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OPEN SKIES AND ITS RECENT IMPACT ON THE ASIA-PACIFIC REGION

by

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ABSTRACT

The primary intention of this thesis is to examine open skies policy and its far-reaching impact on the Asia-Pacific region.

In order to achieve this, we will describe the historic evolution of economic regulation in civil air transport, which laid the foundation for an open skies regime. Moreover, the scope of an open skies regime on a global scale is addressed. Then, a detailed study of the essential elements of bilateral open skies agreements is undertaken.

Afterwards, an analysis of the current economic air transport regulation in Asia-Pacific is conducted. With the emergence of the open skies trend, most Asia-Pacific nations began to liberalize their air transport industries. Yet, bilateral agreements remain the primary means to attain this goal.

More necessarily, several Asia-Pacific countries' air transport policies will be comprehensively examined. This examination includes Japan, China, Singapore, Taiwan, South Korea, the Philippines and Australia.

Finally, a perspective for liberalization via a hybrid of bilateral and sub-regional open skies arrangements in the Asia-Pacific region is presented.

RÉSUMÉ

L'intention première de cette thèse est d'analyser la politique Ciel Ouvert et ses répercussions de grande portée sur la zone Asie-Pacifique.

C'est dans ce but que nous décrirons l'évolution historique de la réglementation économique dans le domaine de l'avation civile, qui a servi de base au régime Ciel Ouvert. De plus, après une étude de la portée du régime à l'échelle mondiale, nous analyserons en détails les éléments qui caractérisent les accords bilatéraux de ciel ouvert.

Nous analyserons ensuite la réglementation des transports aériens couramment en vigueur dans la zone Asie-Pacifique. Avec l'implantation d'une politique de ciel ouvert, la plupart des nations de la zone Asie-Pacifique ont commencé à libéraliser leur industrie aéroautique. Les accords bilatéraux y demeurent pourtant le moyen le plus courant d'atteindre ce but.

Nous examinerons nécessairement en détails la politique aéronautique de plusieurs pays de la zone Asie-Pacifique. Cet examen s'étendra au Japon, à la Chine, à Singapour, à Taiwan, à la Corée du Sud, aux Philippines et à l'Australie.

Enfin, un projet de libéralisation basé sur un système hybride d'accords bilatéraux et sub-régionaux dans la zone Asie-Pacifique sera proposé.

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INTRODUCTION

The pro-competitive framework for an open skies environment for the operation of international civil air services was initially introduced by the U.S. at the Chicago Conference of 1944. The participants broadly objected to the position of the U.S.. During the three decades following the Conference, international air transport was subject to competition-controlled bilateral relations with respect to market access, tariffs, capacity and doing business rights. The far-reaching deregulation and liberalization of air transport, which has taken place in the U.S. and the European Community countries since the 1970s, kicked off a new era for the economic regulation of commercial air transport. A short time later, an open skies regime emerged on the ground of profound deregulation and liberalization. Such an open skies regime calls for abolition of national governmental control over economic use by foreign air carriers of the national airspace, leaving international air operations open to market forces. Open skies is now being felt on a broader scale than ever before. A number of open skies agreements, in the form of bilateral or regional agreements, have been concluded. The Asia-Pacific region plays a crucial role in international air transport due to its huge population, delicate geographic situation, and booming economy. No doubt, the impact of an open skies regime on this region will be far-reaching and should not be neglected. The primary objective of the thesis will be to address and to present this impact on the region as a whole and specifically on certain countries in the region.

Chapter 1 will examine the historical background of the open skies regime and its development from a global point of view: despite the failure of liberal multilateral

attempts at the Chicago Conference in 1944, civil air transport regulation has experienced over thirty years of governmental control. However, an open skies environment was introduced through the deregulation and liberalization. In a short period of time, open skies has developed so much that a number of open skies agreements appeared one after another in North America, Central America, Latin America, Europe, and Africa. Most of these agreements are subject to bilateral measures.

To understand the concept of open skies in detail, Chapter 2 will introduce and analyze several significant elements of bilateral open skies agreements. These elements will include market access, capacity, pricing, market cooperation, fair competition and some other regulatory issues.

After obtaining an overall picture of the open skies regime, this thesis will, in Chapter 3, review its impact on the Asia-Pacific region. Asia-Pacific economies and tourism have experienced tremendous growth during the past decade, and are expected to continue to prosper in the 21st century as a result of a significant increase in the demand for air transport. Western countries in Europe and North America are eyeing the attractive Asia-Pacific aviation market and trying to profit from new opportunities. Confronted with the situation, the Asia-Pacific countries, like other parts of the world, are responding to the open skies tendency and have been experiencing profound deregulation and liberalization in the air transport industry. With respect to the methods used by these countries, this thesis will examine the impossibilities of global multilateralism and regional multilateralism on the Asia-Pacific region. Then, the thesis will make its

conclusion; that is to say, bilateralism will be the primary form of liberalization of international air transport in the region.

Chapter 4 will study certain Asia-Pacific countries' courses of air transport deregulation and international air transport policies under the impacts of an open skies regime, including countries representing liberal positions, semi-liberal positions, and relatively strict positions, by means of an analysis. The thesis wishes to present a concrete and broad picture concerning the influences of open skies on this region.

Finally, a point of prospect will be addressed in the conclusion. From those conclusions drawn from previous parts of the thesis, bilateral arrangements are the primary tools for achieving an open skies regime for Asia-Pacific countries. However, arrangements of sub-regional open skies cooperation have been initiated by the Australia – New Zealand single aviation market and ASEAN. It is likely that a future trend might be the combination of the two initiatives.

CHAPTER 1

OPEN SKIES – HISTORICAL REVIEW AND CURRENT REGIME

I. Failure of Multilateralism of Commercial Air Transport Regulation in 1944

Towards the end of the Second World War, many governments began to acknowledge the need to develop a multilateral regulatory framework for international air transport. At the invitation of the United States (U.S.), 52 nations met in Chicago in late 1944 for what is now known as the Chicago Conference. The main objective of the Conference was to reach an agreement on how to regulate the technical and commercial aspects of international air transport.

The Conference accomplished less in the economic field than in the technical field because two radically different schools of thinking were present. Some States adopted the stance held by the U.S. and others that of the United Kingdom (U.K.).[1] The U.S., who later became the dominant civil aviation power, was strongly in favor of "free enterprise airline companies and a pro-competitive policy in an open skies environment."[2] Such an environment, the U.S. believed, would allow the market forces to determine capacity and fares, without any governmental intervention. In addition, such a regime would have also granted the so-called five freedoms and unrestricted access to foreign destinations. On the contrary, the U.K. called for a system of government

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[1] See P.P.C. Haanappel, "Bilateral Air Transport Agreements - 1913-1980" [May 1979] Int'l Trade L. J. 243.

[2] A.D. Groenewege, *Compendium of International Civil Aviation* (Montreal: International Aviation Development Corporation, 1996) at 41.

involvement in the regulation of international air transport. Under such a system, routes, capacities, frequencies and fares would be distributed and determined by an international regulatory body. The U.K. believed that such international regulation would "provide its aviation industry with a much-needed period of recovery, which would allow it to survive direct competition with its American counterpart."[3] Despite lengthy negotiations, no meaningful compromises were reached. Neither the liberal multilateral solution nor the protective one was acceptable.

Consequently, although the Chicago Conference did not succeed in creating an international commercial regulatory body or arranging a multilateral exchange of traffic right, it did produce several notable accomplishments. First of all, it reaffirmed each State's control over the airspace above its territory, which was originally articulated in the Paris Convention.[4] This concept of sovereignty over national airspace precipitated the development of a system in which airlines rely on bilateral air transport agreements to determine international airline routes, frequency, and capacity.[5]

Second, the Conference drafted two separate subsidiary agreements: the *International Air Services Transit Agreement*[6] and the *International Air Transport*

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[3] A. Sampson, *Empires of the Sky: The Politics, Contests and Cartels of World Airlines* (Toronto: Hodder & Stoughton, 1984) at 62-63.

[4] See *Convention Relating to the Regulation of Aerial Navigation*, 13 October 1919, 11 L.N.T.S. 173, 1922 U.K.T.S. 2 [hereinafter *Paris Convention*].

[5] See P.P.C. Haanappel, *Pricing and Capacity Determination in International Air Transport – A Legal Analysis* (Deventer: Kluwer Law and Taxation Publishers, 1984) at 17-18 [hereinafter *Pricing and Capacity*].

[6] See *International Air Services Transit Agreement*, 7 December 1944, 84 U.N.T.S. 389, ICAO Doc. 7500 [hereinafter *IASTA*].

Agreement.[7] The *IASTA*, commonly known as the Two-Freedom Agreement, came into force in January 1945. It dealt with the exchange of technical freedoms for scheduled international air services and proved to be widely-accepted by a large number of States. The *Air Transport Agreement*, the so-called five freedom agreement, came into force in February 1945. It exchanged all five freedoms of the air for scheduled international air services. The five freedoms granted a State's airline:

a. the privilege to fly across another State's territory without landing;

b. the privilege to land for non-traffic purposes;

c. the privilege to p ' down passengers, mail and cargo taken on in the territory of another State whose nationality the aircraft possesses;

d. the privilege to take on passengers, mail and cargo destined for the territory of another State whose nationality the aircraft possesses; and

e. the privilege to take on passengers, mail and cargo destined for the territory of any other contracting State and the privilege to put down passengers, mail and cargo coming from any such territory.[8]

"The agreement, drafted mainly upon American insistence, was virtually a dead letter due to lack of ratification."[9] As a result, the third, fourth, and fifth freedoms became terms to be negotiated between nations when creating of bilateral air transport agreements.

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[7] See *International Air Transport Agreement*, 7 December 1944, 171 U.N.T.S. 387, US Department of State Publication 2282 [hereinafter *Air Transport Agreement*].

[8] See *Ibid.*, art. 1, s. 1.

II. Post-war Bilateral Regulation

Due to the failure of the Chicago Conference to realize the five freedoms of the air through multilateralism, States had no alternative but to grant each other commercial traffic rights on a reciprocal basis through bilateral agreements.[10]

A. Bermuda I

In 1946, the U.S. and the U.K., as a means of compromise between the free market and conservative approach, entered into a bilateral agreement,[11] known as Bermuda I, for air services between their territories. The *Agreement* was important because "it represented a compromise between the philosophies of the two States that had been so divergent during the Chicago Convention."[12] The U.S. agreed to governmental tariff control and allowed the International Air Transport Association (IATA) to set international tariffs. Designated airlines might use the rate-making machinery of IATA in determining their fares and rates on condition of their final approval by the civil aviation authorities of both countries, which is the so-called double approval regime. In the event

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[9] Haanappel, *supra* note 1 at 244. Ironically, the U.S. itself denounced the Agreement in 1964, realizing that a multilateral agreement on this problem was not possible in the short-term.

[10] One scholar has defined bilateral air transport agreements as "international trade agreements in which the governmental aviation authorities of two nations establish a regulatory mechanism for the performance of commercial air services between their respective territories and, in many cases, beyond." P.S. Dempsey, *Law & Foreign Policy in International Aviation* (New York: Transnational Publishers Inc., 1987) at 146-149.

[11] See *Agreement between the United Kingdom and the United States*, 11 February 1946, 3 U.N.T.S. 253, 60 Stat. 1499, T.I.A.S. No. 1507 [hereinafter *Bermuda I*].

[12] R.I.R. Abeyratne, "The Economic Relevance of the Chicago Convention – A Retrospective Study" (1994) XIX:II Ann. Air & Sp. L. 16.

that no agreement could be reached by IATA, the designated airlines would seek to agree on a price between themselves. If the designated airlines could not reach a compromise, the aeronautic authorities of both parties would involve themselves in the tariff dispute. In return, the U.K. accepted the concept of free determination of capacity by allowing airlines to determine their frequency and capacity according to the market demand of such transport. However, the capacity would be subject to guidelines and *ex post* review if either Party felt that its interests are unduly affected. With respect to route and designation, the U.K. further agreed to fifth freedom rights[13] and multiple designation of air carriers.

After the U.S. and the U.K. proclaimed Bermuda I as the model for their future bilateral air transport agreements, Bermuda I soon became the broadly-accepted prototype for bilateral air transport agreements during the next three decades. It was not just a bilateral agreement between two aviation powers; it also provided a general regime by which countries achieved commercial regulation of the air transport industry. However, "[i]t actually went a considerable distance towards liberalizing and stabilizing trade in air transport services, particularly with regard to capacity."[14] As A.D. Groenewege stated "the Bermuda I Agreement has introduced a regime of controlled competition."[15]

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[13] In June 1976, the U.K. raised the issue of fifth freedom rights as a reason to denounce the Bermuda I Agreement. See Haanappel, *supra* note 1 at 260.

[14] B. Stockfish, "Opening Closed Skies: the Prospects for Future Liberalization of Trade in International Air Transport Services" (1992) 57 Int'l Air Transport 609.

B. Bermuda II

Although the U.S. remained faithful to the original Bermuda I principles, the U.K. grew increasingly uncomfortable with the increasing number of U.S. designated airlines and fifth freedom rights; the U.K. began to realize that its airlines were losing benefits. The U.K. sought an equal share of traffic and routes, together with the predetermination of capacity. Accordingly, the U.K. issued its renunciation of Bermuda I in June 1976.

The U.S. and the U.K. re-negotiated their bilateral agreement in 1977, culminating in Bermuda II,[16] which was more restrictive than its predecessor. Bermuda II drastically reduced the number of gateway cities and fifth freedom rights of American airlines, while U.K. carriers benefited from new routes. However, the British failed to attain an equal share of capacity.

Bermuda II was not as influential in the international arena as *Bermuda I* had been, due to reasons of specification (it simply dealt with the issues related to the U.S. – U.K. aviation relationship) and U.S. deregulation.

C. Post-Bermuda Bilateralism

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[15] Groenewege, *supra* note 2 at 43.

[16] See *Agreement Between the Government of the Kingdom of Great Britain and Northern Iceland and the Government of the United States of America Concerning Air Services*, 23 July 1977, 28 U.S.T. 5376, T.I.A.S. No. 8641 [hereinafter *Bermuda II*].

Generally, for the thirty years following the signing of the Bermuda I Agreement, economic regulation of international air transport could be characterized by loss of competition, or the heavy intervention of governments with respect to designation, allocation of routes, capacity and fares. Many bilateral agreements contained the provision of single designation, prior governmental predetermination of capacity, double approval of fares, and strict allocation of routes.[17] The lasting thirty-year system was changed when U.S. deregulation commenced in 1978.

III. Open Skies

A. Air Transport Deregulation in the United States

Between 1938 and 1976, the U.S. air transport industry was strictly regulated by the Civil Aeronautics Board (CAB). This regulatory system contributed to unduly high fares for consumers and lower profits for airlines. Taking into consideration these problems and a diminished need to protect its mature airlines, the U.S. Congress passed the *Airline Deregulation Act of 1978* (*Airline Deregulation Act*). "The goal of the *Act* was for encouraging, developing, and attaining an air transportation system which relied on competitive market forces to determine the quality, variety, and price of air service."[18] The U.S. then began to push for domestic and global liberalization. Domestic

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[17] Post-Bermuda route schedules showed a gradual disappearance of intermediate points, due to the development of long range aircraft, and a similar disappearance of fifth freedom routes, due to the creation of international airlines in most of the world's nations. See Haanappel, *supra* note 1 at 252.

[18] G.L.H. Goo, "Deregulation and Liberalization of Air Transport in the Pacific Rim: Are They Ready for America's 'Open Skies'?" (1996) 18:1 Univ. Hawaii L. Rev. 550.

deregulation achieved initial success by privatizing State-owned airlines and gradually removing restrictions of entry, tariffs, and capacity. As a result, many new airlines entered the market and introduced lower fares.

This success drove "the American government to export its policy of deregulation to international air transport markets, recalling the 'open skies' position taken by the U.S. at the Chicago Conference."[19] Under this framework, the U.S. granted foreign carriers access to interior U.S. cities in exchange for price flexibility, which gave carriers the freedom to set fares, and promises from such foreign carriers to refrain from anti-competitive behavior.[20] Accordingly, the U.S. negotiated liberal bilateral air transport agreements and attempted to persuade other nations to open their air transport markets. Between 1978 and 1982, approximately eleven liberal bilateral agreements were concluded by the U.S.. "Some were in the form of full-scale bilateral agreements; others were in the form of protocols to existing agreements, memoranda of understanding or exchanges of diplomatic notes."[21] A model liberal bilateral agreement was drafted, containing the key points of the new deregulation policy. Despite such great efforts by the U.S., the promotion of liberalization did not succeed in Southern Europe, Latin America, and Asia. After 1983, the U.S. took a cautious approach in international aviation relations and did not enter into any new full-scale liberal bilateral agreements, possibly because of the difficulties to find like-minded partners.

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[19] Stockfish, *supra* note 14 at 615.

[20] This policy was widely-criticized by the U.S. Congress and airlines, calling the policy trading "hard rights" for "soft rights". See Dempsey, *supra* note 10 at 231.

[21] Haanappel, *supra* note 1 at 261-262.

On 31 March 1992, the U.S. Department of Transportation (DOT)[22] promulgated a new initiative to negotiate open skies agreements with other countries, especially those in Europe. The DOT first issued an "Order Requesting Comments" on open skies. In this Order, the basic elements that the DOT would include in an open skies definition were enumerated.[23] The action by the DOT indicated the milestone of the U.S. government's attempts to liberalize international air transport. It introduced a rather liberal international civil aviation regime, which departed from the "Bermuda model".

Immediately after launching the open skies initiative, the Netherlands accepted the U.S. offer and reached the first bilateral "open skies" agreement with the U.S..[24]

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[22] The DOT replaced the CAB in 1985.

[23] These elements read as follows:
(1) Open entry on all routes (no limit on number of carriers);
(2) Unrestricted capacity and frequency on all routes;
(3) Unrestricted route and traffic rights that would allow "the right to operate service between any point in the United States and any point in the European country, including no restrictions as to intermediate and beyond points, ... or the rights to carry fifth-freedom traffic[;]"
(4) Double-disapproval pricing in third and fourth-freedom markets (which would allow disapproval of tariffs originating out of one state only if the other state also assents to the disapproval as well);
(5) Liberal charter rules arrangements (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight);
And a number of very liberal allowances in areas such as cargo rights, reservations and booking, self-maintenance rights in foreign countries, monetary conversion, and free rights to capitalize on commercial opportunities associated with an air transport service. As to unrestricted route/traffic rights, an "open skies" agreement would allow an airline to carry traffic between any point in the country of origin and any point – intermediate, destination, or beyond – within the participating country. Such an arrangement would stand in direct contrast to the rigid pre-negotiated routings and carriage rights normally associated with bilateral agreements.
See Goo, *supra* note 18 at 551, quoted from Department of Transport, *Order Defining "Open Skies" and Requesting Comments*, Order 92-4-53, 57 Feb. Reg. 19323-01 (5 May 1992). Department of Transport, *Final Order Defining "Open Skies"*, Order 92-8-13, 1992 DOT Av. LEXIS 568 (5 August1992).
It is worth noting that the U.S incorporated many traditional elements of bilateral agreement into its open skies definition, but excluded the provisions on foreign investment and cabotage. The limitation is called "United States protectionist policy" and criticized in the future air transport negotiations.

Thus, the U.S. airlines were able to fly from anywhere in the U.S. territory to any point in the Netherlands. In addition, U.S. carriers received beyond rights to fly to other parts of Europe. Likewise, the Dutch flag-carrier, KLM, was allowed access to the huge U.S. market. In reality, the Americans expected to compel other European countries to enter into similar agreements. However, other European countries, especially some of the larger ones, such as the U.K., Italy, and France, preferred to slow down the plan of open skies.

Despite this situation, the process of U.S. open skies agreements was well underway with other countries. In the years that followed, eleven more European countries signed similar bilateral agreements with the U.S..[25] In 1995, an agreement with its trade partner, Canada, was concluded.[26] As to Central America, six countries finally accepted the U.S. offers after lengthy negotiations.[27] The most crucial achievement of U.S. open skies effort can be said to be the five open skies agreements concluded between the U.S. and five Asia-Pacific countries, namely Singapore, Taiwan, Brunei, Malaysia, and New Zealand. Meanwhile, another open skies negotiation with South

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[24] A liberal air transport bilateral agreement has existed between the United States and the Netherlands since 31 March 1978 as amendment of the Air Transport Agreement of 1957.

