

Globalization, Regionalism and International Transport System

—Challenges for Air Transport in Japan and East Asia—

Tae Hoon Oum

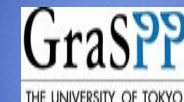
Professor, The University of British Columbia

Katsuhiro Yamaguchi

Visiting Professor, The University of Tokyo



ITPU *International Transport Policy Research Unit*



Outline

- Global Economy and Air Transport
- Air Transport in East Asia
- Challenges for regulatory reform

Global Economy and Air Transport

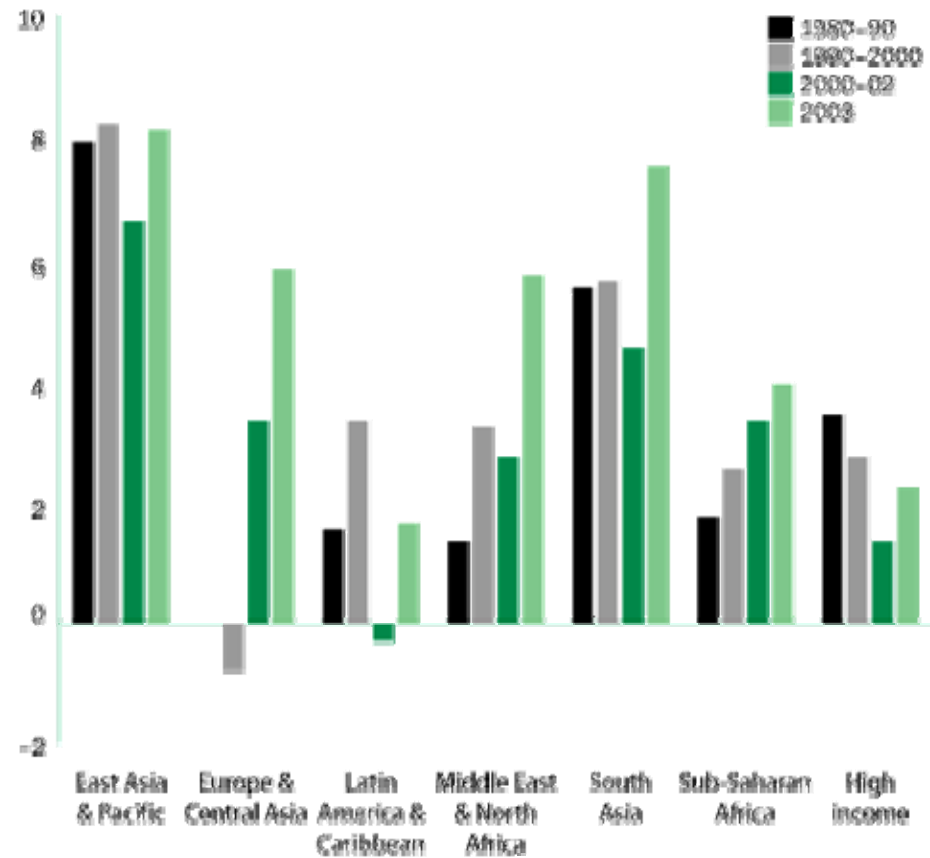


- **Global Economy**

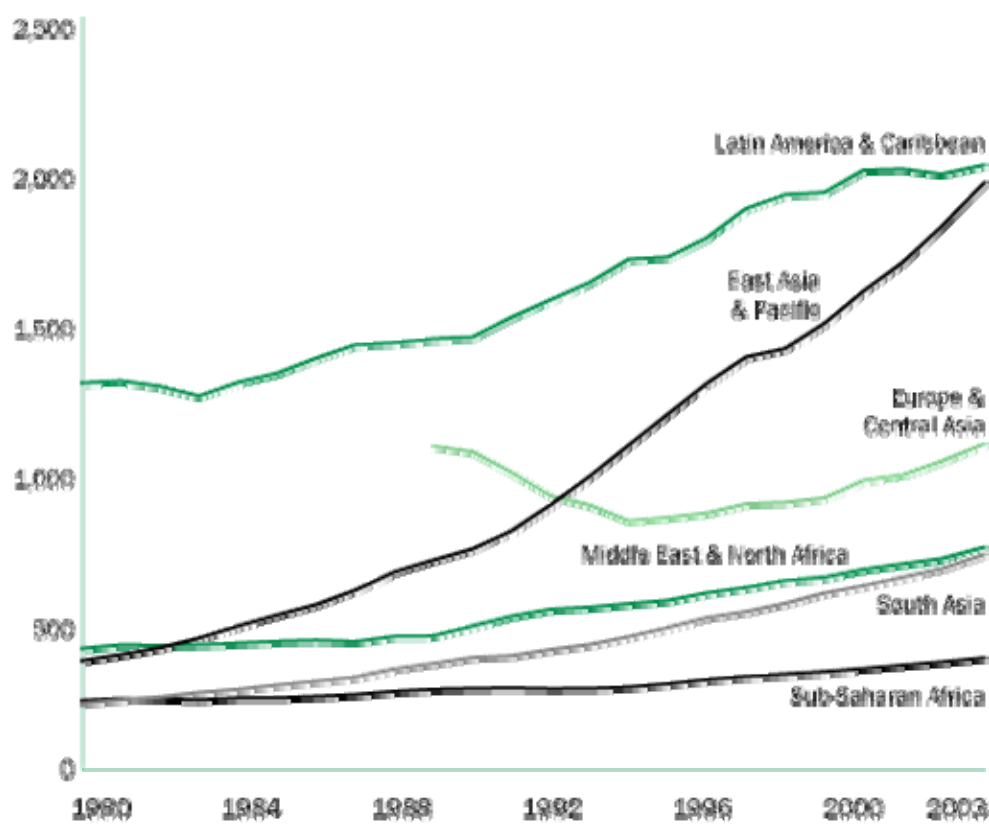
- Stable economic growth is expected, despite high oil prices.
- Growth continues in most Asian countries, although extreme differences in per-capita incomes would persist.

