TESTIMONY OF

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INTERNATIONAL AND REGULATORY AFFAIRS,

UNITED AIRLINES

SUBMITTED TO

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Mr. Chairman, Members of the Committee, thank you for the opportunity to present the views of United Airlines on the Department of Transportation's (DOT) proposal to reduce regulatory barriers and expand investment opportunities for U.S. and foreign carriers in the global aviation market. As the nation's largest international airline, we strongly support the elimination of outmoded restrictions that discourage cross-border investment in the airline industry. Excessive restrictions on the ability of foreign investors to participate in the commercial management of U.S. airlines – and reciprocal restrictions that other countries impose on U.S. investors in foreign airlines – constrain our ability to tap global capital markets and to compete most effectively in the international marketplace.

The DOT last week published a 74-page supplemental rulemaking proposal (SNPRM) that refines the proposal on which today's hearing focuses. While we are closely reviewing that document, and expect to submit detailed comments on it, United wishes to make clear that it supports the overall direction DOT is taking, and fully endorses the process in which the Department is engaged.

Facilitating a more market-oriented environment for cross-border investment is a natural, logical, and necessary extension of longstanding U.S. open skies policy for aviation. With the strong support of several Administrations, Republican and Democratic, that policy has already done much to transform international aviation from a highly-regulated, government-directed sector to a robustly-competitive worldwide enterprise at least partly guided by free market forces. In just 15 years, the U.S.-led open skies campaign has afforded U.S. and foreign airlines much greater freedom to traverse the globe without artificial limits on where, when, and how often they can fly, what they can charge, or how they can market their international services.

The DOT proposal to facilitate cross-border investment by enabling meaningful foreign investor participation in the commercial management of the airlines in which they invest represents another significant and positive step along this same market-opening path – a path that started with the 1978 deregulation of the domestic airline industry. We would prefer that DOT go further and eliminate, reciprocally, all limits on foreign ownership and control, except as they relate to national security oversight. But we welcome this progress toward the ultimate goal of allowing the airline sector to operate with the same freedom and flexibility as any other global U.S. industry – like financial services, energy, and telecommunications.

That is the only goal that makes sense in today's global economy – one in which our international passengers can readily access their multinational bank accounts, stay in international hotel chains, and connect with worldwide communications networks on a global basis. In today's business world, it is profoundly ironic that U.S. international airlines -- the quintessential infrastructure of the global marketplace -- remain bound by regulatory restrictions of a bygone era.

The DOT proposals to encourage cross-border airline investment come at an important moment, and should not be unnecessarily delayed or unduly limited in scope. The benefits are very clear -- not only for the financially-challenged U.S. airline industry, but also for consumers and communities, and for U.S. international competitiveness.

U.S. airlines have undergone tremendous financial stress over the last five years, and today face escalating fuel and other costs that threaten the balance sheets of every major airline. We at United have come through a difficult and extended bankruptcy – one of the largest ever in the U.S. -- in a process that required sacrifice and painful adjustment for thousands of employees and businesses across the country. We have emerged with a much more stable financial base -- unit costs down 20 percent (excluding fuel), anticipated annual average cost savings of $7 billion through 2010, and productivity up by 27 percent. Despite these hard-won gains, we must further build our financial strength to respond to tough competition and extraordinary fuel prices. We and virtually all of our U.S. competitors must be able to continue to attract new capital investment in response to market forces and incentives, without undue regulatory impediments.

Enhancing opportunities for investment is also plainly in the interest of not only U.S. airlines, but also of the many communities that depend on financially stable and successful U.S. airlines for their economic well-being, jobs, and needed air services. Ironically, some have suggested that allowing more foreign participation in the management of U.S. airlines would somehow undermine U.S. carrier service to smaller markets. Except for certain markets within the Essential Air Service (EAS) program, in which service is legally guaranteed, domestic markets are served because they generate adequate revenues for the airlines. There is no basis to assume that foreign managers would have less of a profit motive than U.S. citizen managers, and would drop profitable services to communities now being served.

The DOT proposal is far more than a matter of attracting foreign capital to U.S. airlines, though. We at United also look at it from the standpoint of potential U.S. investment in, and partnership with, foreign airlines (DOT properly proposes to offer the benefits of its proposal only to investors of those foreign countries that afford U.S. airlines reciprocal investment freedoms). We hope that the proposal, when finalized, will remain sufficiently broad to meaningfully facilitate U.S. carrier investment in, and integration with, foreign carriers in key markets. In the long run, the enduring path to aviation industry success is to become more competitive, embracing opportunities for international growth, integration, and inter-carrier cooperation and consolidation, including through strategic cross-border investments.

