United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Aviation, Committee on Commerce, Science, and Transportation, U.S. Senate

For Release on Delivery Expected at 2:00 p.m. EDT Wednesday June 4, 1997

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

GAO/T-RCED-97-103

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on U.S. aviation relations with the United Kingdom, our largest aviation trading partner overseas. As we testified before this Subcommittee in March 1996, access to London's Heathrow Airport is important to any airline that desires to be a major participant in the transatlantic market.[1] Unfortunately, our bilateral aviation agreement with the United Kingdom restricts the number of U.S. airlines that can serve Heathrow to two carriers—American Airlines and United Airlines. In June 1996, American Airlines and the United Kingdom's largest airline, British Airways, announced that they intended to form an alliance that would allow both carriers to market each other's flights as their own (referred to as "code-sharing") and that they would seek immunity for the alliance from U.S. antitrust laws. Such alliances must be approved by the Department of Transportation (DOT), and as a matter of U.S. policy, DOT only grants antitrust immunity to such alliances if there is an "open skies" agreement.[2] Since July 1996, DOT has been negotiating with the British government but the two sides have yet to agree on such an accord.

Over the past several years, we have issued a number of reports on international aviation issues, including our April 1995 report on the competitive impacts of code-sharing alliances.[3] As requested, we will draw on this body of work to discuss the (1) current status of airline competition in the U.S.-U.K. market and of negotiations between the United States and the United Kingdom, (2) potential competitive impacts of the proposed alliance between American Airlines and British Airways, and (3) obstacles that might prevent U.S. airlines from having adequate access to Heathrow.

In summary,

- The current bilateral accord between the United States and the United Kingdom places substantial limits on competition. As a result, consumers in both countries have more limited service options and likely pay higher

[1] International Aviation: DOT's Efforts to Increase U.S. Airlines' Access to International Markets (GAO/T-RCED-96-32, Mar. 14, 1996).

[2] Generally, an open skies agreement removes all restrictions on air travel between two countries and allows airlines to fly between the countries when they want, where they want, and set fares in response to market forces.

[3] International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain (GAO/RCED-95-99, Apr. 6, 1995). Other related GAO products are listed at the end of this statement.

fares than they would in a more competitive environment. In addition, these limits on competition disproportionately impact U.S. airlines—most of whom are not allowed to serve Heathrow. Only two U.S. airlines can currently serve Heathrow, and even those two are only permitted to do so from certain designated cities. By contrast, British Airways has already obtained, in previous negotiations, extensive access to the U.S. market. Partly as a result, U.S. airlines' share of the U.S.-U.K. market has steadily declined over the past few years, while British Airways' share has risen. With little leverage with which to deal, DOT has achieved little success in securing increased access for U.S. airlines to Heathrow. As we noted in our March 1996 testimony, progress would likely not occur until the United Kingdom identified something else it wanted from the United States. That moment arrived a year ago with the announcement by American Airlines and British Airways of their planned alliance. However, several difficult issues, such as the British government's insistence that an open skies agreement also contain a formal mechanism to resolve disputes, have stalemated negotiations.

- The potential alliance of American Airlines and British Airways—the two largest carriers in the U.S.-U.K. market—raises significant competition issues. In 1996, the two airlines accounted for 60 percent of the scheduled passenger traffic that flew between the United States and the United Kingdom. In addition, they currently provide over 70 percent—and in some cases all—of the service between Heathrow and several key U.S. gateways, including New York, Chicago, Boston, and Miami. As a result of this level of market concentration, DOT's approval of the alliance would further reduce competition unless, as a condition of the approval, other U.S. airlines are able to simultaneously obtain adequate access to Heathrow. Specifically, the available evidence suggests that to ensure increased competition, the other major U.S. airlines that fly internationally would need to serve Heathrow from their principal hubs.
- Barriers exist at Heathrow in the form of a limited number of takeoff and landing slots and a scarcity of available gates and facilities that prevent U.S. airlines from having adequate access to that airport. As a result, action will be necessary to address these barriers if open skies is to result in increased competition. However, both American Airlines and British Airways have indicated that even if they agree to relinquish some of their slots to the other U.S. airlines, they would expect to be paid the fair market value for those slots. European Union (EU) officials believe that their regulations governing the transfer of slots at airports in EU-member countries prohibit the buying and selling of slots. British officials, however, believe that flexibility may exist to accommodate the payment to the potential alliance partners for any slot transfer. In addition to a