[25] Most of the agreements were signed in 1995: Austria, Denmark, Belgium, Finland, Luxembourg, Sweden, Iceland, Norway, and Switzerland. An agreement with Germany was reached in 1996. An agreement with the Czech Republic was signed in 1997.

[26] The agreement provides a three-year phase-in period to be implemented.

[27] Bilateral open skies agreements were signed between the governments of El Salvador, Guatemala, Nicaragua, Costa Rica, Panama, and Honduras and the government of the U.S. in 1997. See "Slater Sings Open Skies Agreements with Central American Countries" *Transport News* (2 June 1997).

Korea has been sparked.[28] By far, the only area where the U.S. has not achieved any concrete developments is in the Caribbean region.

Although U.S. deregulation has had critical influence on a global scale, it is not the single force driving the liberalization of international air transport.[29] We will briefly examine the open skies situation in various parts of the world hereunder.

B. European Community (EC)

In 1986, the Court of Justice of the European Community held that the European Economic Community's antitrust laws applied to civil aviation matters. One year later, the European Council passed the *Single European Act*,[30] which has been the most important development for the liberalization of air transport in the EC. To prepare for a single EC air transport market, the European Council took three steps to liberalize the air transport industry. The first step, in1987, was called the First Liberalization Package. The package called for scheduled intra-EC air services to adopt a series of measures toward wider third and fourth freedom routes access, more flexible pricing and capacity, free new entry into the market, automatic multiple designation and more fifth freedom traffic on scheduled intra-EC air services. It applied the antitrust rules of *EEC Treaty* to EC air transport, while granting block exemptions to EC air carriers in a number of fields.[31]

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[28] We will examine further details in the chapters which follow.

[29] We will address the Asia-Pacific region the later parts of this thesis.

[30] See *Single European Act*, 28 February 1986, 2 C.M.L.R. 741, 25 I.L.M. 506.

However, the first step towards liberalization "caused negligible effects on competition in the European Community and resulted in only slight reductions in air fares."[32] The second step, which was adopted and in force in 1990, deepened the liberalization granted in the first package by further relaxing tariffs, capacity sharing, and market access and further prepared the EC for an integrated aviation market.[33] In June 1992, the Council approved the third step of liberalization, which "effectively created a single EC airline market."[34] It introduced common rules for licensing airlines and lifted the restrictions on capacity, fares, and routing, giving the carriers third, fourth, fifth, even sixth and seventh freedoms.[35] From 1 January 1993, the real single aviation market was formulated, except that predatory or "dumping" pricing was not approved. However, stand-alone cabotage was only achieved on 1 April 1997. The three packages founded the non-boundary single aviation market and free competition network within the EC. EC liberalization became the most far-reaching multilateral open skies effort.

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[31] See EEC, *Council Regulation of 14 December 1987 on the Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices in the Air Transport Sector*, OJ Legislation (1987) No. 3976; EEC, *Council Regulation of 14 December 1987 Laying down the procedure for the Application of the Rules on Competition to Undertakings in the Air Transport Sector*, OJ Legislation (1987) No. 3975; EEC, *Council Decision of 14 December 1987 on the Sharing of Passenger Capacity between Air Carriers on Scheduled Air Services between Member States and on Access for Air Carriers to Scheduled Air-Service Routes between Member States*, OJ Legislation (1987) No. 602.

[32] S.M. Warner, "Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Non-citizens in Second Class" (1993) 43 Amer. Univ. L. Rev. at 296.

[33] See EEC, *Council Regulation of 24 July 1990 on Fares for Scheduled Air Services*, OJ Legislation (1990) No. 2342; EEC, *Council Regulation of 24 July 1990 on Access for Air Carriers to Scheduled Intra-Community Air Service Routes and on the Sharing of Passenger Capacity between Air Carriers on Scheduled Air Services between Member States*, OJ Legislation (1990) No. 2343.

[34] Warner, *supra* note 32 at 297.

C. Other Efforts

1. Latin America

Five members of the Andean Pact, Columbia, Venezuela, Peru, Bolivia and Ecuador, signed the *Cartagena Agreement* in 1969 in Caracas.[36] In 1991, the *Agreement* established a free trade zone for aviation on the sub-regional level. Decision 297 and its subsequent amendments – Decision 320 of June 1992 and Decision 360 of 1994 – liberalized third, fourth, and fifth freedom rights and applied a multiple designation system. A regime of complete freedom for non-scheduled cargo services was also adopted. Furthermore, all the air carriers in the region are regarded as national carriers, ignoring the rule of substantial ownership and effective control. The *Cartagena Agreement* is another successful example of regional liberalization.

Before signing the *Cartagena Agreement*, Colombia and Venezuela established an open skies regime between the two countries in July 1991. The parties exchange full third, fourth, and fifth freedom rights. However, tariffs have not been fully liberalized since they are subject to the "country origin" pricing system rather than double disapproval system. In addition, the agreement introduced "doing business" rights, such as self-handling, allowing parties to use their own staff to handle the services at airports.

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[35] See EEC, *Council Regulation of 23 July 1992 on Licensing of Air Carriers*, OJ Legislation (1992) No. 2407.

There were two new regional arrangements on international air services in 1996. In July, member States of the Caribbean Community (CARICOM) concluded a more liberal aviation multilateral agreement to boost healthy competition and enhance service quality and efficiency.[37] "In December, six States in South America, all members or associate members of the Mercosur trade area, concluded a sub-regional air services agreement to encourage third and fourth freedom services between cities which are not being served under bilateral agreements."[38] Nevertheless, the agreement is a first step to open the skies; all flights are still subject to strict official supervision of capacity, frequency and tariffs.

2. Africa

The African ministers of civil aviation reached the Yamoussoukro Declaration in 1988,[39] deciding to integrate air transport policy in three steps in order to establish a totally integrated air carrier and common external air policy. In spite of the existing barriers to this far-reaching plan, "States sought to increase cooperation in implementing the Yamoussoukro Declaration's provisions concerning liberalized traffic rights for African airlines, particularly at the sub-regional and regional levels."[40]

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[36] See H. Lapointe, *Regional Open Skies Agreements: Law and Practice* (LL.M. Thesis, Montreal: McGill University, 1995) at 72-73.

[37] See "Annual Civil Aviation Report" (1997) 52:6 ICAO J. 21.

[38] *Ibid.*

[39] See B. Nsang, *Africa and the Liberalization of the Air Transport Regulatory System* (Paris: ITA Press, 1990) at 99. See also "Annual Civil Aviation Report", *ibid.*.

[40] "Annual Civil Aviation Report", *ibid.*

In summary, by far, world-wide air transport regulation has stepped into a new era after nearly 50 years of development and evolution. Deregulation and liberalization of the air transport industry has become inevitable. Since the 1990s, open skies arrangements have emerged one after another, either by means of bilateral agreements or by multilateral agreements. However, bilateralism still retains its dominant status for international air transport regulation, although certain countries, especially the U.S. and some smaller countries with limited domestic aviation markets, advocate regionalism or global multilateralism. Even if there are few successful multilateral deals, countries pursuing open skies still need to deal with individual countries and to continue to work on bilateral agreements which consider the reality of States' various air transport policies. To understand the concept of open skies better, we will examine the major open skies elements in bilateral agreements.

CHAPTER 2

ESSENTIAL ELEMENTS OF BILATERAL OPEN SKIES AGREEMENT

I. Introduction

According to P.P.C. Haanappel, bilateral air transport agreements can be defined as "international trade in services agreements, whereby two sovereign nations regulate the performance of commercial air services between their respective territories, and beyond in many cases."[41] Bilateral agreements can be categorized into three groups: Bermuda-type agreements, predetermination or protectionist agreements, and liberal agreements.[42] After years of evolution, open skies agreements, a special kind of liberal agreement, emerged. Although no two bilateral open skies agreements are exactly alike, their backbone is uniform. Moreover, they venture beyond the traditional liberal agreement, leaving air transport operation entirely to market forces, without governmental intervention. ICAO defines an open skies agreement as:

> A type of agreement which, while not uniformly defined by its various advocates, would create a regulatory regime that relies chiefly on sustained market competition for the achievement of its air service goals and is largely or entirely devoid of a priori governmental management of access rights, capacity and pricing, and has safeguards appropriate to maintaining the minimum regulation necessary to achieve the goals of the agreement.[43]

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[41] P.P.C. Haanappel, *Government Regulation of Air Transport: Cases & Materials* (Montreal: IASL, McGill University, 1989) at 54 [hereinafter *Government Regulation*].

[42] See P.P.C. Haanappel, "The Implications of Open Skies Agreements at the Bilateral, Regional and Multilateral Levels" (Address, the International Conference on Air and Space Policy, Law and Industry for the 21st Century, Seoul, Korea, July 1997) [hereinafter "Implications of Open Skies Agreements"]. See also the discussions, *supra* Chapter 1.

[43] ICAO, *Manual on the Regulation of International Air Transport*, ICAO Doc. 9626 (1996) at 2.2-2 [hereinafter *Manual on the Regulation*].

In essence, the regulatory contents of bilateral open skies agreements focus on the reciprocally-exchanged "hard rights" and "soft rights". The so-called "hard rights" concern basic market access, including route rights, traffic rights, and operational rights. "Soft rights", also referred to as "doing business rights", are guarantees of fair competition in the marketplace. A detailed analysis and clarification of the various issues of market access, capacity, pricing, strategic alliance, fair competition, and some other regulatory concerns is provided below.

II. Market Access

A. Traffic Rights

1. The First Five Freedoms[44]

Whenever either of the parties of an open skies agreement is not a member of *IASTA*, the *Agreement* will automatically include the provision of the first and second technical freedoms. The third and fourth freedoms are considered as the primary objectives of an air transport service and have been exchanged in all traditional bilateral agreements, but strict restrictions on routes, capacity and frequency remain. Open skies agreements effectively remove the restrictions by allowing unlimited rights for the parties

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[44] The definitions of these five freedoms appear in Chapter 1.

to fly between any points in their home nation and any points in the territory of the other State party.

Fifth freedom rights are very controversial under the regulatory regime. The introduction of large seating capacity aircraft and long haul services has tremendously increased the demand for fifth freedom traffic rights. This right enables air carriers to pick up or put down passengers in the territory of another contracting party to/from the beyond or intermediate points in the third country,[45] thus making multi-stop services very economical. However, granting fifth freedom rights would inevitably constitute excessive competition to the other party's third and fourth freedom services to and from the third country, thus threatening its air carriers' operation interests. Therefore, fifth freedom rights were not included in post-Bermuda agreements.[46]

Pro-competitive open skies agreements call for no restrictions concerning intermediate and beyond rights, which means the complete grant of the fifth freedom. Air carriers of both parties may serve foreign countries from any points in their home country via any intermediate points and to any beyond points. With the advent of aviation deregulation, many carriers are developing international hub-spoke systems in order to increase efficiency. Such systems permit them to "comb" traffic flows from sub-routes (spoke) to a central point (hub), and transmit the traffic to other destinations. With fifth

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[45] The fifth freedom rights are called the "'third' country traffic 'en route'" as well.

[46] Fifth freedom rights were exchanged in Bermuda I because they were subject to the capacity principle. In accordance with this principle, the third and fourth freedom traffic were "trunk-line", thus, the capacity for the carriage of fifth freedom services seemed less important. In addition, aircraft in 1946 were only capable of relatively short-haul flights. See *Government Regulation*, *supra* note 41 at 248.

freedom rights, substantial access is ensured not only to key hub cities overseas, but also through and beyond them to numerous other cities in third countries. As such, the competitive field has been significantly expanded.

2. The Sixth Freedom Issue

The sixth freedom, which was not officially recognized in the *Chicago Convention* of 1944,[47] refers to the "right or privilege, in respect of scheduled international air services, of transporting, via the Home State of the carrier, traffic moving between two other States."[48] For example, if Singapore Airlines carries a passenger from New York to its hub airport, Changi International Airport, where the passenger transfers to another Singapore Airlines flight on which he travels to Manila, the airline is engaging in the carriage of sixth freedom traffic.

There is some controversy regarding the notion of the sixth freedom. Some States have considered it to be a special form of the fifth freedom, because neither the origin nor the destination of the traffic concerned is in the State of Registration. They argue that restrictions which apply to the fifth freedom should also apply to sixth freedom traffic. On the contrary, some other States that have ample opportunities to carry sixth freedom traffic, such the Netherlands and Singapore, as discussed above, view the sixth freedom as the combination of the third and fourth freedoms from two different countries. They

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[47] See *Convention on International Civil Aviation*, 7 December 1944, 15 O.N.T.S. 295, ICAO Doc. 7300/6 [hereinafter *Chicago Convention*].

believe that sixth freedom rights should not be subject to the restrictions that apply to fifth freedom rights. As such, they could more easily get sixth freedom traffic rights simply in accordance with the conditions for obtaining the third and fourth freedom rights. These conditions are obviously more flexible than those of fifth freedom rights. This issue has been discussed extensively in the academic arena. B. Cheng has pointed out that the sixth freedom is merely a combination of the third and fourth freedoms secured by the flag-state from two different countries, producing the same effect as the fifth freedom.[49]

It is not necessary to discuss extensively whether the sixth freedom is really the fifth freedom or a combination of the third and fourth freedoms under the open skies regime. In a traditional bilateral agreement, en route third country fifth freedom air traffic carriage is rather restrictive, while the basic exchange of third and fourth traffic rights is relatively easy to obtain. Most countries would rather regard the sixth freedom as the fifth freedom in order to protect their air carriers' economic interests. In this regard, parties of traditional bilateral agreements do not allow operations to/from points behind their home countries via their home countries to points in foreign countries to carry freely "sixth" freedom traffic.[50] Nevertheless, open skies calls for free competition, sharply departing from the tradition of specific routes, agreed services, and traffic restrictions based on the freedom category of traffic. Therefore, the bone of contention of the sixth freedom ceases

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[48] *Manual on the Regulation, supra* note 43 at 4.1-9.

[49] See B. Cheng, *The Law of International Air Transport* (London: Stevens & Sons Limited, 1962) at 13.

[50] See H.A. Wassenbergh, "The 'Sixth' Freedom Revisited" (1996) XXI:6 Air & Sp. L. 286.

to exist under the open skies regime because there are no restrictions on third, fourth, and fifth freedoms rights.

Sixth freedom rights are attractive for smaller States with geographical advantages, due to their limited domestic markets. They believe that exercising sixth freedom rights is the only way to gain more transit traffic via their home countries and to strengthen their air carriers, thus allowing them to survive free competition under these conditions. An airline's sixth freedom opportunities depend, to a large extent, upon the geographical position of its hub in relation to major flows of air traffic, ideally connecting traffic globally. The major airports of the small territory countries become the hubs of the air services of their designated carriers, enabling the airlines to attract a larger volume of traffic to and via their country.

The countries whose airlines have relatively good opportunities for sixth freedom traffic are those in Europe, the Middle East and the Far East.[51] In the case of the Netherlands, in spite of its small internal aviation market, its geographical advantage led to situations in which the Netherlands derived notable benefits from its agreement with the U.S.. Therefore, the Dutch flag carrier KLM was granted the right to fly behind and via its homeland to access the U.S. market in order to maximize its opportunities to carry connecting traffic. It is, therefore, not surprising that "[t]he Amsterdam airport has been kept as an international hub for air traffic to flow in, to and from the EEC."[52] Singapore is

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[51] See B. Graham, *Geography and Air Transport* (New York: John Wiley & Sons Ltd., 1995) at 80-81.

[52] H.A. Wassenbergh, *Principles and Practices in Air Transport Regulation* (Paris: ITA, 1993) at 93 [hereinafter *Principle and Practices*].

another State whose geographical situation promoted its liberal aviation policy and led it to become the first Asian country to sign an open skies agreement with the U.S. In the Singapore-U.S. open skies agreement, such sixth freedom exchange offers Singapore and the designated U.S. airline the opportunity to fly from a point or points behind and via the respective country and intermediate points to a point or points in the respective country and beyond.[53]

3. Cabotage – Eighth Freedom Rights

One may say that the exchange of cabotage rights (the eighth freedom rights) represents the zenith of the open skies regime. It grants carriers reciprocally full rights to provide air services in the other party's domestic market. Cabotage is usually categorized into two types: consecutive cabotage[54] and stand-alone cabotage.[55]

Despite the fact that an open skies regime demands the unlimited exchange of cabotage rights between two negotiating parties, it is still a highly contentious and delicate issue during bilateral negotiations. Almost all of the existing bilateral agreements

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[53] See *Air Transport Agreement Between the Government of the United States of America and the Government of the Republic of Singapore*, 8 April 1997, treaty is available in Office of the Assistant Secretary for Aviation & International Affairs of Department of Transportation of the United States, s. 1, ann. 1 [hereinafter *US – Singapore Agreement*].

[54] Consecutive cabotage can be defined as the exercise of traffic rights on a service constituting an extension of a service from or as a preliminary of a service to the State of registration of carrier. For example, if an air carrier from France flies between two points in Spain, the flight must originate in France. See S.M. Warner, "Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Non-citizens in Second Class" (1993) 43 the American U. L. Rev. 231 at 296.

[55] Stand-alone cabotage is defined as "A foreign carrier operates a domestic route in a foreign territory without connection to any of its international air services to and from the home base in its own country." *Principle and Practices, supra* note 52 at 110.

do not take into account the cabotage issue. To date, neither does the U.S. open skies initiative cover this concept, nor do most open skies agreements recently concluded. For example, the Canadian negotiator originally proposed a form of cabotage exchange to be included in its open skies agreement with the U.S., which was rejected by the U.S. due to latter's reluctance to open their lucrative domestic market to Canadian carriers. But for the multilateral aviation block, most typically the EC single aviation market, cabotage rights could be exchanged by using a phase-in period. According to the 1993 EC third package of airline liberalization, in 1 April 1997[56] the full cabotage meaning of both consecutive and stand-alone cabotage was permitted. This package enables EC carriers to access any EC members' internal air market.

There are several reasons for the difficulties concerning cabotage rights. The first reason is rooted in the second sentence of Article 7 of the *Chicago Convention*. It requires that the bilateral party countries grant cabotage rights on a non-exclusive basis, which is viewed to be a Most Favored Nation (MFN) clause.[57] Under this clause, "a nation that grants cabotage rights to one country would be obligated to grant cabotage rights to other nations demanding similar rights."[58] Thus, "it limits a sovereignty State's freedom when entering in agreements or arrangements concerning cabotage privileges, either as grantor or as grantee."[59] The exclusion of cabotage rights in open skies

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[56] See *supra* Chapter 1.

[57] See *Chicago Convention*, *supra* note 47, art. 7(2).

[58] Warner, *supra* note 54 at 315.

[59] M.C.G. Vilao, *Air Cabotage - Current Legal Issues* (LL.M. Thesis, Montreal: McGill University, 1991) at 26.

agreements can be attributed to three other concerns. First of all, most States consider that cabotage directly relates to their sovereignty and integrity. Second, they fear that allowing the access of foreign carriers would cause their airlines to lose their competitive advantage in their internal market. Finally, some States are reluctant to put a cabotage clause in agreements since they think that they will not benefit from such reciprocity if their counterpart has a small territory.

In reality, Article 7 should not constitute a barrier to the exchange of cabotage rights in open skies agreements. A more liberal interpretation of Article 7 could be applied, namely, "[t]wo nations may agree to grant cabotage rights to each other, provided than the agreement allows for the possibility that other nations may receive similar cabotage rights."[60] Regarding this point, P.M. de Leon makes an objective and realistic evaluation:

> It is suggested that the meaning of it (Article 7(2)) cannot be separated from its historical and political background. [...] There is no prohibition against the granting of an exclusive concession to another State, nor is there a duty to extend that concession to all other contracting states. It could be viewed as a provision, which is designed to prevent these exclusive concessions within a special, namely historical and political, context.[61]

Moreover, it appears that the MFN clause in Article 7 greatly contradicts the spirit of bilateral agreements – reciprocity between the two contracting parties.

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[60] Warner, *supra* note 54 at 315.

[61] P.M. de Leon, "Air Transport as a Service under the Chicago Convention: the Origins of Cabotage" (1994) XIX:II Ann. Air & Sp. L. 538.