Significantly, the DOT proposals afford particular impetus to longer-term, strategic investment in U.S. airlines -- investment by those interested in building and maintaining airline businesses, not just venture capital or hedge funds seeking transitory investment gains. Short-term, speculative investors are unlikely to be concerned about participating in the commercial management of their investment targets. In contrast, the

DOT proposal will encourage the kind of longer-term strategic industry investment – whether by foreign investors in the U.S. or by U.S. airlines in foreign carriers – that can play an important role in stabilizing the volatile airline sector.

Expanded foreign investment opportunities would enhance the scope and level of inter-carrier integration that has been shown to benefit consumers. Specifically, it would enable airlines to take today's alliance-based airline cooperation to the next level by facilitating cross-carrier equity investment and participation in business decision-making. Such investment and financial commitments would cement and strengthen the inter-carrier relationships that today rest solely on contractual agreements, albeit in some cases enhanced by DOT-granted antitrust immunity.

From a broader policy perspective, strategic cross-border airline investment may be the surest way to enlist market forces to help stabilize a global industry – a sector that is notoriously sensitive to world economic shifts and regional booms and busts, and vulnerable to unpredictable geopolitical events. Such global diversification among international airlines enables carriers in one region to broaden their financial exposure to other regions where growth and demand may be relatively strong, and so help flatten the often drastic and cyclical peaks and valleys of airline operations and profitability. Conversely, global equity-based financial exposure can help spread risk – and so avoid the potential catastrophic impact of what has become for aviation the expectation of the unexpected – from SARS to terrorism to the potential for avian flu. Strategic cross-border investment can also help normalize airline industry structure, eliminating some of the inefficient and destructive fragmentation of the international airline market.

Opponents of the DOT proposal have predictably failed to focus on its benefits for U.S. aviation competitiveness in the global economy. Instead, they have sought to stoke overblown fears that allowing minority foreign investors to participate in certain commercial management decisions of U.S. airlines will somehow subvert the safety and security of U.S. aviation. Such misplaced efforts to protect U.S. aviation from foreign competitors obscure the opportunities for U.S. airlines to regain their historic primacy in the global marketplace.

Historic U.S. leadership of global aviation -- and scores of other global industries – has long been built on forward-looking, risk-taking competitive zeal, not on protecting U.S. flag companies from foreign competition or foreign investment. Reducing some constraints on the regulatory conditions now imposed on cross-border investment can help bolster U.S. competitive strengths and entrepreneurial resilience in an international marketplace where the opportunities are manifest. While North America's share of world air traffic is projected by Boeing to shrink from 25 percent to 20 percent over the next two decades, for example, the share of all intra-Asia markets will grow from 16 percent to 20 percent. And while domestic air traffic grows only 3.5 percent annually during that period, transatlantic traffic is projected to grow by 4.6 percent annually, at the same time traffic to Southeast Asia and China jumps every year by 7.3 percent and 8.0 percent respectively -- more than <u>double</u> the rate of North American growth.

With improved cost efficiencies and renewed competitive strength in important international markets, we at United are eager to pursue these global service opportunities, including through partnerships with foreign airlines. Over the last three years, we began service to 12 new foreign cities, increased the number of foreign routes we serve by 44 percent, and grown our overall international departures by 31 percent.

In the end, efforts to protect U.S. airlines by restricting cross-border investment, or by other means, just do not work. To the contrary, since European regulators facilitated and encouraged open cross-border investment within the European Union, international aviation leadership has been shifting from U.S. carriers to such combinations as Air France/ KLM-- now the world's largest airline by revenues. And U.S. carriers now lag far behind their Asian and European competitors in the acquisition of new long-haul jet aircraft – with no U.S passenger orders for the super-jumbo Airbus 380, and only a relative few for the high-efficiency Boeing 787 or Airbus 350 aircraft.

Mr. Chairman, while the DOT airline investment initiative has real merit on its own, it is also a fact that the pending agreement to create a full open skies aviation market between the U.S. and Europe will not occur without significant progress on this issue, as the Europeans have made abundantly clear. We would not support a bad DOT policy simply to gain European approval of the pending agreement, nor do we see any reason to believe the U.S. government would do so, but it is essential to understand the importance of the US-EU agreement that may hang in the balance here. We fully support the US-EU agreement, in light of the open skies and operational flexibility benefits it offers us and other U.S. airlines. And we do so even though it will expose United to significant new competition from major European airlines, as well as from U.S. competitors on certain key routes.