transfer of slots, agreement would be needed to address the facility constraints at Heathrow so that new entrants have access to the gates, ticket counters, terminal space, and baggage facilities they would need. Over the past few years, local community opposition and environmental concerns have delayed plans for expansion in these areas.

Background

In the international sector, the routes that airlines can fly, the frequency of their flights, and the fares they can charge are governed by 72 bilateral agreements between the United States and other countries. Many of these agreements, including the accord with the United Kingdom, are very restrictive. Since the late 1970s, U.S. policy has been to negotiate agreements that substantially reduce or eliminate bilateral restrictions. DOT's Office of the Assistant Secretary for Aviation and International Affairs, with assistance from the State Department, is responsible for negotiating these agreements and awarding U.S. airlines the right to offer services provided for in those agreements.

In April 1995, DOT issued the U.S. International Aviation Policy Statement in which the agency reiterated its desire for open skies agreements and endorsed the growing trend toward alliances between U.S. and foreign airlines. Since issuing that statement, DOT has negotiated a number of more liberal agreements, including open skies accords with Germany and numerous smaller European countries. In conjunction with these agreements, the agency granted antitrust immunity in 1996 to the alliances between United and Lufthansa, which is Germany's largest airline, and between Delta and several smaller European carriers.[4] In 1992, DOT granted antitrust immunity to the Northwest/KLM alliance in conjunction with the U.S.-Netherlands open skies accord. In announcing their proposed alliance, American Airlines and British Airways emphasized that they are at a competitive disadvantage to these alliances because the airlines in those alliances can, among other things, better coordinate service and jointly set fares.

Despite success in negotiating open skies agreements throughout much of Europe, DOT has had very little success with the United Kingdom. The current U.S.-U.K. accord, commonly known as "Bermuda II," was signed in

[4]Our April 1995 report on code-sharing alliances found that DOT's ability to monitor the impact of alliances on airfares was limited because foreign airlines are not required to report data from a sample of their tickets involving travel to or from the United States. We reported that DOT's data provided information only from tickets sampled by U.S. airlines, and thus the agency only had fare data for trips that at some point involved a U.S. carrier. We recommended that DOT require that foreign airlines report ticket data to DOT. Since our report, DOT has required foreign airlines in alliances that have been granted antitrust immunity to report such data.

1977 after the British renounced the prior agreement. Since that time, DOT has expressed increasing dissatisfaction with Bermuda II and attempted to negotiate increased access for U.S. airlines to Heathrow. Negotiations with the British also take on particular importance because of the size of the U.S.-U.K. market. In 1996, 12 million passengers travelled on scheduled service between the United States and the United Kingdom, which is more than twice the U.S.-Germany market and three times the U.S.-France market.

