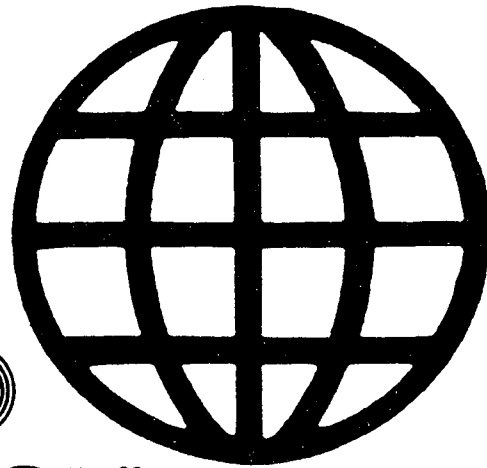


December 1999

INDUSTRY
TRADE AND
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REVIEW



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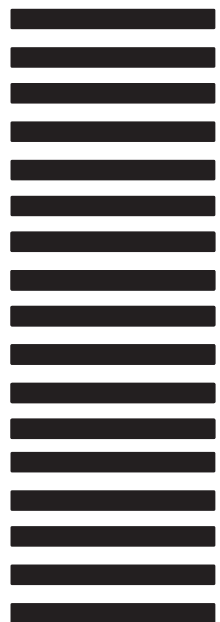
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Air Transport Services: International Regulation and Future Prospects for Liberalization

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Bilateral air service agreements that govern trade in air transport services² allow countries to regulate the operation of foreign carriers flying to, from, and through their home markets. The international regulatory regime for aviation has evolved gradually, from a system that is highly restrictive to one that allows for “open skies,” or the ability of airlines to fly to and from foreign countries with relatively few limitations. Although concluding open skies agreements with 40 countries, the United States has yet to forge such agreements with its top two trade partners in air transport services, Japan and the United Kingdom. This article examines these issues and considers the outlook for further liberalization of air transport services. A glossary of technical terms appears at the end of this article.

Origins of the Bilateral Framework

The first endeavor to develop a multilateral framework pertaining to trade in air transport services occurred in 1944 at the Chicago Conference, which was evidently convened in anticipation of the end of World War II and a need for multilateral disciplines to govern international air transport. The 52 nations represented at the Conference differed widely as to how far to liberalize the international air transport market.³ The United Kingdom, along with other major European countries whose civil aviation industries had been damaged during the war, favored a regulatory environment that would help them to redevelop their air transport sectors. These countries proposed the creation of a multilateral body that would rigidly limit foreign carriers' routes and flight frequency.⁴ By contrast, the United States,

¹ The views expressed in this article are those of the author. They are not the views of the International Trade Commission or any of the Commissioners.

² The subject of this article is limited to scheduled passenger services, and with few exceptions, does not include reference to the cargo operations of passenger airlines or to all-cargo carriers. The article also does not address charter, or nonscheduled, passenger services.

³ The Paris Convention of 1919 established that each nation has sovereignty over the airspace above its own territory. An open, or liberalized, international air transport regime would thus result from each nation permitting foreign air carriers to operate within its sovereign airspace.

⁴ Purfez F. Captain and Robin C. Sickles, “Competition and Market Power in the European
(continued...)”

along with Sweden and the Netherlands, supported “open skies”, or virtually unrestricted access to foreign air transport markets.⁵ In large part, because many of the countries represented at the conference perceived that U.S. airlines held a strong competitive advantage compared to their domestic carriers, the United States was unsuccessful in its bid for open skies in 1944.⁶ The Chicago Conference concluded without an agreement providing for the multilateral exchange of traffic rights,⁷ which would have permitted signatories’ airlines to fly freely to and from one another’s country.⁸

Chicago Conference Agreements

Although the Chicago Conference was unsuccessful in establishing an open regime for the exchange of traffic rights, it produced three multilateral aviation agreements: the Chicago Convention; the International Air Services Transit Agreement; and the International Air Transport Agreement. The Chicago Convention created the International Civil Aviation Organization (ICAO) (table 1), and established a general set of standards and practices for the conduct of international civil aviation.⁹ The Convention granted each nation control over the operation of foreign carriers in its airspace and permitted countries to preserve cabotage, or the provision of domestic point-to-point service, for national carriers.¹⁰

The Chicago Convention provided the organizational framework within which members would regulate trade in air transport services whereas the International Air Services Transit Agreement furnished signatories with the first two “freedoms of the air”: the right to fly over another country’s territory, or airspace, without landing; and the right to land in another country for non-traffic purposes (e.g., refueling) (table 2).¹¹ These freedoms form the conceptual foundation upon which signatory countries grant foreign carriers traffic rights,

⁴ (...continued)

Airline Industry: 1976-90,” *Managerial and Decision Economics*, vol. 18 (1997), p. 210.

⁵ Mahlon R. Straszheim, *The International Airline Industry* (Washington, D.C.: The Brookings Institution, 1969), p. 32, and Captain, “Competition and Market Power in the European Airline Industry: 1976-90,” *Managerial and Decision Economics*, p. 210.

⁶ Clyde Prestowitz, Jr., Don Hilty, Lawrence Chimierine, and Laura Sweeney, “Turbulence Over the Pacific,” *Economic Strategy Institute*, Mar. 1996, p. 22.

⁷ Traffic rights permit designated airlines to: (1) operate over routes specified within the agreement; (2) determine seating capacity to be provided over such routes (e.g., through flight frequency or type of aircraft deployed); and (3) establish fares. WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, p. 24.

⁸ Straszheim, *The International Airline Industry* (Washington, D.C.: The Brookings Institution, 1969), p. 32

⁹ The Chicago Convention still serves as the organizing framework for trade in air transport and currently includes 185 member nations. World Trade Organization (WTO), Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, p. 19.

¹⁰ Ibid.

¹¹ Air Transport Association (ATA), *Air Service Rights in U.S. International Air Transport Agreements*, Glossary of Terms, last updated Aug. 10, 1998, p. 4.

Table 1
Aviation agreements governing the exchange of traffic rights

Date	Title	Scope
1944	Chicago Convention	A multilateral agreement developed during the Chicago Conference of 1944. It provides a general set of standards and practices governing trade in air transport services, and established the International Civil Aviation Organization (ICAO), a multilateral forum permitting countries to consult one another on air transport issues.
1944	International Air Services Transit Agreement	A multilateral agreement established concurrently with the Chicago Convention. It outlines the first two "freedoms of the air", which include: (1) the right to fly over another country's territory, or airspace, without landing; and (2) the right to land in another country for non-traffic purposes (e.g., refueling).
1944	International Air Transport Agreement	A multilateral agreement also established jointly with the Chicago Convention. It defined the third, fourth, and fifth freedoms of the air referring to passenger transport between home and host country markets, as well as to third-party countries.
1946	Bermuda I Agreement	The first U.S. bilateral aviation agreement, which was concluded with the United Kingdom. This agreement limits airlines' access to foreign markets through controls on routes, seating capacity, and fares. It also served as a model for future bilateral agreements between the United States and foreign countries.
1977	Bermuda II Agreement	A revised and more restrictive version of the Bermuda I Agreement between the United States and the United Kingdom. The agreement imposed additional limitations on routes, seating capacity, and fares (requiring prior approval by both governments), and restricted the provision of air transport services between second- and third-country markets.
1978	Post-1977 Bilaterals	A liberalized bilateral agreement providing for multiple carrier designation and prohibiting either signatory from unilaterally limiting fare levels, the volume of traffic served, and the frequency of scheduled flights.
1992	Open Skies	A bilateral agreement that liberalizes the foreign provision of air transport services. Open skies agreements remove restrictions on the number of designated airlines; routes served; seating capacity; and frequency of flights. In 1992, the United States negotiated its first open skies agreement with the Netherlands, and concluded an additional 39 open skies agreements as of December 1999.

Sources: Compiled by USITC staff from: Air Transport Association (ATA), *Air Service Rights in U.S. International Air Transport Agreements*, Glossary of Terms, last updated Aug. 10, 1998, pp. 1-3; OECD, *International Air Transport: The Challenges Ahead*, 1993, pp. 48-49; Bruce Stockfish, "Opening Closed Skies: The Prospects for Further Liberalization of Trade in International Air Transport Services," *Journal of Air Law and Commerce*, vol. 57 (spring), p. 616; Office of the Assistant Secretary for Aviation and International Affairs "U.S. Bilateral Aviation Agreements: New/Expanded Agreements in the Current Administration," updated November, 1999; and U.S. Department of Transportation, press release, "U.S. Transportation Secretary Slater Leads Transportation and Trade Mission to Central America, Caribbean Nations," Dec. 13, 1999, found at <http://www.dot.gov/affairs/dot21199.htm>, retrieved Dec. 14, 1999.

Table 2
“Freedoms of the air”¹: Principles for the exercise of traffic rights

Freedoms of the air	Traffic rights
1st Freedom	The right to fly across the territory of foreign country without landing.
2nd Freedom	The right to land in a foreign country for non-traffic purposes (e.g., for aircraft refueling or maintenance).
3rd Freedom	The right to carry passengers from the airline’s country of registration to a foreign country.
4th Freedom	The right to carry passengers from a foreign country to the airline’s country of registration.
5th Freedom	The right to carry passengers between two foreign countries, provided that the flight begins or ends in the airline’s country of registration.
6th Freedom	The right to carry passengers between two foreign countries, provided that the flight passes through the airline’s country of registration.
7th Freedom	The right to carry passengers between two foreign countries, without the flight originating, terminating, or transiting the airline’s country of registration.
8th Freedom	The right to carry passengers between two points within a foreign country (also known as ‘cabotage’).

¹ In international civil aviation, airlines are permitted to serve foreign markets based on eight so-called “freedoms of the air”. The first two freedoms were established under the authority of the International Air Services Agreement, and the third, fourth, and fifth freedoms were defined in the International Air Transport Agreement. The last three freedoms were reportedly identified through subsequent air transport negotiations. Although freedoms of the air are not defined in bilateral agreements, they form the conceptual framework within which signatory countries grant foreign carriers traffic rights, or the authority to operate over particular routes.

Source: WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, pp. 20-21.

or the authority to operate over particular routes. Subsequently, a second agreement, the International Air Transport Agreement, defined the third, fourth, and fifth freedoms of the air, referring to passenger transport between home and host country markets, as well as to third-party countries.¹²

Bermuda Agreements and Post-1977 Bilaterals

In the absence of a multilateral framework for the exchange of traffic rights, nations have predominantly relied on bilateral arrangements to govern trade in air transport services. In 1946, the United States and the United Kingdom signed the first bilateral air service agreement, the Bermuda Agreement. The Bermuda Agreement represented a compromise between the U.S. aspiration for a liberal air transport regime and the British desire to maintain strict regulatory controls on international air transport.¹³ The Bermuda Agreement outlined both “hard” and “soft” rights accorded to U.S. and British airlines and established

¹² The International Air Transport Agreement was ratified by just 19 countries. Eight of these countries subsequently withdrew from the Agreement. WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, pp. 19-20.

¹³ Stockfish, “Opening Closed Skies: The Prospects for Further Liberalization of Trade in International Air Transport Services,” *Journal of Air Law and Commerce*, vol. 57 (spring 1992), p. 605 and 608.

controls on routes, seating capacity, and fares.¹⁴ “Hard” rights pertain directly to the exercise of traffic rights. “Soft” rights include such elements as dispute resolution, exemption from taxation and customs duties, the right to sell air transport services in the currency of the other party to the agreement, the right to own and operate ground handling services in the territory of the other party to the agreement, and conditions for the provision of computer reservation system (CRS) services.¹⁵ The United States subsequently concluded “Bermuda I Agreements” with a host of foreign countries including, for example, Australia, Bolivia, Egypt, Germany, and Spain.¹⁶

In 1976, the United Kingdom sought renegotiation of the Bermuda I Agreement, reportedly claiming that under its terms, the United States enjoyed a disproportionately high share of U.K.-U.S. traffic.¹⁷ The new agreement, Bermuda II, was more restrictive than its predecessor, and many of its elements continue to govern the U.S.-UK bilateral aviation relationship, in particular a requirement for dual government approval of ticket prices.¹⁸

Following steps to deregulate the U.S. domestic airline market in 1978,¹⁹ the United States began negotiating bilateral agreements that allowed for greater market access by U.S. carriers. The first “post-1977” bilateral was negotiated between the United States and the

¹⁴ Access to routes was controlled through designation of the number of national airlines (i.e., airlines which are predominantly owned and controlled by citizens of the country in which the airline is registered) that could operate as well as by the traffic points, or cities, that they could serve. Seating capacity was determined by limiting the number of flights per carrier and, in some instances, the share of traffic that they could transport or the type of aircraft that they could fly. Fares were set by a multilateral organization, the International Air Transport Association (IATA) and, like controls on seating capacity and routes, were subject to the approval of both signatories. In the early 1980s, the United States began eliminating IATA tariff procedures from its bilateral air service agreements. WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, p. 22, and Organization for Economic Co-operation and Development (OECD), *International Air Transport: The Challenges Ahead*, p. 51.

