'open skies-plus' agreement between the US and the EU, which closely parallels the regulatory levels of the bilateral agreement signed between the US and the Netherlands in 1992, the most laissez-faire of the bilateral agreements signed with the Member States.

The following chapter will further analyze the regulatory competition that took place between the Member States in the bilateral agreements signed with the US. These negotiations occurred at the historical reference point, t_0 . The chapter

will continue with an examination of levels of regulation in the 'open skies-plus' agreement, at the historical reference point t_1 . The comparative analysis of these two historical reference points will demonstrate first, that policy convergence resulted when the 'great powers' did eventually agree, and second, that this convergence took place at a level of regulation similar to the standards of the most laissez-faire previous agreement.

Regulatory Competition between the Member States (t_0)

In April 1992, the US developed the Open Skies Initiative, aimed at renegotiating their bilateral agreements with the goals of opening the air transportation market and decreasing regulatory barriers. The first of these new agreements was reached with the Netherlands in September 1992. The Netherlands had consistently shared common goals with the US for liberalization of the industry. The agreement signed between these two trading partners exemplified the 'open skies'-framework ideals and became the standard for bilateral agreements of this type for the decade to follow.

This 'open skies' agreement grants carriers from the Netherlands and the US full fifth-freedom rights, and allows for multiple stops to be made in the territory of the foreign trading partner. The agreement also contains provisions allowing for complete freedom from governmental regulation over the capacity, route, pricing and destination for an airline operating under this accord (Cordes, 1993). This is in strong contrast to previous bilateral agreements between the US and its transatlantic partners, particularly the 'Bermuda II' agreement with the UK. Under the agreement between the US and the Netherlands, the national controls are

removed, and the carriers from both trading partners are allowed to compete equally in this market.

The 'open skies' agreement also allows for harmonization of commercial interactions between carriers in the US and the Netherlands. The agreement established a conflict-resolution mechanism, enabling quick arbitration and settlement of disputes. The accord also grants carriers of both trading partners to enter into code-sharing alliances with each other. Such alliances allow for carriers to cooperate on air transportation operations, greatly increasing their access to foreign markets. Immediately following the 'open skies' agreement, the Dutch carrier KLM and Northwest Airlines entered into a code-sharing alliance, which has proven to be largely successful in increasing access to foreign markets for both carriers (Hedlund, 1994).

The provision granting the ability for air carriers to enter into code-sharing alliances carried a large effect on the regulatory competition that took place in the mid-1990s between the Member States. The US DoT maintained the policy of granting anti-trust immunity to international air carriers wishing to form code-sharing alliances only if the foreign airline's home country had agreed to an 'open skies'- framework agreement with the US (Chang and Williams, 2002). Immunity from antitrust legislation in the US is legally required for the development of a code-sharing alliance for foreign carriers. In 1993, the Dutch carrier KLM was granted immunity by the US DoT, and quickly thereafter entered into a code-sharing alliance with Northwest, which allows the two carriers to "operate as if they were a single global airline system" (Hedlund, 1994:272). Through this alliance, KLM and

Northwest have been able to integrate their ticketing, marketing, and baggage handling services, allowing for seamless transportation of passengers to any destination offered by either airline.

In 1996, largely due to the desires of Lufthansa to enter into a code-sharing alliance with United, Germany signed an 'open skies' agreement with the US. France signed a liberalizing bilateral agreement with the US in 1998, but it fell short of full 'open skies'- framework qualifications. As a result, Air France's 1998 request to the US DoT for anti-trust immunity was denied. In 1999, France signed an 'open skies' agreement with the US, and Air France's request for anti-trust immunity was subsequently granted by the US DoT, allowing them to enter in a code-share agreement with Delta. Code-share agreements can provide large benefits for an airline by allowing them greater access to international markets. Through their agreement with Delta, Air France was able to sell tickets to 100 different destinations in the US. Previous to the agreement, they were only allowed access to seven US cities (Chang and Williams, 2002). Traffic for Air France to the US also increased by 20% over the three years following their alliance with Delta (Harbrecht, 2001).