It should be noted that the essence of an open skies regime is to surrender sovereignty to free competition. Without the exchange of cabotage rights, open skies agreements virtually become disabled agreements. States pursuing open skies agreements should be confident in their airlines' competitive ability and in the maturity of their air transport industry. For those States there is no longer a need to fear access of foreign carriers in the domestic market. In this regard, States could readily incorporate cabotage rights in open skies agreements subject to the requirements of ownership and control.

B. Airline Designation

The designation clause of open skies agreements routinely contain the following provisions:

(1) multiple designation; and

(2) substantial ownership and effective control.

1. Multiple Designation

Traditional bilateral agreements provide for a strict designation system, which allows each nation to choose limited carriers (usually just one carrier) to perform air services on the designated routes. Under a multiple designation system, the contracting party shall have the right to designate in writing to the other contracting party as many airlines as it wishes to conduct international air transportation on the specified routes. The other party shall grant the appropriate authorizations and permissions with minimal

procedural delay.[62] According to H.A. Wassenbergh, "as the deregulation brings free competition in the international air traffic market, no longer was a 'designation' the key for an air carrier to enter the international air traffic market place, but simply having a 'safety' authority and an 'economic' authority became sufficient."[63] For example, the U.S. DOT applies "fit, willing and able" criterion to investigate the qualifications of its applicants. The U.S. DOT considers an applicant air carrier to be "fit" if it has the managerial skills and the technical ability to conduct the proposed operations. In addition, it should have access to sufficient financial resources not to pose a risk to consumers and be willing to comply with the applicable regulations. Finally, the applicant must be a U.S. citizen.[64]

Multiple designation opened the question of whether the doctrine of "the more the merrier" applies to airline designation. In essence, free flight in the market by any qualified carrier promotes free competition, which indeed benefits consumers. However, dumping airlines in the aviation market will lead to unhealthy competition and, therefore, waste resources and eventually impair the consumer. H.A. Wassenbergh proposed that, in order to justify the actual entry into the market of a new competitor, that there might be a need to regulate the competition by limiting the designation to what the traffic can bear.[65]

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[62] See *Air Transport Agreement between the Government of the United States of America and the Government of Malaysia*, 21 June 1997, treaty is available in Office of the Assistant Secretary for Aviation & International Affairs of Department of Transportation of the United States, art. 3.

[63] H.A. Wassenbergh, "The Regulation of Market Entry" (2 November 1996) [unpublished] [hereinafter "The Regulation of Market Entry"].

[64] See DOT Order 96-2-28, Docket OST 95-585/586 (16 February 1996) for applications of Sun Pacific International Inc.

[65] See "The Regulation of Market Entry", *supra* note 63 at 3.

2. Substantial Ownership and Effective Control

The issue of substantial ownership and effective control is perhaps the most delicate when negotiating a bilateral agreement. The first question is what constitutes "substantial" and "effective". The "substantial" issue is legislated by each State's national law. States are generally concerned about the proportion of the airline's equity, in other word, the extent of foreign ownership. They usually consider that control of more than 50 per cent of the equity in an air carrier constitutes "substantial ownership". For example, the "Dutch Royal Decree of 1970 states that licenses will generally only be granted to Netherlands companies which have demonstrated that *the majority of the capital* and the actual management are in the hands of Dutch nationals."[66] However, the issue of "effective control" cannot be resolved purely in terms of a particular ownership share. For instance, the European Commission decided that Air France had effective control of Sabena, even though it had acquired only 37.5 per cent of the shares, and imposed strict conditions before granting approval.[67] Briefly,

> Most states rely on a case-by-case approach, using either the applicable national laws and regulations concerning corporate responsibility for decision making; or special laws, regulations and policies specifically related to determining who exercises control of air carriers, or a combination of the two.[68]

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[66] H.P. Van Fenema, "Substantial Ownership and Effective Control as Airpolitical Criteria" in T.L. Masson-Zwaan & P.M. de Leon, eds., *Air and Space Law: De Lege Ferenda – Essays in Honor of H.A. Wassenbergh* (Dordrecht: Martinus Nijhoff, 1992) at 27.

[67] See A. Dikkerboom, *Nationality of Aircraft and Nationality of Airlines in the Perspective of Globalization* (LL.M. Thesis, Montreal: McGill University, 1994) at 69.

So far, even though there are several exceptions to the bilateral criteria of national ownership and effective control,[69] a nationality clause is important when negotiating bilateral agreements because liberalization of this provision would lead to increased airline alliances, which may diminish the significance of bilateral treaties. Even in some recently reached open skies agreements, the clauses concerning substantial ownership and effective control seem strict. Contracting States continue to protect their domestic air carriers from meaningful third country investment and control. For instance, Article 3 of the open skies agreement between Singapore and the U.S. states:

> The other contracting party shall grant appropriate authorizations and permissions with minimal procedural delay, *provided* that substantial ownership and effective control of that airline are vested in the contracting party designating the airline, nationals of the contracting party (which may include natural or legal persons), or both.[70]

In other words, each contracting party has the right to refuse to license or to impose conditions on a designated airline of the other party if it is not satisfied that such a carrier is substantially owned and effectively controlled by the designating State or its nationals.

It is worth noting that the *Germany – U.S. Aviation Agreement* reached on 23 May 1996 includes a supplementary clause to the designation provision, namely, a waiver of

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[68] *Manual on the Regulation, supra* note 43 at 4.4-2.

[69] For example, some airlines (Gulf Air, Air Afrique, SAS, LIAT) with multinational ownership may be designated as the "national" carrier by a number of States and accepted as such by countries with which they have bilateral relation.

[70] *U.S. – Singapore Agreement, supra* note 53, art. 3(2).

objection to certain ownership interests.[71] While negotiating, Germany sought analogous treatment for German investments in third-country airlines. The text of this provision contains a reciprocal waiver by Germany and the U.S. of their right to object, under bilateral agreements with third countries, to ownership interests of less than 50 per cent by nationals of the other party solely on the basis that that ownership interests constitutes control or effective control. However, it is important to bear in mind that this limited waiver applies under two specific conditions:

(1) the third state permits airlines of both parties to invest in its airlines on an equal basis up to 50 per cent; and

(2) both parties have open skies agreements or the equivalents thereof with the third state.[72]

It is apparent that the U.S. and Germany intended to emphasize the need for open skies agreements before allowing foreign ownership liberalization to take place.

One may say that national rules regarding ownership and control of airlines will inevitably be relaxed in the future. To date, several possible changes to the ownership and control criteria for carrier designation have been proposed.[73] The supporters deem that

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[71] See *Protocol between the Government of the United States of America and the Government of the Federal Republic of Germany to Amend the Air Transport Agreement*, 7July 1955, 23 May 1996, treaty is available in D. Bartkowski, "Forty Years of U.S. – German Aviation Relations" [January 1997] 46 ZLW 33-45, art. 1(3).

[72] See *Ibid.* at 30-31.

[73] The first one is allowing designation of airlines even if up to 49 per cent is owned by nationals who are not from the designating State. In the second one, a State could designate any carrier, which is substantially owned or effectively controlled by nationals of any State that are parties to a common market access agreement. Finally, a State could designate any airline whose headquarters, administration or principal place of business is in the designating State regardless of who are the beneficial owners. See R. Doganis, "Relaxing Airline Ownership and Investment Rules" (1996) XXI: 6 Air & Sp. L. at 269-270.

these criteria are more appropriate when a regime of open skies and free market conditions applies. However, it should be born in mind that some aspects of the proposals are more appropriate for a global multilateral or regional regime. In regard to the bilateral system, nationality control will be relaxed, but will never be abolished during bilateral negotiations. The reason for this is simple: nationality control ensures that each State gets its own share, with no third party being able to benefit from bilateral exchanges of rights between States.[74]

III. Capacity and Pricing

A. Capacity

Open skies agreements allow free-determined capacity. Air carriers can freely decide types of aircraft to be used, frequency of services, and in some cases, number of seats based on statistics for existing traffic and on reasonable estimates for future traffic. This method relies on the principle of market forces rather than government regulation, opening the door wide for fair competition between the designated airlines and, thus, benefiting the consumer.

However, regulation has not been abolished, but has switched from the predetermination of capacity by governments to the protection of free competition and the most efficient use of resources. Under competitive pressure, the airlines view capacity

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[74] See H.A. Wassenbergh, "The Regulation of State-aid in International Air Transport" (Address, International Seminar on International Air Transport, Taipei, Taiwan, 28 June 1997) at 3 [hereinafter "Regulation of State-aid"].

as an essential means to extend or maintain market shares. It is quite possible for one airline to operate at a larger capacity than another, or at least to match the other's capacity. Excessive competition of this kind may easily lead to capacity dumping. Moreover, excessive capacity causes a waste of resources and an imbalance in the airline's financial statement. In view of this unhealthy trend, ICAO recently issued a guideline for determining capacity which encourages the development and expansion of air transport on a sound economic basis and in the public interest. The guideline further states that contracting parties expect that market forces will result in capacity offerings at a level which will assure a reasonable economic return to the carriers and avoid the "dumping" of capacity. Finally, it emphasizes that capacity should be consistent with airport traffic and airway capacity.[75]

B. Pricing

When establishing prices, market forces will be the primary consideration in open skies agreements. Designated airlines are free to establish tariffs based upon commercial considerations in the marketplace. Furthermore, carriers are not required to file their routine tariffs with their governments. There are two types of liberalized pricing clauses: the "county of origin" and "double disapproval".

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[75] See ICAO, *Regulation of Capacity in International Air Transport Services, Policy and Guidance Material on the Regulation of International Air Transport*, ICAO Doc. 9587 (1995) at 20-21 [hereinafter *Regulation of Capacity*].

The country of origin clause is not as liberal as double disapproval clause because it allows governments to control a certain degree of price fixing in their own territories. "The tariffs of foreign air carriers may be disapproved by the aeronautical authorities of the country where the air transportation commences, either on a one-way or roundtrip basis."[76] Some open skies agreements apply this rule to pricing establishment. The *Colombia-Venezuela Bilateral Agreement* stipulates that until an agreement to establish a common tariff policy is reached, designated airlines must comply with the regulations of each of the contracting States for flights originating in their territories.[77]

The double disapproval regime is the most liberal method of determining prices. Under this provision,

> [p]rices proposed to be charged or charged by airlines come into force or remain in force automatically, unless, after notification of dissatisfaction and intergovernmental consultations, they are disapproved by the aeronautical authorities of both contracting parties.[78]

This regime gives price-leadership to the designated air carriers of both parties, but the adoption of applicable competition law is inevitable where it is necessary for:

> (1) prevention of unreasonably discriminatory prices or practices; (2) protection of consumers from prices that are unreasonably high or restrictive due to the abuse of a dominant position; and (3) protection of airlines from prices that are artificially low due to direct or indirect governmental subsidy or support.[79]

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[76] *Pricing and Capacity, supra* note 5 at 151.

[77] See *Air Transport Agreement between the Republic of Venezuela and the Republic of Colombia,* 7 July 1991, ICAO Registration No. 5682, art. 90 (1).

[78] *Pricing and Capacity, supra* note 5 at 148.

[79] *Air Transport Agreement between the Government of the United States of America and the Government of New Zealand,* 18 June 1997, treaty is available in Office of the Assistant Secretary for Aviation &

IV. Strategic Alliance

In open skies agreements, a clause usually provides that any designated airline of one Party, in operating or holding out the authorized services on the agreed routes, may enter into cooperative marketing arrangements, such as block spacing,[80] code-sharing[81] (in practice, block spacing is often combined with code-sharing) or leasing arrangements[82] with any air carrier of the other Party and/or the third country carrier, in the event that such arrangements are also authorized between the third country and the contracting Parties.[83] This clause is viewed by P.P.C. Hanaappel to be the special feature which distinguishes open skies agreements from earlier liberal agreements.[84]

International Affairs of Department of Transportation of the United States, art. 12(1) [hereinafter *U.S. – New Zealand Agreement*].

[80] "Block spacing is defined to be a kind of partial 'wet' lease. One airline allocates to another a number of seats on some of its flights, other airline then sells these seats to the travelling public through its own marketing and distribution system." P. Hanlon, *Global Airlines* (Birmingham: Butterworth Heinemann, 1996) at 100.

[81] Code-sharing is defined as: "A commercial arrangement between two airlines under which an airline operating a service allows another airline to offer that service to the travelling public under its own flight designator code, even though it does not operate the service." *Ibid.*, at 101. With the advent of computer reservation system (CRS), code-shared flights are treated by CRS to be on-line connections instead of inter-line connections. Carriers can gain screen preference on CRS by on-line connections.

[82] Leasing is classified into "dry-lease" and "wet-lease". "Dry-lease" is to lease the aircraft of the first air carrier as from the connecting point but without the crew of the first air carrier, resulting in a seamless through-connection. In such case both air carriers still "operate" their own route, the lessee providing the crew in the leased aircraft. In "wet-lease", the second air carrier leasing the aircraft of the first air carrier with the crew of the lessor, the wet-leased aircraft may not carry traffic for which carriage the lessor has no traffic rights. See H.A. Wassenbergh, "Franchising and Code-sharing in International Air Transport" (Address, the International Conference on Air and Space Policy, Law and Industry for the 21st Century, 23-25 June, 1997, Seoul, Korea) [hereinafter "Franchising and Code-sharing"].

[83] For example, *U.S. – Singapore Agreement*, *supra* note 53, art. 8(7).

[84] See "Implications on Open Skies Agreements, *supra* note 42 at 2.

There are several advantages regarding this liberal provision. First, these cooperative arrangements have pro-competitive effects. In traditional bilateral agreements, designated air carriers are strictly limited to defined capacity and traffic rights, so an airline alliance is usually regarded as being related to the possession of traffic rights or is treated as a quasi-traffic right. These legal points are especially demonstrated by the contracting parties where they concern third-country code-sharing to and from their cities. In an open skies regime, this view is difficult to accept, since alliances increase sale opportunities and market shares rather than extend traffic rights of air carriers having no operating rights on new routes or route sectors.[85] In open skies agreements, market cooperation is considered as a marketing tool, which introduces more services to consumers by means of allowing foreign carriers to serve more destinations and frequencies. It is obvious that such a co-operative commercial arrangement has departed from the strict philosophy of a reciprocal exchange of economic privileges and, therefore, promotes free competition.

The second advantage concerns passengers. First, consumers have more choices of services introduced by such arrangements. Second, a strategic alliance facilitates the provision of higher quality services in terms of more convenient connections, single check-ins, baggage transfers,[86] transferable bonuses in frequent flyer programs and so on.[87] It may also have the effect of reducing through fares.[88] The final advantage, namely,

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[85] See "Franchising and Code-sharing", *supra* note 82 at 5.

[86] It enables passengers' baggage to be transferred at each stop all the way through to their final destination with only a single check-in. Passengers do not need to make long stop-overs between connecting flights.

commercial arrangements favor air carriers because they enable the airlines to expand their services under the present route system without expanding their facilities.

In spite of the advantages of strategic alliances, three legal concerns must be mentioned. The first relates to anti-competition potential. As the co-operative parties are actual or potential competitors, marketing co-operation may eliminate existing and future airline competition. Consequently, strategic alliances need to be examined under applicable antitrust and competition laws. For instance, the U.S. DOT did not grant anti-trust immunity to the commercial marketing agreement between KLM and Northwest (NW) until after initial considerations of possible lost competition. It based its decision on the fact that the agreement would "benefit the public with better service and cost savings".

The second issue is respect of consumer protection. Controversy always exists concerning marketing arrangements since passengers are not fully aware of the real meanings of such cooperation and do not know who the real operator of the flight on which they are travelling actually is. Therefore, it may appear that it is deceptive to the consumer if he takes a flight that is not what he chose when he bought the ticket, particularly, in the case of code-sharing. In reality, commercial cooperation does not inherently have a deceptive nature. The most fundamental issue is to take the necessary measures to disclose the connection between the operating carrier and the grantor. In this

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[87] "Seamless travel" is the perfect word to be used to describe such convenience, especially in connection with "common product" code-sharing.

[88] See Hanlon, *supra* note 80 at 105.

regard, "the U.S. DOT issued *a Notice of Proposed Rulemaking* that would require ticket agents and air carriers to give reasonable and timely written notice to passengers of the transporting carrier's identity at the time of sale, and possibly also to mention this on the first flight coupon."[89]

The last question concerns the third country commercial arrangement, which is normally prevented in bilateral agreements. This consideration depends on the effect of a third country alliance on capacity and frequency restrictions. However, a third country alliance is permitted in open skies agreements on the condition that such third countries are fairly liberal in granting permission for commercial cooperation to the two contracting Parties.

V. Fair Competition

A. Computer Reservation System (CRS)

CRS issue was the direct result of aviation deregulation. With the removal of constraints on route entry and tariffs, travelers faced a number of options in terms of carriers, routes and fares rather than relying on the limited air services provided by a single airline. The most efficient way for customers to access information is via CRS, that is to say, their decisions rely on major CRS owners. This situation promoted two competitive practices. First, CRS owners would program the computer in order to have

their flight service listed on the first screen page, even at the top of the page so as to bias the selection of flights. As a result, a competitor's flights often appeared on a later screen page than those of CRS owner. Second, the CRS owner would charge higher prices for services provided to their competitors. These two discriminatory concerns "involve rules preventing use of carrier-owned reservations systems in the foreign country and denying the foreign carrier access to and fair display in the CRS in the host nation."[90]

In an open skies agreement, both parties recognize that both parties' airlines have a fair and equal opportunity to compete. Competitive opportunities are represented by the quality of information for airline services available to travel agents and the ability of an airline to offer those agents competitive CRS. Hence, one Party should ensure that the CRS operating in its territory will have integrated primary displays, meaning that information concerning international air services shall be edited, based on non-discriminatory and objective criteria, and comprehensively demonstrated without any deletion.[91] In addition, both parties shall require that each CRS vendor operating in its territory charge all airlines non-discriminatory fees to participate in its CRS in order that each party's airlines receive non-discriminatory treatment from the CRS in the territory of the other Party.

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[89] J. Balfour, "Airline Mergers and Marketing Alliances - Legal Constraints" (1995) XX:3 Air & Sp. L. 117.

[90] A.L. Schless, "Open Skies: Loosening the Protectionist Grip on International Civil Aviation" (1994) VIII Ann. Air & Sp. L. 449 – 450.

[91] Code-sharing and change of gauge flight should be clearly identified.

B. Self-handling

Although there is no formal, official definition, ground handling is generally understood to broadly "include services necessary for an aircraft's arrival at, and departure from, an airport but to exclude those provided by air traffic control,"[92] including the handling of passenger, baggage and cargo. These services may be furnished by the airport operator, an independent handling company or by the third party air carrier. Self-handling is prevented in most cases due to the fear of competition. No doubt, the exclusion of any competition has a deleterious effect on efficiency and results in unreasonably high prices.[93] In some cases, "ground-handling charges at airports with no competition are more than two times higher than charges at the few liberalized airports."[94] Open skies agreements allow the designated airline to perform its own ground-handling in the territory of the other Party or select among competing agents for such services in whole or in part. These rights shall be subject only to physical constraints resulting from considerations of airport safety.[95]

C. Slot Allocation

An airport slot is usually defined as one take-off from or landing at an airport runway. With deregulation, airports have become an increasingly congested and scarce

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[92] *Manual on the Regulation, supra* note 43 at 4.7-1.

[93] See W. Deselaers, "Liberalization of Ground Handling Services at Community Airports" (1996) XXI:6 Air & Sp. L. 260.

[94] *Ibid.*

resource. Multiple designation, unlimited capacity and traffic rights, and the hub-spoke route system are the direct reasons for such congestion at airports. Slot problems have become more acute at certain major or hub airports. Under such circumstances, it is quite possible for individual airlines to get dominant positions in the airport slots, particularly in international hub airports. The dominant airline – usually an air carrier of the State where the airport is situated – intends to expand its exclusive traffic and block new entry, in particular for competitive rivals. Blocking new entry to the airport facility renders it difficult for designated carriers to exercise their hard rights and, consequently, this becomes a barrier to fair competition. Hence, to guarantee traffic rights and promote fair competition, open skies agreements have a fair slot allocation clause.[96] Such allocation is based on non-discriminatory treatment, including a "use it or lose it" rule.

D. Other Provisions

Open skies agreements grant to the designated airlines "doing business rights". The airlines have the right to establish offices in the territory of the other Party for the promotion and sale of air transportation. They are also entitled to bring in or maintain the personnel required for the provision of air transportation and to sell air transportation directly in the other Party's territory.