¹⁵ A computer reservation system (CRS) is a database listing fare and flight information used to reserve airline seats. WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, p. 24.

¹⁶ ATA, *Air Service Rights in U.S. International Air Transport Agreements*, last updated Aug. 10, 1998.

¹⁷ Prestowitz, “Turbulence Over the Pacific,” *Economic Strategy Institute*, Mar. 1996, p. 24.

¹⁸ Dual, or double, approval requires that both signatories approve proposed ticket prices. ATA, *Air Service Rights in U.S. International Air Transport Agreements*, Glossary of Terms, last updated Aug. 10, 1998, p. 1.

¹⁹ The U.S. domestic airline industry was regulated by the Civil Aeronautics Board (CAB) between 1938 and 1978. In 1978, Congress passed the Airline Deregulation Act, which terminated the CAB’s authority to award routes, determine flight schedules, and set fares. The following year, Congress passed the International Air Transportation Competition Act to strengthen “the [global] competitive position of United States carriers.” G. Porter Elliot, “Antitrust at 35,000 feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector,” *The George Washington Journal of International Law and Economics*, (1997/1998), p. 185, found at <http://proquest.umi.com/>, retrieved June 9, 1999.

Netherlands, which had been an early supporter of international air transport liberalization.²⁰ In post-1977 bilaterals, signatories were permitted to designate multiple airlines to operate in foreign markets. In addition, neither signatory to the agreement could unilaterally restrict fare levels, the volume of traffic served, the frequency with which flights were scheduled, or the type of aircraft operated by designated airlines.²¹ Following negotiations with Belgium, Germany, and the Netherlands, the United States concluded agreements with other countries such as Singapore, Thailand, and Korea.²²

Bilateral Open Skies Agreements

In 1992, the United States also negotiated its first bilateral “open skies” agreement with the Netherlands.²³ Bilateral open skies agreements permit the designation of an unlimited number of carriers, and place no restrictions on seating capacity, ticket prices, or the routes that carriers may serve.²⁴ Further, carriers are granted extensive fifth and sixth freedom rights, allowing them to carry traffic originating in or destined for third-party countries.²⁵ Finally, open skies agreements include provisions that permit airlines from both signatories to engage in code-sharing alliances, enabling a carrier to list its flights under another airline’s code in a computer reservation system.

Since 1992, the United States has concluded open skies agreements with an additional 39 countries (table 3), and continues to encourage such agreements with other trade partners.²⁶

²⁰ The U.S.-Netherlands agreement reportedly provided an incentive for Belgium and Germany to renegotiate their bilateral aviation agreements with the United States out of concern that not doing so would cause U.S.-Europe traffic to be channeled through Amsterdam. OECD, *International Air Transport: The Challenges Ahead*, p. 52.

²¹ Under post-1977 bilateral agreements, ticket prices are subject to dual, or double, disapproval. Dual disapproval means that fare levels proposed by airlines go into effect unless rejected by both signatories to the agreement. ATA, *Air Service Rights in U.S. International Air Transport Agreements*, Glossary of Terms, last updated Aug. 10, 1998, p. 2.

²² OECD, *International Air Transport: The Challenges Ahead*, pp. 51-52.

²³ “More Skies to Open as U.S. Signs Pacts,” *Aviation Week & Space Technology*, Sept. 14, 1992, p. 32, found at <http://proquest.umi.com/>, retrieved May 25, 1999.

²⁴ As with post-1977 bilateral agreements, open skies agreements allow fares proposed by airlines to become effective unless disapproved by both signatories. U.S. Department of Transportation, Office of Assistant Secretary for Aviation and International Affairs, “U.S. Open Skies Agreements,” found at <http://ostpxweb.dot.gov/aviation/IntAv/OpenSky.htm>, retrieved July 21, 1999.

²⁵ An airline cannot exercise fifth and sixth freedom rights without the approval of the third-party country with whom the airline’s country of registration does not have a bilateral air service agreement. Bijit Bora and Christopher Findlay, ed., *Regional Integration and the Asia-Pacific* (Melbourne: Oxford University Press, 1996), p. 129.

²⁶ For further discussion of “open skies” agreements and their potential benefits, see U.S. International Trade Commission, *The Changing Structure of the Global Large Civil Aircraft Industry and Market: Implications for the Competitiveness of the U.S. Industry*, Investigation No. 332-384, USITC publication 3143, Nov. 1998.

Table 3
U.S. open skies agreements concluded with trade partners as of December 1999

Region	Country/year
<i>Asia Pacific</i>	Brunei (1997) Malaysia (1997) New Zealand (1997) Singapore (1997) Taiwan (1997) Korea (1998)
<i>Africa</i>	Tanzania (1999)
<i>Western Europe</i>	The Netherlands (1992)* Austria (1995)* Belgium (1995)* Denmark (1995)* Finland (1995)* Iceland (1995) Luxembourg (1995)* Norway (1995) Sweden (1995)* Switzerland (1995) Germany (1996)* Italy (1998)* Portugal (1999)*
<i>Eastern Europe</i>	Czech Republic (1995) Romania (1997)
<i>Commonwealth of Independent States</i>	Uzbekistan (1998)
<i>Latin America and the Caribbean</i>	Aruba (1997) Chile (1997) Costa Rica (1997) El Salvador (1997) Guatemala (1997) Honduras (1997) Nicaragua (1997) Netherlands Antilles (1997) Panama (1997) Peru (1998) Argentina (1999) Dominican Republic (1999)
<i>Middle East and Pakistan</i>	Jordan (1996) Bahrain (1999) Qatar (1999) United Arab Emirates (1999) Pakistan (1999)

*EU-member states

Sources: Office of the Assistant Secretary for Aviation and International Affairs "U.S. Bilateral Aviation Agreements: New/Expanded Agreements in the Current Administration," updated November, 1999, and U.S. Department of Transportation, press release, "United States, Dominican Republic Reach Open Skies Agreement," Dec. 16, 1999, found at <http://www.dot.gov/affairs/dot21199.htm>, retrieved Dec. 20, 1999.

Barring a shift to a multilateral regime governing trade in air transport,²⁷ bilateral open skies agreements will likely continue to serve as the mechanism through which international civil aviation is liberalized.²⁸

The successful negotiation of open skies agreements by the United States and its trade partners represents significant progress in efforts to dismantle restrictions on international air transport. Additional elements of these open skies agreements include --

- (1) Liberal provisions on charter, or nonscheduled, air transport service;
- (2) Right to convert earnings and remit them in hard currency promptly and without restrictions;
- (3) Right of airlines to perform ground handling of their passengers and cargo;
- (4) Procompetitive “doing-business provisions,” pertaining to airlines’ commercial and operational activities;²⁹
- (5) Explicit commitment for nondiscriminatory operation of, and access for, computer reservation systems;
- (6) Model provisions on safety and security established by the Chicago Convention; and
- (7) Seventh freedom traffic rights for scheduled and charter all-cargo service (which has been agreed to by many but not all U.S. open skies partners).³⁰

U.S. Bilateral Agreements With Japan and the United Kingdom

Although Japan and the United Kingdom are the two largest U.S. export markets in the air transport sector, accounting for nearly 30 percent of U.S. exports of air passenger transport services,³¹ the United States has yet to conclude an open skies agreement with either

²⁷ The inclusion of air transport services in certain multilateral trade agreements will be discussed in a later section.

²⁸ Industry representative, seminar hosted by the Economic Strategy Institute (ESI) and the Congressional Economic Leadership Institute, Washington, D.C., June 18, 1999.

²⁹ For example, these provisions allow airlines to market and sell their services in the territory of the other party to the agreement; freedom to determine seating capacity and flight frequency levels based on market conditions; and fair and equitable charges for the usage of airport facilities. U.S. Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, “Air Transport Agreement Between the Government of the United States of America and the Government of the Republic of Guatemala,” found at <http://ostpxweb.dot.gov/aviation/IntAv/opensky.htm>, retrieved Dec. 20, 1999.

³⁰ U.S. Department of Transportation, Office of Assistant Secretary for Aviation and International Affairs, “U.S. Open Skies Agreements,” found at <http://ostpxweb.dot.gov/aviation/IntAv/OpenSky.htm>, retrieved July 21, 1999.

³¹ In 1998, Japan accounted for 18 percent of U.S. exports of passenger fares, and the United Kingdom accounted for 11 percent. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1999, p. 71.

country. The United States maintains its Bermuda II Agreement with the United Kingdom and a Bermuda I Agreement with Japan, although the parties have recently made efforts to move toward open skies.

The U.S.-Japan Bilateral Agreement

Major Provisions

The United States and Japan concluded a Bermuda I Agreement on August 11, 1952. The agreement has since undergone multiple revisions, with the objective of providing greater market access for the countries' respective airlines. According to the agreement (table 4),³² U.S. carriers are granted authority to operate over routes between the United States and three traffic points: Naha, Osaka, and Tokyo. The United States is also permitted to carry fifth freedom traffic beyond Naha, Osaka, and Tokyo to third-party countries. In contrast, the agreement allows Japanese carriers to fly from Japan to U.S. cities, including Honolulu, Los Angeles, New York,³³ and San Francisco, as well as to Saipan and Guam. Japanese carriers are also granted beyond rights, permitting them to carry passengers from Honolulu, San Francisco, and New York to Europe and beyond;³⁴ from Honolulu and San Francisco to Mexico and Central America; and from Honolulu and Los Angeles to South America. While in the original agreement Japan designated only one passenger carrier, Japan Airlines,³⁵ the U.S. designated two, United Airlines and Northwest (as well as one cargo carrier, FedEx).³⁶

Between 1952 and 1989, the United States and Japan increased the number of designated carriers, the frequency with which they operated, and the routes that they served.³⁷ Further, a 1989 memorandum of understanding permits increases in seating capacity on previously

³² Gateway cities differed somewhat in the original 1952 bilateral agreement. "Civil Air Transport Agreement Between Japan and the United States of America," Schedule (of routes), signed Aug. 11, 1952.

³³ A route permitting Japanese carriers to fly from Japan via Anchorage to New York is scheduled separately in the agreement. ATA, *Air Service Rights in U.S. International Air Transport Agreements*, Japan, last updated Aug. 27, 1998, p. 1.

³⁴ Here, the term "beyond" denotes the ability of Japanese airlines to carry passengers between Europe and third-party countries.

³⁵ Carrier names are not specified in bilateral agreements.

³⁶ Pursuant to the 1952 bilateral, Pan Am, Northwest, and Flying Tiger, a U.S. cargo carrier, were selected as designated carriers. Pan Am sold its Pacific routes to United Airlines in 1986, while Flying Tiger sold its rights to operate over Japan routes to FedEx.

³⁷ For instance, a 1982 record of consultations adds routes permitting U.S. carriers to fly between Seattle, Portland and Tokyo. Japanese carriers, on the other hand, are allowed to fly between Tokyo, Seattle, and Chicago. In addition, Japanese carriers are permitted to operate two weekly flights between Tokyo, Los Angeles, and Sao Paulo/Rio de Janeiro. In 1985, new routes were added between Japan and Micronesia (Guam and Saipan), as well as between Japan and the U.S. mainland/Hawaii. U.S. and Japanese carriers serving these routes were restricted in the number of weekly flights they were permitted to operate. ATA, *Air Service Rights in U.S. International Air Transport Agreements*, Japan, last updated Aug. 27, 1998, pp. 2-4.

Table 4

A comparison of major provisions regarding more liberalized traffic rights in four types of bilateral air service agreements

Bermuda I (Japan)	Bermuda II (United Kingdom)	Post-1977 Bilaterals	Open Skies
<ul style="list-style-type: none"> Multiple airline designation on routes Named traffic points¹ to be served by designated airlines Ex post facto review of seating capacity, flight frequency² Dual approval of fares Extensive fifth freedom rights 	<ul style="list-style-type: none"> Single airline designation³ on routes Named traffic points to be served by designated airlines Prior approval of seating capacity and flight frequency Dual approval of fares Limited fifth freedom rights 	<ul style="list-style-type: none"> Multiple airline designation on routes Named traffic points to be served by designated airlines No restrictions on capacity or flight frequency Either dual disapproval of fares, or country of origin rules⁴ Extensive fifth freedom rights 	<ul style="list-style-type: none"> No limits on the number of designated airlines No restrictions on routes/no named traffic points to be served by designated airlines No restrictions on seating capacity or flight frequency Dual disapproval of fares Full fifth and sixth freedom rights Approval of code-sharing arrangements

¹ In addition to delineating routes, the agreement specifies traffic points, or cities, to be served by designated foreign airlines.

² Ex post facto review permits airlines to determine independently seating capacity and flight frequency levels on specific routes, although such levels may be later subject to government review.

³ Single designation permits signatories to designate only one national airline to fly on each of the routes specified within the agreement. On some routes, however, the Bermuda II Agreement may also permit the designation of multiple airlines.

⁴ Country-of-origin rules permit one signatory to unilaterally prevent the use of proposed fares with regard to traffic originating in its own country.

Sources: Compiled by USITC staff from ATA, *Air Service Rights in U.S. International Air Transport Agreements*, Glossary of Terms, last updated Aug. 10, 1998, p. 1.; William E. O'Connor, *An Introduction to Airline Economics*, 5th ed., (Westport, Connecticut: Praeger, 1995), p. 51; OECD, *International Air Transport: The Challenges Ahead* (Paris: Organization of Economic Co-operation and Development, 1993), p. 50; WTO, Council for Trade in Services, "Air Transport Services: Background Note by the Secretariat," S/C/W/59, Nov. 5, 1998, p. 23; and Clyde Prestowitz, Jr., Don Hilty, Lawrence Chimere, and Laura Sweeney, "Turbulence Over the Pacific," *Economic Strategy Institute*, Mar. 1996, p. 24.

scheduled routes between the United States and Japan. To this end, signatories were allowed to designate additional new carriers to operate, or to increase the flight frequency of already-named carriers.³⁸ By 1989, the United States had designated four more airlines to serve U.S.-Japan routes, while Japan had named an additional two carriers.³⁹

³⁸ *Ibid.*, p. 5.

³⁹ New U.S. carriers named to the agreement included American, Delta, and Continental airlines, as well as cargo carrier UPS. Japanese carriers included All Nippon Airways (ANA) and Nippon Cargo Airlines (NCA). Hufbauer, ed., *Flying High: Liberalizing Civil Aviation in the Asia Pacific*, Nov. 1996, p. 52.

Highlights of Recent Negotiations⁴⁰

On January 30, 1998, the United States and Japan concluded a new memorandum of understanding (MOU) that substantially amends the 1952 bilateral agreement and enhances significantly the operating rights of U.S. and Japanese carriers. The agreement permits both signatories to have the same number of incumbent carriers and allows such incumbents to have unrestricted access on scheduled routes.⁴¹ Under the MOU, Japan's All Nippon Airways and Nippon Cargo Airlines were newly-designated as incumbent carriers, providing Japan with the same number of incumbents as the United States. Both U.S. and Japanese incumbent carriers are permitted to fly between any two points in the United States and Japan without limitation on capacity or frequency of service.⁴² The MOU also allows nonincumbent U.S. carriers - American, Delta, and Continental - to increase the frequency of their flights. Further, the United States is permitted to designate two added carriers, TWA and US Airways, to serve U.S.-Japan routes. In addition, the MOU provides for code-sharing arrangements between U.S. and Japanese carriers. For example, in October 1998, American Airlines and Japan Airlines initiated their code-sharing alliance, which serves nearly 290 cities in the United States and 70 cities in Japan. The code-sharing agreement also permits the two airlines to operate joint flights to third-country destinations, including countries in the Asia Pacific region and Latin America.⁴³ Other proposed pairings include United Airlines/All Nippon Airways, and Northwest Airlines/Japan Air System. Finally, the MOU grants U.S. carriers access to a greater number of landing slots in Japan's Narita and Kansai airports. Such access stems from reallocation of unused slots previously held by U.S. cargo carrier FedEx.⁴⁴

Along with the liberalizing measures outlined above, the 1998 MOU provides for followup negotiations to take place by January 1, 2001, the aim of which is to further liberalize the air transport market between the United States and Japan. In the event that negotiations are not successful in reaching a subsequent agreement, the 1998 MOU provides that nonincumbent carriers will be able to increase the frequency of their flights between the years 2002 and

⁴⁰ Discussion of a 1996 MOU has been omitted because it addresses primarily the provision of air cargo services between the United States and Japan, which is outside the scope of this article. For further information, see ATA, *Air Service Rights in U.S. International Air transport Agreements*, Japan, last updated Aug. 27, 1998, pp. 7-10.

⁴¹ Memorandum of Understanding amending Civil Air Transport Agreement between Japan and the United States of America, signed Mar. 14, 1998, p. 1.

⁴² Incumbent U.S. passenger carriers Northwest Airlines and United Airlines still face capacity restrictions on their beyond rights from Japan to third-party countries. Memorandum of Understanding amending Civil Air Transport Agreement between Japan and the United States of America, signed in Tokyo, Japan on Mar. 14, 1998, pp. 2-6.

⁴³ "JAL, American Agree Deal," *Financial Times*, Feb. 26, 1998, p. 26.

⁴⁴ Carole A. Shifrin and Eiichiro Sekigawa, "U.S. and Japan Agree On Historic Air Bilateral," *Aviation Week & Space Technology*, Feb. 9, 1998, p. 74.

2005, thus allowing for greater market access by such carriers.⁴⁵ This provision of the MOU may be viewed as a “phased-in” approach to liberalization, stopping just short of open skies.⁴⁶

The U.S.-U.K. Bilateral Agreement

Major Provisions

Trade in air transport between the United States and the United Kingdom continues to be regulated by the relatively restrictive Bermuda II Agreement. Unlike the air service agreement between the United States and Japan, the U.S. bilateral agreement with the United Kingdom controls market access through strict limitations on routes, seating capacity, and fares (see table 4). Apart from these limitations, the bilateral agreement restricts access to London airports. Both signatories are permitted to designate only two airlines to operate between airports in London and a host of U.S. cities named within the agreement.⁴⁷ The United States has claimed that the limited access of U.S. airlines to Heathrow Airport has helped perpetuate the dominant position of British Airways in the U.S.-U.K. market.⁴⁸

Bilateral efforts to amend the Bermuda II Agreement have liberalized the U.S.-U.K. air transport market only to a limited degree.⁴⁹ In 1991, the agreement was revised to enable the United States to replace the two U.S. carriers permitted to serve Heathrow, Pan Am and TWA, with American and United Airlines. In turn, the United Kingdom required the United States to pay for succession rights, and also negotiated the right for its largest carrier, British Airways, to enter into a code-sharing arrangement with US Airways.⁵⁰ A 1995 agreement further opened the U.S.-U.K. market by permitting U.S. and British carriers to expand service on certain routes,⁵¹ and by increasing code-sharing opportunities.⁵²

⁴⁵ Memorandum of Understanding amending the Civil Air Transport Agreement between Japan and the United States of America, signed Mar. 14, 1998, pp. 21-23.

⁴⁶ “U.S. Urged to Repudiate Flight Treaty With Britain,” *The Washington Times*, Oct. 23, 1998, found at <http://newsedge/NewsEDGE/PreviewSt...>, retrieved Jan. 8, 1999.

⁴⁷ ATA, *Air Service Rights in U.S. International Air Transport Agreements*, United Kingdom, last updated July 1, 1997, pp. 1-2 and 15.

⁴⁸ U.S. General Accounting Office (GAO), Testimony Before the Subcommittee on Aviation, Committee on Commerce, Science, and Transportation, U.S. Senate, “International Aviation: Competition Issues in the U.S.-U.K. Market,” Statement of John H. Anderson, Jr., Director, Transportation Issues, Resources, Community, and Economic Development Division, June 4, 1997, p. 4.

⁴⁹ Since 1977, there have been over a dozen amendments to the agreement. ATA, *Air Service Rights in U.S. International Air Transport Agreements*, last updated July 1, 1997, p. 1.

⁵⁰ U.S. Department of Transportation, Statement of Federico Pena, Secretary of Transportation, Before the Sub-Committee on Aviation, Committee on Commerce, Science, & Transportation Concerning International Aviation Agreements, May 24, 1995, found at <http://www.dot.gov/affairs/1995/avtest.htm>, retrieved Feb. 9, 1999.

⁵¹ For example, a second U.S. airline was permitted to fly between Chicago and London’s Heathrow Airport, while British Airways was permitted to increase the frequency of its flights

(continued...)

Highlights of Recent Negotiations

Until recently, negotiations to amend the U.S. bilateral agreement with the United Kingdom toward an open skies arrangement centered around the proposal of a strategic alliance between American Airlines and British Airways.⁵³ The two carriers are estimated to carry nearly 60 percent of scheduled passenger traffic, between the United States and the United Kingdom.⁵⁴ While the United States made antitrust exemption of the alliance contingent upon an open skies agreement,⁵⁵ the United Kingdom opted for continued close regulation of air transport between the two countries. In July 1999, the U.S. Department of Transportation rejected an application submitted by American Airlines and British Airways seeking antitrust approval for the alliance but, at the same time, reaffirmed its commitment to establish an open skies agreement with the United Kingdom.⁵⁶

Talks between the United States and the United Kingdom remain ongoing. For instance, U.S. negotiators have requested more takeoff and landing slots at Heathrow Airport.⁵⁷ Such slots would be used primarily by new entrants and/or by carriers which had been denied prior access to that airport. The United States also proposed that carriers be permitted to set fares unless disapproved by both governments. Further, the United States aims to expand

⁵¹ (...continued)

between Philadelphia and London. In addition, both U.S. and British carriers were allowed to fly between regional airports in the United Kingdom (airports located outside of London), and the United States. U.S. Department of Transportation, press release, "U.S., U.K. Reach Agreement on Expanded Services," June 5, 1995, found at <http://www.dot.gov/affairs/1995/ukagree.htm>, retrieved Feb. 9, 1999.

⁵² Ibid.

⁵³ The alliance was initially proposed in June 1996. "EU Ponders Stiff Terms for Approving Alliance," *Aviation Week & Space Technology*, Aug. 4, 1997, p. 38.

⁵⁴ GAO, "International Aviation: Competition Issues in the U.S.-U.K. Market," June 4, 1997, p. 7.

⁵⁵ Antitrust approval was granted for alliances between Northwest Airlines and Dutch carrier, KLM, and between United Airlines and German carrier, Lufthansa, after the Netherlands and Germany signed open skies agreements with the United States in 1992 and 1996, respectively. Carole A. Shifrin, "U.S., U.K. Open Talks on Bilateral Framework," *Aviation Week & Space Technology*, June 24, 1996, p. 32, and Dan Reed, "U.S. Officials Cancels Talks on American Airlines, British Airways Alliance," *Fort Worth Star-Telegram*, Oct. 10, 1998, found at <http://newsedge/NewsEDGE/PreviewSt...>, retrieved Jan. 8, 1999.

⁵⁶ The U.S. Department of Transportation works in conjunction with the U.S. Department of Justice in reviewing the antitrust implications of airline alliances. GAO, Testimony Before the Subcommittee on Aviation, Committee on Commerce, Science, and Transportation, U.S. Senate, "International Aviation: DOT's Efforts to Increase U.S. Airlines' Access to International Markets," Statement of John H. Anderson, Jr., Director, Transportation Issues, Resources, Community, and Economic Development Division, Mar. 14, 1996, p. 9, and U.S. Department of Transportation, Office of the Secretary, Office of Public Affairs, "Statement of Transportation Secretary Rodney E. Slater on American/British Airways," press release, July 30, 1999, found at <http://www.dot.gov/briefing.htm>, retrieved Aug. 2, 1999.

⁵⁷ For added detail, see U.S. International Trade Commission, *The Changing Structure of the Global Large Civil Aircraft Industry and Market: Implications for the Competitiveness of the U.S. Industry*, Investigation No. 332-384, USITC publication 3143, Nov. 1998, p. 6-16.

beyond rights for U.S. carriers, permitting them to pick up passengers in the United Kingdom, and transport them to third-party countries.⁵⁸

The United Kingdom has resisted U.S. efforts to achieve open skies. In recent negotiations, the United Kingdom has expressed concern over pricing issues, U.S. restrictions on foreign ownership, and “Fly America” rules.⁵⁹ First, the United Kingdom desires to retain the right for one country to unilaterally veto a proposed new fare, or, as an alternative, to establish a formal arbitration mechanism to resolve pricing disputes between the two countries.⁶⁰ Second, the United Kingdom seeks the relaxation of restrictions on foreign investment in U.S. airlines, thus permitting U.K. firms to own and operate U.S. domestic carriers.⁶¹ Under U.S. law, a foreign entity is permitted to own no more than 25 percent of voting stock and 49 percent of nonvoting stock of a U.S. airline.⁶² Finally, the United Kingdom views “Fly America” rules, requiring that, whenever feasible, U.S. Government employees fly on U.S.-owned carriers, as an impediment to British carriers’ serving the U.S. market.⁶³

According to industry sources, the United States and the United Kingdom have engaged in discussions on an agreement that gradually liberalizes competitive conditions, similar in approach to agreements concluded between the United States and Japan, and between the United States and France.⁶⁴ Under this scenario, Bermuda II reportedly would continue to serve, in the short term, as the bilateral framework governing air transport between the United States and the United Kingdom.⁶⁵ Industry sources indicate that gradual liberalization of the U.S.-U.K. market would be achieved through the successful negotiation of core issues

⁵⁸ Under the current U.S.-U.K. bilateral, limited beyond rights exist for U.S. carriers. Charles Goldsmith, “Open Skies Talks Between U.S., U.K. to Address Pricing, ‘Fly America’ Rules,” *The Wall Street Journal*, Oct. 2, 1998, p. A12.

⁵⁹ Remarks by Richard Branson, CEO, Virgin Atlantic, at “Aviation in the 21st Century” Conference, hosted by the U.S. Department of Transportation in Chicago, Illinois, Dec. 5-7, 1999, and Goldsmith, “Open Skies Talks between U.S., U.K. to Address Pricing, ‘Fly America’ Rules,” *The Wall Street Journal*, Oct. 2, 1998, p. A12.

⁶⁰ Goldsmith, “Open Skies Talks Between U.S., U.K. to Address Pricing, ‘Fly America’ Rules,” *The Wall Street Journal*, Oct. 2, 1998, p. A12.

⁶¹ Michael Skapinker, “BA-American Air Alliance Faces a Further Setback: Carriers’ Planned Link-up May Be Delayed After U.S. Walks Out of ‘Open Skies’ Talks With U.K.,” *Financial Times*, Oct. 8, 1998, p. 23.

⁶² GAO, “Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines,” Dec. 1992, p. 22.

⁶³ Goldsmith, “Open Skies Talks Between U.S., U.K. to Address Pricing, ‘Fly America’ Rules,” *The Wall Street Journal*, Oct. 2, 1998, p. A12.

⁶⁴ In June 1998, the United States and France signed a bilateral agreement which allows for the complete elimination of restrictions on air transport service between the two countries within 5 years. “U.S. Aims to Open U.K. Skies,” CNN Financial Network, found at <http://www.japan.cnnfn.com/>, posted Feb. 15, 1999, and retrieved June 9, 1999, and U.S. Department of Transportation, Office of the Assistant Secretary for Public Affairs, “United States, France Sign Aviation Agreement,” news release, June 18, 1998, found at <http://www.dot.gov/affairs/1998/dot11798.htm>, retrieved July 8, 1999.

⁶⁵ Michael Skapinker, “U.S. Willing to Accept Phased Progress on Open Skies by U.K.,” *Financial Times*, Feb. 15, 1999

that have heretofore stalled progress on open skies talks. Such issues might include, for example, U.S. carriers' access to Heathrow Airport and the relaxation of foreign ownership limitations on U.S. airlines.⁶⁶

Toward a Multilateral Framework

While the liberalization of international aviation has been achieved primarily through the negotiation of bilateral open skies agreements, multilateral agreements have also served to lift restrictions on the provision of air transport services (table 5). For instance, some regional trade agreements, such as the Andean Pact and Mercosur, contain measures which remove restrictions on access to all intra-regional routes for member country airlines. Other agreements, including NAFTA and the Group of Three, include provisions on ancillary transport services, such as aircraft maintenance and repair, and computer reservation system (CRS) services. Two multilateral efforts may have particular impact on U.S. open skies policy: the common aviation area of the EU and the General Agreement on Trade in Services (GATS).

Common Aviation Area in the European Union

In April 1997, the European Union concluded the last of a three-step process to deregulate the EU aviation market. The "third package," as it is termed, permits any airline belonging to an EU member state to fly on any route inside the European Union.⁶⁷ The deregulatory package also allows such airlines to provide cabotage, or point-to-point service, within any EU country.⁶⁸ While the conclusion of the third package has had a significant liberalizing impact on the operation of European airlines inside the EU, it has also held important implications for aviation relations between EU member states and trade partners.

Following the establishment of a common aviation area, EU authorities have challenged the right of individual EU Member States to negotiate bilateral agreements with the United States. In particular, the European Commission (EC) has claimed that such bilaterals run counter to the purpose of the common aviation market by discriminating between airlines from EU countries that have concluded open skies agreements with the United States and those from countries that have not.⁶⁹ The EC has also claimed that the negotiation of

⁶⁶ Skapinker, "U.S. Willing to Accept Phased Progress on Open Skies by U.K.," *Financial Times*, Feb. 15, 1999, and Joan M. Feldman, "To Phase or Not to Phase," *Air Transport World*, Apr. 1999, p. 44.

⁶⁷ The first and second packages liberalized measures in existing bilateral aviation agreements between EU members. Jack Hayward, ed., *Industrial Enterprise and European Integration*, (New York: Oxford University Press, 1995), p. 197.

⁶⁸ J. Mawson, ed., "Air Transport Liberalization in the European Union: An Assessment," *Regional Studies*, vol. 31.8 (1997), p. 808.

⁶⁹ "European Commission Takes Legal Action Against EU Member States' Open Skies Agreements With the United States," European Union press releases, No. 16, Mar. 11, 1998, found at <http://www.eurunion.org/news/press/1998-1/pr16-98.htm>, retrieved June 9, 1999.

Table 5
Multilateral initiatives which include provisions on air transport

Agreement	Air transport-related efforts/measures
Asia-Pacific Economic Cooperation (APEC) Forum	Established a working group in 1995 to address the creation of a more competitive environment for the provision of air services among APEC members. ¹ In February 1998, the APEC Air Service Group (ASG) recommended liberalizing eight categories of air transport services, including air cargo services. (For more detail, see "APEC Committee on Trade and Investment," available at http://www.apecsec.org.sg/cit/cti96/11trspot.html .)
Andean Sub-regional Integration Agreement (Andean Community)	Beginning in June 1992, airlines from member-countries (Bolivia, Colombia, Ecuador, Peru, and Venezuela) were permitted unrestricted access to intra-regional routes, and were also allowed to provide domestic point-to-point service (cabotage). (For more detail, see Organization of American States (OAS), "Provisions on Trade in Services in Trade Integration Agreements of the Western Hemisphere," FTAA.ngsv/w/08/Rev.3, Washington, DC, June 22, 1999.)
General Agreement on Trade in Services (GATS)	Addresses ancillary air transport services, including aircraft maintenance and repair, the selling and marketing of air transport services, and computer reservation system (CRS) services. (For more detail, see WTO: Council for Trade in Services, "Annex on Air Transport Services," available at http://www.wto.org/services/9-anats.html .)
Group of Three	Liberalizes the provision of aircraft maintenance and repair services, speciality air services, ² and computerized reservation services (CRS) among the three member countries (Colombia, Mexico, and Venezuela). (For more detail, see OAS, "Provisions on Trade in Services in Trade Integration Agreements of the Western Hemisphere," Washington, DC, June 22, 1999.)
European Common Aviation Market	Concluded in April 1997, the EU's third package on aviation deregulation permits EU airlines to operate on any route inside the European Union, and to provide cabotage within member-states. (For more detail, see J. Mawson, ed., "Air Transport Liberalization in the European Union: An Assessment," <i>Regional Studies</i> , vol. 31.8, 1997.)
Southern Cone Common Market (Mercosur)	The Annex on Air Transport Services, established during the Protocol of Montevideo, removes market access restrictions on routes between member countries (Argentina, Brazil, Paraguay, and Uruguay). (For more detail, see OAS, "Provisions on Trade in Services in Trade Integration Agreements of the Western Hemisphere," Washington, DC, June 22, 1999.)
North America Free Trade Agreement (NAFTA)	Liberalizes the provision of two air transport services among NAFTA members (Canada, Mexico, and the United States). These two services are: (1) aircraft maintenance and repair services, during which an aircraft is withdrawn from service; and (2) speciality air services. (For more detail, see OAS, "Provisions on Trade in Services in Trade Integration Agreements of the Western Hemisphere," Washington, DC, June 22, 1999.)

¹ APEC members include Australia, Brunei Darussalam, Canada, Chile, People's Republic of China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Chinese Taipei, Thailand, Vietnam, and the United States.

² Specialty air services include, for example, aerial mapping, aerial surveying, aerial photography, forest fire management, fire fighting, aerial advertising, glider towing, parachute jumping, and aerial construction, among other activities.

Source: Compiled by USITC staff from various sources.

bilateral agreements by individual member states contravenes EU community law. In December 1998, the EC filed suit against eight EU members for concluding separate aviation agreements with the United States since the adoption of the European Common Market in 1992.⁷⁰ Finally, the EC has asserted that because all cross-border trade issues fall within its jurisdiction, it alone has the authority to negotiate traffic rights with foreign countries on behalf of EU members.⁷¹ The latter assertion has not been agreed to by most EU countries, however, and the line between the EC's and individual EU member's authority, with respect to aviation issues, is still unclear.⁷²

The future shape of aviation relations between the United States and the EU could depend largely on whether the EC is found to have the authority to negotiate traffic rights on behalf of EU members. The EC has indicated its desire for a multilateral agreement between the United States and EU member states, which it feels would provide for a more balanced exchange of traffic rights than existing U.S. bilaterals with EU countries.⁷³ For its part, the United States has indicated that it is not in a position to negotiate an aviation agreement with the EC concerning traffic rights until the EC has been given a mandate to negotiate traffic rights on behalf of EU members.⁷⁴ The United States has further indicated its intent to forge more open skies agreements with individual EU countries.⁷⁵

⁷⁰ These countries were Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Sweden, and the United Kingdom. The open skies agreement concluded between the United States and the Netherlands in 1992 was not included in the suit because it was determined to have preceded the adoption of the European Common Market. Reportedly, as of November 1999, no resolution had been achieved in the EC's case, which was presented before the European Court of Justice in December 1998. "European Commission Takes Legal Action"; John D. Morocco, "European Commission Challenges Bilaterals," *Aviation Week & Space Technology*, Mar. 16, 1998, p. 30; and Alan George, "Europe's Majors Call for Liberalised Transatlantic," *Airline Business*, Nov. 1999, p. 19.

⁷¹ The EC has been given a mandate to negotiate ancillary air transport services and has addressed such services under the European Union's schedule of commitments in the GATS.

⁷² "European Commission Takes Legal Action," and David Knibb, "Double Standards," *Airline Business*, Mar. 1999, p. 32.

⁷³ "European Commission Takes Legal Action Against EU Member States' Open Skies Agreements With the United States," The European Union press releases, No. 16, Mar. 11, 1998.

⁷⁴ Official from the U.S. Department of Transportation, response via electronic mail to questions posed by USITC staff, Aug. 9, 1999.

⁷⁵ The United States has open skies agreements with 10 EU Member States (see table 3). U.S. Department of Transportation, "U.S.- European and U.S.-EU International Transportation Issues," Briefing at the Foreign Press Center in Washington, D.C., presented by U.S. Secretary of Transportation Rodney Slater and A. Bradley Mims, Deputy Assistant Secretary of Transportation for International and Aviation Affairs, Mar. 19, 1999, and U.S. DOT, "U.S. Mission to the EU Press Briefing," presented by Rodney E. Slater, U.S. Secretary of Transportation, Brussels, Mar. 24, 1999, and Office of the Assistant Secretary for Aviation and International Affairs, "U.S. Bilateral Aviation Agreements: New/Expanded Agreements in the Current Administration," updated Dec., 1999.

GATS: The Annex on Air Transport Services

The General Agreement on Trade in Services (GATS) provides limited coverage of aviation issues through the Annex on Air Transport Services.⁷⁶ Specifically, the GATS addresses three ancillary services with respect to air transport: (1) aircraft repair and maintenance; (2) the selling and marketing of air transport services; and (3) computer reservation system (CRS) services. Aircraft repair and maintenance pertain only to those activities performed on the aircraft when it is on the ground. The selling and marketing of air transport services includes the advertisement of air transport services and the distribution of airline tickets, but does not address the pricing of airline seats. CRS services pertain to information regarding airline fares and seat availability.⁷⁷ The GATS does not include measures on traffic rights or “services directly related to the exercise of traffic rights.”⁷⁸

The coverage of air transport services under the GATS will be re-examined in upcoming services negotiations (see related article in this issue), with a view toward possibly augmenting the scope of commitments in this sector. For example, consideration has been given to incorporating traffic rights under the framework of the GATS. If full market access commitments were made regarding traffic rights, such rights could allow foreign carriers to fly without limitation between their home country and host-country markets.⁷⁹ National treatment commitments would imply further liberalization of services provided by foreign carriers. In particular, national treatment could allow a carrier to fly, without restriction, between two foreign countries.⁸⁰ Unqualified national treatment could also permit an airline to carry traffic within a foreign country (cabotage),⁸¹ although the granting of cabotage rights to foreign carriers is currently prohibited by most countries, including the United States.⁸²

Expanding the coverage of air transport services under the GATS poses both advantages and disadvantages. Potential advantages may include the opportunity for carriers to better serve

⁷⁶ It should be noted that there are some issues pertaining to the provision of air transport services that are addressed both in bilateral agreements and in the GATS. These include, for example, measures related to dispute resolution, currency conversion, ground handling operations, and CRS services.

⁷⁷ WTO, “Annex on Air Transport Services,” summary document found at <http://www.wto.org/wto/services/9-anats.htm>, retrieved Feb. 4, 1999.

⁷⁸ The phrase “services directly related to the exercise of traffic rights” is not defined within the Annex on Air Transport Services, and it appears that some countries have scheduled commitments that do in fact relate to traffic rights, such as those pertaining to “aircraft leasing with crew” and “air transport passenger services.” WTO, Council for Trade in Services, “Air Transport Services: Background Note by the Secretariat,” S/C/W/59, Nov. 5, 1998, pp. 1 and 16.

⁷⁹ This would be the equivalent of third and fourth freedom traffic rights. Such rights would be granted to the airlines of GATS signatories only.

⁸⁰ This would be the equivalent of fifth, sixth, and seventh freedom traffic rights. Such rights would be granted to the airlines of GATS signatories only.

⁸¹ An eighth freedom traffic right.

⁸² U.S. Department of Transportation (DOT), Office of International Aviation, Office of the Secretary, “Aviation Issues in GATS 2000 and Other Fora,” June 1999.

third-party countries⁸³ and develop hub networks in foreign markets.⁸⁴ At the same time, however, it is not certain whether air transport commitments under the GATS would necessarily be more equitable than a consensus the United States and a trade partner could reach in bilateral agreements. Moreover, concerns have been raised about the nonretractability of GATS commitments and the potential for “free-riders”⁸⁵ to benefit from such commitments in the absence of exemptions to the Most Favored Nation (MFN) principle.⁸⁶

Outlook

In order to sustain progress toward full liberalization of the international air transport market, the United States has launched a “beyond open skies” initiative. The primary objective of this initiative is to develop an alternative framework to the current bilateral system to facilitate trade in air transport services. Although, at present, it is uncertain how the United States will proceed with a beyond open skies agenda, recent discussions between the United States and its aviation trade partners have produced several proposals. One proposal entails a bilateral agreement between the United States and EU member states which would establish the Transatlantic Common Aviation Area (TCAA). This proposal, advanced by the European Commission and the Association of European Airlines (AEA),⁸⁷ is intended to facilitate further market access and to provide a common framework to harmonize aviation regulations (with regard to airline ownership, and competition policy, for example) among signatory countries. Another proposal entails regional aviation agreements which include provisions on air traffic rights, such as an initiative by the Asia-Pacific Economic Cooperation (APEC) forum (see table 5). Ultimately, U.S. aviation officials envision that multilateral liberalization of air transport services will likely take place through a phased approach, with agreements negotiated initially among groups of like-minded trade partners and applicable to distinct categories of air transport services (e.g., air cargo). Although the conclusion of a multilateral aviation agreement as originally proposed at the Chicago Conference of 1944 may not be achieved, it is with this objective in mind that the United States and its trade partners pursue alternative frameworks encompassed by the “beyond open skies” initiative.⁸⁸

⁸³ As noted earlier, under the bilateral regime, airlines must obtain permission from third-party countries with whom their country of registration does not have a bilateral agreement before flying to such countries.

⁸⁴ DOT, “Aviation Issues in GATS 2000 and Other Fora,” June 1999.

⁸⁵ Free-riders enjoy favorable terms of trade in foreign countries, although they do not grant similar benefits to foreigners operating in their own markets.

⁸⁶ DOT, “Aviation Issues in GATS 2000 and Other Fora,” June 1999.

⁸⁷ Association of European Airlines (AEA), “Towards a Transatlantic Common Aviation Area,” AEA Policy Statement, Sept. 1999.

⁸⁸ “Aviation in the 21st Century” Conference, hosted by the U.S. Department of Transportation in Chicago, Illinois, Dec. 5-7, 1999.

Glossary of technical terms

Ancillary services	Services auxiliary to the transport of passengers and cargo by air as defined under the General Agreement on Trade in Services (GATS). Such services include aircraft maintenance and repair; the selling and marketing of air transport services; and computer reservation system services.
Beyond rights	The right of an airline to fly between two foreign countries, also known as a “fifth freedom” right. (See definition of “Freedoms of the air”, below.)
Bilateral air service agreement (bilateral agreement)	An agreement between two foreign countries permitting the countries respective airlines to fly to, from, and beyond each other’s markets, and placing certain restrictions on the operation of foreign airlines. (See table 4 for a comparison of four types of bilateral air service agreements.)
Cabotage	The transport of passengers between two points (cities) within the same country.
Code sharing arrangement	An alliance in which one airline is permitted to list its flights under another airline’s code in a computer reservation system (CRS). Participating carriers also coordinate flight schedules and payment methods.
Computer reservation system (CRS)	An electronic database listing fare and flight information used to reserve airline seats.
Designated airline	An airline from a signatory country that has been given the right to operate over routes in a bilateral agreement. The names of designated airlines are usually not specified in the agreements themselves.
Dual approval	A provision under a bilateral agreement requiring that both signatories approve proposed ticket prices before they take effect. Also known as “double approval”.
Dual disapproval	A provision under a bilateral air service agreement which permits proposed ticket prices to take effect unless disapproved by both signatories. Also known as “double disapproval”.
Flight frequency	The number of flights an airline operates during a given period over scheduled routes in a bilateral agreement.
Freedoms of the air	An eight-item list that delineates the type of routes over which airlines from signatories to a bilateral agreement may operate (see table 2). The list forms the conceptual foundation for airlines’ exercise of traffic rights (see below).
Traffic rights	Traffic rights permit designated airlines of signatory countries to: (1) operate over routes specified within a bilateral agreement; (2) determine seating capacity to be provided over such routes; and (3) establish fares. Also known as hard rights, or economic rights.
Seating capacity	Refers to the supply of available seats for the transport of air passengers. Seating capacity supplied by designated airlines is regulated in a bilateral agreement through restrictions on the frequency of scheduled flights, the volume of traffic served, and/or the types of aircraft deployed over scheduled routes.
Soft rights	Rights accorded airlines of signatories to a bilateral agreement that are separate and distinct from traffic (or hard) rights. Soft rights pertain to dispute resolution, exemption from taxation and customs duties, the right to own and operate ground handling services, as well as other areas.

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Renewed Services Trade Negotiations in the WTO

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Negotiations to improve the effectiveness of the General Agreement on Trade in Services are scheduled to commence in January 2000. These negotiations will pursue improvements to the general framework of the agreement and seek to elicit stronger commitments to liberal trade principles by World Trade Organization (WTO) members. This article describes the structure and elements of the agreement, discusses the commercial value of existing commitments, and presents some of the objectives and approaches likely to characterize the renewed negotiations.

When the General Agreement on Trade in Services (GATS) entered into force on January 1, 1995, it broke new ground as the first multilateral, legally enforceable agreement covering trade and investment in services. The GATS essentially establishes a framework of rules for trade in services and provides for commitments by individual countries to liberalize market access with respect to specific service sectors. However, the GATS framework does not fully address trade impediments that may result from a government's regulatory process, and specific commitments vary widely by country and largely only prevent countries from adopting more restrictive practices. Thus the GATS did not bring about widespread liberalization of trade in services but instead laid a foundation from to proceed.

Recognizing that further work would needed to liberalize trade in service, GATS signatories² agreed to resume negotiations after a period of 5 years. The mechanism effecting this commencement is article XIX of the GATS framework, which reads as follows:

“Members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement, and periodically thereafter, with a view to achieving a progressively higher level of liberalization.”

The inability of WTO ministers to launch broad, multisector negotiations during the Seattle Ministerial meeting does not necessarily mean that the negotiations agreed to in article XIX will not move forward. Although it remains to be seen how enthusiastically new services negotiations will be pursued in the near term, negotiations nevertheless are still scheduled to

¹ The views expressed in this article are those of the author. They are not the views of the International Trade Commission or any of the Commissioners.

² All WTO members are signatories to the GATS.

begin in January 2000 with the ultimate objective of achieving progressive liberalization of international trade in services.

GATS Structure

Structurally, the GATS may be divided into two major sections: a general framework and schedules of specific commitments (hereafter referred to as schedules), which are augmented by supplemental schedules, lists of exemptions to most-favored-nation (MFN) treatment,³ and other annexes. The general framework contains broad disciplines that apply to all service sectors.⁴ These include obligations regarding MFN treatment, transparency, domestic regulation, and dispute settlement. Unlike other trade agreements, the general obligations do not include the important principles of market access and national treatment, which are addressed separately in the schedules.

General Framework Obligations

MFN Treatment

The GATS obligation regarding MFN treatment is contained in article II, which states that each Member shall treat the services and service suppliers of any other Member no less favorably than the services and service suppliers of any other country.⁵ This means that all foreign service providers must be treated in the same manner, regardless of their national origin. However, this does not mean that foreign service providers need to be treated in a way comparable to domestic service providers, or need to receive national treatment.

Exemptions to MFN treatment are permitted, but must be clearly described in a separate list, annexed to the agreement. The MFN exemption list must include the following information: the sector name, the description of the measure inconsistent with MFN, the country/countries to which the exemption applies, the duration of the exemption, and the reason for the exemption. Often these exemptions are taken when some countries have been granted special or preferential access to a sector, such as when two neighboring countries accord each other preferential treatment with respect to transportation services. In principle, MFN exemptions can only be taken for 10 years and are subject to review after 5 years.

Transparency and Domestic Regulation

Domestic regulation often creates significant barriers to services trade. Many service industries are heavily regulated. From telecommunications to finance to medicine, government regulation plays an integral role in defining the industry and determining which

³ MFN is also referred to as normal trade relations (NTR) in the United States.

⁴ Coverage of air transport services is circumscribed, however, as traffic rights and services directly related to the exercise of traffic rights are excluded from the scope of the GATS.

⁵ The full text of the GATS and all related schedules, exemptions, and supplements may be found at Internet address <http://www.wto.org>.

firms can participate and under what terms and conditions. The ongoing global trend of regulatory reform is indicative of a shift in favor of market disciplines, but fundamental regulatory functions endure. Foreign service firms can be adversely affected in local markets by explicit discriminatory policies (e.g., foreign equity caps) or market access limitations (e.g., economic needs tests⁶), as well as limitations that result from a nontransparent policy process (e.g., regulations change without notice, publication, or any private sector input into the process). Some impediments to services trade may include:

- Measures that limit national treatment by providing more favorable treatment to local firms than to foreign firms.
- Certification requirements that limit national treatment or market access for professional services like medicine, architecture, engineering, and accounting by applying criteria based on nationality or specific university course work rather than knowledge and ability.
- Measures that limit market access by preventing private service providers from operating, as in cases where the government restricts private provision of education and health care services.
- Screening procedures that may limit market access, such as economic needs tests, licensing requirements, or investment approval policies, particularly if the criteria used are not objective and transparent.
- Limitations to market access presented by direct market participation by regulatory agencies, such as in instances where the telecommunications or electric power regulator is also a service provider, and, therefore, a potential competitor.
- Limitations to market access or national treatment presented by nontransparent rule-making procedures.

The GATS addresses transparency and regulatory barriers to services trade in articles III and VI. Transparency obligations (article III) require WTO members to publish promptly relevant measures of general application that may affect services trade and to notify the WTO Council for Trade in Services of significant changes in laws, regulations or administrative guidelines with bearing on services trade. In addition, Members are obligated to respond promptly to information requests from other Members and to establish an enquiry point for use by other Members.

Domestic regulation obligations (article VI) require WTO Members to avoid using their regulatory powers in such a way as to create services trade barriers. Members are to

⁶ Economic needs tests assess the impact of proposed investment on the domestic social, political, and economic environment. The findings of these tests are often subjective, which reduces regulatory transparency and leaves regulators with broad discretionary powers.

ensure that measures of general application are administered in a reasonable, objective, and impartial manner. In addition, for sectors in which a Member has listed a specific commitment to grant market access or national treatment (see below for more detail on these commitments), Members must ensure that licensing and qualification requirements or technical standards (1) are based on objective and transparent criteria, (2) are not more burdensome than necessary, and (3) in the case of licensing procedures, are not in themselves a restriction on the supply of the service.

Dispute Settlement

Article XXIII of the GATS provides for the settlement of disputes between Members through the WTO dispute settlement mechanism. Under the dispute settlement mechanism, a dispute may be brought before a panel by any Member if it perceives that another Member has failed to uphold its commitments. The findings of the panel are subject to an appeal process. Ultimately, in cases where the panel or the appellate body concludes that a measure maintained by a Member is inconsistent with the agreement, the Member may then choose whether to change its measure to satisfy the GATS obligations or provide compensation to the Member that brought the case. If adequate compensation cannot be negotiated, the Member that invoked the dispute settlement procedures may suspend some of its trade concessions, which effectively means they may retaliate by denying services trade privileges (such as market access) or even by raising tariffs on goods imported from the Member that violated the agreement.

Schedules of Specific Commitments: Obligations and Structure

As mentioned previously, market access and national treatment obligations are not contained in the general framework of the GATS, but in the separate schedules of specific commitments. In its schedule, each country makes commitments to adhere to the GATS market access and national treatment obligations on a sector-by-sector basis.⁷ This is called a “bottom-up” or “positive list” approach because it begins from a base in which no industry sectors are included, and builds upward as individual sectors are added one by one. Each country chooses whether to include a sector, in which case the sector will be identified by name and often by the applicable United Nations Central Product Classification (CPC) code.⁸ Then each country specifies which modes of supplying the service (see below) will be bound by the market access and national treatment obligation. Modes of supply are important because they encompass the manner in which services are provided and thereby facilitate the process of identifying and subsequently disciplining restrictions to services trade.

⁷ To simplify the presentation of sector specific commitments that apply to every service sector, most countries provide a "horizontal commitments" section at the beginning of their schedule. These horizontal commitments generally apply to measures governing foreign investment and the temporary entry and stay of foreign citizens.

⁸ Negotiators worked from a list of service sectors developed by the Secretariat which included cross-references to the UN CPC codes. This list is identified by the WTO document code MTN/GNS/W/120.

Modes of Supply

Under the GATS definition, services may be provided through one or more of the following modes of supply: cross-border supply, consumption abroad, commercial presence, and presence of natural persons. Three of these modes are means of providing services across borders:

- Cross-border supply occurs when a service is provided in one country to a customer in a second country without either party traveling, such as when a U.S. securities broker purchases shares in New York in response to a telephone request from a client in London.
- Consumption abroad occurs when a customer travels abroad to the service provider's country in order to receive a service, such as when an individual from Venezuela travels to Miami to receive medical treatment.
- Presence of natural persons occurs when the service provider travels to the customer's country on a temporary basis to provide a service, such as when a U.S. engineering consultant travels to Brazil to provide advice on the construction of a wastewater treatment plant.

The remaining mode, commercial presence, refers to the provision of services through foreign-based affiliates. This mode is particularly significant because, in order to establish a foreign affiliate, there usually must be some form of foreign direct investment. Thus, through the commercial presence mode, the GATS became the first multilateral agreement to extend trade disciplines to foreign investment.⁹

Limitations to Market Access and National Treatment Obligations

After listing an industry sector and indicating which modes of supply will be subject to the market access and national treatment obligations, countries may use their schedules of commitments to limit the scope of these obligations. Such limitations are permitted only to provide for *existing* measures that are inconsistent with these disciplines. This enables countries that are not ready to fully liberalize a particular sector to make a partial commitment to the market access and national treatment obligations by effectively freezing the existing level of restrictiveness. For example, a country could make a commitment to accord market access through a commercial presence for foreign insurance companies, but then indicate that national treatment remains limited by an existing law that restricts foreign ownership to no more than 49 percent of local establishments. In this case, the country has committed to fully adhere to the market access obligation, but to only partially adhere to the national treatment obligation. In addition, the country is now obligated to ensure a standstill;

⁹ World Trade Organization (WTO), "General Agreement on Trade in Services - The design and underlying principles of the GATS," found at Internet address <http://www.wto.org/wto/services/services.htm>, retrieved Dec. 30, 1999.

in other words, future measures cannot reduce the level of foreign ownership below 49 percent. Thus, the actual coverage of the market access and national treatment obligations under the GATS can only be determined through a detailed examination of the schedules of commitments. This also means that there are wide variations from one country to another, making it difficult to assess the commercial value of commitments or to compare commitments across sectors and from one country to another.

Supplemental Schedules

At the conclusion of the Uruguay Round in 1994, services negotiators determined that they had not made significant progress in a number of areas. As a result, they extended negotiations concerning movements of natural persons, maritime transport services, basic telecommunications, and financial services. Negotiations in all sectors have concluded, and significant progress was achieved in the basic telecommunications and financial services sectors.¹⁰ As a result of these extended negotiations, many countries created supplementary schedules of commitments and MFN exemption lists, which then became part of the bundle of documents that constitute each country's GATS obligations.

Value of GATS Commitments¹¹

A country's complete set of GATS commitments thus consists of several documents, which principally include the general framework, the schedules of commitments, supplemental schedules, and lists of MFN exemptions. All of these documents must be consulted in order to determine the commercial significance of a country's commitments under the GATS. Consequently, it is difficult to develop objective indicators to compare the extent to which WTO members have bound their service sectors through the GATS. However, some general observations may be made.

¹⁰ Joseph Papovich, Assistant United States Trade Representative for Services, Investment, and Intellectual Property, "Services in the New Round," testimony before the House Commerce Committee, Subcommittee on Telecommunications, Trade, and Consumer Protection, Washington, D.C., Nov. 4, 1999, found at Internet address <http://www.usia.gov/topical/econ/wto99/se1104.htm>, retrieved Nov. 18, 1999.

¹¹ This section is based on information drawn from the USITC series of studies that examined the GATS commitments from 62 countries across a range of service sectors. The studies include *General Agreement on Trade in Services: Examination of Major Trading Partners' Schedules of Commitments* (USITC publication 2940, Dec. 1995), *Examination of South American Trading Partners' Schedules of Commitments* (USITC publication 3007, Dec. 1996), *Examination of the Schedules of Commitments Submitted by Asia/Pacific Trading Partners* (USITC publication 3053, Aug. 1997), *Examination of the Schedules of Commitments Submitted by Eastern Europe, the European Free Trade Association, and Turkey* (USITC publication 3127, Sept. 1998), and *Examination of the Schedules of Commitments Submitted by African Trading Partners* (USITC publication 3243, Oct. 1999).

Industry sectors *least* effectively covered by the GATS schedules include:

- Private education (e.g., private programs, on-line learning),
- Private health care (e.g., health care facilities management, private hospitals, physician and nursing care, telemedicine),
- Audiovisual (e.g., film, television, and music production and distribution through cinemas, broadcasting, or cable television),
- Transportation (e.g., road/trucking, rail, maritime, and air (see related article in this issue)),
- Distribution (e.g., wholesaling and retailing),
- Energy,
- Environment,
- Express delivery, and
- Foreign legal consultancy.

On a regional basis, the quality of commitments tends to be highest among the developed countries, followed by countries in Eastern Europe and the Asia/Pacific region. Countries in South America and Africa provided the fewest commitments. In the Asia and Pacific regions, India appears to have provided the fewest commitments, whereas commitments scheduled by ASEAN members were only slightly more inclusive. Asia and Pacific countries tended to be willing to commit to developmentally oriented sectors such as construction, architecture, and engineering, but were less forthcoming with services such as audiovisual, private education, and private health care. India and the ASEAN members also tend to maintain the most restrictive policies on foreign investment in services, often by limiting foreign equity to a minority position or requiring joint ventures. Perhaps as a result, service sectors in most of these countries account for a smaller portion of GDP than average for low and middle-income countries.¹²

In Latin America, only Argentina and Mexico made commitments across a broad range of service sectors, whereas most other countries made commitments covering less than 20 percent of the range of industries. The commitments are generally of minimal value in terms of guaranteeing market access and national treatment for all but the travel and tourism service sectors. Audiovisual, education, health, and transportation services received the poorest coverage, with distribution services faring only somewhat better. In some cases, the limited scope of these commitments may not reflect actual market conditions, but a reluctance to make binding commitments due to other negotiating objectives (e.g., trade sources reported that Chile may have wished to avoid entering into WTO obligations in 1994 to preserve leverage for NAFTA accession talks that were being considered at the time, and that Brazil may have been holding out for concessions in agricultural products like oranges).

¹² The World Bank, *World Development Indicators 1998* (Washington, D.C., 1998).

Eastern European countries tended to provide a consistent level of industry coverage that only moderately lagged behind the position of developed countries. The EU accession process may be partially responsible for these relatively inclusive commitments, as it provided a model for regulatory reform that in some respects is compatible with GATS principles. In addition, pressure from EU members may be partially responsible for the fact that none of the Eastern European countries scheduled commitments on audiovisual services, as such an approach is consistent with EU commitments on audiovisual services. Health care, transportation, and courier services also generally lack adequate coverage in Eastern European schedules.

Finally, countries acceding to the WTO after its initial establishment on January 1, 1995, have made considerably broader commitments to accord market access and national treatment to foreign service providers. These seven new members are Bulgaria, Ecuador, Estonia, Kyrgyzstan, Latvia, Mongolia, Panama, and Slovenia.

Renewed Negotiations

Long-Term Objectives

As noted, the GATS broke new ground by establishing a framework of rules applicable to trade and investment in services and by setting a baseline of sector-specific commitments from which future negotiations would proceed. The ultimate objective of future negotiations could include both the further development of the general framework and improvement in the scheduled commitments.

One major prospect for further developing the general framework obligations is strengthening provisions on domestic regulation under article VI so that they more effectively promote transparency in the regulatory process and better ensure that, while preserving the ability of governments to meet legitimate regulatory objectives (e.g., public safety and welfare), neither regulations nor their implementation procedures unnecessarily restrict trade.¹³ Provisions that could be particularly helpful include those that encourage foreign regulators to (1) apply equal treatment to foreign and domestic firms, and (2) follow due process (to include allowing a process for hearings, providing information in a timely manner, and providing an opportunity for comment from the private sector).

¹³ U.S. Dept. of State cable, "GATS 2000: Services Trade Negotiations in the WTO," message reference no. 221415, Nov. 23, 1999.

Objectives for improving the schedules of commitments are highlighted in the text box.

U.S. Objectives to Improve the Schedules of Commitments

- Increase the number of industry sectors listed in each country's schedule, which would broaden the scope of the GATS obligations on market access and national treatment to cover more of the economy.
- Increase the number of countries that have signed the supplemental agreements on financial and telecommunication services.
- Extend coverage of commitments to all segments of each sector (e.g., ensuring that commitments on construction services apply to the whole sector, and not simply to the construction of off-shore oil platforms, as is sometimes now the case with the GATS).
- Deepen the substance of listed commitments (e.g., removing limitations such as foreign equity caps or restrictions on the form of establishment that qualify the terms under which foreign firms are granted market access and national treatment in a bound sector). Deeper commitments could be pursued in most sectors, including audiovisual, construction, distribution, energy, express delivery, finance, private education and training, private healthcare, telecommunication, travel and tourism, and the various professional service sectors.
- Improve the industry classification system to better reflect actual economic activity (e.g., redefining "courier" services, to include relevant aspects of customs brokerage, ground transportation, and warehouse and storage services in order to more effectively encompass the scope of integrated service providers like Federal Express).
- Ensure that new technologies are adequately addressed under the GATS, such as on-line learning made possible through the Internet; home entertainment programming delivered by satellite and the Internet; and advanced health care provided directly to homes or rural clinics via telemedicine.
- Formalize the treatment of commitments that apply to all service sectors such that all countries address the same elements in a consistent manner.
- Incorporate references to applicable laws and regulations within the schedules of commitments to enhance transparency and understanding of the limitations to market access and national treatment.

Source: Compiled by USITC staff from U.S. Dept. of State cable "GATS 2000: Services Trade Negotiations in the WTO," message reference 221415, Nov. 23, 1999; and the USITC series of GATS studies referenced in footnote 11.

Alternative Approaches

WTO negotiators have identified at least three different approaches toward achieving future liberalization of services trade. Negotiators will likely employ, to some degree, the time-honored "request-offer" approach through which each WTO Member identifies priorities for liberalization in the economies of selected other Members and then presents formal requests while offering compensatory concessions. Since such a process is highly laborious and may

result in separate negotiations for each industry sector and mode of supply, consideration is also being given by WTO negotiators to advantages of adopting different approaches that offer a means of bundling sectors or issues together so that they may be negotiated at a more comprehensive level. For this reason, alternative “horizontal” and “sectoral” approaches have also been proposed.¹⁴

A horizontal approach might involve pursuing liberalization across all industries. For example, negotiators could choose a particular mode of supply, such as commercial presence, and negotiate a broad commitment to accord a certain level of treatment across all service sectors (i.e., horizontally), such as agreeing to a common permissible level of foreign ownership.¹⁵ Alternatively, a sectoral approach could involve targeting key industry sectors such as energy or environmental services. For the selected sectors, a model set of commitments could be developed that presents an ideal position of full market access and national treatment.¹⁶ Members could then base their own commitments on this ideal, listing only limited exceptions or necessary phase-in periods.

Another device recently used by negotiators, which could facilitate negotiations of highly regulated sectors, is the development of additional commitments under GATS Article XVIII.¹⁷ This approach was used to support the extended negotiations on telecommunication services. Essentially, negotiators developed a set of disciplines to which countries could bind themselves and then incorporate in their schedules. These principles for telecommunication services include:¹⁸

- Prevention of anti-competitive practices,
- Nondiscriminatory and cost oriented interconnection rules,
- Implementation of universal service obligations on a nondiscriminatory, transparent and competitively neutral basis,
- Transparency or public availability of licensing criteria,
- Independence of regulators from any market competitors, and
- Nondiscrimination in the allocation of scarce resources, such as spectrum.

Additional commitments in telecommunication facilitated negotiations by ensuring that market access commitments would not be undercut by anticompetitive regulatory practices. The development of similar additional commitments for other industries may likewise help negotiators find common ground.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ambassador Richard Fisher, Deputy United States Trade Representative, “Services in the World Trading System,” speech to the World Services Congress, Atlanta, GA, Nov. 1, 1999, found at Internet address <http://www.usia.gov/topical/econ/wto99/se1101.htm>, retrieved Nov. 18, 1999.

¹⁷ Article XVIII states that the Members may negotiate additional commitments that extend beyond the scope of market access and national treatment commitments and then inscribe such commitments in their schedules.

¹⁸ The full text of the basic telecommunications regulatory reference paper may be found at Internet address <http://www.wto.org/wto/services/tel23.htm>.

Outlook

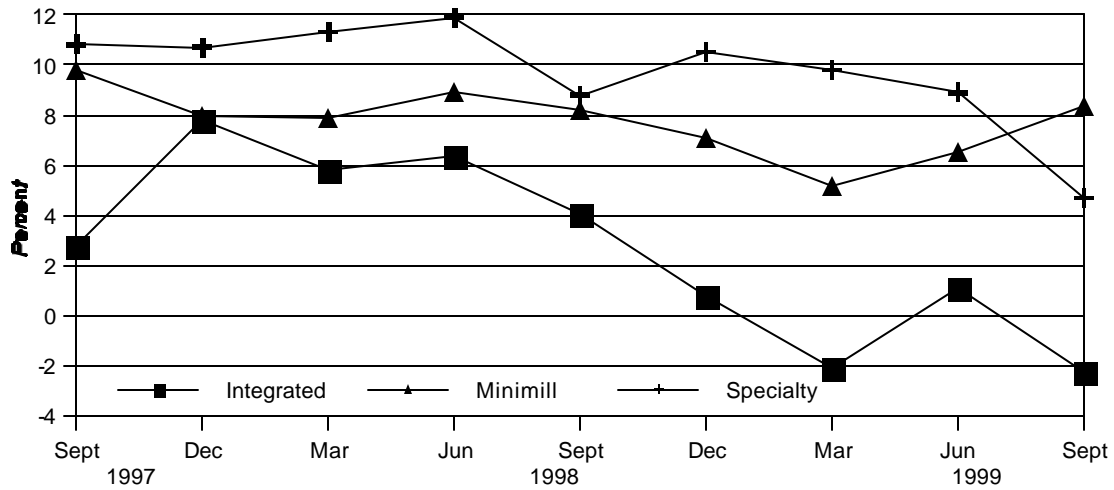
The foregoing discussion suggests that trade negotiators are likely to employ a combination of approaches to pursue the goal of services trade liberalization. The specific objectives of the current round of talks include further development of the basic framework of the agreement, stronger commitments to liberal trade principles by WTO members, and more effective coverage of service industries. Some of these objectives will likely be achieved more rapidly than others, and perhaps new objectives will come to light. As with merchandise trade, however, services liberalization is expected to be a long, gradual process. The steps being taken now build upon a foundation developed 5 years ago, and these efforts will in turn lay the groundwork for future liberalization. Incremental gains toward achieving the long-term objectives of the renewed negotiations will, nonetheless, serve as necessary building blocks that may result in some improved value of commitments for industry sectors and regions currently least effectively covered by the GATS schedules.#

APPENDIX A
KEY PERFORMANCE INDICATORS OF SELECTED
INDUSTRIES

- ~ **STEEL** (Tracy Quilter, 202-205-3437/tquilter@usitc.gov)
- ~ **AUTOMOBILES** (Laura A. Polly, 202-205-3408/polly@usitc.gov)
- ~ **ALUMINUM** (Karl Tsuji, 202-205-3434/tsuji@usitc.gov)
- ~ **FLAT GLASS** (James Lukes, 202-205-3426/lukes@usitc.gov)
- ~ **SERVICES** (Tsedale Assefa, 202-205-2374/assefa@usitc.gov)

STEEL

Figure A-1
Steel industry: Profitability by strategic group¹



¹ Operating profit as a percent of sales. Integrated group contains 9 firms. Minimill group contains 8 firms. Specialty group contains 4 firms.

Source: Individual company financial statements.

- Profitability for integrated and specialty producers slipped in the third quarter of 1999 compared with the second quarter of 1999. Although most firms increased shipment tonnages compared to the third quarter of 1998, lower average selling prices contributed to losses in the integrated sector and cut profitability of specialty producers almost in half. Profitability of the minimill sector improved slightly, as lower raw material (scrap) costs and increased shipments overcame price declines.
- Armco and AK Steel completed their merger September 30, 1999, making AK Steel the fourth largest steelmaker in the United States. Consolidation of facilities, including the closure of Armco's Pittsburgh, PA headquarters and a galvanizing plant in Dover, OH has already begun.

Table A-1
Steel mill products, all grades

Item	Q3 1999	Percentage change, Q3 1999 from		YTD 1999	Percentage change, YTD 1999 from	
		Q3 1998 ¹	YTD 1999		YTD 1998 ¹	YTD 1999
Producers' shipments (1,000 short tons)	26,811	7.7	77,644	-2.1		
Imports (1,000 short tons)	9,681	-12.7	26,497	-13.2		
Exports (1,000 short tons)	1,414	13.5	3,814	-11.2		
Apparent supply (1,000 short tons)	35,078	5.5	100,327	-5.0		
Ratio of imports to apparent supply (percent)	25.5	-8.7	26.3	-1.6		

¹ Based on unrounded numbers.

² Percentage point change.

³ No change.

Note.—Because of rounding, figures may not add to the totals shown.

Source: American Iron and Steel Institute.

STEEL

Table A-2
 Steel service centers

Item	June 1999	Sept. 1999	Percentage change, Sept. 1999 from June 1999 ¹	Q3 1999	Q3 1998
Shipments (1,000 net tons)	2,529	2,523	-0.2	7,465	7,487
Ending inventories (1,000 net tons)	7,854	8,013	2.0	8,013	8,465
Inventories on hand (months)	3.3	3.2	(²)	3.2	3.4

¹ Based on unrounded numbers.

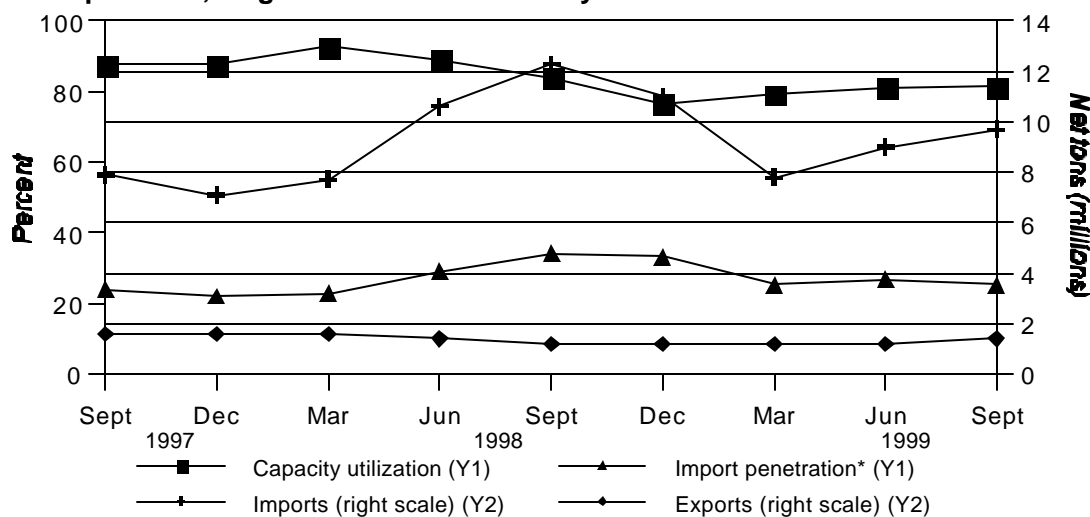
² Not applicable.

Note.—Because of rounding, figures may not add to the totals shown.

Source: Steel Service Center Institute.

- The Steel Service Center Institute (SSCI) reported a slight decrease in shipments for Q3 1999 compared with Q3 1998. The service center industry, already undergoing consolidation, will face additional volume and pricing pressure given General Motors' announcement that it will begin purchasing more steel than it needs and require GM suppliers to buy their steel from GM. GM, which can purchase steel at lower prices than service centers due to its size, will sell any surplus steel across the Internet.
- While Q3 1999 imports fell 21 percent compared to Q3 1998 and imports for the first nine months of 1999 were 13 percent below prior year levels, Q3 1999 import levels were 14 percent above Q2 1999. Semifinished steel products, representing more than one-third of total steel imports in Q2 1999, slipped to 24.9 percent for Q3 1999 but was well above the 17.0 percent share posted a year earlier.
- Capacity utilization averaged 81.5 percent for Q3 1999, which is an improvement from the average of 81.1 percent reported for Q2 1999. However, capacity utilization is still below the 84.1 percent average level reported for Q3 1998.

Figure A-2
 Steel mill products, all grades: Selected industry conditions



* Import share of apparent open market supply.

Source: American Iron and Steel Institute.

AUTOMOBILES

Table A-3

U.S. sales of new automobiles, domestic and imported, and share of U.S. market accounted for by sales of total imports and Japanese imports, by specified periods, January 1998-September 1999

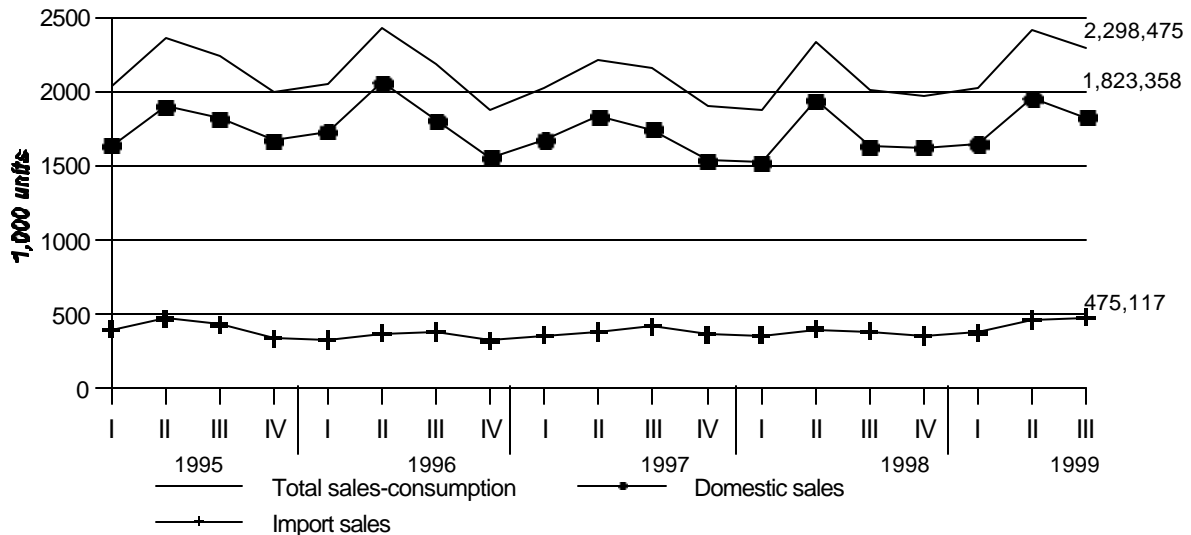
Item	Jul.- Sep. 1999	Jan.-Sep. 1999	Percentage change	
			Jul.-Sep. 1999 from Apr.-Jun. 1999	Jan.-Sep. 1999 from Jan.-Sep. 1998
U.S. sales of domestic autos (1,000 units) ¹	1,823	5,422	-6.6	5.2
U.S. sales of imported autos (1,000 units) ²	475	1,305	3.5	21.9
Total U.S. sales (1,000 units) ^{1,2}	2,298	6,727	-4.7	8.3
Ratio of U.S. sales of imported autos to total U.S. sales (percent) ^{1,2}	20.7	19.4	8.6	12.6
U.S. sales of Japanese imports as a share of the total U.S. market (percent) ^{1,2}	9.8	9.2	0.1	1.5

¹ Domestic automobile sales include U.S.-, Canadian-, and Mexican-built automobiles sold in the United States.

² Imports do not include automobiles imported from Canada and Mexico.

Source: Compiled from data obtained from *Automotive News*.