Global Economy

Economic growth by region (%)



Gross domestic product (2000 US\$ billions)

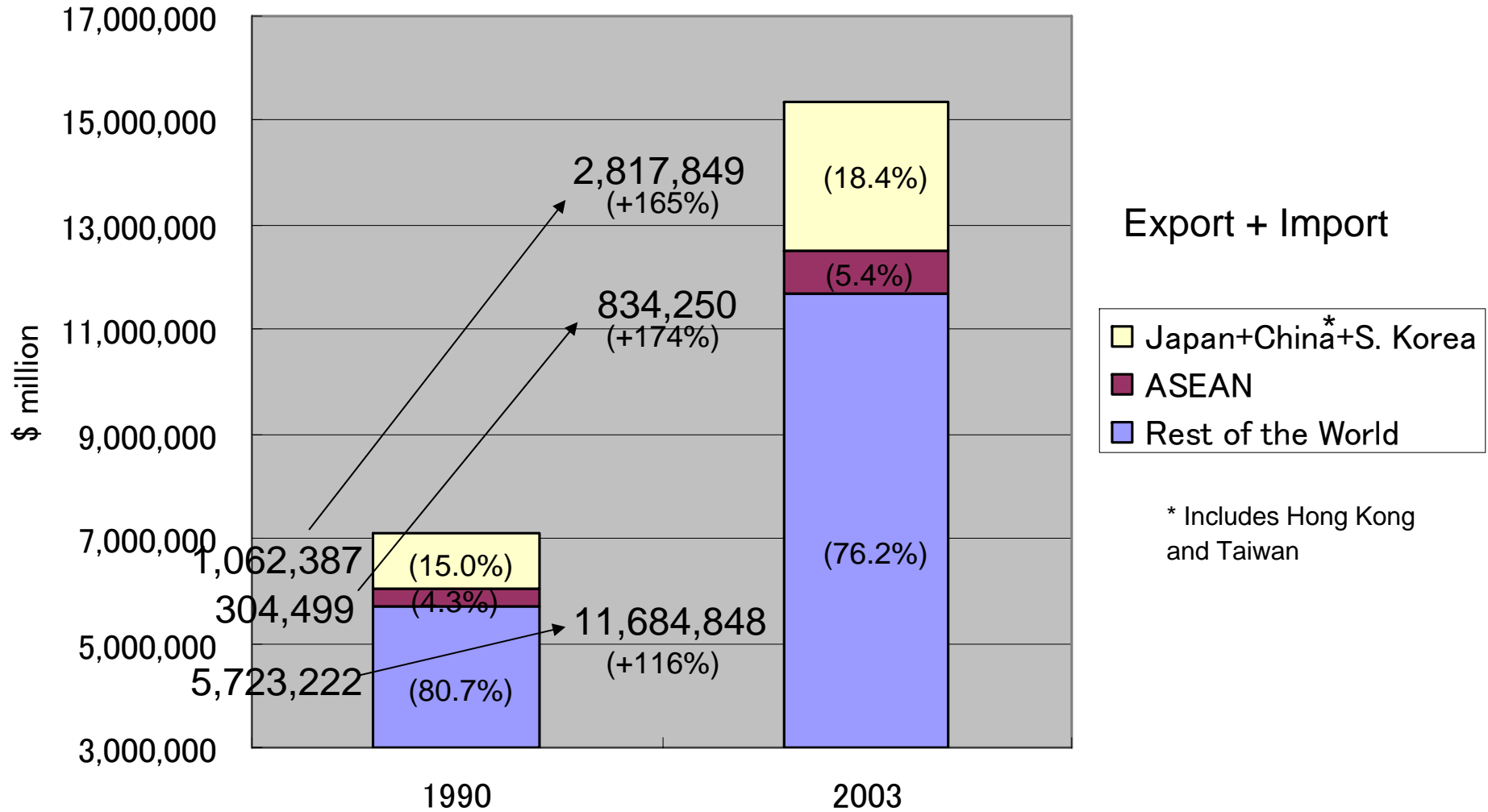


Source: World Bank

- **Global Trade**

- Global trade continues to grow.
- East Asia, now the “manufacturing complex”, and “growth engine” of world economy.
- Trade of “ASEAN + 3” accounts for $\frac{1}{4}$ of global trade.

Global Trade

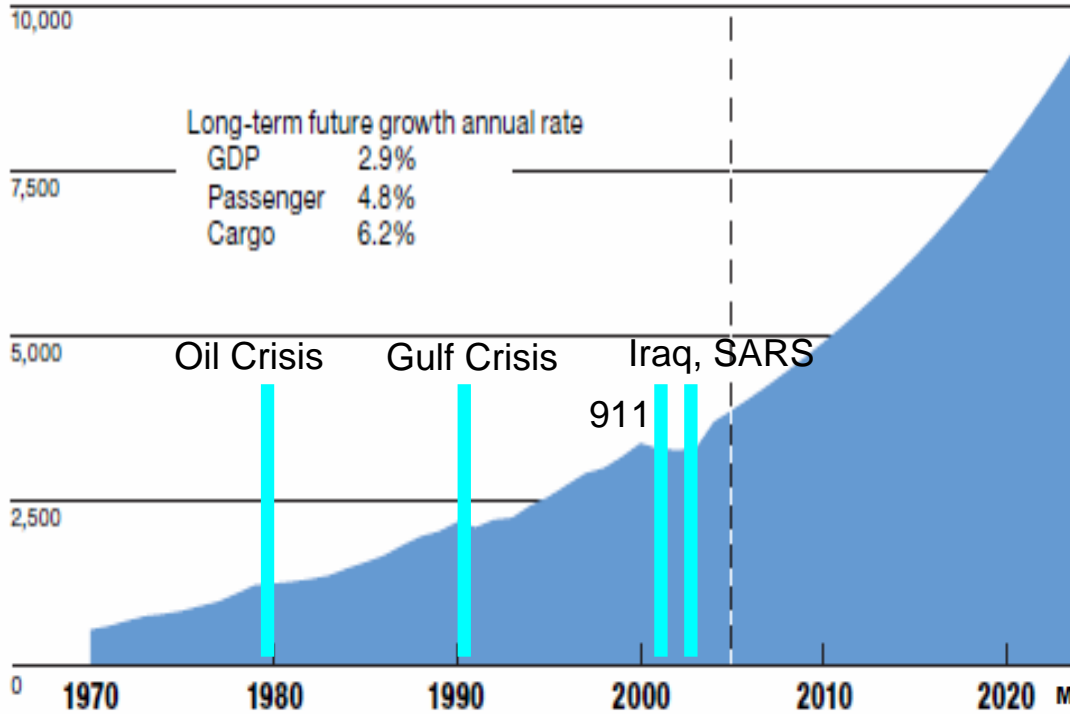


Source: World Bank

Air Transport

World Air Travel Continues to Grow

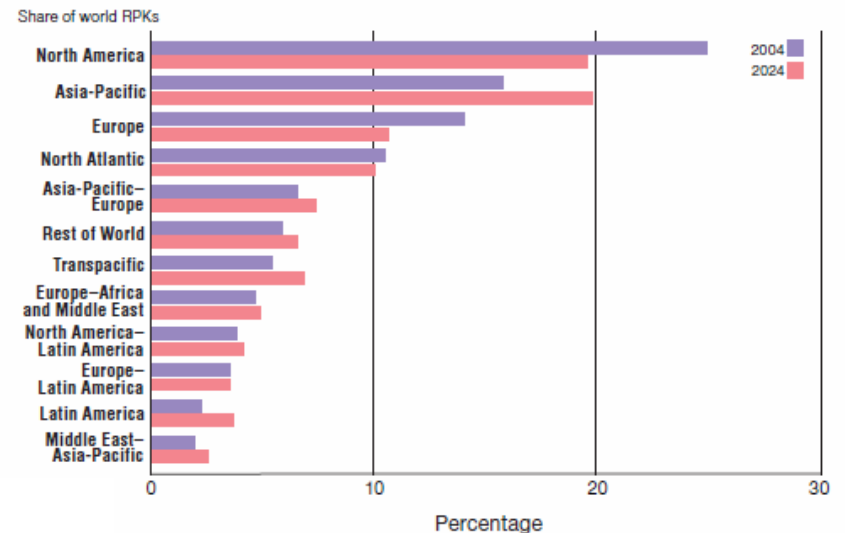
Revenue passenger kilometers, billions



- Growth exceeds GDP growth
- Asia-Pacific expected to outperform other markets

Source: Boeing (edited by author)

More Mature Markets Lose Share



Global Trend in Air Transport

Inter-continental Competition

➤ In the long-haul global market, inter-continental alliance and feeder network alliance between major carriers have been established.

Global Alliance in Air Transport

STAR ALLIANCE™



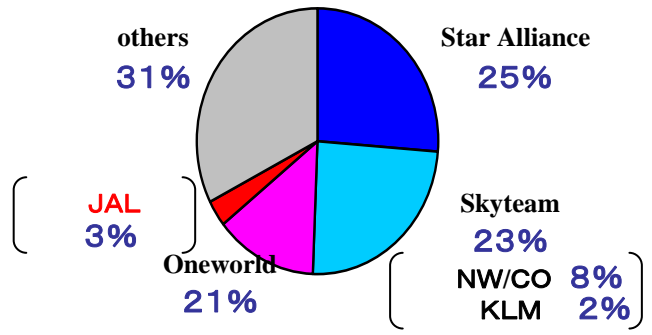
oneworld



SKYTEAM



Share of alliance groups (RPK, 2003)



※ as of Nov. 2005
 ※ Share calculated from IATA stats and airline HPs

Global Trend in Air Transport

Regional Bloc formation: “Continentalization”

- EU market integration begun in 1997.
- Australia = New Zealand Single Aviation Market (Trans-Tasman) Arrangements initiated in 2000.
- In regional markets, LCCs have established their business model, starting from US, then in EU, and now in Asia. Challenges legacy carriers' business model even in mid-distance markets.
- Large liberalized markets in US and EU have driven the industry to become pro-competitive and more efficient.

Regions and Air Transport

Europe

- EU (15→25)
- Integrated Air Transport Market (1997~)

2004年5月現在
25カ国

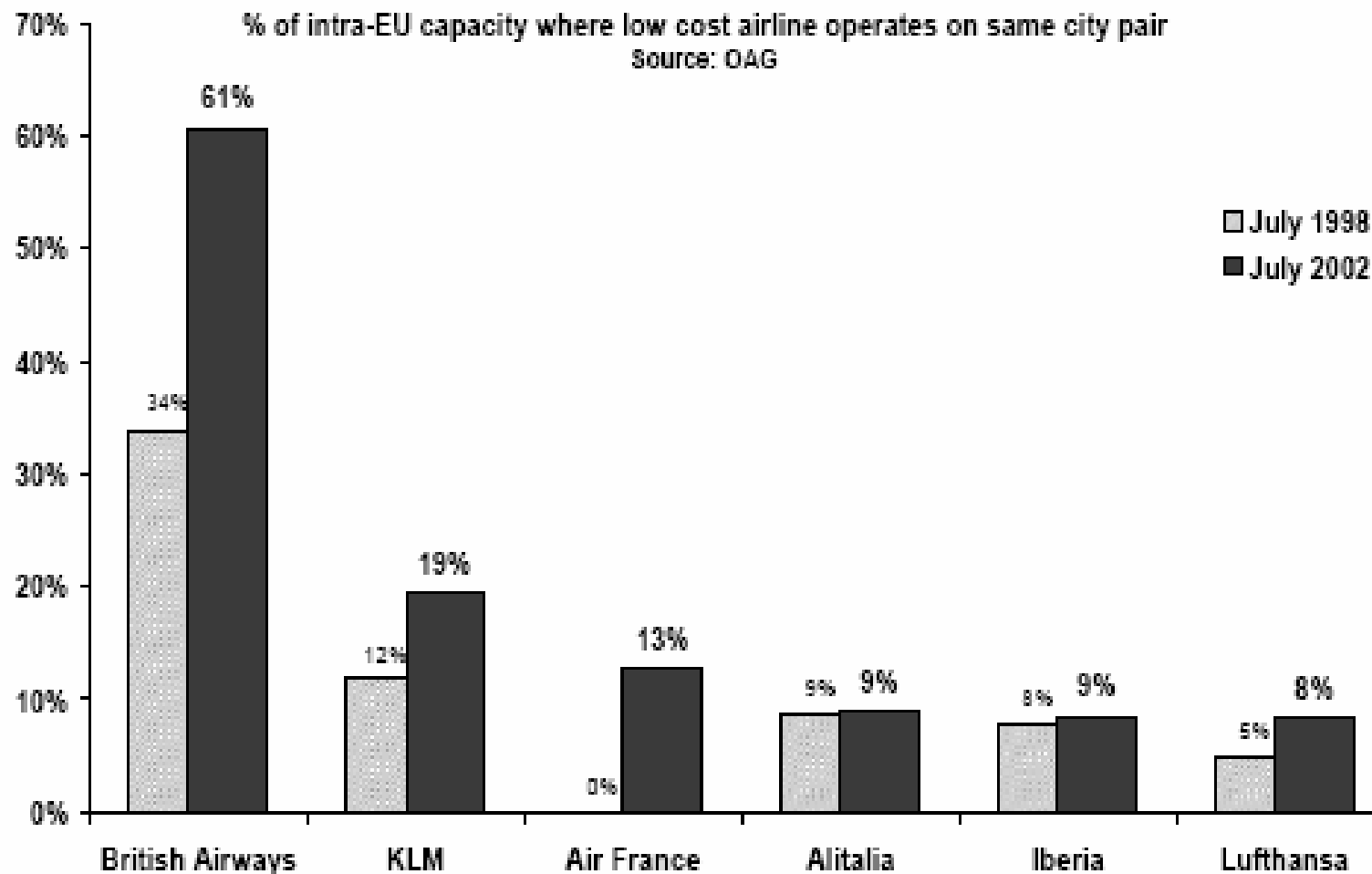
交渉中

- ✈ Air Transport Industry: Alliance between mega-carriers, merger of AFR and KLM, growing LCCs (Ryanair, Easyjet, etc.)
- ✈ Public Policy: Common competition policy, common safety standards, Community ownership rule, single sky;
- ✈ External Policy: ASA Negotiation with US, etc., common security interfaces, etc.

Level of Direct Low Cost Competition faced by Major Flag Carriers

% of intra-EU capacity where low cost airline operates on same city pair

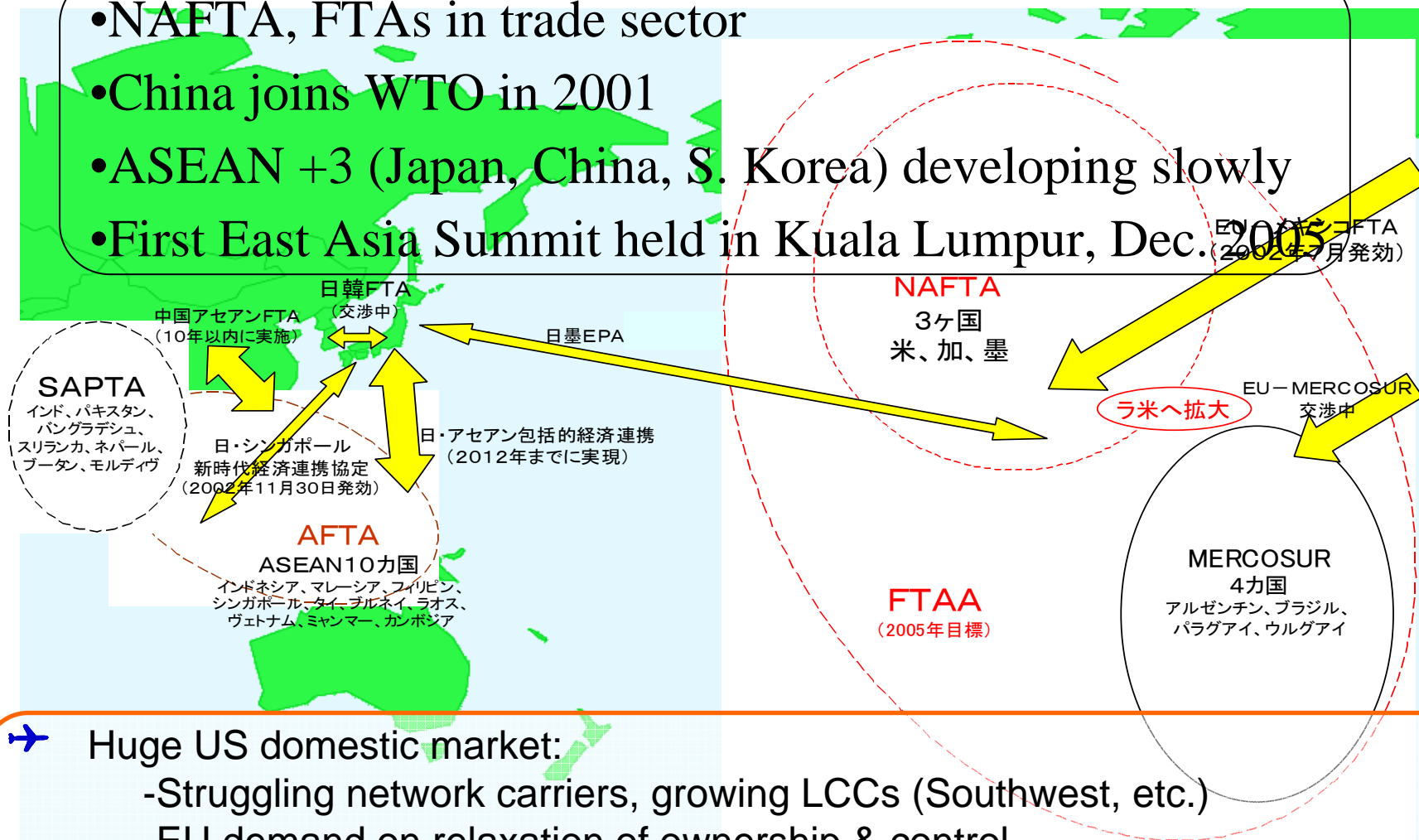
Source: OAG



Regions and Air Transport

Asia - Pacific

- NAFTA, FTAs in trade sector
- China joins WTO in 2001
- ASEAN +3 (Japan, China, S. Korea) developing slowly
- First East Asia Summit held in Kuala Lumpur, Dec. 2005



- Huge US domestic market:
 - Struggling network carriers, growing LCCs (Southwest, etc.)
 - EU demand on relaxation of ownership & control
- Open Sky (US, NZ, SIN....) vs. Progressive Liberalization (China, Japan.....)
- Wave of LCCs: South East Asia → North East Asia, India.....

Air Transport in East Asia



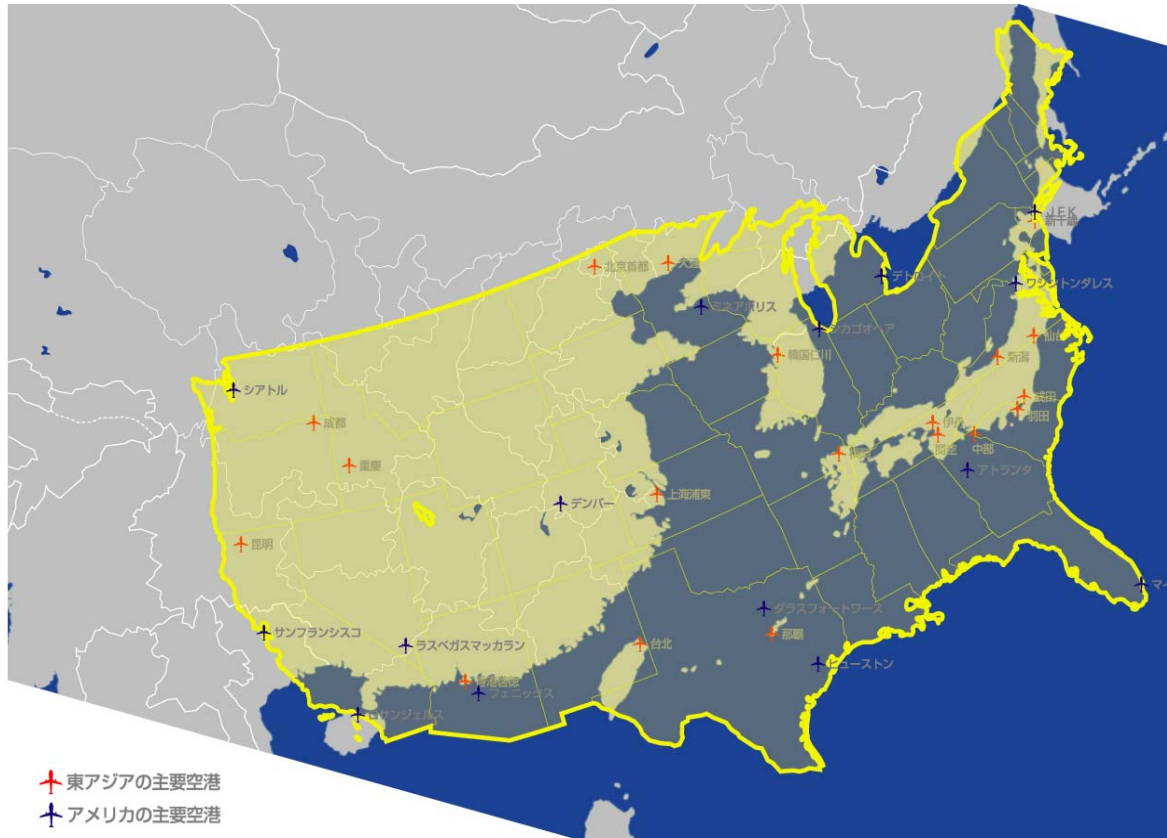
Emerging Agenda for Air Transport in East Asia

- East Asian networks have long been shaped by restrictive bilateral ASAs; creating a very fragmented system of single hub networks.
- In the long-run, international air accessibility would affect economic geography of East Asia.
- Thus, international transport system needs to be developed not only as national infrastructure, but also as common basis for East Asia region.

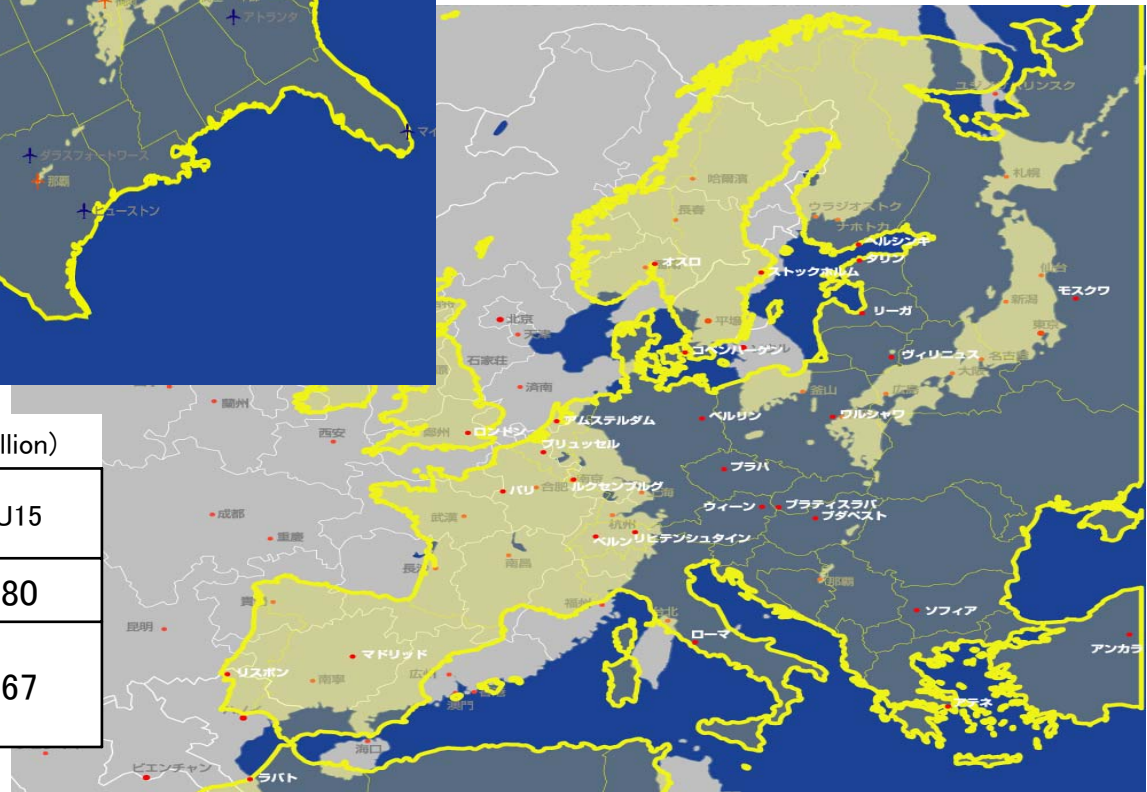
Emerging Agenda for Air Transport in East Asia – cont'd

- Recent EU-US deal, if ratified, would have a profound impact for Asia.
- It is not just a legal issue regarding ASA between EU member countries.
- Under stronger market forces, air carriers on both sides of the Atlantic would enhance their efficiency and competitiveness, while leaving Asian carriers less competitive in the long run in international markets.

Geography and Air Transport



✚ 東アジアの主要空港
✚ アメリカの主要空港



	(million)		
	Japan+China +S.Korea	US	EU15
population	1,493	291	380
intra-regional passenger air transport	206*	587	367

Figures for 2003. * sum of domestic market.

Japan

- Japanese air transport market has grown considerably.
- In recent years, however, Japan seems to have fallen into a negative lock-in situation.
- Much of the inputs are constrained to be purchased from high-cost Japanese sources. Regulatory Reform, therefore, may need to be proceeded while addressing such input cost issues.
- Regional market integration would provide airlines with opportunities to source inputs from optimal location as well as allowing to participate in rapidly growing in East Asia.

China

- Strongest and major growth market in the world.
- Problem for the industry is how to secure capable human resources.
- Sharp discrepancy between highly developed coastal regions and underdeveloped inland areas causes political economy problems.
- Market integration with adjacent countries would solve these problems at partly.

.

Korea

- At the moment, Korean carriers are in the most advantageous position among the three countries.
- Development as East Asian logistics/distribution hub similar to Netherlands and Singapore is in progress, although they fight uphill battle against Shanghai and other Chinese ports.
- Trade and transport liberalization for the success of Korea's regional logistics hub initiatives.
- Although their optimal policy is really Singapore-style open skies policy with all major countries, their bilateral ASA process is also influenced heavily by flag carriers.

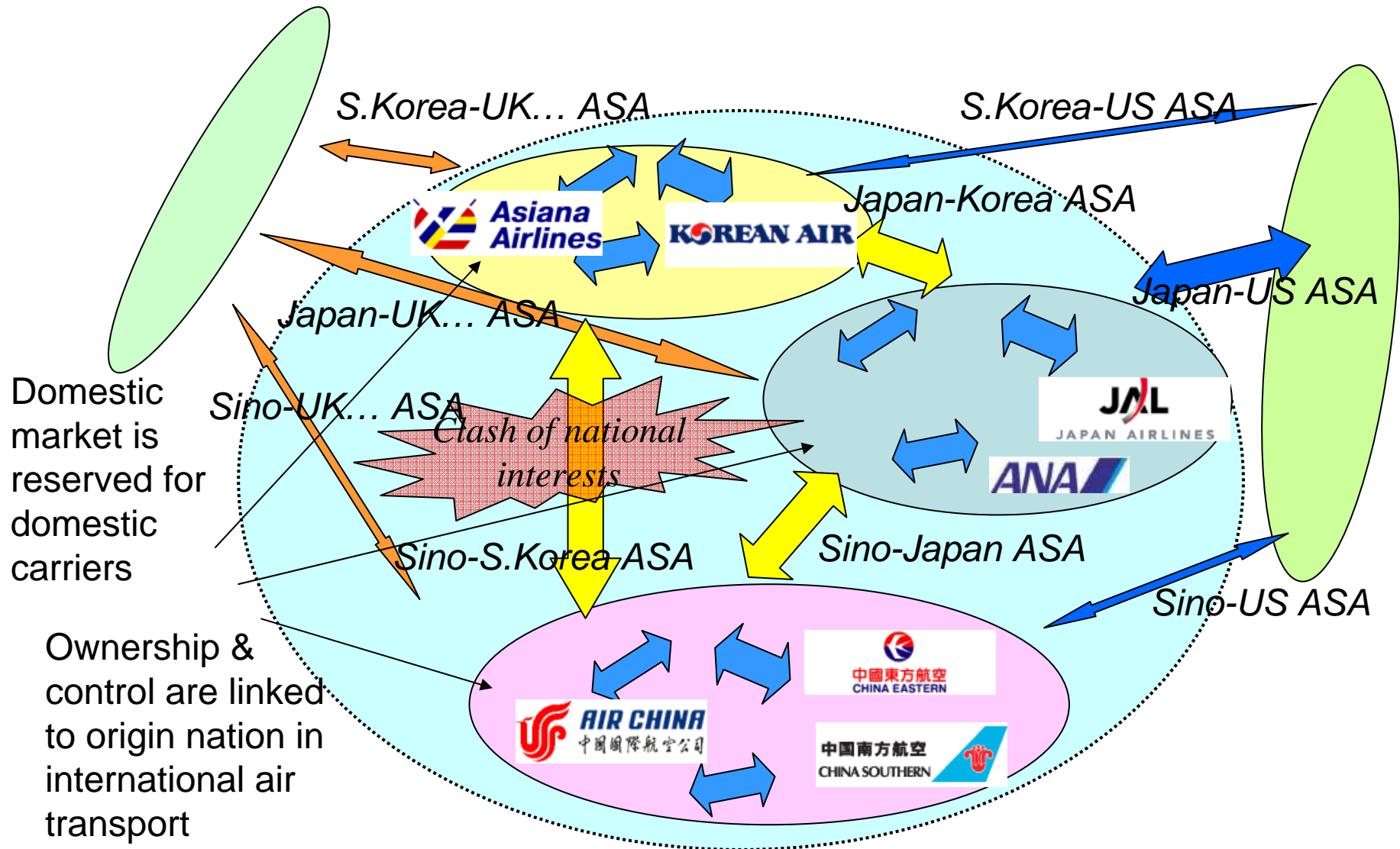
Challenges for regulatory reform



Current Regulatory Framework

- Air transport has traditionally been provided under a framework that segregates international and domestic activities.
 - Under Air Services Agreements (ASAs), the airlines designated to serve on international routes should be majority owned and controlled by citizens of the country
 - Domestic markets are reserved sole for own carriers; Since China has a very large domestic market (like US), it will eventually shape East Asian air transport network structure.

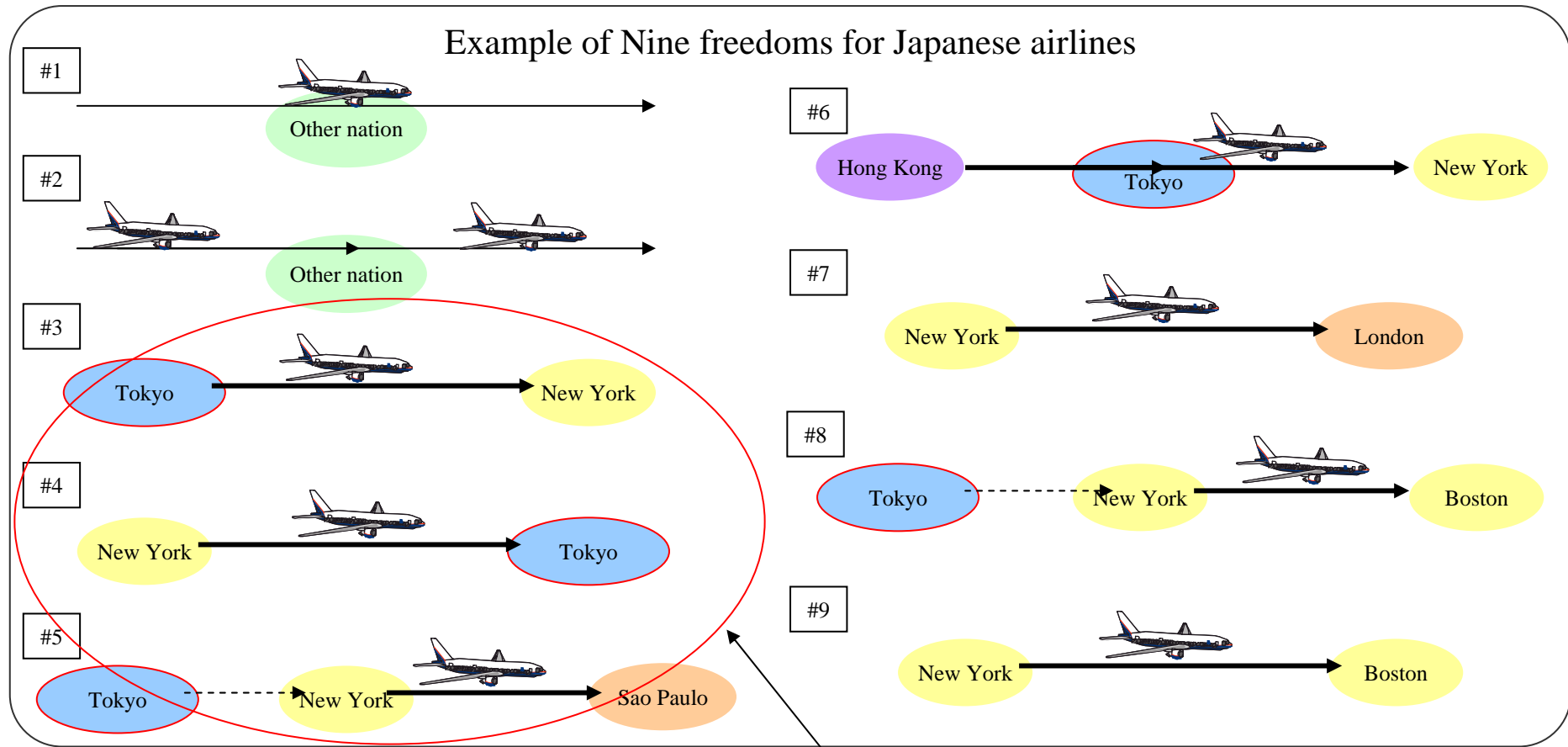
Current Regulatory Framework



Effects of Current Regulatory Framework

- Offers limited growth opportunities to airlines based in Asia
- Has prohibited development of efficient multiple hub networks by Asian carriers
 - ⇒ ⇒ Each Asian airline is essentially a single hub carrier based in their country of residence
 - ⇒ ⇒ No airline in Asia is truly ***an Asian carrier*** having an effective coverage of Asian markets
- Bilateral ASA processes are too heavily influenced by flag carriers; leading to capacity/market sharing between the two bilateral carriers in most markets, against the interest of consumers and overall economic benefits of the nations.

Nine freedoms in international air transport



Routes, frequencies, number of airlines set under ASA and negotiated between aeronautical authorities

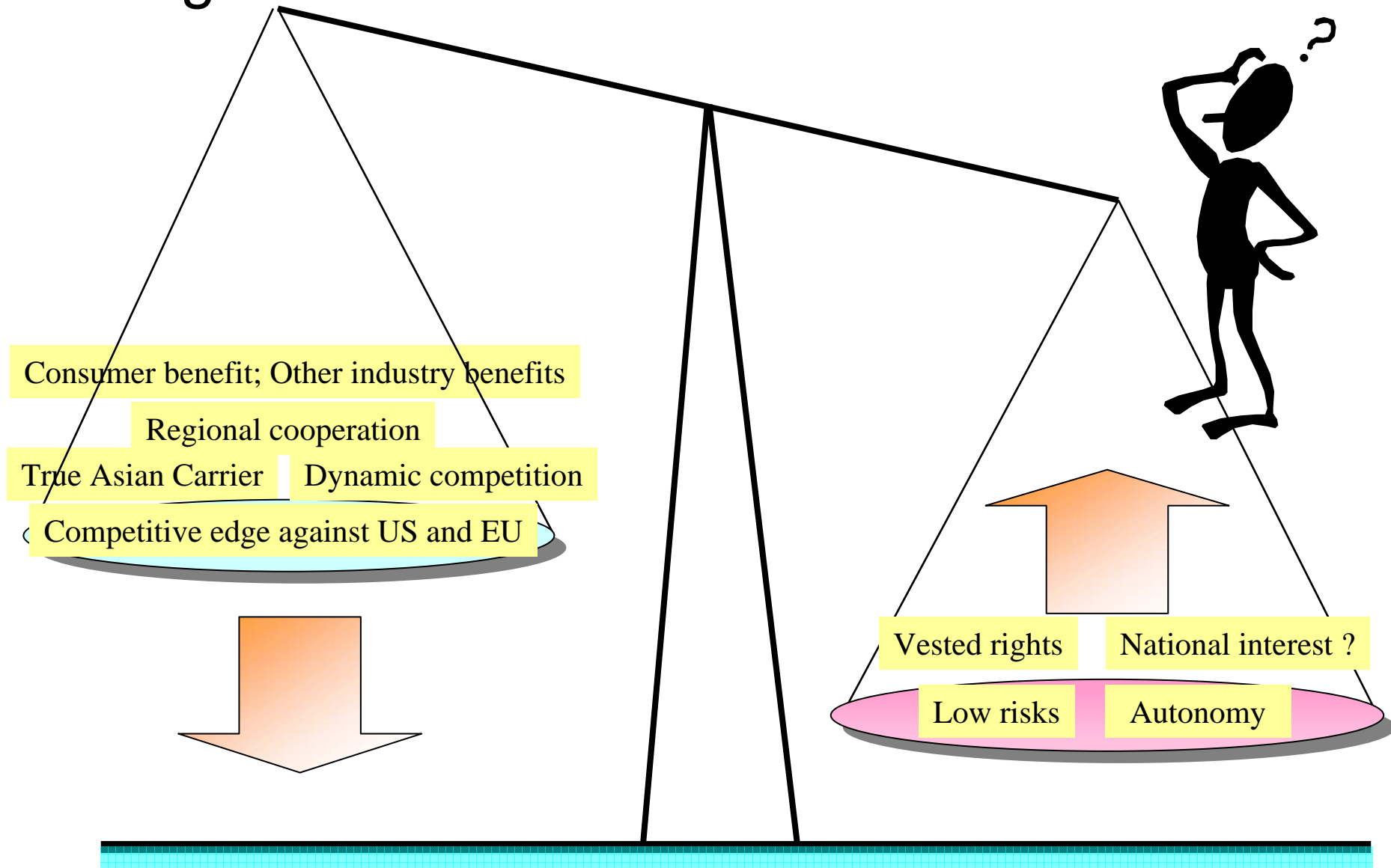
Challenges for Regulatory Reform

- Economic theory would point out that increased competition in larger regional markets would improve economic welfare of the countries and the region.
- The notion of enhancing and safe-guarding “national interests” intervene in the process. Negotiators are charged to enhance and protect national interest.
- However, the most significant problem, in fact, is the mis-guided notion that “flag carriers’ interests equal to the national interest” many bilateral negotiators hold.
- As a result, many of them in fact, work against true economic interest of the nation for which they are doing negotiations.

Challenges for Regulatory Reform

- Because of the mis-guided notion of national interests (myopic world), the negotiators turn the game into a “non cooperative” game, and thus, they are driven to protect the markets where national flag carriers may lose, and to expand necessary traffic rights for the flag carriers.
- In this myopic world, “tough negotiators” are respected despite the fact that in many cases, they fail to find “positive-sum” games via which both countries can increase economic pies.

So how could we achieve a cooperative regime in an anarchical situation?



Challenges for Regulatory Reform

- Recent discussions in international political economy and economics suggest that anarchical perception could be changed through 'repeated interaction and common goal setting'.
- This constructive approach would foster development of common grounds that may facilitate market integration and create positive-sum games.
- It is, therefore, important to identify area or agenda that is suitable for repeated interaction and common goal setting.

Challenges for Regulatory Reform

- **Establishment of a forum (e.g., trans-national Committee) consisting of governments, industries and academia** would go a long way for fostering close relationships, creating common grounds and finding positive sum approach and agenda for negotiation.
- East Asian countries should seriously consider revising current regulatory framework for air transport in order to develop efficient regional air transport networks which also serves long term interests of flag carriers as well.

Thank you

For Listening