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[95] See *U.S. – New Zealand Agreement, supra* note 79, art. 8(3).

[96] The Air Transport Agreement between Canada and the U.S. gives a quite detailed provision on slot allocation. See *Air Transport Agreement between the Government of Canada and the Government of the United States of America*, 24 February 1995, ICAO Reg. 3770, ann. 2.

Other provisions concern the sale of air transportation in the territory of the other Party directly in the currency of that territory or in freely convertible currencies. Moreover, conversion and remittance of earnings as well as payment in the local currency are permitted without any restrictions on the carriers' ability to convert their earnings into hard currency. Finally, airlines are permitted to pay for local expenses, including purchases of fuel, without discrimination.

IV. Other Regulatory Elements

Open skies agreements generally concern charter flights. Charter flights are characterized by their flexible schedules and low prices, constituting competition with scheduled air services. States generally consider that charter flights affect the commercial profits of the scheduled flights, and thus, impose restrictions on them, such as marketing control, geographical and route restrictions, capacity and price control. Under the liberal regime, airlines of contracting parties have the right to carry international charter traffic of passengers and cargo, separately or in combination, between any points within each other's territory. They can also serve points between one Party and a third country subject to certain conditions.

Most governments traditionally regard air cargo as part of passenger air services, so restrictions which apply to passenger services automatically also apply to cargo services in respect of traffic rights, routes, and capacity. Most open skies agreements partially release the restriction on cargo services, providing that all-cargo services are permitted at any point or points between the contracting Parties.

CHAPTER 3

AIR TRANSPORT REGULATORY REFORM IN THE ASIA-PACIFIC REGION

I. Introduction

"The Asia-Pacific region encompasses an enormous segment of the earth's surface. It extends 16,000 kilometers from Afghanistan in the west to Tahiti in the east and more than 11,000 kilometers from Mongolia in the north to the furthest tip of New Zealand in the south."[97] This region covers one-fifth of the world's total area and includes almost 50%of the world's population. "With an expected annual growth rate of passenger-kilometers of 8.5%, both for scheduled services and international scheduled services, from 1992 to 2003, the Asia-Pacific region will be the fastest growing region of the world in the field of air transport."[98]

Airline deregulation and air transport liberalization have developed in certain parts of the world. An open skies phenomenon is very likely to become the global trend in international air transportation. In the case of the Asia-Pacific, with the growing importance of the region to global air transport, it is worth examining the impact of such a trend on Asia-Pacific air transport. In this chapter we analyze the reasons why Asia-Pacific air transport is subject to the same forces of liberalization and privatization that are restructuring the air transport industry world-wide while taking into account the

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[97] Graham, *supra* note 51 at 182.

[98] ICAO News Release, PIO 10/94 (October 1994), data drawn from ICAO, *Outlook for Air Transport to the Year 2003*, AT Conf/4 (15 November 1994).

region's economic development, tourism boom, demographic factors, and external pressures from the U.S. and Europe. Then, we discuss the reasons why bilateral open skies agreements should be used by Asia-Pacific countries in liberalizing their international air transport.

II. Air Transport Liberalization

A. Factors Promoting Liberalization

In Asia-Pacific, air transport has long been regarded as a special economic activity with its own regulatory system, particularly in that all States relate air space to their sovereignty and national security. "This is because of the region's affinity to particular political, legal, economic and trade regimes, as well as other considerations of ideology, national prestige, diplomatic necessity, security and the protection of national carriers."[99] These elements of geopolitics were the long-lasting results of strict regulation of the air transport system in the region following the Second World War.

After the cold war ended, economic interests came to the forefront of international relations. Market economy principles have progressed rapidly to the dogma of the planned economy. Free trade and fair competition are prevalent concepts insofar as economic activity is concerned. Asia-Pacific countries have been quick to recognize their

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[99] C. Cheng, "Deregulation for Third Country's Air Traffic in the East Asian Region". (Article, International Seminar on International Air Transport, Soochow University, Taipei, Taiwan, 28 June 1997) at 2.

advantages and benefits and have taken considerable strides to liberalize their aviation policies and to release the control of pricing, capacity and frequency to keep with regulatory features of the economy as a whole. The decisive factors influencing the movement towards liberalization are as follows:

1. Economic Development and Booming Tourism

The economies in the Asia-Pacific region experienced strong growth from 1980 to 1994. "The region's economies grew in real terms at an average of 4.4 per cent per year, compared to an average annual growth in North American of 2.6 per cent. Economic growth was 6.1 per cent in 1991, 8.1 per cent in 1992, 8.4 per cent in 1993, 8.2 per cent in 1994 and 7.3 per cent in 1995."[100] Japan is no doubt the most developed industrialized country in the world, whose economy accounts for about one-half of the region's economy. The four so-called tiger countries or NIC (Newly Industrialized Countries), South Korea, Singapore, Taiwan and Hong Kong, which is now a part of China, dominate economic growth statistics. China, as the largest territory country in this area, also emerged strongly with the highest growth rate in Gross National Product (GNP) per capita. Economic development boosted the Asia-Pacific countries' export-oriented policy, thus increasing the volume of export trade, which means an increased demand for commercial travel and cargo transportation.[101]

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[100] ICAO, *Report of the Asia/Pacific Area Traffic Forecasting Group: sixth meeting*, Bangkok, 20-29 May 1996, ICAO Doc. 9687 (1996) at 1 [hereinafter *Report of APA TFG*].

The increase in the per capita income caused a boom in the travel industry. For example, "[a]round 1985, about 5m (million) Japanese traveled overseas. This number rose to 10m (million) in 1990, a total which is estimated to double by 2000."[102] This growth is obviously driven by a greater disposable income. More and more people in Asia have extra money available for overseas travel. On the other hand, Asia-Pacific is attracting, as a highly desirable travel destination, enormous numbers of tourists and over 80 per cent of them arrive by air.

The rapidly developing national economies, booming tourism and large population accelerated the growth of the aviation market. Passenger traffic is expected to continue to have the highest rate of growth. According to recent forecasts by ICAO's Asia-Pacific Area Traffic Forecasting Group, "air passenger travel within the region is expected to grow by about 6 per cent yearly and by 7 per cent across the Pacific."[103] "By 2010, international travel to, from and within the Asia-Pacific region will represent 51 per cent of the world total, or 375 million travelers."[104] The Asia-Pacific region has also achieved the fastest rate of air cargo traffic growth of any region in the world. In 1992, air cargo traffic within the region reached 18.43 billion tonne-kilometers.[105] If we examine the busiest international routes, seven of the top ten are in Asia. Hong Kong –

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[101] See C. Cheng, *Highways of Air and Space over Asia* (Dordrecht: Martinus Nijhoff Publishers, 1992) at 37-39 [hereinafter *Highways*].

[102] D. Eddington, "A Bright Future for Asian Aviation?" [June 1994] Aerospace 8.

[103] *Report of APA TFG, supra* note 100 at 10.

[104] K. Nagata, "A Time of Change in the Asia/Pacific region" [February 1994] IATA Rev. 13.

[105] See K. Kyoto, "International Air Transport in the Asia and Pacific Region: Present and Future" (Article, Regional Cooperation Forum for International Air Transport in Asia and Oceania, Japan, 31 January-1 February 1996.

Taipei is the busiest; a route on which Cathay operates 12 TriStars or 747s a day, with the competition using just as many.[106]

The dynamic and exponential growth of air transport is both the cause and the effect of economic and tourism development in Asia-Pacific. Air transport has played a vitally important role in the growth of tourism in Asia-Pacific, which in turn affects the national economy. Asia-Pacific countries have come to realize that liberalization of their air transport policies keeps pace with economic development, and, if aviation policies restrict the numbers of foreign tourists coming to their country, the overall effects on its economic development are likely to be harmful. Moreover, since national carriers have been unable to handle the increased number of outbound passengers, aviation authorities are forced to lift the restrictions on air carrier designation. Reform is desirable in order to achieve increased gains from trade in aviation services. "It will enable travelers to have access to lower cost services and more cost competitive airlines to gain a greater share of the traffic."[107]

2. External Pressure

Asia-Pacific countries have faced an ever-increasing external pressure from Western countries to deregulate, most notably by the U.S. and Europe. Since 1978, the U.S. has abandoned its restrictive regime and has extended its new open skies regime to

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[106] See Eddington, *supra* note 102 at 8.

the international aviation market. The EC also took three steps to gradually formulate an aviation-integrated package. In April 1997, the integrated EC aviation market was established.[108] Due to this situation, the aviation markets in North America and Europe have become quite saturated and increasingly competitive. U.S. airlines have few profitable routes at home to provide the basis for future growth. In addition, Western carriers were hit hard by the recession in the late 1980s and early 1990s.[109] Therefore, Asia-Pacific, in their eyes, is an attractive and ideal market, which offers them growth and increased profit opportunities. Consequently, many Western, especially U.S. carriers are cager to gain access to Asia-Pacific, particularly Asia, and they have been attempting to gain a foothold in the promising region.

To meet the demands of its airlines, the U.S. has placed a new emphasis on reaching open skies accords in the closed aviation market of the Asia-Pacific region. U.S. officials say "open skies initiatives are humming along around the world, and they expect the rest of Europe and key parts of Asia to eventually fall neatly, if not quickly, into place."[110] According to Mark Gerchick, the DOT's Deputy Assistant Secretary for aviation and international affairs, "without the DOT's new focus on Asia-Pacific, the U.S. would miss the opportunity to take advantage of this region's growth."[111] With this

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[107] M. Samuel, C. Pindlay & P. Forsyth, "International Aviation Problems and Responses: An Asian Pacific Perspective" (1994) XIX: 2 Air and Sp. L. 171.

[108] See more details in *supra* Chapter 1.

[109] See G.C. Hufbauer & C. *Findlay, Flying High – Liberalizing Civil Aviation in the Asia Pacific* (Washington: Institute for International Economics, 1996) at 18.

[110] "U.S. Airlines' Prospects Are Grim on Expanding Access to Asian Skies" *Wall Street Journal* (25 September 1996).

[111] "U.S. Woos Five Open Skies Prospects in Asia-Pacific" *Aviation Daily* (21 November 1996) at 305.

new policy, the U.S. plans to take gradual steps to set up a series of open skies agreements with Asia-Pacific countries, in particular, with the South-East and East Asian countries.

Stiffer competition cannot be avoided under such circumstances. Asia-Pacific countries are feeling the pressure and have to consider how to ready themselves to face new challenges from North America and Europe and, accordingly, to formulate their own policy of deregulation and liberalization to compete with foreign carriers in the Asia-Pacific market.

With all the above-mentioned factors in mind, it is impossible for the Asia-Pacific countries to resist the trend of liberalization and open skies, not only from the Western world but also directly from domestic enterprises.

B. The Situation of Liberalization

In response to the trend of liberalization, most countries in this region have taken steps of varying degrees to liberalize both domestic and international air transport.

As concerns domestic aviation, one of the most significant deregulation approaches has been the airline privatization. Many airlines in the Asia-Pacific region were founded during the 1950s when their countries became independent and needed airlines as national instruments to carry out their policies for trade and tourism. Thus,

most of these airlines were government-owned or controlled.[112] However, beginning in the 1990s, governments in this region began to realize that private ownership of air carriers would enable their operations to be more efficient and more responsive to constantly changing demands in the marketplace, thus benefiting consumers and making the airlines more competitive internationally. Consequently, the Asia-Pacific countries, like others all over the world, have cut back on subsidies to their airlines in order to accelerate airline privatization (*i.e.*, the total privatization of Japan Airlines, Korean Air, China Airlines and the Philippine Airlines, and the partial privatization of Thai International, Garuda Indonesia and Malaysian Airlines.)[113]

The second fundamental reform has been to license new carriers to operate on international routes and to release restrictions on air carriers, due to the increasing amount of travelers and routes. The purpose is to allow more airlines to operate on domestic and international routes. It is believed that this reform will meet the booming tourism demands and boost competition, thus benefiting consumers. A number of large carriers with predominantly domestic operations have been permitted to operate extensive international routes in competition with national carriers. In Japan, All Nippon Airways, previously a domestic carrier, has began international scheduled operations. In China, the Civil Aviation Administration of China (CAAC) approved the operation of 45 domestic air carriers by 1996, which is almost eight times more than the six carriers

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[112] See Nagata, *supra* note 104 at 13.

[113] The Thai Cabinet has approved in principle to exclude Thai Airways International from the Government's State Enterprises Regulations to allow it to compete more effectively. The Cabinet has also asked the Transport and the Finance Ministries to study whether Thai Airways International should be

in 1989. Besides the increased number of carriers on international routes, new entries were also introduced into the domestic competitive field. Since the late 1980s the Australian government has relaxed air transport regulation, allowing Qantas to operate in the domestic market.

Apart from those considerations mentioned above, policies concerning restrictions on capacity, frequency, and route operating rights were also revised. Determinations of those concerns are to be based on the market-oriented principle of supply and demand.[114]

As to international air transport, particularly trans-Pacific air services, Asia-Pacific countries have realized that old bilateral restrictions were an encumbrance, preventing them from accessing international aviation markets, and foreign air carriers carrying inbound travelers from entering the country. Some countries have announced their full or limited liberal policies. A series of new liberal bilateral agreements have been reached between Asia-Pacific countries and the U.S. within the framework of bilateral trade negotiations. There is no reason to suppose that Asia-Pacific countries will not benefit from a more liberal and efficient international civil aviation market. For instance, Indonesia introduced a limited open skies policy in a move aimed at boosting inbound visitors to seven million a year by the end of the decade. To achieve this ambitious visitor target, Indonesia has encouraged more foreign airlines to serve the

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pushed to achieve a higher level of privatization. See "Asian Aviation" Oct. 1996 at 7 from *Bangkok Post* (25 September 1996). See also *Highways, supra* note 101 at 38.

[114] See *Highways, ibid.* at 38.

country.[115] Since Thailand announced its open skies bilateral policy in 1989, the number of scheduled airlines serving Bangkok increased three times from 1989 to 1994. This more liberal aviation policy has produced a substantial increase in tourists to Thailand.[116] In addition, Singapore, South Korea and Taiwan also announced their open skies policies one after another. Obviously, Asia-Pacific countries cannot isolate themselves away from the global regulation reform and have taken the necessary steps to keep pace with the open skies trend.

III. The Framework of Regulatory Reform

The most crucial question challenging Asia-Pacific countries today is: What is the most appropriate approach to reach regulatory reform within the global multilateral, regional, or existing bilateral framework?

A. Attempts of Global Multilateralism

The most popular concept which has emerged in international air transport over the past years is multilateralism. Bilateralism was widely and severely criticized for its lack of transparency and inefficiency. ICAO's Special Air Transport Conferences held in 1992 and 1994, respectively, provided opportunities for disclosing different views in this regard.

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[115] See "Indonesia Planning Limited Open Skies to Boost Tourism" [July 1995] Asia Aviation 10.

ICAO convened a World-wide Air Transport Colloquium from 6 to 10 April 1992 in order to re-evaluate the existing system of bilateral air services agreements between States. The Colloquium was a seminal event in the annals of ICAO in that it was to be the first global review of the regulation of air transport since 1944. At this Colloquium, two schools of thinking, bilateralism and multilateralism, were well-represented. There were arguments against bilateralism, on grounds that it was outdated due to its lack of integration, transparency, inefficiency and so on.[117] The proponents of this school advocated the liberal multilateral policy as a timely emergence in a period of rapid trans-nationalization of ownership and globalization in the service industries. In addition, multilateralism was represented as a system that would better serve the fiscal interests of airports, while giving the consumer a wider choice of product.[118] On the contrary, countries advocating bilateralism regarded it as "a system which protects weaker airlines, provides equal and fair opportunities for airlines, offers national airlines from all the nations of the world the high degree of protection, and fills a multilateral void."[119] The Colloquium emerged as expected, as a forum for collecting the points of view of experts in the field and did not align itself either way – towards bilateralism or multilateralism.[120]

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[116] See W. Stephen, *Aviation and Tourism Policies: Balancing the Benefits* (London: Routledge, 1994) at 65-66.

[117] See *Proceedings of the ICAO World-wide Air Transport Colloquium, Montreal 6-10 April 1992*, ICAO Publication Order No. WATC92, s. 5.1 at 1 [hereinafter *Proceedings of Colloquium*].

[118] See *ibid.* at 2.

[119] *Ibid.*

[120] See R.I.R. Abeyratne, "The Air Traffic Debate – A Legal Study" (1993) XVIII:I Ann. Air & Sp. L. 3.

With the suspended questions, on 23 November 1994, ICAO opened the world-wide Air Transport Conference in Montreal to examine the timely subject of both the present and the future of international air transport regulation. Its particular focus was on the possible new economic regulatory arrangements of international air transport,[121] which had sparked considerable interest at the 1992 Colloquium. The origins of the conference "lay in the changing air transport environment of privatization, liberalization and globalization, along with changes in the external environment such as new world trading arrangements developed through the Uruguay Round, and especially through GATS."[122] However, the majority at the conference rejected a comprehensive plan for a move to a multilateral arrangement.

Agenda Item 1 was a review of the present regulation. A number of delegates addressed the value and benefits of the widespread bilateral structure of regulation of international air transport and supported the idea that past experience of liberalization had shown disbenefits as well as benefits and that, according to perspective, the former might well outweigh the latter. Many delegates declared that they had no objection to regulatory change, liberalization, or increased competition in international air transport. However, they shared concerns as to possible adverse consequences of unrestricted competition and

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[121] The Conference discussed issues involving the economic regulation of international air transport, with air navigation, safety and similar topics excluded.

[122] ICAO, *Report of the World-wide Air Transport Conference on International Air Transport Regulation: Present and Future*, ICAO Doc. 9644 (1996) at 5. The GATT Uruguay Round was successfully concluded in 1994 and a World Trade Organization (WTO) has been in place since 1 January 1995 for the gradual liberalization of world trade in goods and services. The General Agreement on Trade in Services (GATS), one of the instruments of *The Final Act Embodying the Uruguay Round of Multilateral Trade Negotiations*, came into force on 1 January 1995.

effects on competition by physical and environmental restraints.[123] In this context, some delegates maintained that economic and other disparities amongst States exist. What they advocated was "a gradual but progressive liberalization process with suitable safeguards devised to ensure participation by all states, including most importantly, developing countries."[124]

With respect to the prospected future regulatory process and structure, ICAO indicated in Item 3 that the economic regulation of international air transport is likely to have a mixed framework for the foreseeable future. "Many States would continue to rely primarily on bilateral air services agreements; others would rely on both multilateral agreements within group of States and bilateral agreements with other States."[125] In view of the continued reliance on bilateral agreements, a "primacy principle" would be applied, that is to say, future regulatory arrangements would not be used to impair existing rights, many of which were formulated after many years of bilateral negotiations.

ICAO also concluded that, "in view of the diversity of views and policies and disparities in economic and competitive situations, there was no prospect in the near future for global multilateral agreement on the exchange of traffic rights."[126] In addition, it is particularly important that future regulatory measures take into account the needs of developing countries.

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[123] See *ibid.* at 8.

[124] *Ibid.* at 8-9.

[125] *Ibid.* at 53-54.

Obviously, the conclusions reached at the ICAO conference fully took into consideration the interests of developing countries, including those Asia-Pacific countries whose airlines are still very weak compared to their competitive rivals. Even though the final purpose of global mutilateralism is widely viewed to eventually abolish all government ownership, influence and subsidies in the airline industry, and to minimize the importance of the "nationality" of airline activities, this kind of freedom should be established on the basis of "level playing field". Most Asia-Pacific countries, except for certain industrialized countries like Japan, Australia and New Zealand, are developing countries at different stages of development. Their airlines, at present, are unable to confront challenges by global airlines and the "mega-carriers" of western industrialized countries. From this perspective, it is reasonable to argue that acceptance of global multilateralism would undoubtedly amount to the acceptance of the Darwinian notion of freedom, which will lead to the demise of weaker airlines in the region. It must be recognized that "only when the airline industry of a State becomes mature and efficient can a State indulge in the luxury of a pursuit of full freedom for the benefit of its own airline industry which it considers to be fully competitive."[127] As Mr. Susumu Yamaji, Chairman of Japan Airlines, stated at the 1992 Colloquium:

> [...] Most Asian countries are not in a position to accept the sort of "law of jungle" competition in which, I am sure, the strong mega-carriers would be the only survivors in control of the market and the consumer. I cannot think of any country which will allow the loss of their airline to excessive

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[126] *Ibid.* at 54.

