

MR. CARTY: Well, thank you, Ms. Hills, and good morning, everyone, and I really do appreciate the opportunity to be here today to represent American Airlines and participate in this very important business of this Commission.

As everyone here today knows, the size and the dimension of the United States trade deficit has a significant consequence for the well-being of the U.S. economy and for the men and the women and businesses, both large and small, whose activities drive it. Thus, it behooves us all to better understand the nature, the causes, and the consequences of this deficit, and we applaud this Commission's efforts to do that.

I'll try to provide whatever insight I can this morning as to the role that the airlines and American Airlines in particular can, and I believe ought to play in driving even more U.S. exports in years to come.

In American, our own international activities have been steadily rising since the mid-1980s, and during the past decade and a half we've developed a robust service network in Europe, in Latin

America, and in the Caribbean as well as a small but nonetheless growing presence in Japan.

Our international efforts have intensified in recent years driven by an increase in demand, as more and more of our customers wanting to avail themselves of the opportunities of a global marketplace now want and expect a network that can take them anywhere in the world that they want to go; an increase in opportunity, of course, as many of the old, restrictive, bilateral aviation agreements that have been in place for many years have been replaced by liberalized open skies agreements.

By and large in an open skies framework, U.S. airlines have proven, I think, to be very, very able competitors. Owing at least in part to our two decades of intense free market competition in the domestic marketplace, U.S. airlines are among the most efficient in the world, and the marketplace success that efficiency tends to drive creates a very positive impact on the flow of funds back to the United States, which at least partially offset the country's trade and goods deficit.

Now, this is because American travelers choose U.S. carriers for their world travel, and frankly, a disproportionate number of foreign travelers prefer our airlines as well, making the United States, of course, essentially a net exporter of global air transportation services.

Now, this efficiency has certainly helped us in the U.S.-Latin American market. In fact, since taking over the Latin American network of Eastern Airlines back in 1990, we've managed to expand American's service to that region tremendously. In fact, our capacity between the United States and the Latin American market has grown by some 23 percent a year, and we've grown recently by about 7 percent in the U.S. to Mexico market, and we now serve some 28 cities in 16 countries, and we have the leading market share between the United States and virtually all of those destinations.

Now, it's important to note also that today only about 40 percent of the local passengers that are carried by American in the U.S.-Latin American market actually originate in the United States. And in the U.S.-Mexico market, that number approximates 58

percent. That translates into very significant positive flow to the U.S. balance payment, and as a growing number of business travelers and tourists visit the United States each and every year, that number continues to increase.

And we think there is tremendous opportunity for continued growth in Latin America, and we hope that the current Administration and future Administration will continue to pursue open skies throughout the region. And while Latin America is obviously the main topic of discussion today, I think the ability of airlines to make a positive impact in the balance of trade to that region is also illustrative of what is possible in other areas of the world as well.

For example, in recent months as an airline, we've been making our case with the current Administration to give us authority to provide additional passenger service between the United States and China. Now, from a macroeconomic standpoint, one passenger airline serving that country would hardly put a dent in the mass of U.S.-China trade deficit. However, we do believe it would certainly be helpful,

both in terms of generating positive cash flows to the U.S. and facilitating the business relationships that will be required to increase American exports.

And while the liberalization of aviation treaties between the United States and other countries, whether it's in the form of incremental authority to China or full-blown open skies to any nation in Latin America, Europe, or elsewhere, it's obviously good for U.S. airlines. The continued development of global aviation fueled by liberalization is also unequivocally good for U.S. exports of high value manufactured products.

The most striking example of that, of course, is Boeing, and as the United States's largest exporter, Boeing stands to gain enormously as nations around the world develop and upgrade their aviation systems. And as an exclusive Boeing customer, each time American is able to add new international service we are, through our relationship with Boeing, actually helping to fuel that export engine.

But moreover, as countries around the world continue to develop their aviation systems, they simply need to invest in the technology and the

equipment necessary to build modern infrastructures. And the United States is the world leader when it comes to providing the avionics, modern airport technology, and other prerequisites for a modern aviation system.

To sum up our standpoint, there's a clear link between the continued push for open skies, the development of the global aviation system, and the progress that we need to make with regard to the U.S. trade deficit. In a liberalized marketplace, U.S. airlines tend to do very well. Our success in turn increases flows back to the United States and as the aviation bonds between the United States and the rest of the world develop, the demand for aircraft and the other components of aviation infrastructure best provided by U.S. companies will inevitably increase as well.