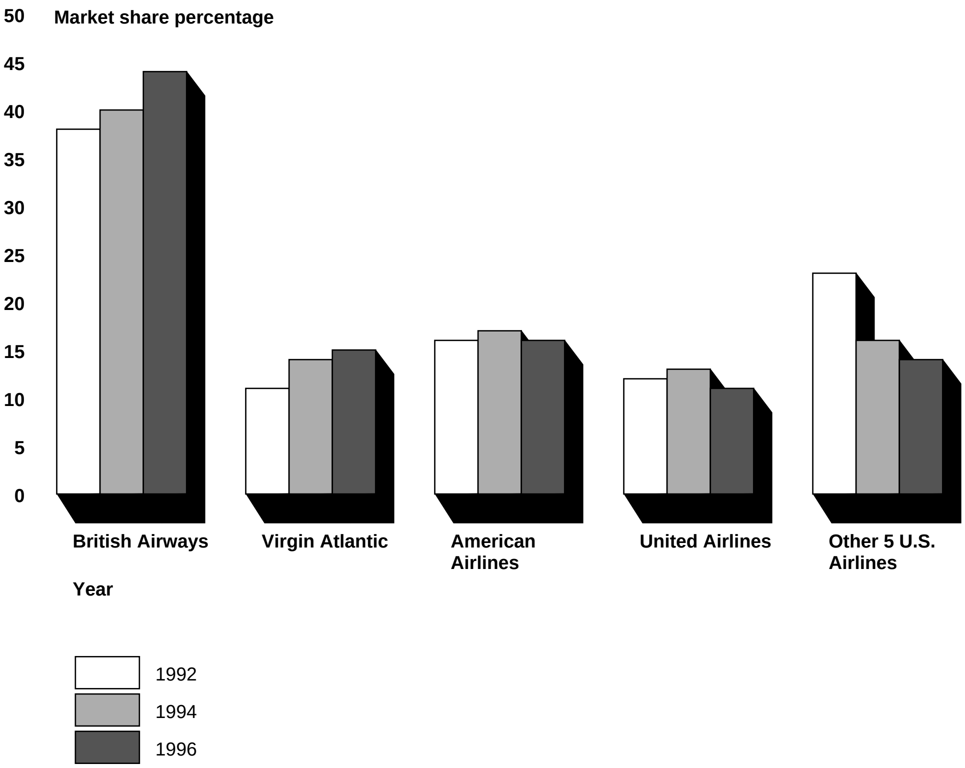
Current Accord's Limits on Competition Continue to Hurt Consumers and U.S. Airlines, While Efforts to Negotiate New Accord Persist

Competition is restricted in the U.S.-U.K. market because Bermuda II, among other things, (1) sets limits on the amount of service airlines can provide, (2) prevents all U.S. airlines except American and United from flying to and from Heathrow[5], (3) does not allow American to serve Heathrow from its primary hub in Dallas, and (4) severely restricts United in the amount of service to Heathrow it can provide from its primary hub at Chicago O'Hare. These restrictions on competition result in fewer service options for U.S. and British consumers. In addition, they also likely result in higher airfares. However, the extent to which this is the case is uncertain. Because DOT has generally not required foreign airlines to report data from a sample of their tickets, as it requires U.S. airlines to do, the agency does not have data on fares paid by passengers flown by British Airways or Britain's other major transatlantic airline, Virgin Atlantic, if those passengers' itineraries did not involve a connection with a U.S. carrier.

Bermuda II's limits on competition also disproportionately affect U.S. airlines. In contrast to the continuing restrictions placed on U.S. airlines, the United Kingdom was successful in negotiating increased access for British carriers to the U.S. market in the early 1990s. Partly as a result, between 1992 and 1996, the British carriers' share of the U.S.-U.K. market rose from 49 percent to 59 percent. As figure 1 shows, this gain by British Airways and Virgin Atlantic has come primarily at the expense of the U.S. airlines who are not allowed to serve Heathrow.

[5]Continental Airlines, Delta Air Lines, Northwest Airlines, and TWA are prohibited from flying to Heathrow and instead must use London's Gatwick Airport. Gatwick is less desirable to business travelers than Heathrow because it is located farther from downtown London and provides fewer connecting flights to Europe, the Middle East, and Africa. US Airways (which changed its name from USAir effective February 27, 1997) currently has no service to either Heathrow or Gatwick.

Figure 1: Share of Scheduled Passenger Traffic Between the United States and the United Kingdom by Airline, 1992, 1994, and 1996



Source: GAO's analysis of DOT's international traffic data.