[127] V. Poonoosamy, "Developing Countries in the Wake of Aeropolitical Changes" (1994) XIX:II Ann. Air & Sp. L. 622.

> freedom of competition, [...] If liberalization abandons the adjustment of differences in competitive ability among carriers, it will only result in the demise of smaller carriers.[128]

It is believed that Asia-Pacific, as a whole, is unable, at this stage of its economic development, to accept totally global liberalization in their external relations with other countries, especially with industrialized countries that have a dominant position in the competition.

B. Difficulty of Regionalism

Regionalism is occurs between neighboring countries, or between countries belonging to a specific geographical area. Here, "certain countries conclude a multilateral air transport agreement or arrangement intended to govern air transport operations within the boundaries of that continent or subcontinent."[129] Countries belonging to a regional agreement may decide to harmonize their air transport policies and exchange air traffic rights on a regionally multilateral basis. A typical example of this kind of regionalism is the EC single aviation market, which is based on EC member countries' political and economic similarity and aspirations.

As to the Asia-Pacific region, a single regional aviation market will probably be quite difficult to achieve. One can say that air transport policy is a function of the

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[128] *Proceedings of Colloquium*, *supra* note 117 at 4, s. 1.13.

[129] B.D.K. Henaku, *Regionalism in International Air Transport Regulation* (Leiden: Koma Publishers, 1993) at 7.

national and international policy of States and of politics and national economies in general. Asia-Pacific countries' interests in aviation will differ due to geographical dispersion, varying degrees of political and economic development and historical and cultural differences.[130] "The coherence of the various states is less apparent than in Europe, North America or Latin America, or even between the Arab countries."[131]

Geographically speaking, Asia-Pacific is not like Europe, whose geographical feature is a continuous continent. It is an extremely diverse and far-flung region. Not only are there large territory countries like China situated on the mainland mass, but also smaller territories with crucial geographical locations, like Singapore and Japan. Besides those, there are still many countries which are located on a chain of islands or peninsular regions, like the Southeast Asian and South Pacific countries. Various geographical positions closely relate to the different aviation policies. For instance, the liberal aviation regulation of Singapore stems mainly from its special location, which grants it the advantage of being an international hub to disperse traffic to spokes in this region. In this case, Singapore will be interested in exchanging access for its airlines to expand in fifth and sixth freedom markets with foreign countries.

Wide dispersion in real incomes and the amount of air traffic generated by different countries also determine aviation policy in certain respects. First, the region is

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[130] See J. Livermore, "Airline Deregulation: Strategies for Asian and Australian Airlines" (Address, the International Conference on Air and Space Policy, Law and Industry for the 21st Century, Seoul, Korea, 23-25 June 1997).

[131] H.A.Wassenbergh, "The Globalization of International Air Transport" in *Highways*, *supra* note 101 at 348.

composed of countries with some of the highest and lowest per capita incomes in the world.[132] Different levels of economic development entail varying traffic demands. Being one of the most developed and wealthy countries in the world, Japan is the major generator of overseas travel. In the case of Australia, it has long been a moderately significant generator of traffic due to its top position in terms of economic power. Conversely, some countries have not yet reached a level of income sufficient to generate much leisure traffic. Second, a powerful economy is generally followed by strong airlines, which are crucial elements when their governments consider aviation policy. Most developing countries in Asia-Pacific still apply restrictive positions to aviation policy, viewing their national airline as the prestige and security of the country. Third, for those countries whose economies rely largely on tourism, they need a liberal air transport policy to attract as much traffic as possible. Finally, unit labor costs are significant for airlines' operation. High salary countries, most typically is Japan, suffer from its high labor costs, making its airlines less efficient and less competitive than its competitive opponents.

In short, according to C. Cheng, the external regimes of international air transport of the countries in this region present various pictures. Countries are neither an integrated political unit nor a regional integration of a single market. The majority of them are unitary States. In this case, "deregulation policy means the policy of each independent sovereign state."[133]

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[132] See Samuel, Findlay & Forsyth, *supra* note 107 at 170.

[133] *Highways*, *supra* note 101 at 43.

C. Assessment of Bilateralism

Bearing in mind the Asia-Pacific region's present situation discussed earlier, we submit that open skies could be pursued within the existing bilateral framework. Thus, the most appropriate option for Asia-Pacific countries is "to reform the current bilateral system from within, along the lines of the opens skies approach."[134] Bilateralism does not have to disappear. Just as R. Eddington, Cathay Pacific's Managing Director answered when asked whether Asia-Pacific's deregulation will be a multilateral or country-by-country approach over the next 10-20 years, "I don't think that you will see multilateralism in place for some time. I think that there will be continuing liberalization of the bilateral process."[135] Since 1994, bilateral agreements have become universally accepted as an effective instrument to enable the operation of air services on an international basis, and they will not lose their domination position in the near future. It is believed that it still makes sense to liberalize operations using this means.[136] Bilateral agreements enable like-minded countries which are at the same stage of liberalization to achieve liberal agreements that fulfil their specific needs. In other words, the bilateral process makes it possible for two governments to get together and move towards a regulatory framework through which liberalization can be achieved. Moreover, the bilateral system of negotiating air transport arrangements may provide greater

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[134] Hufbauer & Findlay, *supra* note 109 at 25.

[135] Eddington, *supra* note 102 at 11.

[136] See B. Stockfish, "Opening Closed Skies: the Prospects for Further Liberalization of Trade in International Air Transport Services" (1992) 57 J. Air L. & Com. at 634.

opportunity for aviation liberalization in the short-term than any of the alternatives. Through it, liberalization can occur on a broad scale between States having a similar free-market philosophy.

Based on all the factors discussed above, a series of liberal bilateral agreements between the U.S. and Asia-Pacific countries have been concluded within the framework of bilateral negotiations. Some of these agreements are entirely new, but some of them replaced the existing *Bermuda I* or *Bermuda II*-type agreements. Bilateral agreements among the countries in this region have also been liberalized by the relaxation of government control. So far, bilateral open skies agreements have been reached between the U.S. and Singapore, Brunei, Malaysia, Taiwan, and New Zealand. Open skies negotiations between the U.S. and South Korea is presently in progress. One can anticipate that more such agreements will follow in this region.

CHAPTER 4

APPROACHING OPEN SKIES ? – CASE STUDY

As discussed in the previous Chapter, the regulatory reform of the air transport industry has been experienced throughout the Asia-Pacific region. However, the status of different countries' domestic liberalization and positions regarding the open skies regime vary. As such, countries in this region can be categorized into three groups: countries that have made some progress in their domestic deregulation but still hold cautious and conservative positions to the open skies regime during bilateral negotiations; countries which have basically completed internal deregulation and have established open skies bilateral relations with other countries; and countries which have partially accepted liberal bilateral relations and are moving slowly towards an open skies regime. In this Chapter, we examine the aviation policies of several notable countries in the Asia-Pacific region, which fall within these three categories, by means of a case study.

I. Japan

A. Domestic Liberalization

Air transport in Japan has developed in a strictly regulated environment. The Civil Aeronautics Law requires that airlines obtain government licenses to establish operations and governmental approval to set fares. The old regime of air transport was intended to secure and nurture the transport capabilities of all members of the airline

industry by establishing a segmented business base for each firm.[137] Influenced by global liberalization, Japan began to shift toward deregulating civil aviation.

In June 1986, the Council for Transport Policy, an advisory group to the Minister of Transport (MOT), submitted a final report to the MOT. The report emphasized the need for changes to the old regime and for greater competition in both the domestic and international markets. In the report, a new aviation policy, with the following features, was advocated: international routes served by multiple carriers; competition on domestic routes promoted by new entries into certain city-pair markets; and complete the privatization of Japan Airlines (JAL).[138] Prior to 1987, JAL was a half-owned public corporation established to operate international services as a national flag carrier. According to the report's proposal, it was completely privatized through a bill passed in 1987. In addition, the report refers specifically to the promotion of double tracking, and even triple tracking in the domestic aviation market.[139] Even though the MOT accepted this proposal and increased the number of double and triple-tracked routes to promote competition, the new aviation policy has not been that successful since the MOT did not do much more than adopt the double and triple tracking policy. Moreover, entry into domestic routes is still under the strict regulation of the MOT. "New entry to a particular route is allowed only when the number of passengers traveling annually on that route exceeds a certain threshold."[140] Even if carriers get permission to serve a particular route,

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[137] See H.Yamauchi & T. Ito, "Air Transport Policy in Japan" in Hufbauer & Findlay, *supra* note 109 at 37.

[138] *See ibid.* at 39.

[139] Double (triple) tracking means two (three) carriers serving the same route.

[140] Yamauchi & Ito, *supra* note 137 at 40.

they are not allowed to compete on fare prices; even discounted fares are controlled. In short, the 1986 policy is extensively criticized for not having introduced effective competition to the Japanese air transport market.

Due to the shortcomings of the 1986 policy, the Council for Transport Policy recommended, in June 1994, an action plan for more competitive air services. The recommendation was designed to create a competitive environment for national carriers so that they could better serve consumers. Based on this recommendation, the MOT took the following measures:

1. Wet-leasing, code-sharing and charters

Increased competition in the global market led airlines to realize that the practices of wet-leasing and code-sharing were good ways to increase their services for the benefit of consumers and to reduce their operational costs. The Japanese government revised the rules pertaining to wet-leasing and code-sharing in March 1995 to permit such arrangements under the conditions of safety and consumer protection. The Japanese government also considered changes to the charter rules to expand travel opportunities.[141]

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[141] See S. Miyoshi, "The Recent Development of Japan's Air Transport Policy" (Address, Regional Cooperation Forum for International Air Transport in Asia and Oceania, Japan, 31 January – 1 February, 1996) at 3.

2. Multiple Designation

In the past, Japan's airline industry was dominated by the "big three": JAL, All Nippon Airways (ANA), and Japan Air System (JAS). "These three carriers collectively account for about 95 per cent of the passengers that scheduled Japanese airlines carry."[142] Since the MOT launched its multiple designation – double and triple tracking policy in 1986, new entries have been gradually introduced into the market. Skymark Airlines is Japan's fourth domestic carrier – its first independent airline in 43 years. It received MOT approval to challenge the nation's three major airlines on domestic routes in 1996.[143] Its first flight will be on trunk routes from Tokyo's domestic airport, Haneda, and Osaka's Itami airport, to Sapporo and other major destinations. JAL has started a new subsidiary airline to operate short-haul flights, beginning in 1998. "The new carrier will start up with two or three 150-seat 737s and be based at Itami Airport in Osaka to compete with Air Nippon, a subsidiary of ANA."[144] So far, Japan has five other carriers apart from the big three.

3. More Flexible Tariffs

The Civil Aeronautics Law was amended, in 1994, to relax the regulation of discounted fares from that of governmental approval to prior notification to the government. A new zone fare system for domestic air services on the basis of the

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[142] *Ibid.* at 33.

[143] See E. Sekigawa, "Three New Carriers Proposed in Japan" [9 December 1996] Av. Wk & Sp. Tech. 41.

standard cost was launched in December 1995 to further diversify tariffs. In 1995 Japanese airlines introduced a new discounted fare, which was priced 25 to 35 per cent below the regular fare. The types of discounts and conditions were further liberalized in 1996.[145]

Apart from the efforts discussed above, the deregulation efforts will persist. The Deregulation Sub-Committee of the Administration Reform Committee[146] released their second additional report concerning deregulation implementations. This report included certain deregulation-promoting plans regarding the aviation sector. In its introduction, the report notes:

> Japan, without a thorough review of traditional socioeconomic systems, cannot survive the challenges from stiffening global competition and the aging of its population and that based on market principle, Japan must establish a "consumer oriented" society and foster entrepreneurship, eliminating bureaucracy-led regulations.[147]

The report proposed that the government gradually stop regulating air transport and leave both market access and capacity to the existing and new airlines' discretion. On un-congested airport pair routes, it proposed abolishing the so-called "supply-demand adjustment", while on the congested airport pair routes, abolishing the regulations relating to route licensing. With respect to pricing, the report advocated replacing the

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[144] "JAL to Start New Domestic Short-Haul Carriers in 1998" *Aviation Daily* (9 January 1997).

[145] See Miyoshi, *supra* note 141 at 5.

[146] "The Deregulation Sub-Committee of the Administration Reform Committee was established by Hashimoto Administration in 1995 as an interim advisory agency planning the Promoting Deregulation Program." M. Sekiguchi, "Some Consideration on the New Aviation Policy in Japan"(Address, International Conference on Air and Space Policy, Law and Industry for the 21st Century, Seoul, Korea, 23-25 June 1997) at 9.

previous pricing zone method with the single tier upper ceiling pricing method, meaning discarding the lower limit of the zone.[148]

The Hashimoto Cabinet accepted the Deregulation Sub-Committee's report in March 1997. Accordingly, the MOT asked the Council for Transport Policy to take the necessary steps to implement concrete measures. However, the report concerns only domestic aviation.

B. International Air Transport Policy

Japan has a very strategic geographic location, which is a natural hub for flights to the Asian mainland from North America and Europe. Geographic advantage makes aviation relations between Japan and European and North American countries quite delicate.

Basically, the aviation rights conflict between Japan and European countries is not that extreme. The reason for this is that European airlines already have nonstop flights to other Asian destinations, and have little interest in flying beyond Tokyo. Meanwhile, Japan's air carriers have little interest in developing any significant connections within or beyond Europe.[149]

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[147] *Ibid.*

[148] See *ibid.*

Air services between Japan and the U.S. have been regarded as the key to more competitive trans-Pacific air services markets. However, Japan – U.S. aviation relations have been contentious since the *1952 Air Transport Agreement* was signed.[150] The *1952 Agreement*, modeled after the *Bermuda I Air Services Agreement*, contains an *ex post facto* capacity article and a unilateral disapproval price system. It also provides for multiple designation and two routes for each party, one via the North Pacific and a second via the Central Pacific. Both U.S. routes contain open beyond rights from Tokyo, but Japan has few beyond rights from the U.S.

Since the late 1950s, Japan has repeatedly argued that the *Agreement* unilaterally favors the U.S.. Japan has focused its attention on two points. The first one is the issue of imbalance in beyond rights. Japan has claimed that beyond rights have been excessively used by the U.S. since its carriers are not restricted to carrying traffic originating or terminating in the U.S. on their flights beyond Japan.[151] On the other hand, the single Japanese incumbent airline, JAL, has limited beyond rights with the U.S. on routes between Los Angeles and Brazil, but Japan is not allowed to carry traffic that is neither bound from nor originating in Japan.[152] Japan complains that this situation has not changed since the early years of the *Agreement*. It believes that solving the beyond rights

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[149] See Yamauchi & Ito, *supra* note 137 at 46.

[150] See *Civil Air Transport Agreement between the United States of America and Japan* was signed at Tokyo on 11 August 1952, and entered into force on 15 September 1953 [hereinafter *1952 Agreement*].

[151] There are about 100 passenger flights a week beyond Japan to Asia by US carriers. See "US – Japan: Fair Play Comes First" [January/February 1996] Airline International 6.

[152] See J.A. Donohgue, "Beyond Japan" [January 1996] Air Transport World 5-6.

issue is crucial to the future progress of bilateral relations. The second issue is designation of carriers. The carriers who were originally granted rights in 1952 are called incumbent or full right carriers. On the U.S. side, the incumbent carriers, United Airlines and Northwest Airlines, control about 80 per cent of passenger traffic between the two nations. However, Japan has only one incumbent airline, JAL.[153] Based on the two concerns, Japan is attempting to revise the *1952 Agreement* to reach so-called "equality" – expand beyond rights and increase the number of incumbent airlines.

The U.S. has been advocating free competition since its 1978 deregulation. Not only is it dissatisfied with the number of its incumbent airlines, but also with the existing beyond rights. The U.S. is calling for Japan to approve more U.S. air carriers to operate both cargo and passenger services beyond Japan, thus reaching more Asian destinations in order to stimulate free competition.

Some progress with regard to the bilateral relations of the two countries was made through a series of Memoranda of Understanding (MOU) reached in 1985 and 1989. New entry to the market was allowed for both sides in the 1985 MOU, namely, for MOU carriers, which includes Delta, Continental, American Airlines and All Nippon Airways (ANA). They now offer services in this same market, but due to sharply different conditions (strict limits on routes and capacity), they do not have the same full traffic rights as incumbent carriers. In addition to designation of airlines, new services came into existence in the U.S. – Japan market. New routes opened to NCA (Tokyo-San Francisco-

[153] See S. Daimon, "Positions Shifting in Aviation Negotiations" [26 February – 3 March 1996] Japan Times Weekly International Edition at 13.

New York), ANA (Tokyo-Los Angeles, Tokyo-Washington D.C.), Delta (Portland-Tokyo), and American (Dallas-Tokyo). The MOU of 1989 further opened markets by allowing JAS and UPS to enter.[154]

However, neither Japan nor the U.S. has been satisfied with such minor progress. Conflicts involving fifth freedom rights and airline designation remain. Moreover, the Japanese government still persists in its efforts regarding the principle of equalization of opportunities between the two countries. So Japan has claimed to upgrade ANA to be its second incumbent carrier so that both countries will have an equal number of incumbent carriers. ANA, which is Japan's primary carrier, also propels this initiative, seeking equal opportunities to compete with incumbent carriers.[155] In addition, Japan is also interested in gaining greater access to Latin America since its carriers could not profitably use beyond rights from the U.S. to Europe.[156] The MOT is expected to achieve this goal through bilateral talks. In the meantime, Japan continues to restrict U.S. beyond rights until what they call a "level playing field" is created.

For its part, the U.S. has never stopped trying to expand its fifth freedom rights and, like Japan, it also wants to "put its three MOU carriers on an equal footing with

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[154] See Yamauchi & Ito, *supra* note 137 at 48-51.

[155] ANA received Japanese and US governmental permission to begin international operations in 1986. Its strong domestic base has made it the sixth-largest passenger carrier in the industry. ANA President Seiji Fukatsu has pushed for full rights status of his airline. The reason is that lack of full rights status hurt ANA badly when Osaka's Kansai International opened in 1994. ANA had hoped that it could use Kansai to develop its international operation. See J.P. Woolsey, "Don't Fence Me In" [May 1997] Air Transport World 66.

[156] See M. Mecham, "Old Issues Stirred in US – Japan Talks" [1 September 1997] Av. Wk & Sp. Tech. 38.

other bilateral carriers."[157] In 1996, the U.S. proposed an open skies aviation agreement with Japan in a move that could have resolved their aviation problems. In the agreement, all the carriers of both nations have the same unrestricted freedom to operate to and beyond each other with no regulations or restrictions on designations, routings, capacity, frequency and pricing or other matters. The U.S. is even willing to consider phasing in any open skies pact. To increase pressure on Japan, the U.S. concluded four open skies agreement with other Asian countries in 1997.[158]

During the conflict, a certain amount of piecemeal progress has been made pertaining to cargo services. In March 1996, the two nations reached an agreement on air cargo services to increase opportunities for such services between them. The agreement provides additional operating flexibility for Northwest Airlines, Federal Express and United Airlines. United Parcel Service got rights beyond Kansai for to up to two points in other countries. Japan also obtained comparable new opportunities for all-cargo services.[159] However, turbulence arose four months after this agreement due to Japan's refusal to grant Federal Express beyond rights.

During the round of talks in 1997, both sides have sought more common ground for the formal negotiation, yet no concrete results have come to pass. Japan has insisted on the principle of equalization and has refused an American open skies offer. But during

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[157] D. Knibb, "Japan Set to Tie Down US" [March 1996] Airline Business 18.

[158] See *supra* Chapter 3.