Again, I'd like to thank the Commission once again for the opportunity to participate today, and we certainly appreciate your efforts and wish you the best of luck in completing your important work.

Thank you.

COMMISSIONER HILLS: Thanks, Mr. Carty.

Do the Commissioners have questions? Yes?

COMMISSIONER WEIDENBAUM: Thank you, Mr. Carty, for your statement. We've been hearing, as you might suspect, from a wide variety of representatives of different industries, and I hate to put them into two simple categories but let me do that anyway: those companies, those industries that see great opportunity in the global economy are very enthusiastic supporters of open trade, and I see you're in their ranks.

However, I have to note that those industries that feel that they are suffering the onslaught of unfair competition or any form of international competition for that matter tend to take the reverse position. Rather than seeing the benefits of an open trading system, they see the benefits of protectionism.

Now, I wonder to what extent a national position on trade should be somewhat more broadly based than specific self-interest? Can I start off by asking you the naive question, in circumstances we

don't expect to occur, but say just be hypothetical, let's say that suddenly your foreign competition would do much better. Would you still like the idea of open skies and all that if you were at the receiving end rather than the giving end of foreign competition?

MR. CARTY: I think as a matter of sorting this out, one really needs to think about what is meant by unfair competition. An act or set of policies by another country to disadvantage a producer or an airline for which there's no defense that creates that advantage for your competition, I think all of us would see as unfair competition.

On the other hand, the airline of the other country, figuring it knew how to do something more cleverly than we have or be more efficient than we have I think simply puts a challenge back on us to do that. So I guess I would have some real reservations when it was active government policy in another country to disadvantage a U.S. producer than I would from simply a competitive disadvantage that we, as management, is our responsibility to right.

COMMISSIONER WEIDENBAUM: I thank you for that. It would be more heartening, frankly, if this

were a more universally accepted view among our witnesses, but I won't pursue that.

COMMISSIONER HILLS: Commissioner Angell has a question.

COMMISSIONER ANGELL: Mr. Carty, I really appreciate your testimony. I'd like to take you back to 20 or 25 years ago when it seemed that American Airlines were -- did not view themselves as efficient in world markets as they do today. And what I'm wondering is, this transition of the American Airline industry to such efficiency, what recommendations might you make to other industries that they might also make the kind of transformation that occurred in the U.S. airline industry?

MR. CARTY: Dr. Angell, I'm not sure that there's a perfect analogy between our industry and others. As you know for many years we were a regulated industry, and I think one of the consequences of being part of a very regulated industry is we were not an industry responsive to the marketplace. And when we had to become an industry responsive to the marketplace, the management of many

of the airlines, although not all, as you'll recall, managed to make that transition.

Part of our efficiency problem was the bottling up of our natural competitive environment, and while that applies to some other regulated industries in this country, it may not apply to others. The problem many of the industries in the United States are in is a consequence, however, of their own history, changing technologies, and their ability to be responsive to those, and I think as a matter of creating the wealth of this country needs to create and the world needs to create -- the U.S. is simply going to have to find a way to be more efficient in those industries or recognize that those are industries they don't necessarily lead the world in.

And we probably won't lead the world in every industry because we don't have natural competitive advantage in every industry.

COMMISSIONER ANGELL: As I recall, when Alfred Kahn began the movement towards deregulation of the airline industry, there were some members of the industry that did not look that favorably upon

deregulation. So should we as a part of economic policy always be that tuned to what someone has to say when we propose more open competition domestically as well as internationally?

MR. CARTY: Dr. Angell, you're quite right. In fact, some of the leadership of American Airlines at the time had many reservations about the deregulation of the industry, and they had reservations about the deregulation of the industry because they knew the change would be severely disruptive. It would be disruptive to our employees. It would be disruptive to our shareholders. It would be disruptive to our customers. And as a consequence of these being relatively big companies, being disruptive to our society. And it was.

Thousands of employees lost their jobs. Companies failed and companies succeeded. So there's no question that that kind of radical change can lead to severe consequences for a company or an industry.

In retrospect, however, I think it's fair to say -- very easy to see that in spite of those disruptions the net benefit to our economy and to our customer base and to the future employees in this

industry was far and away a positive event. But the anxiety I think in companies like American was the certain knowledge that it would be radically disruptive, and it was.

Again, it's a little bit of a unique situation because it's an industry that was so heavily regulated, but was the ultimate disruption that was caused by deregulating the industry or originally regulating it in the first place? I think the answer is it was caused by originally regulating it in the first place.