In contrast, the UK did not negotiate a new bilateral agreement with the US, and their airlines were not granted many of the benefits afforded to carriers of other Member States. In 1996, BA wanted to enter into a code-sharing alliance with American Airlines (AA), which led to talks between the US and the UK towards a new bilateral agreement. These negotiations eventually dissolved, with the UK preferring to keep strong regulations on access to Heathrow airport, which was the

primary concern for the US. Subsequently, the US DoT denied anti-trust immunity to BA, thereby nullifying a possible code-sharing alliance with AA. In 2001, British Midland Airways (BMI) filed a complaint with the ECJ, claiming that the 'Bermuda II' bilateral agreement was against European competition law (Chang and Williams, 2002). This case became irrelevant with the ECJ 'open skies' ruling in the following year. The UK chose to not participate in regulatory competition with many of the other Member States, but in doing so, sacrificed possible economic growth for their air carriers.

In 1992, the Commission once again attempted to gain authorization to negotiate a European-level air transportation agreement with the US, but their request to the Council was denied, and the Commission was only granted 'soft rights' for negotiations. The US, concerned with changing the regulation of the air transportation industry, required 'hard rights' to enter into negotiations with the Commission, and therefore the two 'great powers' failed to agree. The result of this failure was development of policy at 'multiple nodes' in the agreements negotiated between the US and Member States during the 1990s. The Netherlands established the standard for the 'open skies' agreements with the US in 1992, and eight Member States, most notably Germany, followed the Netherlands by signing comparable agreements with the US by 1996. France, on the other hand, had initially resisted granting full 'open skies'- framework rights to US carriers, but eventually acquiesced in 2001, largely in part due to the failed attempt at a code-sharing alliance between

Air France and Delta. The UK, along with eleven other Member States³⁶, did not negotiate a new agreement with the US, resisting competition with other Member States.

The result of this regulatory competition between the Member States was the development of 'multiple policy nodes'. The first 'policy node' was highly restrictive with strong tendencies towards national sovereignty over policy, best exemplified by the 'Bermuda II' agreement. UK refused to become involved in the regulatory competition by retaining the heavily restrictive, regulatory regime of this agreement. Spain and Ireland maintained similar agreements with the US throughout this era of regulatory competition and can also be grouped into this 'policy node'. The second 'policy node', is largely liberalizing, and is best characterized by the 1992 'open skies' agreement between the Netherlands and the US. In 1995, six more Member States³⁷ signed similar agreements with the US, thereby affiliating themselves in this 'policy node'. Initially, the two largest remaining trade partners, Germany and France, refused to enter in an 'open skies' framework agreement, preferring to retain the moderate levels of liberalization developed in the mid-1980s, thereby developing the third 'policy node'. Eventually, both countries did sign 'open skies' agreements with the US, and converging on the second 'policy node'. Finally, the 'fourth policy' node was development of no policy at all. Many of the 5th and 6th Enlargement Eastern European Member States did not have an air transportation agreement with the US, and therefore direct air transport

³⁶ When the 'open skies-plus' agreement between the European Union and the US was signed, 12 of the EU-27 Member States did not already have an 'open skies' agreement with the US

³⁷ Austria, Belgium, Denmark, Finland, Luxembourg and Sweden

operations were not allowed. Before the development of a European-level agreement with the US, transatlantic services were operated out of 4 different 'policy nodes', creating an inconsistent and inefficient regulatory regime.

Movement towards Liberalization

As previously noted, the US has remained the greatest proponent of international liberalization. Because of this liberalization, air transportation traffic for US-based carriers increased from 93.4 million passengers in 1993 to 126.1 million passengers in 1998 (Button and Taylor, 2000:211). This immediate increase in traffic volume provided strong evidence to the US to continue the liberalization of international air transportation, most notably in the transatlantic market. The US did greatly increase their access to European markets through the 'open skies'-framework agreements, but they were unable to conclude such an agreement with the UK, which controlled nearly half of the transatlantic air transportation market. While the US had hoped that the process of negotiating 'open skies' agreements with smaller Member States would eventually lead to the development of a liberalizing agreement with the UK, in the end, this did not materialize.