[159] See B. Mosley, "U.S., Japan Reach Agreement on Air Cargo Services" DOT61-96 (27 March 1996) DOT website http://www.dot.gov.

a recent talk held in Portland in July 1997, Japan proposed "ideas for a joint commitment to move to a fully liberalized market". Japan was also prepared to offer more flexibility in future negotiations[160] and proposed a two-stage approach – a four-year expansion, an assessment of results and further adjustments in a second, three-year bilateral.[161]

By far, it is still difficult to predict by which means the U.S. – Japan conflict will end. For Japan, an open skies approach is rather tough, meaning that Japan has to deal with the crucial issue of high labor costs so that its airlines can be efficient enough to face the U.S. carriers' challenge.[162] Even though some Japanese airlines are taking measures to employ cheaper foreign labor from Southeast Asian countries, in the short- term it will not be as effective as the Japanese expect. This situation will probably lead to Japan repeatedly restricting the U.S. beyond rights giving Japanese carriers a virtual monopoly and resisting the U.S. open skies approach. If this is the case, Japan's status as a hub in East and Northeast Asia will be increasingly challenged. The U.S. will probably switch its focus to other northeastern hubs, for example, South Korea or Taiwan, through which the U.S. still could reach the Asian mainland.[163] In this situation, Japan will lose its advantage as the natural hub, and therefore, it will lose the U.S. – its biggest aviation

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[160] See "Negotiators See Path to U.S. – Japan Bilateral, Aim for September Signing" Aviation Daily (18 July 1997) at 61.

[161] See *ibid.* at 72.

[162] United Airlines' operating costs are 50 per cent lower than its Japanese counterpart. See G. Greenwald, "Open Trade and a New Global Village" [November/December 1995] Airline International 17.

[163] The US Deputy Assistant Secretary for Transportation Mark Gerchick said, "It certainly became clear to me that we were almost fixed upon Japan with too much focus and, indeed, not spending enough time and consideration with the rest of Asia." "Secret Meetings Paved Way into Asia" [June/July 1997] Orient Aviation 24.

companion. In short, the outcome of the U.S. – Japan bilateral negotiation is still rather vague and hard to anticipate at this stage.

II. China

A. Recent Air Transport Development

In recent years, there has been a great deal of interest in the potential of the People's Republic of China as a major air travel market. Although China is classified by the World Bank as a low-income economy, this country is still a major economic power and a significant air travel market in Asia-Pacific. Its enormous population base, vast size, and high growth rate in GNP per capita, combined with the current government's policies to promote economic growth, have made it the world's fastest growing air transport market.[164]

The development and potential of civil aviation in China can be viewed from both the internal and external levels. According to the Statistical Bulletin of the Development of Civil Aviation, in 1980 there were only 191 flight routes in China, of which 159 were domestic, 4 regional and the remainder international. By the end of 1994, there were 567

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[164] Somebody summarized three reasons for the air transport growth: 1. The domestic air transport market in the coastal region, particularly the southeastern region, continues its fast growth due to the booming economy there; 2. The majority of the passengers of air transport are business people at this stage; however, there will be more and more people to choose air transport as their first choice with the increasing of GNP per capita; 3. With the resuming sovereignty of Hong Kong, the number of passengers traveling between Hong Kong and China is significantly increasing. See J. Wu, "Investment in China Civil Air Transportation – Some Legal Aspects" (1995) XX:6 Air & Sp. L. 201. See also Z. Jiang, "The Development of China's Air Transport and Its Prospects" (1994) World Aerospace Tech. 7.

domestic, 13 regional and 67 international routes, totaling 647 routes. During that period, the capacity of civil air transportation expanded enormously. The total capacity of air transportation of passengers grew from 3.43 million to 40.34 million and the annual growth rate was 19.2 per cent. The capacity of air transportation of mail and cargo rose from 88,900 tonkilometres to 584,000 tonkilometres, the annual growth rate of which was 20.5 per cent.[165] The enormous growth has significantly influenced the status of air transport in whole of Northeast Asia. According to one analysis, "Northeast Asia, of which China is the largest component, is expected to have the second-highest traffic growth rate of 8.7 per cent among the world's regions – marginally behind upper South America and Southeast Asia. By 1999, the strongest intra-regional traffic flows will also be within that region, totaling 38.5 million passengers. The forecast is mainly due to the anticipated start of direct links between China and Taiwan, and the further expansion of traffic between Hong Kong and China's mainland."[166] However, inbound tourists still account for an enormous proportion China's air transport, but if the regulation of outbound travel is relaxed, air traffic growth could exceed all expectations.

To keep pace with the global trend of liberalization and increasing air travel demand, the Chinese government has primarily taken two measures to gradually liberalize and deregulate its aviation industry since adopting its opening-up policy of economic reform.

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[165] See "The Statistical Bulletin of the Development of Civil Aviation" [20 April 1995] J. CAAC 3.

B. Decentralization

Decentralization has been shown by the separation of civil aviation regulatory and administrative functions from airline operations in the Civil Aviation Administration of China (CAAC). Until as recently as 1988, CAAC was responsible not only for the operation and management of the national airline and airport, but also for the administration of all civil aviation activities such as delineation of government aviation policy, negotiation of bilateral agreements, management and operation of the Air Traffic Control (ATC), and investigation of accidents.[167] It is also directly involved in the control of the only national flag airline, CAAC, a division of CAAC.

However, a big innovation occurred after the introduction of the landmark Airline Industry Reform of 1984 and the Civil Aviation Management Reform Project and Program Report of 1986, which demanded that the government remain separate from the civil air transport industry.[168] In addition to these two legal tools, a series of administrative measures were adopted one after another, formulating an integral liberalization policy system. The first privately-owned carrier, Shanghai Airlines, began operation in 1986, but the real changes came with the devolution of power from CAAC to six airlines, operating from separate regional bases. These six are called Air China

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[166] See H.P. Mama, "Explosive Growth Swells China's Air Transport Industry" [January 1996] Airport Forum 21.

[167] See N.K. Taneja, *The International Airline Industry – Trends, Issues, and Challenges* (Toronto: Lexington, 1988) at 137.

[168] See T. Shen, "China Civil Aviation is in the Process of Reform and Opening-up" in E.P. Chiang, *The Reform and Opening-up Policy of China Civil Aviation* (Beijing: Beijing Education Press, 1992) at 16-18.

(Beijing), China Eastern (Shanghai), China Southern (Guangzhou), China Northern (Shenyang), China Northwest (Xian), and China Southwest (Chengdu).

The first three airlines are the major international carriers and collectively control 60 per cent of the Chinese market. Air China, the flag carrier and largest airline, has international routes to destinations in the U.S., Europe, the Middle East, Asia and Australia. It remains the leading airline, controlling 28 percent of total tonnage per kilometer of air traffic in China. Shanghai-based China Eastern airlines has overseas routes in Asia, Europe and North America. It has reported the highest profit among the Chinese carriers. China Southern Airlines, based in Guangzhou, has developed a web of international routes.[169] By 1997, Cathay Pacific and its subsidiary, Dragonair, will change nationality when Hong Kong reverts to Chinese sovereignty.

Since 1988, the big six have set up smaller affiliated companies. For instance, the China Eastern air group, based in Shanghai, owns airlines in Anhui, Shandong and Jiangxi provinces. Provincial and local governments have also established their own airlines, such as Yunnan Airlines, which operates out of Kunming, and Xinjiang Airlines, which is based in Urumqi.[170]

Following the separation, CAAC became solely and exclusively a government regulatory agency and was no longer empowered to directly operate the airline industry

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[169] See G. Jaggi & G. Morgan, "Recent Civil Aviation Experience" in Hufbauer & Findlay, *supra* note 109 at 152.

or engage in airport management. Even if all these airlines are more or less supervised by means of company shares, each of the new airlines will be independent and stay out of the direct control of CAAC. It is believed that greater autonomy will lead to a strengthening of the airlines. As such, "[a] new national aviation program, based on market-oriented, macro-economic principles, has emerged."[171]

C. Privatization

1. The Need for Privatization

CAAC realized that the air transport industry is characterized by its large investment and demand for complicated cooperation. Airlines need enough capital to finance new requirements such as aircraft, training, maintenance, and international management. Thus, privatization is viewed as the most effective way to attract the large amount of capital needed to meet the demands of airline operations. In this regard, CAAC Vice Chairman, P.N. He, holds that an airline has to open itself to foreign investors to a certain extent in order to meet its own requirements of development.[172] In addition, "privatization could enhance efficiency, reduce government costs, generate new government revenues, as well as improve the airlines' services."[173]

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[170] See Z. Yu, "Booming of Newcomers" *South China Morning Post* (6 November 1994).

[171] C. Cheng, "Recent Developments in the Aviation Industry of the People's Republic of China" (1995) XX:2 Air & Sp. L. 68 [hereinafter "Recent Developments"].

[172] See P.N. He, "The Prospect of Cooperation between Chinese and Foreign Airlines" (1995) XX:6 Air & Sp. L. 318.

[173] "Recent Developments", *supra* note 171 at 69.

2. The Legal Environment

Article 18 of the Constitution of People's Republic of China stipulates that "the People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter various forms of economic cooperation with Chinese enterprises."[174] To implement this constitutional provision, there are numerous laws concerning foreign investment which have come into force.[175]

In 1994, the Chinese government began to formally open its civil aviation to foreign investors through *The Notice on Policies Concerning the Foreign Investment in Civil Aviation.*[176] This administrative document primarily involves two sectors, foreign investment in airport and airlines.

First of all, the Note stipulates that foreign investment can account for 49 per cent of the total investment for the construction of a civil airport's flight area. Foreign

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[174] Article 18 of the Constitution of People's Republic of China promulgated for implementation by the Proclamation of the National People's Congress on 4 December 1982.

[175] These laws include Law of the Peoples Republic of China on Chinese Foreign Equity Joint Ventures. Regulations for the Implementation of the Law of the People's Republic of China on Chinese Foreign Equity Joint Ventures, Law of the People's Republic of China on Foreign Capital Enterprises, Law of the People's Republic of China on Chinese Foreign Contractual Joint Ventures, and Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment.

[176] CAAC and the Ministry of Foreign Trade and Economic Co-operation jointly issued this document [hereinafter *Note*].

investors are also encouraged to invest in and build terminals, cargo warehouses, ground services, aircraft maintenance, etc.

Second, the Note provides for the regulation of foreign investment in the airline industry: (1) foreign investors are allowed to invest in and establish air transportation enterprises with their Chinese counterparts; (2) the establishment of share-holding airlines is possible, so foreign air carriers are permitted to buy shares of Chinese airlines or mutually participate in setting up new airline companies; (3) foreign capital will be limited to 35 per cent and foreign voting rights cannot exceed 25 per cent; and (4) airlines with foreign investment will enjoy the same treatment as their Chinese counterparts.[177]

3. The Approaches of Privatization

CAAC has considered two ways to privatize the airline industry in order to be consistent with current governmental policies of a market-oriented economy. One of the alternatives is partial privatization, which is preferred by the government and is relatively practical at this transitional stage. China Southern, the pioneer of the privatization, commenced an Initial Public Offering (IPO), representing about 25 per cent of its equity. Following that, the airline offered shares to domestic investors, and then presented a private offer to employees.[178] The other alternative is full privatization. This option not only allows Chinese airlines to be shareholders, but also foreign airlines. Singapore

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[177] See *ibid.*, art. 5. See also Wu, *supra* note 164 at 203.

[178] See M. Mackey, "Great Leap Forward" [March 1997] Air Transport World 28.

Airlines and certain major U.S. airlines have expressed interest in equity stakes or joint ventures with the Chinese carriers. Meanwhile, "Chinese airlines are also allowed to list their companies on the major domestic and international stock exchanges, which will help to accelerate the total privatization process."[179] China Eastern Airlines made history in January 1997, when it became the first airline in the People's Republic of China to apply for a public listing of its stock on the Hong Kong and international stock markets. It is the only Mainland Chinese airline whose stock is traded publicly. The offering is quite straightforward – the airline intends to sell up to 1.4 billion shares of stock in Hong Kong. The 1.4 billion shares represent around 33 per cent of its equity. The government still owns two-thirds of the airline.[180] Later on, as mentioned above, China Southern airlines filed IPO to draw investors from several countries. China Southern said it intended to offer more than one billion Class H common shares in the U.S. market.[181]

D. International Air Transport Relations

CAAC is also trying to expand the Chinese airlines' share of the international aviation market, especially in Asia. China's government has liberalized a series of bilateral agreements with other countries in hopes of expanding its market share. For instance, under the bilateral agreement between China and Singapore, up to six Chinese carriers are permitted to operate into Singapore. Several purely domestic airlines have

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[179] "Recent Developments", *supra* note 171 at 69.

[180] See "Great Leap Forward", *supra* note at 178 at 25.

[181] See "China Southern Files for Global Stock Offering" (30 June 1997) Aviation Daily at 543.

obtained authority to extend their services into international operations in order to compete with their counterparts.[182]

The most noteworthy bilateral agreement recently reached is that between China and the U.S.. This agreement is a modified version of the one signed in September 1980; it came into force on 27 March 1996. Even though the U.S. has been taking aggressive steps to promote its open skies policy world-wide and, in particular, in the Asia-Pacific region in recent years, it has maintained a conservative position towards aviation relations with China. It can be viewed from the agreement that both sides were cautious concerning the major issues, such as capacity, price and designation. With regard to price, the strictest method – double approval – is still applied. Restrictions which apply to capacity and designation also remain.

However, there are two points worth noting: (1) in terms of routes, the agreement allows the first non-stop direct services between Beijing and U.S., capping services by each country at 27 flights a week;[183] and (2) the agreement provides for expanded code-sharing opportunities for U.S. and Chinese airlines. U.S. airlines without direct flights to China will be authorized to put their code on the transpacific flights of the Chinese airlines. Chinese airlines will be allowed to put their code on the flights of any U.S. airline and, thereby, offer improved services to up to five more U.S. cities than are currently authorized for service by Chinese airlines. U.S. airlines will obtain similar

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[182] For instance, China Northwest Airlines has been operating scheduled flights between Singapore and Xian.

code-sharing opportunities with Chinese airlines on a two-year phased-in basis to up to five additional points in China.[184] One can say that these advancements reflect the Chinese government's attitude of progressive liberalization during the international aviation negotiations and its intention to expand services into the U.S. market in order to benefit its airlines and meet the increasing demand of consumers. The U.S. is also discussing whether to move towards the next stage of liberalization with China on aviation relations. The result is not complete but the U.S. is undoubtedly willing to take further steps into the booming Chinese market.

As such, a delicate question is posed as to whether China will accept a more liberal bilateral agreement, or even an open skies regime. There are certain points which should be mentioned: on one hand, China will further keep pace with the global trend of liberalization in the whole economic system, including the sector of aviation industry. As part of its pursuit of economic development, China has moved to reform its strictly controlled economy in order to be more responsive to market forces, and the policy of opening-up to the outside world has become a long-term economic strategy which will be continued. Furthermore, China has been seeking the membership of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO) for many years. This initiative also shows China's intention to pursue and to broaden its liberalization policy. On the other hand, one cannot expect that China will accept an open skies regime in the short-term. First, China, like other

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[183] See "Agreement Reached with China Permitting Expanded Air Services", DOT 222-95 (23 December 1995) at DOT website: http://www.dot.gov [hereinafter "Agreement Reached with China"].

developing countries, regards sovereignty as a crucial factor which cannot be easily ignored during bilateral negotiations. Then, even if the Chinese government authorizes more entry into both domestic and international markets to advocate domestic competition, to some extent, administrative control in response to changes in governmental policies or otherwise is still at the discretion of CAAC. Moreover, China still holds the position of protecting its carriers from the competition of stronger foreign airlines due to its relatively weak aviation industry. China is aware that its airlines' ability to face competition is still not strong enough to compete with their western rivals in terms of quality of service and safety. In the past several years, Chinese airlines have suffered 10 major accidents, together with a constant stream of hijackings, causing their reputation to become damaged. Complaints can also be heard constantly due to the quality of service, such as unreasonable delays. China still has a long way to go to enforce all the rules and regulations put into place before it is able to ensure an efficient and safe operating environment.

Despite the above-mentioned concerns, it is believed that China's role in liberalizing Asia-Pacific's air transport cannot be neglected, especially since China has taken over control of Hong Kong, which will constitute a vigorous power of this country's aviation industry. Hong Kong's strength as an aviation center is based on its strong airline – Cathay Pacific Airways,[185] which ranks eighth in international passengers

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[184] See *Note of Air Service Agreement between the People's Republic of China and the United States of America*, modified on 23 December 1995. See also "Agreement Reached with China" *ibid.*

[185] Cathay Pacific Airways is owned 52 per cent by British capital and 26 per cent by the Chinese government. The Chinese government is prepared to increase its investment in it.

and seventh in international freight tonnage,[186] together with the opening of the new Chek Lap Kok airport in 1998. Hong Kong's dynamism and geographical location make it a naturally prosperous international hub for flights to the U.S., Japan, Singapore, Thailand and other countries around the world.[187] Considering these aspects, combined with the recently meaningful liberalization approaches, there is no doubt that China will be the aviation superpower in the next century due to its unremitting expansion. We can even expect that an open skies regime will be adopted in China, and that we will see its airlines play in the field of free competition in the next century.

III. Singapore

A. Motivations of Singapore's Air Transport Policy

Singapore is the only Asia-Pacific country that has been applying a liberal air transport policy from the outset and was the first of the seven Asian countries targeted to come on board for open skies by the U.S..

Singapore's geographical location plays an important role in its determination of aviation policies. Singapore is just a small island situated in Southeast Asia, but it has the advantage of being an international hub. Air carriers can go from Europe or North America to Singapore and continue on to other Asian countries, particularly to nearby

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[186] See V. Saunier & M. Mecham, "Hong Kong Aviation Bets Future on China" [30 June 1997] Av. Wk & Sp. Tech. 40.

countries such as Malaysia, the Philippines, Indonesia and possibly Australia. While Singapore itself is a small market when compared with other Asian economies, "its importance is magnified by its reputation as an Asian entrepreneurial center, its ability to open beyond markets, and its status as the first beachhead in the U.S. drive to establish and expand open skies throughout the region."[188] "In other words, the small island's real advantage lies in the access it provides to other nations, and the ways in which it will grease trade flows."[189]

Another factor which affects Singapore's aviation policy is the strong causal relationship existing between the development of tourism and that of air transport policy. "Singapore's tourism largely comprises stopover or short-stay traffic."[190] "With its economy projected to continue growing and with the launching of a new National Tourism Plan aimed at encouraging both inbound and outbound tourism, tourism is particularly dependent on the air transport services responsible for creating actual markets."[191]

A final motivation behind the Singapore government's liberal aviation policy is the promotion of its airlines. The country's tiny population of three million means that its carriers will not be able to survive and prosper without its expansion into the international

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[187] See *ibid.* at 41.

[188] "U.S., Singapore Launch Asian Open Skies" *Aviation Daily* (24 January 1997) at 135.

[189] *Ibid.*

[190] Graham, *supra* note 51 at 206.

aviation market. Liberal bilateral relations can introduce an expanded aviation network by allowing unlimited service between the contracting parties. "Testimony to the success of this policy was Singapore Airlines' (SIA) top-placed position in the world airline profit rankings in both 1992 and 1993."[192] SIA's strengths indeed reside in its sound management practices and reputation for quality service. But it depends most importantly on the advantages stemming from its government's liberal policy: an efficient and strategic hub at the excellent Changi International Airport, together with an efficient long-haul route network behind Singapore and beyond other countries. The government does not interfere with the management of SIA, yet provides strong support for traffic rights, negotiations, and the provision of airport facilities.[193]

B. Singapore's Air Transport Policy

Singapore has pursued a liberal aviation policy with the objective of ensuring adequate passenger and freight capacity and an extensive air network. It advocates an international aviation environment that relies on free and open competition[194] and little government intervention in airline management decisions. As to market access, it objects to government intervention concerning distribution of routes. It also considers that

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[191] *Agenda Item 2: Singapore's Information Paper* (Regional Cooperation Forum for International Air Transport in Asia and Oceania, Japan, 31 January – 1 February 1996) at 67.

[192] Graham, *supra* note 51 at 187.

[193] See "Step Toward Multilateral Pacts Urged for Asia" [7 March 1994] Av. Wk & Sp. Tech. 37-38 [hereinafter "Step Toward Multilateral Pacts"].

[194] Singapore advocates welcoming foreign airlines to come to Singapore. Changi International Airport is now linked by 70 airlines to 135 cities in 54 countries with over 3300 weekly scheduled flights. E-mail message of Z. Ramli, Public Relations Assistant of Civil Aviation Authority of Singapore (CAAS) to the author (20 September 1997).

capacity sharing creates an artificial environment, which does not interest consumers. Therefore, Singapore believes that the government should not involve itself in the arrangement of capacity, but let it be determined by market forces and consumer demand.[195] However, Singapore has not released its restriction on fares, meaning airlines are not allowed to decide their own fare levels. Apart from this point, Singapore's aviation policy has led to a competitive air service environment that benefits not only consumers but also promotes trade, investments and tourism to the country.