COMMISSIONER ANGELL: Thank you.

COMMISSIONER HILLS: Yes, Commissioner Wessel, and then we have Commissioner Lewis and if we have time, Commissioner Thurow.

COMMISSIONER WESSEL: I appreciate your being here this morning.

I think one of the industries that has led the effort, if you will, in terms of managed trade has been the airline industry, where your "beyond rights" are all controlled and are probably where some of the most intense international negotiations occur that we see among our trade negotiators.

What would be your utopian situation? Would it be the ability to simply fly -- land beyond rights, et cetera, and giving other countries the same rights here, or do you believe that well into the future we're going to continue to need to manage airline traffic and travel?

MR. CARTY: That's a very good question, because obviously we still are a heavily regulated industry internationally, and even with the liberalization that has occurred in the last decade, we have an enormous amount of regulation.

We are a unique industry. We don't have flagship companies and we don't have flag chemical companies. We don't have flag technology companies but we have flag airlines. And as a consequence, the globalization that is occurring in our industry is a little bit different than that that is occurring in other industries. We are limited in what we can do around the world, and so we partner with others that can do those things.

I think in the long run those barriers will come down. I think this industry will look a lot more like other industries. I think inevitably there will

be a transition period because many other countries are far less certain that that's what they want to see happen. Again, to stress the importance of having a flag carrier even to very many small countries -- we probably can't participate as a leader in this particular industry if it's fully deregulated in a global sense. There's a lot of reluctance there.

So time will tell, but I think to create the transportation infrastructure that we will need for a truly global economy in other industries that our industry is going to have to look, from a regulatory point of view, a lot more like other industries 20 years from now, but I think it will be a slow transition.

COMMISSIONER HILLS: Commissioner Lewis?

COMMISSIONER WESSEL: Excuse me. I have a follow-up question.

One of the issues as well is the question of safety, and when anyone gets on an American Airlines flight, they have confidence that you have the highest standards no matter where somebody goes through the terminal and onto the plane. In trade generally,

there's been a question as to how standards can be applied; the question of, for example, food safety.

Do you believe that we should be able to impose those domestic safety standards we have here on any airline that's going to enter the U.S. market and is there, therefore, some overlay with food safety and other issues that -- safety standards that we'd be looking at in other products?

MR. CARTY: You raised a very good question and one that is of genuine significance is not only safety but in our industry security a very analogous situation.

Obviously, we are going to stay and are very comfortable staying heavily regulated from a safety point of view, as simply a matter of government policy. The question is how to affect the same kind of safety standards around the world for American travelers in particular as a matter of U.S. government policy?

I think our view has been as a matter of both creating a competitive industry into and out of the United States and protecting U.S. travelers, the U.S. government should exercise a right to demand

certain safety standards for people that take off and land in the United States. I think longer term, we need to find other international forums for establishing safety standards around the world, whether the airplane is taking off or landing in the United States or not.

Associations such as ICAO are perfectly designed to do that, and I think we should be looking to reach international agreement to see those safety standards put in place around the world.

COMMISSIONER HILLS: Commissioner Lewis?

COMMISSIONER LEWIS: The airlines, yours in particular -- you're a great company -- are trying to get more rights to fly in foreign countries. Would you also like to be able to fly between cities in foreign countries, between Tokyo and Osaka, pick up passengers in Tokyo and drop them off in Osaka? How would you feel if foreign airlines are able to carry American passengers between American cities?

MR. CARTY: Yes. I think in the ideal world we'd be unconstrained as to all of those things as our foreign competitors would. I think it will be some time in coming. But I think the U.S. carriers are in

a position to compete effectively anywhere in the world, and therefore, we'd like to have those rights and at least in the case of our carrier, we'd be perfectly prepared to give those rights to foreign competitors in the United States.

As a matter of law, that simply isn't able to happen today, so even as a matter of trade policy, we couldn't trade anyway without a change in the legislation.

COMMISSIONER LEWIS: Would you be in favor of it?

MR. CARTY: But we'd be in favor of it. I guess it's fair to say we wouldn't be in favor of unilateral disarmament and allowing others to fly around in the United States when we couldn't fly in other countries, so we're going to have to look for a balance of economic opportunity in our view, but we would have no reservations about a truly liberalized commercial system of aviation around the world.

COMMISSIONER LEWIS: Thank you. I think that's a remarkable answer. I don't want to ask you a trade secret, but what percentage of your total costs are labor costs?