British carriers' increased access to the U.S. market largely came as a result of a revision to Bermuda II in 1991 that allowed American and United to replace TWA and Pan Am as the U.S. carriers allowed to serve Heathrow. In exchange, British Airways gained the right to code-share with a U.S. airline. In 1993, British Airways entered an alliance with USAir and began exercising its right to market as its own USAir's domestic flights that connected to British Airways' transatlantic service.[6] As we reported in April 1995, British Airways' exercising of its code-sharing rights was

[6]As a condition of approval of the USAir/British Airways alliance, USAir agreed to divest itself of its three U.S.-U.K. routes. USAir had been serving Gatwick from Baltimore, Charlotte, and Philadelphia. As a result of the proposed American/British Airways alliance, US Airways terminated its alliance with British Airways in March 1997. In May 1997, British Airways sold its 24.6 percent stake in US Airways.

yielding substantial traffic gains, largely at the expense of U.S. airlines. Similarly, Virgin Atlantic's access to the U.S. market has grown substantially. Prior to 1991, the airline was not allowed to use Heathrow but instead was required to use Gatwick. As part of the revision to the bilateral agreement in 1991, Virgin Atlantic was allowed to transfer much of its service from Gatwick to Heathrow.

Recognizing Heathrow's importance, DOT over the past few years has engaged in numerous negotiations with the British in an effort to increase U.S. airlines' access to that airport. In light of the extensive access to the U.S. market that British Airways and Virgin Atlantic had already secured, DOT has had little leverage. It only secured direct access to Heathrow for United from O'Hare in 1995 (limited to one flight per day prior to April 1, 1997, and currently limited two flights per day). Expressing frustration with the lack of progress in negotiations, Delta in 1995 implemented an alliance with Virgin Atlantic under which it code-shared on Virgin Atlantic's flights between the United States and Heathrow.[7] With the announcement by British Airways and American Airlines in June 1996, DOT had apparently been given the leverage it had long sought. According to DOT officials, the agency's approval of the alliance and granting of antitrust immunity would be based, at a minimum, on the conclusion of an open skies agreement. The latest round of negotiations, however, ended in mid-February without such an accord.

Issues that have proved problematic in the past continue to stymie talks between the two countries. In particular, DOT does not share the British view that a formal mechanism is needed to resolve disputes that may arise or that the governments need to retain the right to monitor fares set by the airlines and disapprove them if they are too high or too low. Disagreement also exists over whether British Airways and Virgin Atlantic would be able to bid for the right to carry U.S. government workers under an open skies regime. Despite these disagreements, DOT and British officials told us they are confident that they will eventually be able to reach an open skies accord.

[7]In March 1997, Delta and Virgin Atlantic announced that they would terminate their code-sharing alliance. Also in March 1997, Continental and Virgin Atlantic indicated that they planned to seek approval from the U.S. and British governments for a code-sharing alliance. The proposed Continental-Virgin Atlantic alliance has not yet been approved by either government.

Under Open Skies, Alliance Would Dominate and Competition Would Decline Further Unless Substantial New Entry Occurred

While the proposed American/British Airways alliance would likely increase competition in markets between the United States and the European continent, the Middle East, and Africa because the number of alliances competing in these markets would increase from three to four, it raises serious competition issues in the U.S.-U.K. market. This is because rather than competing with each other, under the alliance the two largest airlines in the U.S.-U.K. market would in essence be operating as if they were one airline. In 1996, American Airlines and British Airways accounted for 60 percent of the scheduled passenger traffic that flew between the United States and the United Kingdom. Moreover, as of June 1997, the two airlines account for 38 of the 55 total daily roundtrips (69 percent) between the United States and Heathrow offered by scheduled U.S. and British airlines.[8]

American Airlines and British Airways currently compete with one another in five key U.S. gateways to Heathrow, including the two largest—New York and Los Angeles, and one gateway to Gatwick—Dallas. New York's importance is underscored by the fact that the market between it and Heathrow accounts for one-fifth of all U.S.-London service and is nearly three times the size of the Los Angeles-Heathrow market. At 5 of the 6 gateways where American Airlines and British Airways compete—New York, Chicago, Boston, Miami, and Dallas—they account for over 70 percent of the service, and at Los Angeles they account for over 60 percent. In addition, in the Boston and Miami markets, American Airlines and British Airways currently are the only carriers that serve Heathrow, and in the Dallas market they are the only nonstop competitors.