Figure A-3
U.S. sales of new passenger automobiles, by quarter

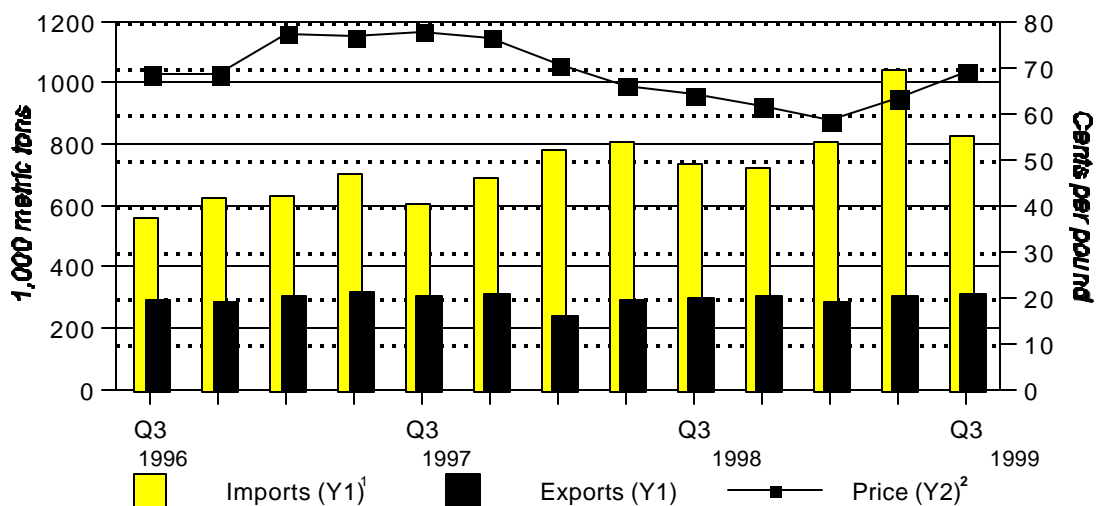


Note.—Domestic automobile sales include U.S.-, Canadian-, and Mexican-built automobiles sold in the United States; these same units are not included in import sales.

Source: *Automotive News*; prepared by the Office of Industries.

ALUMINUM

Figure A-4
Aluminum: U.S. imports, exports, and price



¹ Crude forms (metals and alloys) and mill products (e.g., plates, sheets, and bars) for consumption.
² Quarterly average of the monthly U.S. market price of primary aluminum ingots.

Source: U.S. Geological Survey.

- The price for primary aluminum ingot rose sharply by 5.8 cents per pound during third quarter 1999 to the highest level since the first quarter of 1998. In spite of increased global production, market confidence has been strengthened by continued robust or strengthening demand worldwide, and the investment community's favorable long-term outlook for the industry as a result of recent mergers.
- Overall U.S. consumption continued to remain strong, as a slight dip in shipments of certain aluminum mill products was countered by improved can shipments. Although domestic output increased slightly, significantly lower imports of unwrought aluminum from Russia were reflected in the noticeable percentage-point decline in the level of import penetration.
- Alcan (Canada), Pechiney (France), and Algroup (Switzerland) announced a management restructuring of their proposed combined operations (currently named APA) into six business sectors. As part of the regulatory clearance process, the Department of Justice has requested additional information from both APA and from U.S.-based Alcoa and Reynolds about their respective proposed mergers. Nevertheless, Alcan announced its confidence that APA's merger transactions will be completed by early next year.

Table A-4

U.S. production, secondary recovery, imports, import penetration, exports, average nominal price, and LME inventory level of aluminum, for third quarter 1998, second quarter 1999, and third quarter 1999

Item	Q3 1998	Q2 1999	Q3 1999	Percentage change	
				Q3 1999 from Q3 1998	Q3 1999 from Q2 1999
Primary Production (1,000 metric tons)	946	938	953	0.7	1.6
Secondary Recovery (1,000 metric tons)	835r	884r	872	4.4	-1.4
Imports (1,000 metric tons)	736	1,043	825	12.1	-20.9
Import Penetration (percent) ¹	32.5r	40.8r	36.1	² 3.5	² -4.7
Exports (1,000 metric tons)	295	306	312	5.7	1.9
Average Nominal Price (¢/lb)	64.1	63.3	69.1	7.9	9.2
LME Inventory Level (1,000 metric tons)	513	756	797	55.3	5.3

¹ Calculations based on unrounded data.

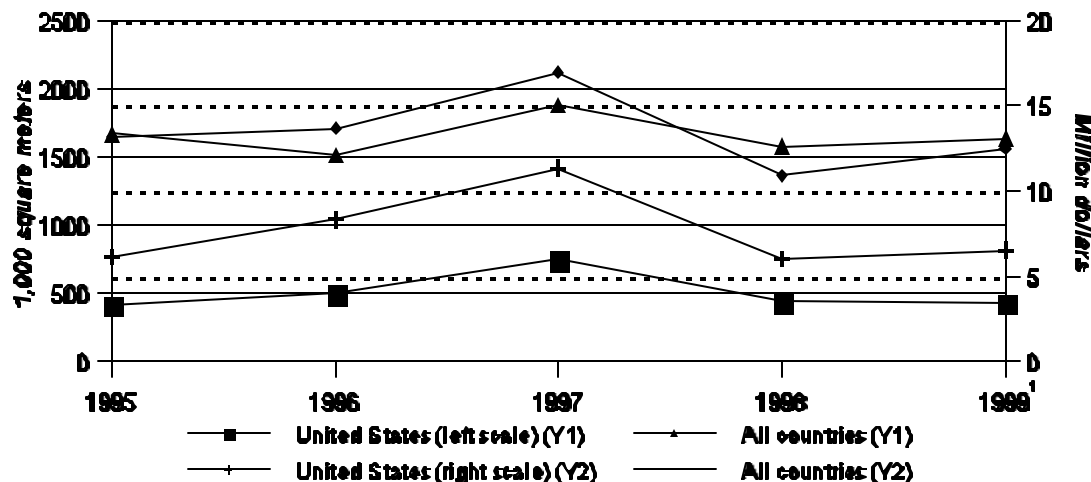
² Percentage point change.

Note.—revised data indicated by "r"

Sources: Compiled from data obtained from U.S. Geological Survey and World Bureau of Metal Statistics.

FLAT GLASS

Figure A-5
Average monthly Japanese imports of flat glass, by quantity and value, from the United States and all countries, 1995-99¹



¹ Data for 1999 include Jan.-June.

Source: Compiled from official statistics of the Ministry of Trade and Industry, Japan.

Background

- The U.S.-Japanese agreement on Japanese market access for imports of flat glass seeks to increase access and sales of foreign flat glass in Japan through such means as increased adoption of nondiscriminatory standards and expanded promotion of safety and insulating glass. The agreement covers the 1995-99 period.
- Japanese demand for imported glass has remained weak since the second half of 1997.

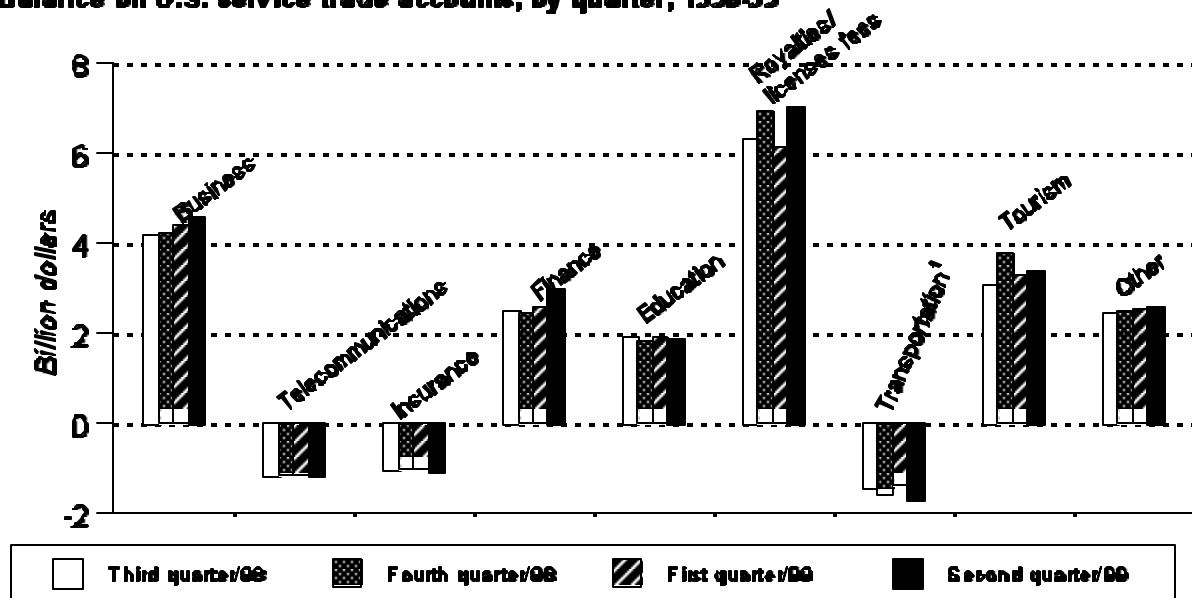
Current

- Japanese demand for imported glass has improved slightly, although the U.S. share of the market has declined. The average monthly quantity of Japanese imports from all countries increased by 4 percent for the first six months of 1999 to 1.6 million square meters, while the average monthly value of such imports increased by 14 percent to \$12.5 million as the average unit value of imports increased by 10 percent. Imports from the United States in Jan.-June 1999 decreased 4 percent to 428,000 square meters, but increased in value by 8 percent to \$6.5 million. Imports from the United States and China recorded the most significant declines for the period, while imports from the Republic of Korea and Indonesia posted the most significant growth.
- A proposal by the U.S. Government to negotiate a new bilateral agreement on flat glass to replace the 1995 agreement that expires at the end of 1999 was rejected by the Government of Japan during flat-glass talks held in Tokyo on Nov. 10-11, 1999.¹ The U.S. Government claims that the expiring agreement failed to open the Japanese market. The Government of Japan maintains that a new agreement is not needed because Japan's flat glass market already is fully open to foreign glass products. Discussions between the Governments are continuing as the December deadline approached.

¹ U.S. State Department telegram, "Tokyo Press Reaction to Flat Glass Talks," message reference no. 09447, prepared by U.S. embassy, Tokyo, Nov. 16, 1999.

SERVICES

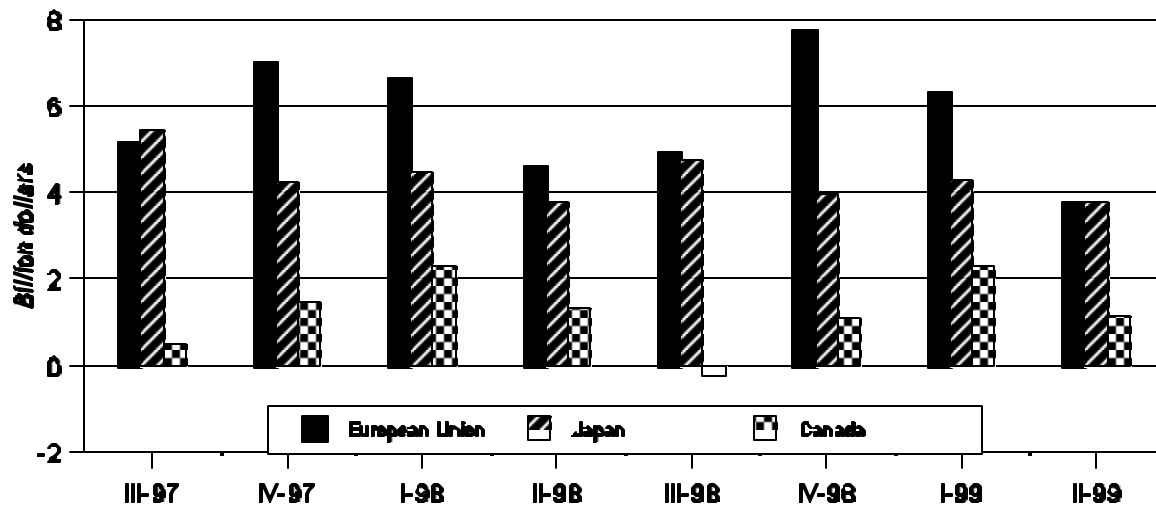
Figure A-6
Balance on U.S. service trade accounts, by quarter, 1998-99



¹ Includes port fees.

Source: Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 34.

Figure A-7
Surpluses on cross-border U.S. service transactions with selected trading partners, by selected quarters, 1997-99¹



¹ Private-sector transactions only; military shipments and other public-sector transactions have been excluded.

Source: Bureau of Economic Analysis, *Survey of Current Business*, table 1D, Oct. 1999, pp. 42-45.