Like the US, the Commission had also been active in developing liberalization for air transportation. The international air transportation regulatory regime between European nations is historically heavily restrictive, even after the development of the EC. In fact, "as late as the mid-1980's, national governments still guarded virtually unchallenged authority to regulate air transport policy" (O'Reilly and Stone Sweet, 1998: 447). Much of the continued regulatory capacity of national governments is attributable to the entrenchment of 'flag carrier' airlines in the

European industry, which operated virtual monopolies in their domestic European markets. Under this regulatory regime, “services provided on existing routes were inefficient and costly, and restrictions in the bilateral intergovernmental agreements often prevented airlines from meeting demands for new services” (O’Reilly and Stone Sweet, 1998:451-452). In the mid-1980’s, the Commission sought to change this regulatory regime by introducing liberalizing measures into the industry, in hopes of furthering intra-European trade. The Commission’s efforts to liberalize EC air transportation resulted in the ‘three packages’ of legislation, which deregulated the intra-European industry.

While the domestic air transportation industries in the US and the EU were liberalized, the transatlantic market, controlled by incompatible separate bilateral agreements, remained largely inefficient. The US and the Commission recognized the benefit of creating a common regulatory regime, as well as the economic benefits of liberalization of the industry. Private actors were also largely in favor of removing restrictions to trade, particularly European carriers desiring to enter into code share alliances with their US counterparts. The US and the Commission were motivated towards the establishment of common trade liberalization in the transatlantic air transportation industry, but were simply unable to develop an agreement because the Commission lacked competency in this area.

Setting the Level of Liberalization (t₁)

In the early 1990s, the ‘great powers’ failed to agree on a common policy for the regulatory regime for transatlantic air transportation, resulting in minimal congruence between the Member States. The transatlantic regulatory regime

entered into regulatory competition, resulting in 'multiple policy nodes'. The regulatory competition between the Member States developed some measures of liberalization, the 'open skies' bilateral agreements, but failed to produce convergence on a specific policy or a specific level of regulation. In 2007, following the 'open skies' ruling of the ECJ and subsequent authorization of negotiating rights by the Council, the two 'great powers' did eventually agree on a common policy for the regulation of the air transportation industry, which resulted in international convergence towards this specific policy. In December 2008, the EU and Canada concluded an 'open skies-plus' air transportation agreement, replicating the provisions in the 2007 EU-US agreement (Breakthrough in EU-Canada negotiations on far-reaching aviation agreement, 2008). The Commission is also currently negotiating 'open skies-plus' framework agreements with Australia and New Zealand, which are set to be similar to the agreements already reached with Canada and the US (Open Skies- Europe and Australia, 2008; Developing a Community civil aviation policy towards New Zealand, 2008).

This development of policy convergence closely parallels Drezner's (2005) theory of neoliberal institutionalism, which describes the results of convergence, when the 'great powers' agree/fail to agree. When the 'great powers' failed to agree, regulatory competition ensued, culminating with development of convergence at 'multiple policy nodes', which contains diverse levels of regulation. When the 'great powers' did agree, the result was a large degree of policy convergence. According to Drezner (2001), this policy convergence is likely to be set at the standards of the most laissez-faire country. While developing the model for transatlantic air

transportation services, the US and the Commission both favored liberalization, but disagreed at precisely what level of regulation the degree would be set.