At another eight U.S. cities, either British Airways or American has a monopoly on nonstop service to either Heathrow (two cities) or Gatwick (six cities). As a result, the proposed alliance would account for over 70 percent of the service in 13 U.S. gateways to London (fig. 2).[9] In our October 1996 report on domestic competition, we found that competition was most limited and airfares highest in markets dominated by one airline.[10]

[8]As of June 1997, British Airways has 24 daily roundtrips and American Airlines has 14 daily roundtrips between the United States and Heathrow.

[9]These 13 gateways account for about 54 percent of all U.S.-London service. There are a total of 25 U.S. gateways to London.

[10]Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets (GAO/RCED-97-4, Oct. 18, 1996).

Figure 2: Markets in Which American and British Airways Either Currently Compete With Each Other and Provide Over 70 Percent of the Service or One of the Carriers Has a Monopoly on Nonstop Service, 1997

Note: “H” denotes service to Heathrow; “G” denotes Gatwick. According to American and British Airways representatives, under open skies the alliance would likely switch much of the current Gatwick service to Heathrow.

As figure 3 shows, if the other six major U.S. airlines that fly internationally had access to Heathrow from their primary and secondary hubs, competition would be enhanced in nearly all of these markets.[11] This would provide consumers with a wide range of service to Heathrow that would compete with the alliance. Specifically, 6 of the 13 gateways would have new nonstop service.[12] In each case, the airline providing the service would be supported by its domestic network: New York (Delta and TWA), Chicago (United), Philadelphia (US Airways), Charlotte (US Airways), Boston (US Airways), and Pittsburgh (US Airways).

[11]The other six major U.S. airlines' primary hubs for transatlantic service are Chicago (United), Detroit (Northwest), Newark (Continental), New York (Delta and TWA), and Philadelphia (US Airways). In general, these airlines' secondary transatlantic hubs are Atlanta (Delta), Houston (Continental), Minneapolis (Northwest), Charlotte (US Airways), St. Louis (TWA), and Washington Dulles (United). However, exceptions to this exist. For example, Delta currently serves Gatwick from both Atlanta and its other international hub, Cincinnati. In addition, US Airways operates hubs in two other gateways—Boston and Pittsburgh—that would otherwise be dominated by the alliance. United already serves Heathrow with three daily flights from its secondary transatlantic hub at Dulles.

[12]The current bilateral limits the amount of service United can provide between Chicago and Heathrow.

Figure 3: U.S. Airlines' Potential Nonstop and One-Stop Service That Would Compete Against the American-British Airways Alliance If They Could Serve Heathrow From Their Primary and Secondary Hubs

Our analysis of current competitive conditions in the New York-Heathrow market indicates that because of the (1) size of the market, (2) large share of that market currently held by American Airlines and British Airways, (3) frequency of service in that market—13 flights a day—provided by the two airlines (compared to 2 daily flights by United and 2 daily flights by Virgin Atlantic), and (4) substantial portion of the market accounted for by time-sensitive business travellers, both airlines (Delta and TWA) that have hubs at New York JFK—as well as Continental from its hub at nearby Newark—would need to enter the market with several flights a day to ensure a sufficient number of competing flights. In the Boston and Chicago markets, new nonstop service would offset the effect on competition caused by the joining of the two largest competitors in those markets. In addition, new nonstop service in the Philadelphia, Charlotte, and Pittsburgh markets would increase competition because British Airways currently has a monopoly on nonstop service to London from those gateways.