The proposed US-EU agreement would enable any European airline, regardless of its nationality, to fly to anywhere in the U.S. from any city in Europe, not just from the airline's homeland. Together with the proposed new investment policy, the agreement would mean more competition for United – including from foreign airlines serving key U.S. markets from London's Heathrow airport, where we are now one of only four U.S. and European airlines authorized to serve that airport. In addition, a new transatlantic open market agreement would open Heathrow service to other U.S. airlines as a matter of law. United recognizes this competitive reality, and is prepared to accept this commercial challenge. We are willing to pay this competitive price because, in the long run, we will only succeed if we can prevail in a truly open global market. United and other U.S. airlines can do so, and can reassert U.S. aviation leadership, but only if they are prepared to compete efficiently and effectively as normal businesses on a global playing field.

Not every U.S. carrier has taken this long term view. Indeed, even some who actually stand to gain in the short term -- like Continental Airlines, which would obtain legal access to Heathrow Airport under a U.S.-EU agreement -- have loudly and extravagantly protested. To be frank, Mr. Chairman, we are surprised at the degree of rancor that this relatively modest DOT proposal appears to have generated, albeit by a small minority of U.S. airlines. Looked at fairly, the DOT proposal is essentially an incremental step – albeit an important one -- along an extended path to a fully-deregulated, market-based, global industry. The proposal does nothing to affect the actual foreign ownership statutory requirements – that U.S. citizens own 75 percent of voting stock and serve as President and two-thirds of every U.S. airline's Board; rather, it would relax only the regulatory interpretation of the regulatory control requirement.

The SNPRM issued last week makes even clearer that DOT's proposal would not infringe on U.S. citizen control of U.S. airlines. Aside from even more specifically ensuring U.S. citizen control over issues relating to safety, security, and Defense Department obligations of U.S. airlines, the SNPRM makes explicit that the U.S. citizen-dominated Board of a U.S. airline maintains actual control of the airline. Particularly with this clarification, it is difficult to see any remaining basis for legitimate concerns about U.S. control. To the contrary, it will be important to ensure that DOT's effort to clarify this issue in its SNPRM does not provide fodder for opponents of the proposal -- here and abroad – to argue that it now does not go far enough to encourage foreign investment.

The other significant source of concern about the DOT proposal, voiced by part of the organized labor community, is that the proposal could lead to fewer or less desirable jobs for U.S. airline workers. The fact is that U.S. airline labor has borne much of the burden as airlines have struggled to cut costs, increase efficiency, and compete effectively in an extraordinarily competitive environment. But it is impossible to see how the proposal to encourage more investment in their U.S. carrier employers can realistically make matters any worse for U.S. labor. Nor is it clear why foreign participation in a U.S. airline's managerial decisions would increase outsourcing of that airline's operations, including maintenance or long-haul operations, where the economics did not dictate such a shift. To the contrary, U.S. workers could only benefit from a more robust and competitive U.S. airline industry.

Given the circumscribed nature of the regulatory step at issue here, it is clear that much of the high-pitched opposition to it is generated by those pursuing other individual agendas. DOT's critics raise exaggerated fears of minority foreign investment in U.S. companies, and of appeasement of European interests, while virtually ignoring the numerous direct benefits of U.S. investment in foreign airlines, and the broader importance of maintaining global momentum for open aviation markets, free trade, and investment freedom. Regrettably, such objections are not entirely unexpected. Virtually every significant step toward aviation liberalization has met unwarranted opposition – from the 1978 deregulation of the U.S. domestic industry, to the pursuit of global open skies policy more than a decade later, to the current DOT proposal on foreign investment.

Mr. Chairman, DOT's proposal to facilitate cross-border airline investment, together with the transatlantic open market agreement we hope it will encourage, represents an important step for U.S. and international aviation – one that works to the benefit of a resilient U.S. airline industry and to consumers. Especially as the proposal moves toward freeing airlines from anachronistic marketplace distortions, and in the direction of enabling U.S. airlines to compete like other global businesses, it can help bring about a more fully deregulated environment in which U.S. carriers can regain their historic global aviation leadership.

We urge the Committee to support this modest effort, and we also take the opportunity to encourage DOT to maintain its focus on achieving the many, critical deregulation goals that remain. In today's competitive international airline industry, the only path that makes sense is the one that leads toward full deregulation, and the elimination of restrictions that continue to hold back U.S. carriers.

Thank you again for the opportunity to appear and present the views of United Airlines. I would be pleased to respond to any questions of the Committee.