MR. CARTY: In our case, it runs in the mid-30s. It depends -- it fluctuates a little bit and it fluctuates because our other big cost component fluctuates fairly heavily as well, and it's fluctuating in the wrong direction today, which is, of course, driving down labor as a percentage of the total. So we are a very labor-intensive business.

COMMISSIONER LEWIS: In follow-up to Mike Wessel's question to you, if there were a lower cost airline because of the lower labor cost from other countries that didn't have the safety record of your airline and they wanted to carry passengers between American cities, you would really be concerned that the U.S. should exercise some control in making sure that there is safety in those airlines?

MR. CARTY: Certainly. Certainly safety, but I think the big U.S. carriers today have demonstrated their ability to compete with low-cost carriers both around the world and within the United States. We have to do it by exploiting other advantages. We have to create technology advantages. We have to create advantages of selling and marketing, but the success of this business, while

it's highly labor-intensive, is not solely dependent on having the lowest labor cost in the world.

COMMISSIONER LEWIS: Thank you very much.

COMMISSIONER HILLS: Lester Thurow has the last question.

COMMISSIONER THUROW: Let me ask you a quick question, which is a little bit unfair. It's partly of economics and partly about bargaining.

Somebody this morning already mentioned Adam Smith. I think if Adam Smith was advising the Clinton Administration on air traffic, what he would say is the United States, in your terms, unilaterally disarm; have open skies in the United States regardless of whether any other country in the world had open skies, because it would give the consumers more benefits.

Now, what would your response, if I was sitting up here Adam Smith and I made that argument to you and you had to respond? Why isn't that the right thing to do --

MR. CARTY: Well --

COMMISSIONER THUROW: -- unilateral disarmament, open skies, Americans get the advantage and who cares what goes on in Chile?

MR. CARTY: It's a fair question and again, the question isn't so much of whether we want a full liberalization around the world. It's a question of transition. Again, we're back to this issue we talked about when we talked about deregulating the U.S. industry. It would be terribly disruptive. In excess of a half a million people would lose their jobs in the aviation business.

Now, that might create more wealth for the U.S., but if you could manage the transition to truly open markets through a negotiation that gave those half a million people a chance to participate in the economy, that might even be a better way to get from here to an Adam Smith world.

COMMISSIONER HILLS: Commissioner Lewis cannot restrain himself. He has a follow-up question.

COMMISSIONER LEWIS: What's your view when a foreign country says to a company like Boeing, if you want to sell us planes, you have to build them here in this country?

MR. CARTY: That has been one of several issues, of course, that has been a problem for Boeing. Boeing is an enormously successful exporter as all of

you know, and has been the envy at least of the European aviation community and there's been a lot of explicit government action taken in Europe to at least get a piece of that.

Again, I don't think that's a good way to do business, but both major manufacturers around the -- I don't think those people are again, optimizing the net wealth, but Boeing and Airbus are the two major manufacturers today, and that's just the competitive response that they or Airbus have to decide whether to respond to. Will they manufacture there or will they not?

COMMISSIONER LEWIS: But that concerns you?

MR. CARTY: I simply think it's silly government policy. I actually grew up in Canada and spent a number of years watching the Canadian government leverage Boeing into doing precisely that.

Today, most of those Boeing plants are unsuccessful and have been closing, and so it hasn't been useful long-term government policy in Canada.

COMMISSIONER LEWIS: Thank you very much.

COMMISSIONER HILLS: Mr. Carty, thank you very much. We really appreciate your remarks --

MR. CARTY: Thank you.

COMMISSIONER HILLS: -- and your attendance. And you and Mr. McTeer have opened our hearings in Dallas in a very favorable way, and we're grateful to you both.

MR. CARTY: Thank you very much, Ms. Hills, and wonderful to see you again.

COMMISSIONER HILLS: Good to see you.

We now will convene our first panel; our ten o'clock to 11:30 panel where we have four professors who will comment on the trade deficit issues.

(Pause.)

COMMISSIONER HILLS: Let me welcome the four of you. Our practice, when we've had a panel, has been to have a timed presentation. As you can see, my fellow Commissioners are very eager to ask questions and then follow-up questions and then follow-up the follow-up questions.

So if I can prevail upon you, I would like to limit you to seven minutes in your opening remarks. We have only an hour and a half, and I know it's going to be a lively session.

And Professor Leamer from the University of California, we'll call on you first. We're delighted that you could join us, and thank you for sending some remarks in advance. That was very helpful.