In addition, as figure 3 also shows, consumers in the other seven gateways would have several new one-stop options competing with the alliance's nonstop service in those markets. Because British Airways currently has a monopoly in four of these markets (Baltimore, Phoenix, Seattle, and Tampa) and American a monopoly in another (Raleigh), this increase in the number of one-stop options would produce an increase in competition in those five markets. For example, if Northwest Airlines, which is one of the largest carriers in Seattle, could serve Heathrow from its hub in Minneapolis, consumers in Seattle would have more and better connecting opportunities to Heathrow and hence there would be more competition than today. Similarly, consumers in nongateway cities, such as Des Moines or Fargo, would experience an increase in the number of one-stop options offered by competing airlines to Heathrow than are available today.

While the increase in one-stop service options would increase competition in five of the seven gateways, for the other two gateways—Dallas and Miami—it would likely not offset the reduction in the number of competitors providing nonstop service. In the Dallas-London market, American Airlines and British Airways are currently the only competitors providing nonstop service. In the Miami-London market, the number of nonstop competitors would fall from four to three, and the alliance would bring together not only the two largest carriers in the market but the only carriers in the market currently serving Heathrow.[13] In both Dallas and Miami, Delta is the second largest carrier next to American and thus is best positioned to provide one-stop service via Atlanta and/or Cincinnati. Nevertheless, time-sensitive business travelers in the Dallas-London and Miami-London markets will have fewer nonstop options and thus will likely pay higher fares for nonstop service. As a result, DOT will need to be well-positioned to monitor competition in these and other markets, and as we have recommended, collect the data necessary to do so.

While acknowledging that new entry by U.S. carriers is critical to ensuring competition, Britain's Office of Fair Trading (OFT) recently concluded that U.S. carriers would only need 12 daily roundtrips to Heathrow—service

[13]Starting June 30, 1997, however, Virgin Atlantic will begin serving Miami from Heathrow. Currently, Virgin Atlantic serves Miami from Gatwick.

that would be phased in over the next few years.[14] OFT focussed its analysis on service that would be needed to ensure that the alliance does not reduce competition, and therefore only considered the six gateways where both American Airlines and British Airways compete with one another.

Based on our discussions with representatives of the six U.S. airlines seeking access to Heathrow to compete with the American/British Airways alliance, the cumulative number of daily roundtrips to Heathrow that they believe they would need to effectively compete totals 38 daily roundtrips. DOT analysts indicated during the early stages of negotiations that U.S. airlines would need at least 30 daily roundtrips to Heathrow to ensure that an open skies agreement resulted in an increase in competition. Because it is the subject of ongoing negotiations, we do not believe it would be appropriate for us to specify a precise number of daily roundtrips to Heathrow that may be needed. Ultimately, DOT will have to make this determination through its review and negotiation process. Our analysis of existing DOT international traffic data and review of the analyses conducted by the six U.S. airlines as well as by the potential alliance partners and other interested parties suggests to us that the basis for an agreement that increases competition would likely have to accommodate—but not necessarily be limited to—the following simultaneous to the alliance's approval:

- at least three daily roundtrips to Heathrow for each of the three U.S. airlines with primary hubs in the New York area—Continental, Delta, and TWA;[15]
- at least two daily roundtrips to Heathrow for each of the other three U.S. airlines—Northwest, United, and US Airways—from their primary hubs (Detroit, Chicago, and Philadelphia, respectively) to effectively utilize those hubs' competitive strengths;
- at least two additional daily roundtrips to Heathrow for Delta for use from Atlanta and/or Cincinnati in order to maximize the one-stop competition for consumers in the Dallas-London and Miami-London markets;[16]

[14]A roundtrip requires two slots—one for arrival at Heathrow and one for a return departure. Thus, 12 daily roundtrips is equivalent to 24 daily slots or 168 weekly slots. As of June 1997, the potential alliance partners operate a total of 38 daily roundtrips between the United States and Heathrow, which is the equivalent of 532 weekly slots.