After three years of negotiations, the two trade partners developed an agreement that closely parallels the regulatory standards of the most laissez-faire bilateral agreement, the 1992 US, Netherlands 'open skies' agreement. In the 2007 'open skies-plus' agreement, the US and the EU granted each partners' carriers full fifth-freedom rights, and removed restrictions on capacity, route, pricing and destination in the transatlantic market. The agreement also allows for all carriers to enter into code-share alliances and apply for anti-trust immunity. While the agreement grants greater rights for the foreign ownership of European carriers, 49.9% of the voting stock, the US did not grant reciprocity, retaining the previous cap on foreign ownership at 25% of the voting stock. The provision of this agreement largely match the provisions of the previous 'open skies' bilateral between the US and the Netherlands, supporting Drezner's (2001) theorized result of policy setting at the level of the most laissez-faire country.

In the previous chapter, the international harmonization for policy convergence mechanism was used to identify the ECJ 'open skies' ruling and subsequent granting of rights to the Commission as the explanatory power in this development of policy convergence. The 2002 'open skies' ruling developed directly out of the regulatory competition between the Member States in their negotiations with the US. The agreements created inequitable competition conditions for air carriers from varying Member States. In order to uphold the equal right to establishment, the ECJ ruled to resolve the regulatory competition by

invalidating the 'open skies'- framework agreements between the US and specific Member States. Regulatory competition concluded with the development of a European-level air transportation agreement with the US, standardizing the regulation of the industry at the level negotiated between the US and the Commission.

Comparing the conditions at historical reference points t_0 and t_1 established the process of regulatory competition, in which Member States competed with each other in the development of air transportation policy with the US. The final result of this regulatory competition is the establishing the standards of liberalization in the EU-US 'open skies-plus' agreement. The regulatory competition mechanism provides theoretical background for the development of policy convergence, particularly when the great powers either agree or fail to do so, and describes how the level of regulation is set at the standards of the most laissez-faire level.

Chapter Six: Conclusions, Outlook and Recommendations

The international air transportation industry is a paradox. While the technological development of air transportation has been indispensable to the formation of global trade, the “industry itself remains subject to highly restrictive national controls on cross-border competition and investment” (Robyn *et al*, 2002: 50). Preceding the development of powered flight, national governments sought protective actions for the regulation of air transportation. The ‘highly restrictive national controls’ were originally instituted as means of national defense, but as the national governments began to develop their own air carriers the motivation for heavy regulation shifted. The interest for national governments shifted from protection of its territory from military incursion from the air, to protection of its business interests in the air. Beginning with the Conferences of Paris and Chicago and the development of the restrictive ‘Bermuda’ regulatory regime, national governments asserted that the ownership and operation of air transportation services within their territory was to be tightly controlled and influenced for their own advantage.

The restrictive transatlantic regulatory regime began to change with the US’ campaign to open the industry to market forces, beginning with the deregulation of their domestic market in 1978. This was followed by a series of liberalizing air transportation bilateral agreements with many of the Member States, most notably between the US and the Netherlands. International air carriers, specifically Air

France, KLM and Lufthansa, often heavily influenced the national governments towards the further liberalization of transatlantic air transportation. For decades, the 'environmental conditions' for the development of a European-level agreement were present: the US, many Member States and international air carriers were strongly in favor of continually developing further liberalizing trade agreements, yet such an agreement could not be reached.

Through an examination in the historical developments of the international air transportation regulatory regimes, European-level governance of the industry, and the bilateral agreements between the US and Member States, I have argued that policy convergence has taken place in the transatlantic air transportation industry because of the 2002 ECJ 'open skies' ruling and subsequent Council granting of negotiating rights to the Commission, and that the standard of regulation in this policy was set by the previous bilateral agreement between the US and the Netherlands. This argument was established using the theory of policy convergence, specifically focusing on two mechanisms, international harmonization and regulatory competition, to examine how and why the US and the EU converged on an air transportation policy at this specific level of regulation. This thesis utilized two historical time references, t_0 and t_1 , as case studies to develop a comparative analysis of the 'environmental conditions' present, in order to isolate the explanatory power in the development of this policy.

While the 2007 'open skies-plus' agreement has not completely resolved the paradox of international air transportation, it has terminated many of the highly restrictive national controls over the industry. Complete resolution of this

contradiction in globalization would require a further liberalizing agreement, which would remove all national controls over ownership and operation of air transportation services.

Open Aviation Area

The US and the EU have recently begun a second round of negotiations for the regulation of transatlantic air transportation operations, with the ultimate goal of establishment an OAA (EU, US Launch Second Round of 'Open Skies' Talks, 2008). An OAA would develop "a free trade zone in air transport" between the US and the EU for air transportation operations within and between the two partners (Robyn *et al*, 2002:58). The creation of an OAA "would remove the constraints imposed by the system of historic bilateral air services agreements that have included restrictions on the number of airlines and flights as well as the destinations that may be served between two countries" (Boaz Allan Hamilton, 2007:3). This would involve granting full 'freedom of air' rights to both partners, including the right to 'true cabotage'³⁸ for foreign carriers. An OAA would also ease, or possibly remove, the remaining restrictions on cross-border investment between nationals of the US and EU. The United State's chief aviation negotiator, John Beryl, recently remarked that, "the idea is to break down the sticky spider's web of restrictions in bilateral agreements that are a real hindrance to cross-border investment" (Zwaniacki, 2008).

Booz Allan and Hamilton Ltd, a strategy and technology consulting firm, were tasked by the Directorate General Energy and Transport of the European Commission to produce a report on the economic impact of an OAA between the US

³⁸ see footnote on page 30 for definition

and the EU. The report found that removal of the final restrictions to air transportation would generate 26 million additional passengers in the transatlantic market over the next five years, which equates to an increase of between €6.4 and €12 billion over this period (Booz Allan Hamilton, 2007). The report also calculated that this would result in the creation of 72,000 new jobs in the US and the EU for passenger transport, and five to nine thousand jobs for cargo services during this five-year period (*Ibid*). While the possible economic benefits from the creation of an OAA are large, they involve the removal of any remaining nationality-based restrictions on ownership.

The US has remained reluctant to opening their domestic market to foreign carriers, as well as allowing international investors to control majorities of their domestic carriers. In the 'open skies-plus' agreement, the EU eased restriction on foreign investments to allow up to 49.9% of the ownership and controlling vote of an airline. This was not reciprocated by the US, which granted foreign ownership of up to 49.9% of an airline, but only 25% of the controlling vote, because of long-standing national legislation. For the US to grant greater foreign investment, or reciprocal rights, to EU nationals, the Congress must change these legislative restrictions. As of yet, Congress has resisted relaxing foreign ownership regulations. In 2006, the Bush Administration presented a "modest attempt" at easing restrictions on foreign investors to Congress, which was blocked and subsequently removed (Zwaniiecki, 2008). US Special Envoy to the EU Boyden Gray remarked that he believes convincing Congress to agree to an OAA is not "impossible...that it is doable, but it is not easy" (EU, US Launch Second Round of 'Open Skies' Talks, 2008).

Lufthansa recently published a policy brief on the prospect of an OAA in June 2008, in which they praised the prospect of opening up the US market and increasing harmonization in security, environmental and consumer protection issues, as well as “stopping protectionism” in the US foreign ownership policies (Lufthansa, 2008). The policy brief asserts that granting only 25% voting rights is “inconsistent with a common market and place EU airlines at a disadvantage” (*Ibid*). The disproportionate granting of voting rights has also been criticized by the UK recently, which has also warned that it advocates for the termination of the ‘open skies-plus’ agreement if the US fails to lower its barriers to foreign investment (EU, US Launch Second Round of ‘Open Skies’ Talks, 2008).

As previously discussed in Chapter Three, the ‘open skies-plus’ agreement, the EU and the US are to come an agreement on “further liberalization of traffic rights, additional foreign investment opportunities, effects of environmental measures and infrastructure constraints on the exercise of traffic rights, and further access to Government-financed air transportation” (Air Transport Agreement, 2007). The ‘open skies-plus’ agreement also states that if no second-stage agreement has been reached by November 2010, than “each Party reserves the right thereafter to suspend rights specified in this Agreement” (*Ibid*). This constricted timeframe for the development of a further liberalizing agreement, likely towards an OAA, creates an uncertain environment for the future of the ‘open skies-plus’ agreement, especially considering possible policy changes in the Obama administration. Because of the potential loss to US carriers through the suspension of rights granted in ‘open skies-plus’, the US is essentially required to develop a

second-stage agreement with the EU. Whether Congress will be persuaded to remove restrictions to foreign investment of airlines remains to be seen, but whatever the outcome, the regulation of air transportation between the US and the EU and of the 'open skies-plus' agreement will assuredly be altered in the near future.

Recommendations

To ensure the continued cooperation between the US and the EU towards the further development of liberalization in transatlantic air transportation, I propose the following three recommendations. First, the second-stage negotiations between the US and the EU should culminate with an agreement leading to the removal of all remaining restrictions of the eight freedoms of air, which would develop a transatlantic open aviation area. This OAA should be gradually developed over the course of a decade through multiple stages of increasing liberalization, similar to the deregulation of the domestic European market through the 'three packages' of legislation. This would allow for the air transportation industry to gradually redesign their business operations to best fit this system. The traditional 'hub and spoke' network model of air transportation has been challenged recently by the 'low-cost' carriers, which have enacted more creative models in their operations, particularly in Europe. The larger US carriers, already struggling to compete with the current domestic 'low-cost' airlines, will be forced to evolve their traditional network in order to remain competitive. While in the short-term, the development of a transatlantic OAA may result in the decline of larger carriers; the industry will ultimately redevelop into a more efficient model. Also, the gradual introduction of

greater traffic freedoms for transatlantic air carriers will allow them to slowly evolve to fit the needs of the developing market.

Second, to ensure the successful completion of the second-stage of air transportation negotiations, the agreement must develop reciprocity between the US and the EU in the granting of rights for foreign ownership of airlines. The current provisions on foreign ownership have been largely criticized in Europe, and any second-stage agreement must develop reciprocity. I propose the level of liberalization on foreign investment to be set at a maximum of 49.9% of the total ownership and voting stock of an airline for both US and EU investors. This will require legislation by the US Congress overturning the current 25% cap on foreign ownership of airlines. This proposal does not grant unlimited foreign ownership rights because Congress is unlikely to approve anything over the current amount of foreign ownership allowed for US investors.

The 'open skies-plus' agreement between the EU and Canada contains provisions for the removal of all nationality-based barriers to foreign investment. These provisions are set to be phased in through four tiers, culminating with the eventual development of a full OAA (Breakthrough in EU-Canada negotiations on far-reaching aviation agreement, 2008). This process should be replicated between the US and the EU. The removal of the last remaining nationality-based restrictions on air transportation must be gradual and cautious, otherwise governments, particularly the US, will not approve. The gradual introduction of foreign investment liberalization will also allow for easier transition for air carriers into the developing environment of unrestricted transatlantic traffic rights. If unlimited

restrictions on investments were to be granted, carriers may become more apprehensive about being bought by foreign investors, and therefore unable or unwilling to make the changes necessary to successfully adapt to the induction of freedoms of air into their domestic market.

The third and final recommendation is the development of a regulatory agency with strong enforcement capability to ensure the enactment of these provisions and to mediate conflicts. This agency would have to be developed with equal EU and US involvement and be granted specific jurisdiction over all regulatory matters in the transatlantic air transportation industry. The development of an OAA and continued liberalization of the transatlantic air transportation industry can provide great benefits for airlines, consumers, and employees. These recommendations were developed from an examination of previous successful formation of policy, and are intended to maximize the potential benefits of liberalization, while minimizing the possible negative effects for consumers, airlines, and governments. A transatlantic OAA could become very rewarding, but it must be developed intelligently and gradually in order to ensure its successful enactment.

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