Singapore anticipates that its aviation policy will promote a global multilateral international aviation order, which will be created by a more liberal regime for commercial aviation within the framework of the GATT. This view is strongly supported by SIA because the theory of multilaterlism benefits small home territories and powerful carriers, who have everything to lose under the bilateral system, as they cannot offer destinations to their bilateral partners. At the World-wide Air Transport Colloquium of 1992, M. Samuel of Singapore Airlines, who strongly advocated a liberal multilateral policy, gave certain points of view:

- Today's world needs a reorganization of air transport industry;
- The most appealing solution is the concept of a multilateral regime that allows increased liberalization in the developed countries while protecting the interests of less developed countries;
- Liberalization and bilateralism do not mix; and

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[195] See *Ibid.*

- A liberal multilateral agreement works equally well for both large and small States.[196]

To be consistent with its air transport policy, Singapore's government has progressively expanded its airport infrastructure and facilities, such as catering centers and aircraft hangars. With the construction of a second terminal at Changi International Airport, capacity has expanded to 24 million passengers a year. A third terminal, which will increase capacity to 36 million passengers, is scheduled for completion by the year 2000.[197]

C. Asia-Pacific First Open Skies Agreement

Singapore's aviation policy is well presented in its first open skies agreement, of 8 April 1997, with the U.S..[198] The new agreement replaces the air services agreement between the U.S. and Singapore signed in March 1978.

This new agreement lifts restrictions on routing, allowing the airlines of both countries to operate to and beyond each other's countries.[199] This is particularly important to Singapore, since it gives its airline open access to the U.S. market with no limits on the number of destinations. Meanwhile, it enables the carriers of both countries

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[196] See *Proceedings of Colloquium*, *supra* note 117 at 1-5, ss. 2-13.

[197] See Hufbauer & Findlay, *supra* note 109 at 198.

[198] The agreement was signed by Singapore's Minister for Communications, Mr. Mah Bow Tan and the Ambassador of the United States of America to Singapore, Mr. Timothy Chorba on 8 April 1997.

[199] The agreement grants the carriers to operate 1-6 freedom services and seventh freedom of cargo.

to respond more quickly and effectively to market forces by releasing the restrictions which applies to frequency and capacity.

The new agreement also permits third-country alliances and code-sharing, allowing airlines of either party to enter into such cooperative marketing arrangements with airlines of the other party or a third country.[200] Delta Airlines and SIA have a code-sharing agreement that could be expanded under the new pact. This is important for both carriers because "it allows market penetration without full capital expenditures."[201]

It is worth noting the unique characteristic of the pact – the seventh freedom,[202] which is not permitted under the European model. The granted seventh freedom traffic rights, which are commonly referred to as hubbing rights, is limited to cargo in this pact. "It permits scheduled cargo carriers from both countries to use each other's airports as hubs for their operations in the respective regions."[203] But this freedom is under the prerequisite of permission from the third country. With this freedom, U.S. cargo airlines can now make Singapore a hub, hopping from the small nation to other points in Asia with almost no restriction. SIA won the corresponding right to create similar operations in the U.S. using its cargo freighters. Even if, by far, both countries do not need to exercise the rights immediately, they have taken a big step conceptually by obtaining the

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[200] See *US – Singapore Agreement*, *supra* note 53, art. 8(7)-(I).

[201] C.A. Shifrin, "Singapore First Asian Nation to Accept Open Skies Pact" [3 February 1997] Av. Wk & Sp. Tech. 26.

[202] "Seventh freedom refers to the privilege to carry revenue traffic flown between the territories of two nations by a carrier operating entirely outside its own territory." Groenewege, *supra* note 2 at 44.

seventh freedom for cargo.[204] However, the idea of the seventh freedom in the sector of passenger transport has not yet been considered and will be left to future negotiations. It is probable that both countries are not prepared to go so far as to include the seventh freedom for passengers in the pact. They will probably examine the seventh freedom cargo traffic and see the effects before they take further steps.

Due to these liberal aviation relations, SIA operates a combined total of 39 weekly passenger and cargo services to the U.S., while seven U.S. carriers operate a combined total of 49 weekly passenger and cargo services to Singapore. Over the past five years, passenger and freight traffic growth between the U.S. and Singapore has been impressive. The annual compound growth rates for air passenger and freight movements between the U.S. and Singapore from 1992 to 1996 were 14.8% and 27.4%, respectively.[205]

IV. Taiwan

A. Regulatory Regime of Air Transport

Taiwan adopted a national aviation policy of limited liberalization and deregulation through an amendment to its legal regime in 1989. The old regime, which restricted the establishment, capacity, frequency, routing and fares of airlines, has

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[203] Shifrin, *supra* note 201 at 26.

[204] See the e-mail message of David Modesitt, Desk Officer, Office of the Secretary of the U.S. DOT to the author (26 August 1997).

gradually been abolished. "The principle of designated airlines 'substantially owned and effectively controlled' by the designating state or its nationals is no longer interpreted in its narrowest sense."[206] In addition, the system of single designation was abandoned, while the existing aviation law and regulations allows multiple airlines to join the market, thereby creating a more competitive environment, which improves the quality of service and increases market shares. Although strict requirements on candidates for international licenses still exist, more airlines have been permitted to fly internationally. There are 11 new carriers who have entered the fray, although most of them have lost money due to the stiff competition.[207] One newcomer is EVA Airways, which began operating in July 1991 and has become the strongest airline over the past few years. It has obtained rights to a number of destinations in the U.S., Europe, Asia and Australia. China Airlines (CAL), Taiwan's flag carrier, has been confronted with EVA's strong competition, and has not operated as well as its competitive rival. Its profits have decreased during the past three years. Apart from CAL and EVA, Taiwan has two other international carriers: Mandarin Airlines and TransAsia Airlines.

Taiwan has tried to expand its international market since its deregulation. Even though, since 1949, Taiwan's airlines have been banned from flying to Mainland China directly due to political complications, Taiwan's government created the so-called "golden route" between Hong Kong and Taipei, which transports a large number of

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[205] See "Steps towards Multilateral Pact", *supra* note 193 at 38.

[206] C. Cheng, "The Changing Features of Aviation Policy in Asian Countries" in T.L. Masson-Zwaan & P. M.J. Mendes de Leon, *Air and Space Law: De Lege Ferenda* (Dordrecht: Martinus Nijhoff Publishers, 1992) at 4 [hereinafter "Changing Features"].

passengers to Mainland China each year. For years, CAL and Cathay Pacific have jointly controlled the Hong Kong – Taiwan route. In October 1995, Taiwan and Hong Kong agreed to renew their bilateral agreement for five more years and added 14 new flights per week between the two regions.[208] With nearly 10 million passengers annually, the Hong Kong – Taiwan route ranks as Taiwan's most important foreign destinations and one of Asia's key routes.[209] Furthermore, Taiwan has taken some preliminary steps toward establishing direct air links with China. In 1995, Taiwan agreed to allow two Chinese-controlled airlines – Dragonair and Air Macau to fly over the Taiwan Strait. These flights have been allowed to continue since Hong Kong's recent return to China.[210]

Apart from expanding its international network, Taiwan has also been attempting to attract new airlines to Taipei, focusing first on cargo services. Benefiting from this initiative, UPS has already opened a regional hub, and Federal Express is also prepared to open a passenger hub after Chiang Kai-shek Airport, Taiwan's main international hub, opens its second terminal in 1998.[211]

B. The Bilateral Open Skies Agreement

Accepting the U.S. offer of open skies could be said to be Taiwan's highest achievement of its recent efforts toward liberalization. On 27 February 1997 the

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[207] See G. Dick, "Emerald Aims to be the Best" [February 1992] Air Transport World 89.

[208] See Hufbauer & Findlay , *supra* note 109 at 201.

[209] See "Taiwanese Watch Handover Carefully" [30 June 1997] Av. Wk & Sp. Tech. 46.

[210] See Hufbauer & Findlay, *supra* note 109 at 202.

American Institute in Taiwan (AIT) and the Taipei Economic and Cultural Representative Office (TECRO)[212] concurred on the text of an open skies aviation agreement. This agreement replaces the bilateral agreement signed on 5 March 1980, which had adopted a traditional form of a *Bermuda II*-type agreement with certain additions and modifications. The 1980 *Agreement* was already quite pro-competitive, reflecting Taiwan's consistent liberal policy. In the agreement, certain liberal elements existed, such as multiple designation, as well as the principle of free determination of pricing, liberal route structure, and fair competition.

The newly reached open skies agreement is, in essence, identical to the *Singapore – U.S. Agreement*. It permits the countries' carriers to operate U.S. – Taiwan air services without restrictions. Most importantly, deregulated fifth and sixth freedoms are reciprocally exchanged. Before the agreement, "EVA and CAL were limited to serve New York, Dallas, Seattle, San Francisco, Los Angeles, Hawaii and Guam with beyond rights limited to one point each in Europe and Latin America."[213] This restriction has now been changed. In addition, the U.S. offers CAL and EVA more destinations than the seven previously stipulated and allows them to determine the frequency. The sixth freedom would increase the load capacity of Taipei's Chiang Kai-shek International Airport, particularly for trans-continental flights from Taipei to Europe, North America

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[211] See L. Eyton, "In the Shadow of Beijing?" [January 1997] Accountancy 29.

[212] Due to Taiwan's special status in international affairs, bilateral agreements between Taiwan and the other country cannot be at state level. AIT is registered in Washington as a legal entity established under private law, while TECRO was established by Taiwan government as an administrative office. However, both governments are bound by such an agreement. See "Taiwan Seen as Next Link in U.S. Open Skies Strategy" *Aviation Daily* (26 February 1997) at 333.

[213] T. Ballantyne, "Open Skies in Asia – Changing Fortunes" [June/July 1997] Orient Aviation 26.

and Australia.[214] However, unlike the *Singapore – U.S. Agreement*, there is no seventh freedom provided in the *Agreement*. Taiwan does not seek the seventh freedom for scheduled and charter flights so far, and the U.S. does not insist on it at this stage either.

Again, the pricing standard is that of double-disapproval – prices can be blocked only if both nations object.[215] "Charter flights are permitted to carry international charter traffic of passengers and/or cargo (including split and combination (passenger/cargo) charters) between any points of the two contracting parties."[216]

In summary, the new air transport agreement signed between Taiwan and the U.S. has virtually liberalized international air transportation, removing all governmental intervention to air transport, and thus ensuring the vital reliance on market forces.

V. South Korea

South Korea is another critical country in Northeast Asia. Its aviation industry has grown rapidly in recent years owning to its strengthening economy and the easing of regulations regarding overseas travel. Since the overseas travel restrictions were removed in 1988, Koreans have become enthusiastic travelers. Over 20 per cent of the population travels abroad by air. In the future, "traffic to and from Korea is expected to rise by 7.7

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[214] See *Air Transport Agreement between the American Institute in Taiwan and the Taipei Economic and Cultural Representative Office*, treaty is available in Office of the Assistant Secretary for Aviation & International Affairs of Department of Transportation of the United States, ann. II, s. 1.

[215] See *ibid.*, art. 12.

per cent per year during 2000 – 2010, to 42.8 million passengers by the end of that period."[217] Even though Japan retains its status as the top market and destination at this stage, it is anticipated that China's market will exceed Japan's in two to three years' time.[218] The extraordinary growth in China's air travel market, including the direct flights between Seoul and cities in China (Beijing and Shanghai), has boosted the South Korean aviation industry, helping South Korea to become a hub in Northeast Asia.

South Korea has adopted a liberal aviation policy, allowing other carriers to compete against their flag carriers on both domestic and international routes. This country's two main airlines, Korean Airlines (KAL) and Asiana, are both privately-owned. KAL has been extremely profitable in recent years. It emphasizes its operations on intra-Asia routes rather the fiercely competitive trans-Pacific market. Asiana now flies to 14 overseas destinations and plans to expand to others. However, this airline has been hit by continuous losses during the past four years. To recover from its difficult position, Asiana has been fighting with its biggest rival – KAL – for the direct services from Pusan to Beijing and Shanghai, with KAL laying claim to Pusan – Beijing, the sector expected to produce the highest load factors.[219]

Due to South Korea's location and its liberal aviation policy, it has become one of the seven open skies targets of the U.S. since the U.S. launched its Asian open skies

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[216] *Ibid.*, ann. II, s. 1, Charter Air Transportation.

[217] H.P. Mama, "Anatomy of Accelerating Growth" [March 1995] Airport Forum 25.

[218] See R. Whitaker, "Aiming High" [April 1996] Airline Business 51.

[219] See T. Ballantyne, "Twin Trouble over China" [June 1996] Airline Business 18.

initiative in June 1996, especially since the chance of success in the U.S. – Japan bilateral negotiation has been diminishing. South Korea has indicated a willingness to proceed with an open skies negotiation.

South Korea already has a very liberal bilateral with the U.S.. Under the agreement, price competition is allowed and does not require governmental approval, and frequency of flight is unlimited. But granting fifth freedom rights to both countries' carriers has caused Korea to be dissatisfied with the U.S., believing that it is an unbalanced agreement that favors Americans more than it does Koreans, since more fifth freedom rights have been extended to U.S. carriers compared to Korea's limited beyond rights. Unfortunately, this controversy permeated the open skies talks in 1997, constituting one of the primary conflicts.

An open skies talk between the U.S. and South Korea took place on 14 and 15 July 1997. Unfortunately, the parties failed to reach a compromise regarding their aviation relations. South Korea was unable to agree to U.S. demands concerning beyond rights, change of gauge[220] and wet-leasing.

With respect to beyond rights, South Korea considers that the current agreement has provided the U.S. with virtually unlimited route rights to and beyond Korea, whereas

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[220] Change of Gauge refers to a change in the type, specifically size, of aircraft en route whereby passengers switch to another plane before reaching their final destination. See Schless, *supra* note 90 at 447-448. Open skies calls for any designated airline to perform international air transportation without any limitation on change of gauge on any segment of the routes.

Korea feels they have access to a restricted number of points in the U.S..[221] In reality, South Korea is more interested in beyond rights to Latin America or even to Europe at a later stage. However, the U.S. argues that it is an open skies agreement which allocates equal rights to both sides.

Second, the conflict focuses on wet-leasing, which is considered to be illegal in South Korea. For this reason, South Korea even stopped a U.S. airline's (Gemini Air Cargo) operation in 1996 by virtue of its flying from Seoul to New York for Asiana using another company's crew.[222] South Korea insisted on not recognizing wet-leasing during the open skies talk.

Finally, South Korea will not add unlimited changing of gauge to the agreement. They will not allow carriers from the U.S. to fly high capacity long haul jets into Seoul, and then to use smaller aircraft to operate shuttle services on short and medium haul flights to beyond destinations in Asia.[223] Nevertheless, the U.S. will not accept an open skies pact without the freedom of changing of gauge. They consider that the government should not determine the capacity or the size of the aircraft from the intermediate point.[224]

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[221] See T. Ballantyne, "Today's US Perspective" [June/July 1997] Orient Aviation 22.

[222] See "South Korea Halts US Airline" [27 November 1996] Transport.

[223] See Ballantyne, *supra* note 221 at 24.

[224] *See ibid.*

At present, it is still questionable when negotiations will be resumed. But one thing is clear: the U.S. will not reach a new agreement without the inclusion of all three of the elements mentioned above, since open skies is its single purpose.

VI. The Philippines

The Philippines aviation liberalization began in 1995 when President Fidel Ramos issued an executive order liberalizing the government's international and domestic aviation policy in order to open the industry to competition.[225] The new policy was initiated due to the urgent need for the Philippines to improve air service availability and efficiency.

The new policy dismantled the dominant position of Philippine Airlines (PAL). PAL was Asia's first airline and became a monopoly in the country's aviation industry when the Philippine government implemented its single airline policy in 1973. However, after the adoption of the new liberal policy, a second Philippine airline entered the market. In January 1996, the Department of Transportation and Communication (DOTC) allowed Grand International Airways (Grand Air) to provide international services to Hong Kong and Taipei.[226] Grand Air's sights are set on services to U.S. destinations, Tokyo, Beijing, Brunei, Jakarta, and Singapore. In the meantime, it intends to focus on

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[225] See "Philippines Moves to Liberalize Aviation" *Air Letter* (16 January 1995).

[226] See "Philippine Aviation Liberalization: Will Open Skies be Next Step?" [15 December 1996] East Asian Executive Rep. 10 [hereinafter "Philippine Aviation Liberalization"].

the Manila/Davao and Manila/Cebu routes, both of which are big money-earners. The arrival of Grand Air will give the deregulation process a significant boost.

In addition to this newcomer to the international arena, there are four new domestic carriers which fly routes previously monopolized by PAL: Air Philippines, Cebu Pacific Air, Corporate Air, and Star Asia. PAL's reaction to the situation is well presented by the remark of its President J. Garcia, "We like competition. Their presence is going to force us to operate more efficiently and we intend to compete on service and efficiency."[227] "With liberalization, the number of domestic flights has increased, fares have dropped, in-flight services have improved, and airline management has become more efficient."[228]

With regard to its bilateral relations with the U.S., the Philippines made airline liberalization a domestic political issue by demanding the renegotiation of the Philippines – U.S. bilateral agreement. The Philippines considered that an imbalance existed in their bilateral relations since U.S. carriers had unlimited access to all Philippine destinations and unrestricted fifth freedom rights. In contrast, Philippine airlines had only limited access to U.S. cities.

In November 1995, the U.S. and the Philippines reached a compromised agreement, which will terminate in about five years. As part of the agreement, the

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[227] "Breading the Monopoly" [July 1996] Airline Business 43.

[228] "Philippine Aviation Liberalization", *supra* note 226 at 11.

Philippines was given additional flights to the U.S. and beyond, and the U.S. was allowed liberal cargo access to the Philippines, some concessions regarding the frequency of flights, and other concessions.[229] Although this is not quite an open skies agreement, it is still quite a liberal treaty.

VII. Australia

Australia was a pioneer in the field of civil aviation, but the Australian government adopted a strict regulatory policy with respect to the interstate aviation early in the 1950s. The "Two Airline Policy" was designed in 1951 to ensure that the only competition to the government's own Trans-Australia Airlines (Now Australian Airlines) would survive.[230] The government consistently refused to permit new airlines into the market. The cost of this policy is that there has been no price on timetable competition during the succeeding four decades.

Public interest in the general removal of economic controls grew during the 1980s. The decision to deregulate the country's domestic airline passenger service was announced in 1987. The aim of the policy was to remove all existing constraints on entry to interstate routes and on the capacity provided. In order to facilitate the entry of new airlines into interstate markets, import controls on aircraft were lifted; controls on fares will also be removed, giving carriers complete pricing freedom for their services.

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[229] See *ibid.*

By the time deregulation came into force in November 1990 only one new entrant, Compass Airlines, actually joined the interstate operation to compete against the state-owned Australian Airlines and privately-owned Ansett. The carrier expected its operating costs to be much lower than its two rivals. However, Compass Airlines only survived for just over a year. It closed its doors in December 1991, following the government's refusal to provide a $20 million bailout.[231]

In light of the failure of Compass, and faced with the increasing world-wide consolidation of the airline industry, in February 1992 the Australian government announced substantial changes to its aviation policy in order to strengthen the position of Australia's carriers. "These changes include the merger of the government-owned international airline, Qantas, with Australian Airlines and allowed Australian domestic and international carriers to enter each other's markets. The merger gave the enlarged Qantas valuable domestic feeder routes."[232] Furthermore, Qantas was fully privatized by the middle of 1993.[233] In the meantime, Ansett, Qantas's competitor, took advantage of the government's new multiple designation policy on international routes by applying for routes in East Asia. It introduced flights to Bali, Japan, Hong Kong, Taiwan, and

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[230] See S.G. Corones, *Competition Policy in Telecommunication and Aviation* (Queensland: The Federation Press, 1992) at 198.

[231] See Hufbauer & Finlay, *supra* note 109 at 138-139.

[232] *Ibid.* at 139.

[233] Qantas was privatized in two steps: BA bought a one-quarter share of Qantas in March 1993 and the balance was sold to the public in July 1995. Just before the final sale of Qantas, the limits on foreign ownership to were raised from 35 to 49 per cent in an effort in increase interest in the shares when they were floated. BA was limited to 25 per cent and any other airline to 10 per cent. See C. Findlay,

Malaysia. Since March 1996, it has offered services between Jakarta and Kuala Lumpur. Since December 1996, after Ansett[234] obtained the route right, two newcomers, Asuuie Airlines and Kiwi International, initiated services on routes dominated by Qantas and Ansett. The 1992 policy also involved the proposed formation of a single aviation market with New Zealand. The landmark agreement was signed in 1992, and came into effect in November 1996.[235]

Apart from the above-mentioned changes, Australia also opened its air charter and air freight markets under a new liberalized policy in 1996. The Australian government considers that passenger charter operators provide fierce competition for scheduled airlines, and play an important role in developing new markets and bringing tourists directly to regional centers outside the traditional gateway cities. With respect to air freight, the Australian government feels that the liberalized international air freight and freight charter policy will increase capacity for exporters.[236]

To sum up, deregulation has had an enormous impact on fares, domestic passenger numbers, quality of service, and competition. Even though deregulation has not resulted in sustained competition by new entrants, there is clear evidence that competition between the incumbents is much more vigorous than that which existed before

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"Development in Transport Policy: the Trans-Tasman Single Aviation Market" [September 1996] J. Transport Econ. & Policy 329.

[234] See T. Ballantyne, "Aussie Hints at Price War" [August 1996] Airline Business 14.

[235] We will present a more detailed discussion in the next chapter.

[236] See H.J. Sharp, Minister for Transport and Regional Development, "Australia Opens up Charter, Freight Markets", Media Statement of Australia Government (October 1996).

deregulation. The structure of the market for interstate air travel has also clearly changed with the large increase in the discount fare market.[237]

As to foreign aviation relations, Australia's policy appears to focus on a more flexible application of the bilateral system of agreements. On one hand, it established a single aviation market with New Zealand. On the other, it still holds a conservative position to the U.S.. Beginning on 30 June 1992, the Australian government canceled Northwest flights on its New York-Osaka-Sydney route because Northwest exceeded a 50 per cent restriction on the number of passengers picked up in Osaka. The U.S. retaliated by restricting Qantas's flights into Los Angeles. Even though the U.S. is also interested in open skies talks with Australia, particularly since it recently forged a single aviation market with its Tasman neighbor, it is still unable to expect substantial development in the short-term.

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[237] See "Deregulation of Domestic Aviation in Australia 1990 – 1995", Information Sheet 6, Bureau of Transport and Communications Economics, Australia.

CHAPTER 5

CONCLUSIONS

World economic regulation of air transport has reached a new stage of development since the movement towards deregulation and liberalization began in 1970s. This movement has laid a firm foundation for an open skies regime. Since then, the open skies phenomenon has been progressively extending to each corner of the world. In the case of the Asia-Pacific region, it has played a vigorous role in international air transport due to the region's prosperous economy. To meet the needs of stimulating their economies and surviving the increasing global air services competition, Asia-Pacific countries, deeply influenced by the open skies tide, have taken measures to deregulate and liberalize their air transport. Considering the difficulties of open skies on the global and continental scales, this has primarily been achieved in the form of bilateralism in this region.

However, despite the dominant role of bilateral agreements in the Asia-Pacific region, we have found the seeds of a sub-regional single aviation market growing in the area, although this process is still in its infancy. Certain Asia-Pacific countries have begun to take sub-regional measures in the course of their aviation regulation. These measures include adopting common air transport regulatory arrangements within the framework of the existing integrated trade bloc by which member nations would allow free access to other member nations. The basis of the thinking is:

> [...] to meet broader objectives such as economic integration, boost trade, support economic and social development, expand and improve air

> services within their combined territory, promote or defend their interests when negotiating with third parties, or as a response to challenges presented by another group.[238]

So far, the Australia – New Zealand trans-Tasman single aviation market (SAM), the first sub-regional aviation bloc, has became the model for sub-regionalism in the Asia-Pacific region. It is quite possible that the Association of South East Asian Nations (ASEAN) will have the next sub-regional arrangement according to its announced open skies initiatives. To understand this new trend, we will examine SAM and ASEAN hereunder in terms of their origins, progress, and potential.

I. Australia – New Zealand Trans-Tasman Single Aviation Market

Australia and New Zealand have longstanding and close cultural, economic, political and defensive links. In terms of geography, the two countries are physically separated by more than 2000 km by the Tasman Sea and, unlike most trading blocs, share no common land borders. The great area of this isolated continent has rendered the air transport system vital to these countries and the countries have developed it very well in spite of their small populations.

The Trans-Tasman SAM stemmed from the *Australia – New Zealand Closer Economic Relations Trade Agreement* (*CER*), which came into effect on 1 January 1983 and replaced the New Zealand Australia Free Trade Agreement (NAFTA) of 1 January

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[238] H. Nuutinen, "The Tortuous Path to Plruilateralism" (1992) 9:4 Avmark Aviation Economist 17.

1966.[239] The *CER Agreement* established a free trade area. The objectives of the agreement are: to strengthen the border relationship between the two counties; to develop closer economic relations between the member States; to progressively eliminate barriers to trade; and to develop trade between the two countries under conditions of fair competition.[240] "Both countries believe that a closer economic relationship will lead to a more effective use of resources and an increased capacity to contribute to the development of the region through closer economic and trading links with other countries, particularly those of the South Pacific and Southeast Asia."[241]

In terms of civil aviation, air transport across the Tasman was regulated by an agreement reached in 1961. The agreement and the subsequent Memoranda of Understanding (MOU) were rather restrictive.[242] However, in the spirit of CER, the breakthrough came following the announcement of a MOU between Australia and New Zealand in 1992. The MOU spelt out the steps necessary to create a single market for air transport services. The purpose of SAM is, in the medium-term, to effectively remove the aviation border between Australia and New Zealand. It allows multiple designation for passengers and cargo, and the freedom to decide fares and capacity. In addition, it provides for airlines of either country to operate in each other's domestic markets, as of 1

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[239] See D.G. Pearce, "CER, Trans-Tasman Tourism and a Single Aviation Market" (1995) 16:2 Tourism Management 111.

[240] See *ibid.*

[241] *Ibid.* at 112.

[242] Under the 1961 agreement and its MOU, fares, frequencies and capacities were subject to governmental control. Only Qantas and Air New Zealand were the designated carriers. See Findlay, *supra* note 233 at 330.

November 1994, subject to consultation; and for international beyond rights to be exchanged and incrementally introduced in the medium-term.[243]

Unfortunately, in October 1994, the Australian government declared its refusal to accept the reciprocal cabotage right when Air New Zealand (Air NZ) prepared to commence its service in the Australian domestic market. In addition, the Australian government withdrew its approval for Air NZ to extend beyond services. But twelve beyond rights remained.[244] "The difficulty related to perceived inequivalencies in the trans-Tasman market. Australian carriers have reciprocal beyond rights on flights to New Zealand, but the demand for services to Antarctic is not an extensive one."[245] As one Australian Minister pointed out, "the existing MOU was clearly an arrangement that, in the absence of any rationalization of the airline structures competing with each other, was in New Zealand's favor to the tune of many millions of dollars."[246] It was obvious that the Australian government's attitude was generally regarded as a move to protect "the public float of Qantas". At that time, Qantas prepared for privatization, and the Australian government was concerned about Air NZ using increased beyond rights to monopolize routes out of Australia, which it thought would affect the sale of Qantas' services.

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[243] See *ibid.*

[244] Air New Zealand already had rights to seek further fifth freedom rights into Australia and beyond. These were provisionally granted in 1993, and thus Air New Zealand has rapidly developed Brisbane as a hub for fifth freedom flights to the West Pacific Rim and North America. See Graham, *supra* note 51 at 197.

[245] *Ibid.*

[246] Findlay, *supra* note 233 at 330.

After Australia's Liberal-National Party was elected in 1996, Australia and New Zealand agreed to revive plans to create a single domestic aviation market, setting 1 November 1996 as the deadline for its implementation. "The SAM arrangements will create a new market worth an estimated $5 billion and covering more than 31 million passengers a year by bringing together the domestic travel market of each country, and the Trans-Tasman market which links them."[247]

The SAM arrangements reaffirm the countries' commitment to the *CER Agreement* and acknowledge the benefits of competition to consumer satisfaction. In accordance with the *Agreement*, there will be no restrictions on capacity and frequency. Tariffs will not be subject to the aeronautical authorities of either country.[248] Code-sharing will be permitted between SAM airlines within the SAM without limitation.[249] A liberal approach has been adopted in respect of charter operations.[250] The *CER Agreement* liberalized the criteria of ownership and control of SAM airlines: at least 50% ownership and effective board control will be by Australian and/or New Zealand nationals, and two-thirds of the Board members will be nationals from both countries.[251] The most significant aspect of the *Agreement* permits the SAM airlines to operate in each

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[247] H.J. Sharp, Minister for Transport and Regional Development, "Australia-New Zealand Agree on Single Aviation Market", Media Statement (September 1996).

[248] See *Australia-New Zealand Single Aviation Market Arrangements*, treaty is available in Australia Delegation of ICAO, art. 5.

[249] See *ibid.*, art. 6.

[250] See *ibid.*, art. 7.

[251] See *ibid.*, art. 8.

other's domestic markets, thus introducing cabotage, a right which was denied to them by the Australian government in 1994.[252]

However, the issue of fifth freedom international passenger traffic rights beyond Australia and New Zealand has been excluded from the new *Agreement*, and will be left to future negotiations after the domestic market pact has been implemented. Some issues, such as immigration and safety controls, must still be discussed and resolved. Furthermore, the two countries will not create a common external aviation policy regarding third countries due to their different positions of international policy.[253]

As discussed earlier, the Australia – New Zealand sub-regional aviation common market is quite developed. Considering the close geographic, economic, and cultural links between the two countries, it is believed that cooperation in the area of air transport will develop further and achieve mutually satisfying results with respect with beyond rights, immigration, and safety controls.

II. Air Transport Integration of ASEAN

The Association of Southeast Asian Nations (ASEAN) was established in August 1967 in Bangkok, Thailand, with the signing of the *Bangkok Declaration*[254] by the five

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[252] See *ibid.*, art. 4.

[253] Compared to Australia, New Zealand prefers a more liberal approach in international services because of its limited domestic market which, like Singapore, mostly depends on access to the international market. As a result, it signed a bilateral open skies agreement with the U.S. on 29 May 1997.

original member countries, namely Indonesia, Malaysia, the Philippines, Singapore and Thailand. Brunei joined the Association in January 1984. Vietnam became the seventh member of ASEAN in July 1995. Laos and Myanmar were admitted into ASEAN in July 1997.

The *Bangkok Declaration* united the ASEAN member countries in a joint effort to: (1) promote economic, social and cultural cooperation in this region; (2) safeguard the political and economic stability of the region against big power rivalry; and (3) serve as a forum for the resolution of intra-regional differences.[255] Nonetheless, in the 1960s and 1970s, both ASEAN economic cooperation and the ASEAN Preferential Trading Arrangement were found to be inadequate. "All empirical studies on the tariff impact of that arrangement on intra-regional trade confirm that the effects were minimal."[256] But, in the sector of economic cooperation, international factors influenced the creation of the ASEAN Free Trade Association (AFTA). At that time, in the rest of the world certain trade blocs had been formulated which constituted a growing threat to ASEAN. Moreover, by 1993, ASEAN had a large domestic market of 330 million people with a combined $320 billion in GNP or nearly $1000 per capita, which shows the rapid economic growth in this area.[257] In these regards, the idea of setting up AFTA within 15 years was launched at the Fourth Summit held in Singapore in January 1992. The Summit

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[254] See *Bangkok Declaration* is also called *the ASEAN Declaration*. It was signed by Indonesia, Malaysia, the Philippines, Singapore and Thailand on 8 August 1967 at Bangkok, Thailand. Treaty is available in website: http://www.aseansec.org [hereinafter *Bangkok Declaration*].

[255] See *ibid.*

[256] B. Bora & C. Findlay, *Regional Integration and the Asia-Pacific* (Oxford: Oxford University Press, 1996) at 197.

urged member States to cooperate in order to facilitate trade, non-border measures and investment promotion activities, thus reducing or eliminating tariff barriers on the import and export of products and exploring further liberalization of trade.[258] Furthermore, the ASEAN Economic Ministers (AEM), at the fifth AFTA Council meeting in Chiangmai in September 1994, decided to accelerate the timetable from fifteen to ten years, that is to say, for AFTA to be achieved by 1 January 2003 instead of 2008.[259] However, aviation was initially not included in this plan.

In the years which followed, concerns that Asian carriers' competitive advantages were being eroded by the EC's final liberalization package and the signing of the *North American Free Trade Area Agreement* between the U.S., Canada and Mexico were increasing. ASEAN member countries began to worry about Europe and America's more efficient carriers taking over the Asia-Pacific market, which would result in the need to create a multilateral defense strategy. Believing that the framework of economic cooperation had paved the way for air transport cooperation, ASEAN countries began to take steps toward aviation integration.

However, concrete measures to achieve open skies within ASEAN as a whole are still experiencing difficulties. Several attempts to form a regional cooperative network that could eventually become a mega-carrier cannot be considered successful because heterogeneity remains the main feature of the group of the ASEAN flag carriers.

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[257] See *ibid.* at 198.

[258] See *Framework Agreement on Enhancing Economic Cooperation*, Singapore, January 1992, art. 2(A).

Moreover, the member states' interests in aviation are so widespread the States they cannot reach an understanding. Singapore, for example, is an extreme model which advocates a fully deregulated aviation environment, while countries like Thailand are still in favor of a strictly bilateral approach to safeguard an equivocal balance of opportunities. Furthermore, "[s]ome ASEAN countries want their own bilateral and regional pacts to be strengthened first: many are outdated, mostly providing for one airline from each country to serve a handful of routes."[260] Finally, harmonization has been more difficult to achieve since the three newest members – Myanmar, Laos and Cambodia – have joined ASEAN. Devastated by war and civil unrest, they remain low-income economies, causing them to stand apart from the hectic development of the ASEAN air transport industry. Nevertheless, another newcomer – Vietnam – is beginning to demonstrate the economic growth rates characteristic of the region. As H. Nuutinen pointed out, "even though the mechanism to negotiate as a block already exists, as the timescale for trade liberalization suggests, the group seems far too fragmented at present to agree on a common aviation policy."[261] In spite of all of these elements, the potential of achieving a sub-regional open skies regime is very promising since recent efforts at an ASEAN meeting have firmly established the theoretical foundation.

The Bangkok Summit could be called a milestone in aviation cooperation. The *Bangkok Summit Declaration* of 1995 launched a new plan of Action in Transport and Communication for 1994-1996, leading to integration in this respect. The dominant

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[259] See Bora & Findlay, *supra* note 256 at 199.

[260] T. Ballantyne, "ASEAN Bloc Hardens" [September 1992] Airline Business 20.

feature of the plan is its development of an open skies policy, which was viewed as the guiding principle for the following efforts. Under the guidance of the *Bangkok Declaration*, the open skies policy has been discussed respectively by the ASEAN Transport Minister's Meeting (ATM), ASEAN Economic Minister's Meeting (AEM), and the Tourism Minister's Meeting in recent years.

The first ATM, held in March 1996, noted the Agenda for Greater Economic Integration pertinent to the transport sector under the *Bangkok Declaration*. Participating ministers agreed to develop a Competitive Air Service Policy, which might be a gradual step towards an open skies policy in ASEAN.[262] The Ministers also agreed that liberalization of air services, which had already begun within the sub-regions, should continue to be vigorously pursued and expanded to other sub-regions.[263] Both the second and third ATM reiterated the importance of the development of an open skies policy in ASEAN. In this regard, the Ministers agreed to accelerate the work program to implement air services liberalization within the ASEAN sub-regional groupings.[264] They agreed that ASEAN member countries would cooperate towards liberalization of the air transport industry, which would further accelerate the growth of business and foreign investments, tourism and trade. Hence, a regional competitive environment in

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[261] Nuutinen, *supra* note 238 at 18.

[262] See *Ministerial Understanding on ASEAN Cooperation in Transportation*, signed at the First ASEAN ATM, March 1996.

[263] See Joint Press Release for the First ASEAN Transport Ministers Meeting, Bali (17-19 March 1996), art. 8(g).

[264] See Joint Press Statement of the Second ASEAN Transport Ministers Meeting, Chiang Mai (28 February 1997), art. 10; Joint Press Statement of the Third ASEAN Transport Ministers Meeting, Mactan, Cebu, Philippines (5 September 1997), art. 8.

international air transport within ASEAN would be developed and promoted, with no restrictions on frequency, capacity and aircraft type for point to point services.[265]

The 27th AEM included in its Plan of Action the development of an open skies policy as an area of possible cooperation. The ASEAN Tourism Ministers, at their meetings in Surabaya (January 1995) and Kuala Lumpur (January 1996), expressed their support of the implementation of an open skies policy. At both meetings, the ministers also discussed the increase of direct air links between secondary cities and tourism areas in ASEAN.

Besides all these theoretical attempts, small groups of countries have practically experienced group cooperation within ASEAN. For instance, Indonesia, Malaysia and Thailand signed a limited open skies deal in December 1994 as part of a package to liberalize trade and services in the Growth Triangle area.[266] In this pact, each member country designated three cities to which two airlines from each country can offer unlimited frequencies, using any type of aircraft. Only third and fourth freedom rights are available initially and fifth freedom rights will be added later, cabotage prohibition being left untouched by the agreement.[267] Certain regional attempts such as this can usually be seen before the implementation of an open skies regime within the ASEAN area.

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[265] See *Integrated Implementation Program for the ASEAN Plan of Action in Transport and Communication*, endorsed by the Third ASEAN Senior Transport Meeting (STOM) and adopted by Second ATM, Program 7, arts. 45-49.

[266] See I. Muqbil, "Open Skies for ASEAN?" [November 1995] Airline Business 18.

Bearing all these efforts in mind and in spite of the existing barriers to an integrated aviation market in ASEAN, no one can deny the potential force of a sub-regional integral aviation market, although achieving this goal cannot be expected in the near future.

III. Evaluation

After examining the two sub-regional air transport arrangements, we can easily conclude that, because neither global multilateralism nor regional cooperation within the Asia-Pacific region is realistic for the countries in that area at present, bilateralism remains the dominant liberal force in international air service regulation. Nevertheless, there is one inescapable fact that Asia-Pacific countries have to face, namely, coordination in the EU and North America poses a direct and immediate threat to Asia-Pacific airlines. Their mega-carriers are eyeing the rich traffic potential in this region. More and more Asia-Pacific countries have begun to acknowledge this situation of fierce international competition, leading them to consider alliances with like-minded neighboring countries that are located in the sub-region as their best weapon of defense. Because this measure could reinforce the strength of the group of countries in third party bilateral negotiations, in particular, they would be strong enough to withstand competition by European or U.S. carriers. In light of the implications of the Australia – New Zealand SAM and ASEAN open skies initiatives, we have seen the promising potential of sub-regional cooperation in the Asia-Pacific region. Even though this kind of

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[267] See I. Muqbil, "Three Points to Open Asia" [December 1994] Airline Business 18.

practice is probably not appropriate for all parts of the region, "it contains a number of rational fundamentals, which offer a useful example."[268]

Nevertheless, the whole picture of future commercial air transport regulation in Asia-Pacific will not be purely a matter of bilateralism or sub-regionalism. On the one hand, one cannot say that bilateralism will be totally replaced by sub-regional open skies arrangements thanks to the Asia-Pacific countries' traditional reluctance regarding alliances and their widespread interests in air transport services. On the other, persisting in the idea that bilateralism is the only alternative does not appear to be advantageous to Asia-Pacific in the long-term. Why not assume that the ideal regime is a combination of both regulatory regimes – bilateral and sub-regional open skies arrangements? Countries wishing to cooperate regionally would be in a position both to respond and to take initiatives, which would be appropriate to achieve the most effective and valuable aviation system for the region. Those (still the majority) who are unable to accept collective coordination could rely on bilateralism. It is believed that such an arrangement of co-existence would be the most feasible operation for the Asia-Pacific region and would achieve favorable results in the foreseeable future.

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[268] P. Harbison, "Aviation Multilateralism in the Asia Pacific Region: Regulatory and Industry Pressures for Change" (1994) XIX: 3 Air & Sp. L. 145.

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