[15]In our recent report on barriers to entry in the domestic airline market, we reported that new entrants generally needed a minimum of three daily roundtrips to effectively compete in the New York market. See Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets (GAO/RCED-97-13, Oct. 18, 1996).

[16]As discussed earlier, Delta is the second largest carrier in Dallas and Miami after American. In 1996, Delta accounted for about 20 percent of all enplanements at Dallas and about 10 percent at Miami.

- at least one additional daily roundtrip to Heathrow for US Airways from each of its three secondary hubs—Boston, Charlotte, and Pittsburgh—that would otherwise be dominated by the alliance; and
- at least one daily roundtrip to Heathrow for Continental, Northwest, and TWA from their secondary transatlantic hubs (Houston, Minneapolis, and St. Louis, respectively).

Regardless of the precise number that may ultimately be agreed upon, because of the size of the U.S.-U.K. market and the fact that the market has been heavily regulated for 2 decades, significant new entry would likely provide substantial benefits for consumers in both countries in terms of lower fares and better service and for the U.S. airline industry in terms of increased revenues.

Barriers to Entry Exist at Heathrow That Are Difficult to Address

Even if agreement can be reached on the number of daily roundtrips to Heathrow that the six U.S. airlines would need to ensure increased competition, capacity constraints exist at Heathrow that do not exist at the airports in the countries where the United States has previously signed open skies agreements. As a result, the limited number of available takeoff and landing slots, gates, and facilities makes a large-scale influx of new service unlikely at Heathrow. Officials of the airport authority that manages Heathrow emphasized to us that the airport is generally operating at capacity and that airlines' demand for slots during peak-period times of the day exceeds the available supply. Similarly, they told us that because of facility constraints, the airport authority announced plans several years ago to build a fifth terminal at Heathrow. These officials noted that under open skies, U.S. airlines seeking to serve Heathrow for the first time would be given priority as "new entrants" and would be allotted slots as they came available. They emphasized that while some slots may come available in the short-term, it would likely take several years under current slot allocation procedures for the number of slots needed to accommodate a significant amount of new entry by the six U.S. airlines to come available.

As a practical matter, therefore, in addition to acquiring some slots under current procedures, the six U.S. airlines will likely need to have slots transferred to them from American Airlines and British Airways.[17] While such a transfer may involve a substantial portion of the over 500 weekly slots currently used by American Airlines and British Airways in the

[17]In some cases, other sources of slots for U.S. airlines may also exist. For example, Lufthansa is currently using slots of its alliance partner United to accommodate three daily roundtrips by Lufthansa between Heathrow and Germany.

U.S.-Heathrow market, British Airways could draw from its holding of about 3,000 weekly slots that it uses to serve the domestic U.K. market, the European continent, Africa, and the Middle East, to replace those slots lost via a transfer to U.S. airlines as well as to increase service in some U.S.-Heathrow markets. To counter the alliance's ability to draw on British Airways' substantial slot holdings, most U.S. airlines could also potentially draw on their alliance partners' slot holdings at Heathrow and all six U.S. airlines could acquire additional slots over time as they become available under current procedures. Nevertheless, slots provided to the six U.S. airlines will need to be at commercially viable times, such as peak morning times, to better ensure competitive service. Finally, in addition to obtaining slots, the other U.S. airlines will need sufficient access to existing gates and facilities at Heathrow, because the planned construction of the fifth terminal has been delayed.

However, significant obstacles exist that make it difficult to resolve these issues. Both American Airlines and British Airways have indicated that even if they agree to give some of their slots to new entrants, they would expect to be paid the fair market value for those slots. Requiring the new entrant U.S. airlines to purchase slots from American Airlines and British Airways has competitive implications because it increases the costs of market entry. Furthermore, EU officials interpret their regulations, which apply to Heathrow, as prohibiting the buying and selling of slots. British officials contend, on the other hand, that flexibility may exist in the rules to accommodate the payment to the alliance partners for any slot transfer and that the EU should consider allowing the buying and selling of slots at high-demand airports such as Heathrow in the long-term. This disagreement, and the existence of the respective authorities of the United Kingdom and the EU to ensure competition, has sparked a major debate between the United Kingdom and the EU.

It is uncertain whether EU officials will ultimately agree to accommodate a one-time transfer of slots from the proposed alliance to U.S. airlines. However, EU officials told us that their decision as to whether to adopt a buy-sell rule in the longer term is a separate issue. Our October 1996 report on domestic competition found that DOT's adopting such a buy-sell rule in 1985 at the four U.S. slot-controlled airports resulted in a decrease in competition at three of those airports.[18] We reported that a few of the large, incumbent carriers were allowed to purchase most of the available slots and increase their slot holdings to such an extent that they could

[18] The four U.S. slot-controlled airports are Chicago's O'Hare, New York's JFK and LaGuardia, and Washington's National.

limit other airlines' access to domestic routes beginning or ending at National, LaGuardia, and O'Hare. This has contributed to higher fares at these airports. Specifically, we found that, compared to 33 other large U.S. airports, fares in 1995 were 46 percent higher at National, 35 percent higher at LaGuardia, and 24 percent higher at O'Hare.

In addition to slots, facility constraints at Heathrow persist. The airport authority's plans for a fifth terminal have been delayed by local community opposition and environmental concerns. The British government began holding public hearings in May 1995 on the need for and potential noise and environmental impacts of constructing the new terminal but, according to British officials, the government will not complete its work until mid-1998 due to the strong opposition. As a result, according to airport authority officials, the first phase of the new terminal will likely not open until the fall of 2004, which is 18 months later than originally planned. In the short term, therefore, the planned new terminal will not have a bearing on efforts to ensure that adequate facility space is available for U.S. airlines if an open skies agreement is reached in the near future.

As a result of the challenges inherent in addressing the barriers to entry at Heathrow, significant intergovernmental agreement will be needed well beyond the scope of a traditional open skies accord. In particular, additional agreement will be needed between the United States, United Kingdom, and EU on issues regarding the transfer of Heathrow slots and use of its facilities to ensure substantial new entry by U.S. airlines at the same time American Airlines and British Airways commence joint operations. Otherwise, consumers in both countries will likely not enjoy the full benefits of lower fares and better service that open skies agreements are designed to bring.

Mr. Chairman, this concludes our prepared statement. We would be glad to respond to any questions that you or any member of the Subcommittee may have.

Related GAO Products

International Aviation: DOT's Efforts to Promote U.S. Air Cargo Interests (GAO/RCED-97-13, Oct. 18, 1996).

Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets (GAO/RCED-97-4, Oct. 18, 1996).

International Aviation: DOT's Efforts to Increase U.S. Airlines' Access to International Markets (GAO/T-RCED-96-32, Mar. 14, 1996).

International Aviation: Better Data on Code-Sharing Needed by DOT for Monitoring and Decisionmaking (GAO/T-RCED-95-170, May 24, 1995).

International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain (GAO/RCED-95-99, Apr. 6, 1995).

International Aviation: DOT Needs More Information to Address U.S. Airlines' Problems in Doing-Business Abroad (GAO/RCED-95-24, Nov. 29, 1994).

International Aviation: New Competitive Conditions Require Changes in DOT Strategy (GAO/T-RCED-94-194, May 5, 1994). International Aviation: Measures by European Community Could Limit U.S. Airlines' Ability to Compete Abroad (GAO/RCED-93-64, Apr. 26, 1993).

Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines (GAO/RCED-93-7, Dec. 9, 1992).

Airline Competition: Effects of Airline Market Concentration and Barriers to Entry on Airfares (GAO/RCED-91-101, Apr. 26, 1991).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

http://www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested