

December 15, 2005
1st ITPU Seminar

Globalization, Regionalism and International Transport System

—Challenges for Air Transport in Japan and East Asia—

Information Paper for the Panel Discussion



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

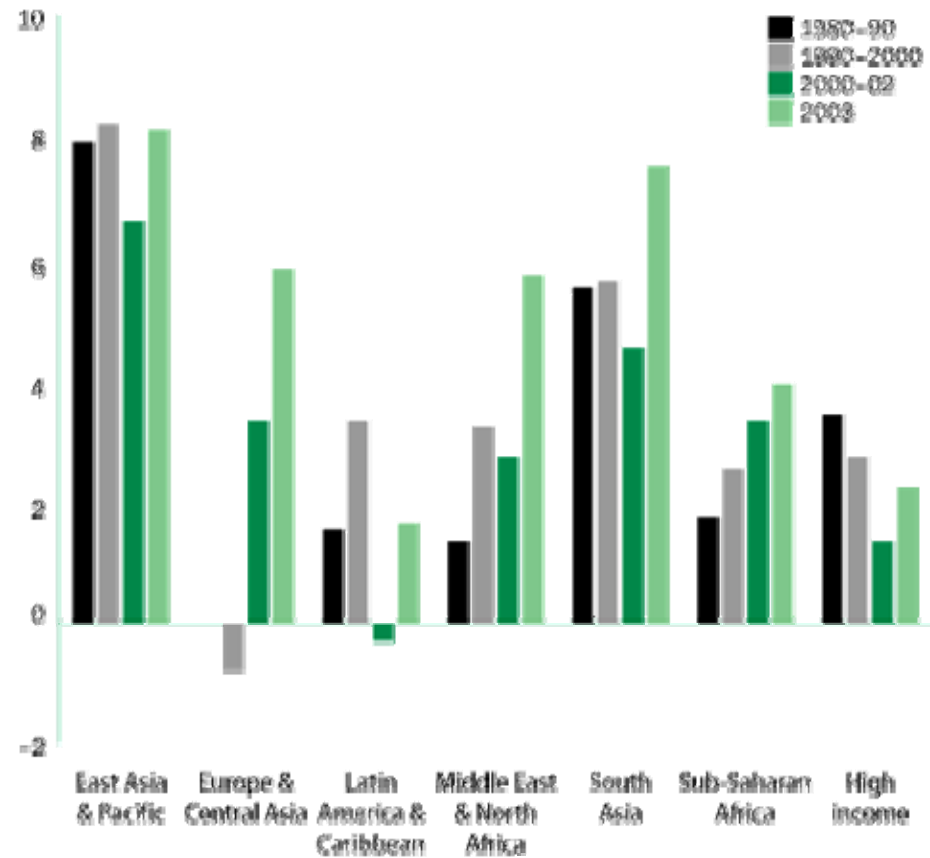


- **Global Economy**

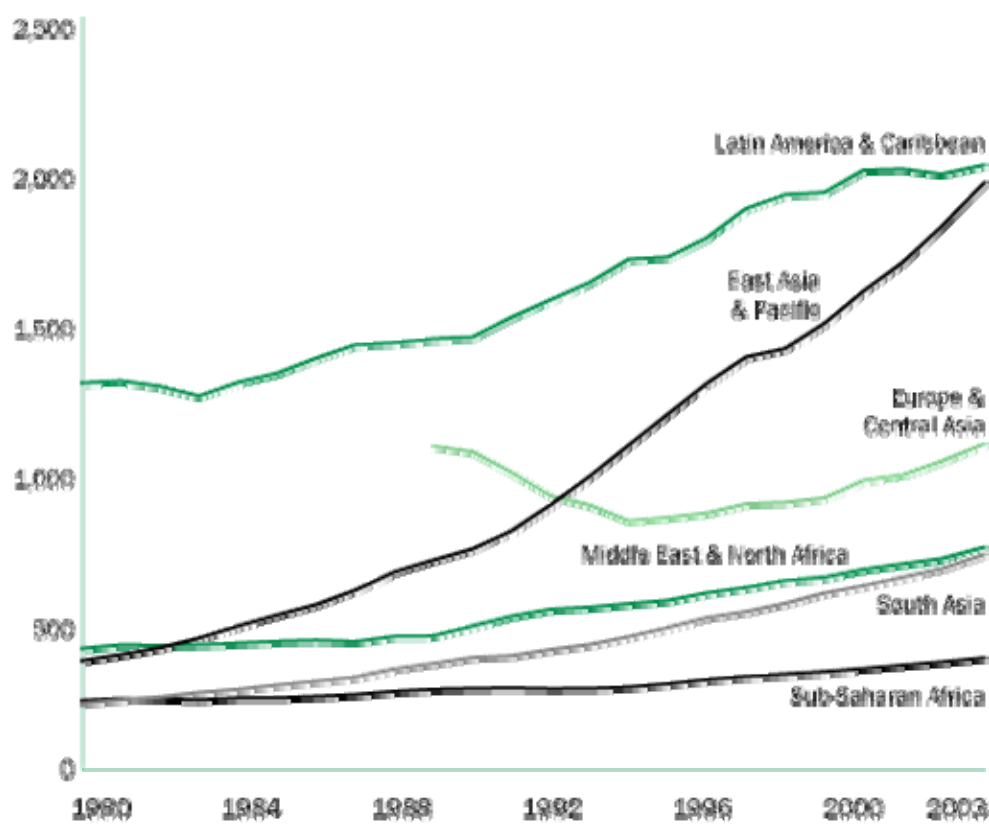
- Stable economic growth is expected, despite high oil prices.
- Growth continues in most Asian countries, although extreme differences in per-capita incomes would persist.

Global Economy

Economic growth by region (%)



Gross domestic product (2000 US\$ billions)



Source: World Bank

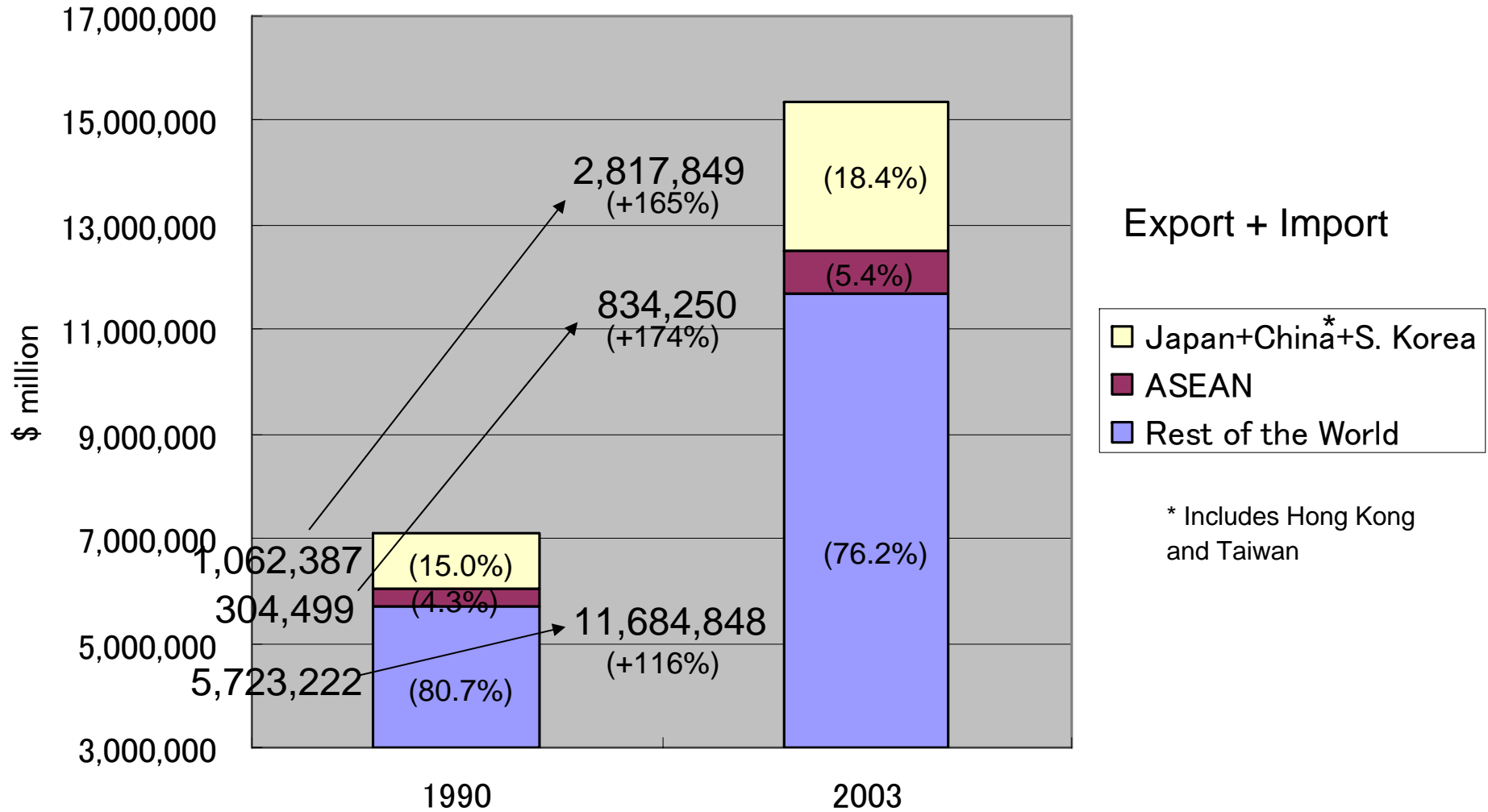
- **Global Trade**

- Global trade continues to grow.

- East Asia, now the “manufacturing complex.”

- Trade of “ASEAN + 3” accounts for $\frac{1}{4}$ of global trade.

Global Trade

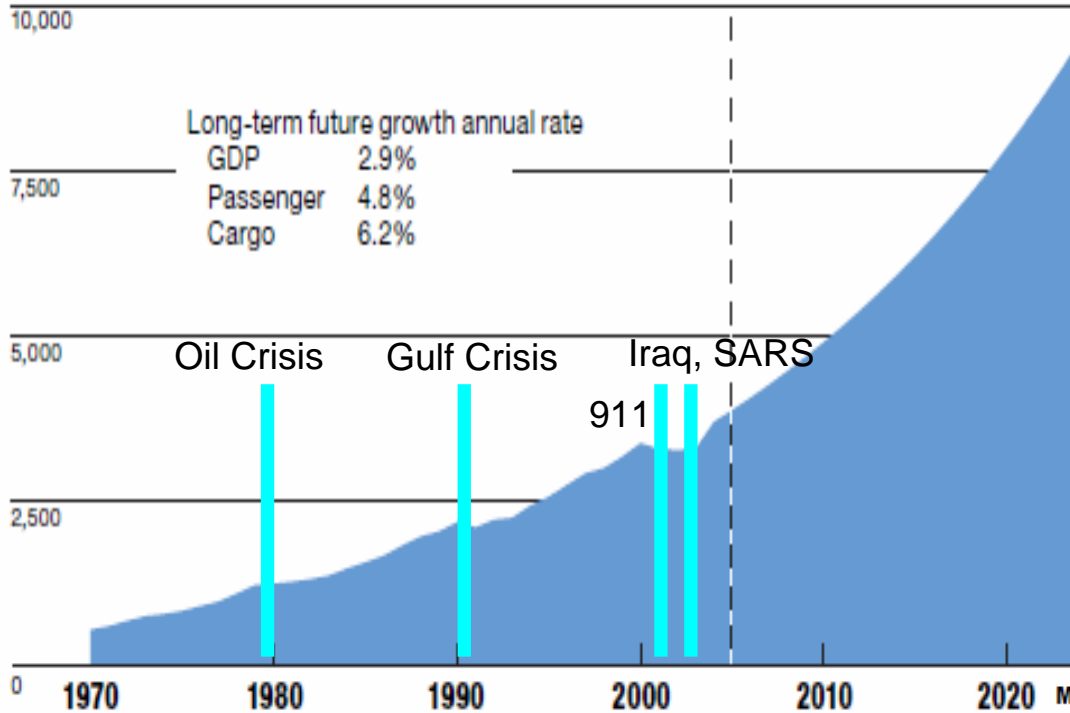


Source: ITPU from World Bank data

Air Transport

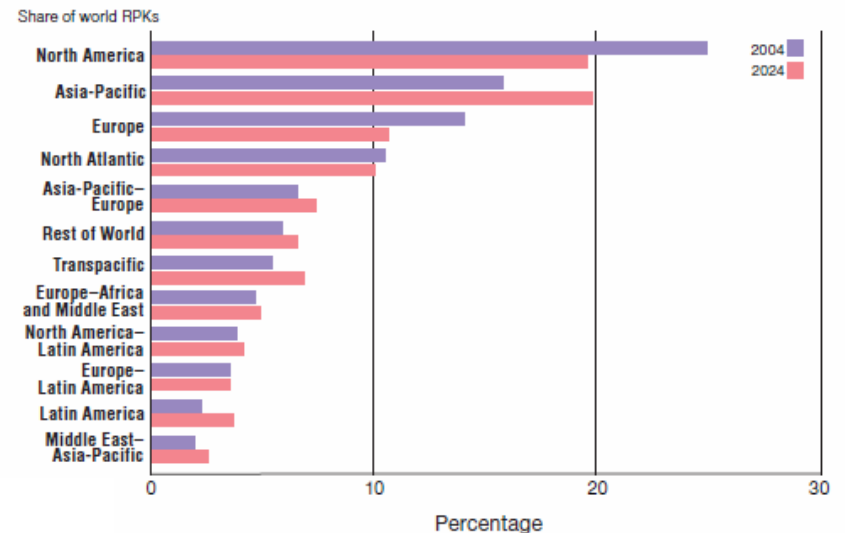
World Air Travel Continues to Grow

Revenue passenger kilometers, billions



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

More Mature Markets Lose Share



Source: Boeing (edited by ITPU)

Global Trend in Air Transport

Inter-continental Competition

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

Global Alliance in Air Transport

STAR ALLIANCE™



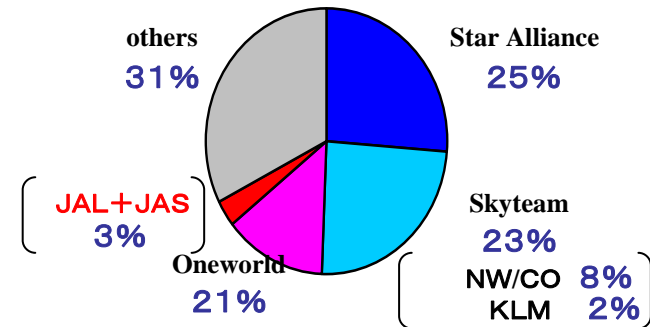
oneworld



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 “Continentalization”

- EU market integration completed in 1997.
- Australia = New Zealand Single Aviation Market (SAM) Arrangements initiated in 2000.
- In regional markets, LCCs have established their business model, starting from US, then in EU, and now in Asia.
- Large pools of liberalized market in US and EU have facilitated evolution of the industry.

Regions and Air Transport

Europe

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

2004年5月現在
25カ国

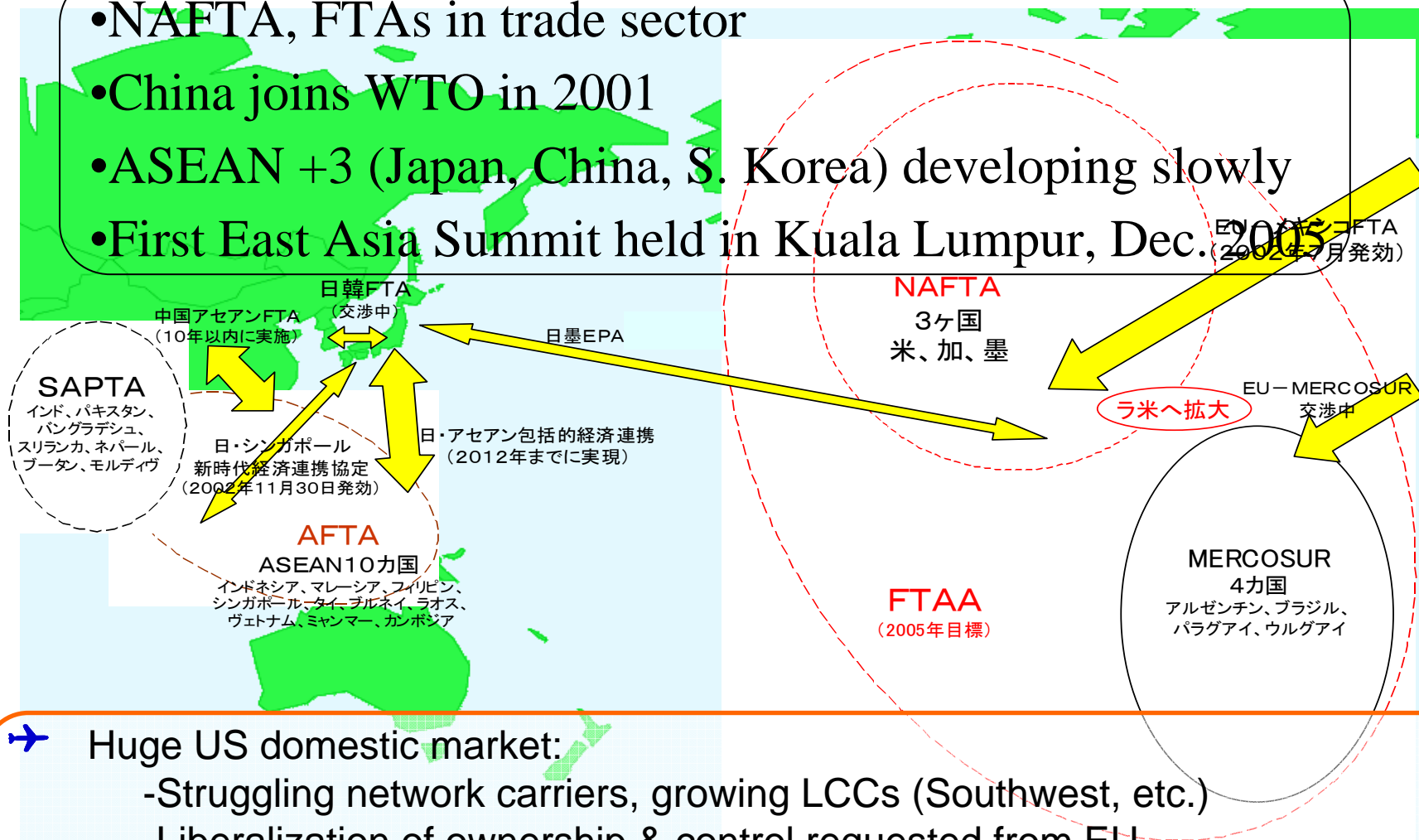
交渉中

- ✈ Air Transport Industry: Alliance between mega-carriers, merger of AFR and KLM, growing LCCs (Ryanair, Easyjet, etc.)
- ✈ Public Policy: Common competition policy, integrated safety standards, single sky
- ✈ External Policy: Negotiation with US, etc., on horizontal ASA, entry of EU member airlines, security, etc.

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.)
 - Liberalization of ownership & control requested from EU
- ✈ 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



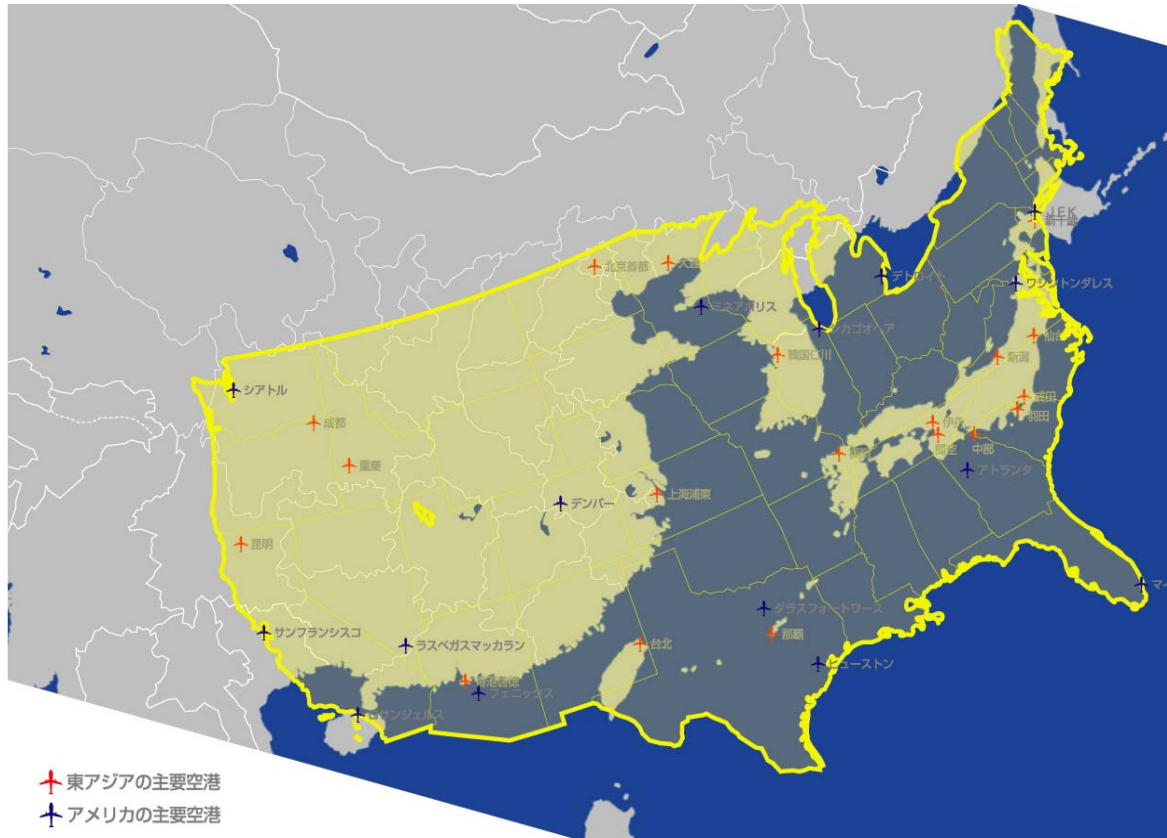
Emerging Agenda for Air Transport in East Asia

- As the regional relationship gets closer, it is imperative for the transport system to leap into a new stage so as to fully support these activities.
- In the long-run, international 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 as a region.

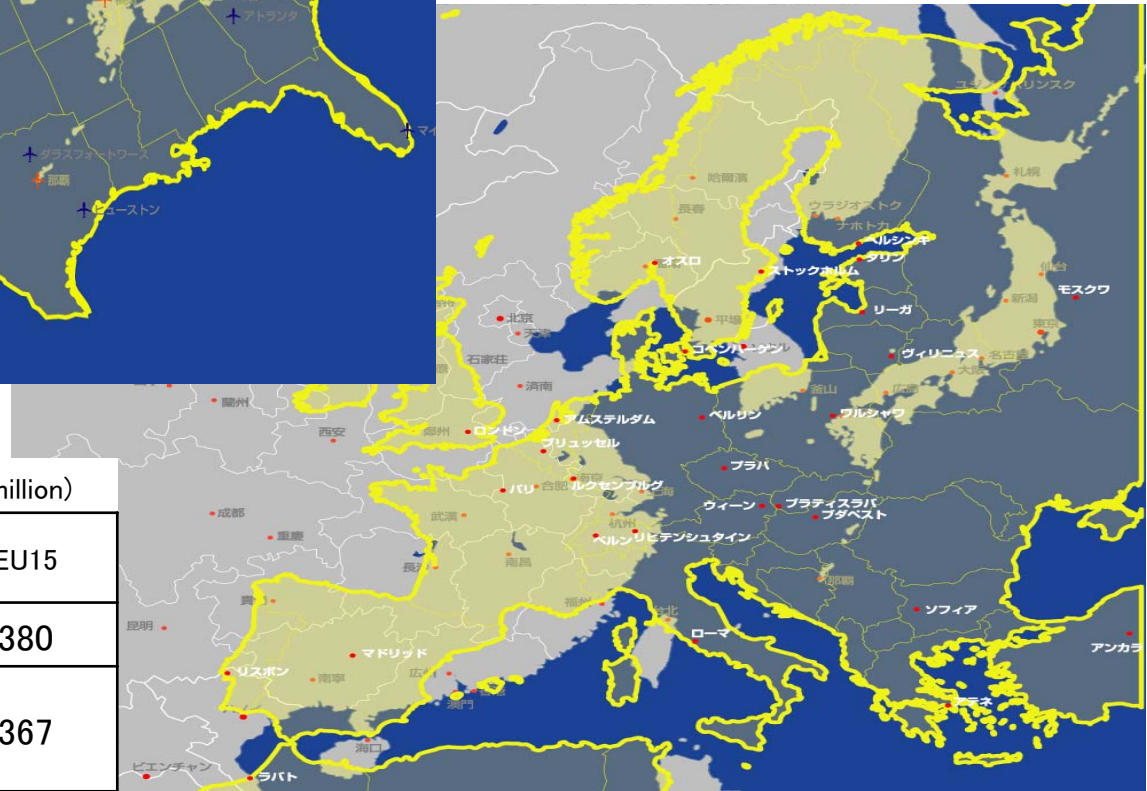
Emerging Agenda for Air Transport in East Asia

- Recent deal between US and EU, 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 competitive power.
- They would head for the growing Asian market.

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

Japan

- Japanese air transport market has grown considerably.
- In recent years, however, Japan seems to have fallen into a negative lock-in situation.
- Many factor inputs are constrained to high-cost Japanese sources. Reform of the regulatory framework should, therefore, come hand-in-hand with mobilization of factor inputs.
- Market integration would provide airlines with opportunities to source factor inputs from optimal location as well as to respond appropriately to intensive demand in East Asia.

China

- Market expected to grow most rapidly in East Asia and in the world.
- Problem for the industry is how to secure human capability and resources.
- Sharp discrepancy between highly developed coastal zone and underdeveloped inland areas causes market disorder.
- Market integration with adjacent countries would provide more established and lucrative markets to enter as well as new sources of factor inputs.

Korea

- Korean air transport industry has the most advantageous position among the three countries.
- Development as East Asian logistics/distribution hub similar to Netherlands and Singapore is in progress.
- There is a competitive edge in combining liberalization in trade and transport.

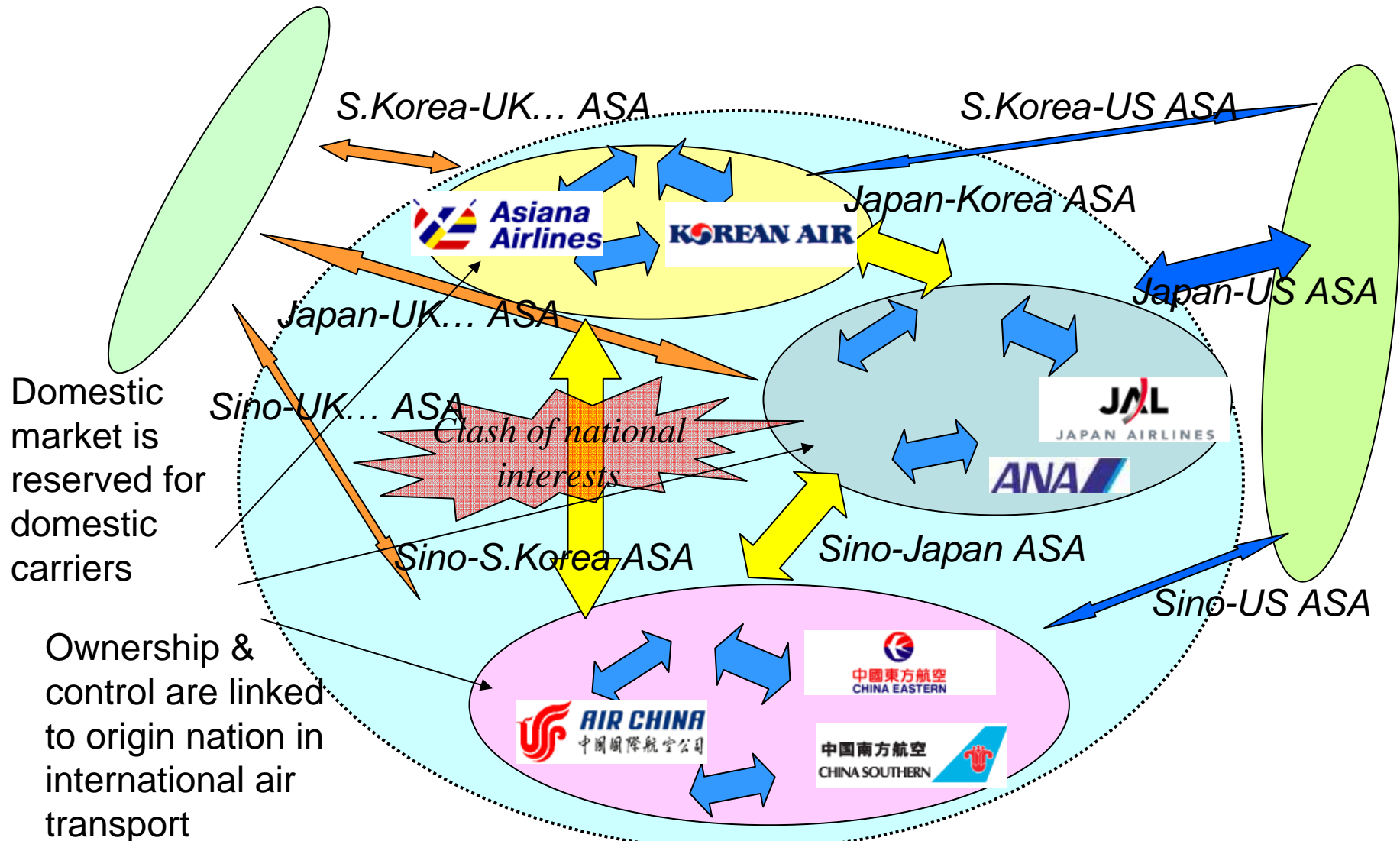
Challenges for regulatory reform



Current Regulatory Framework

- Air transport has traditionally been provided under a framework that segregates international and domestic activities.
- In international air transport ownership and control needs to belong to designating nation under Air Transport Services Agreements (ASAs).

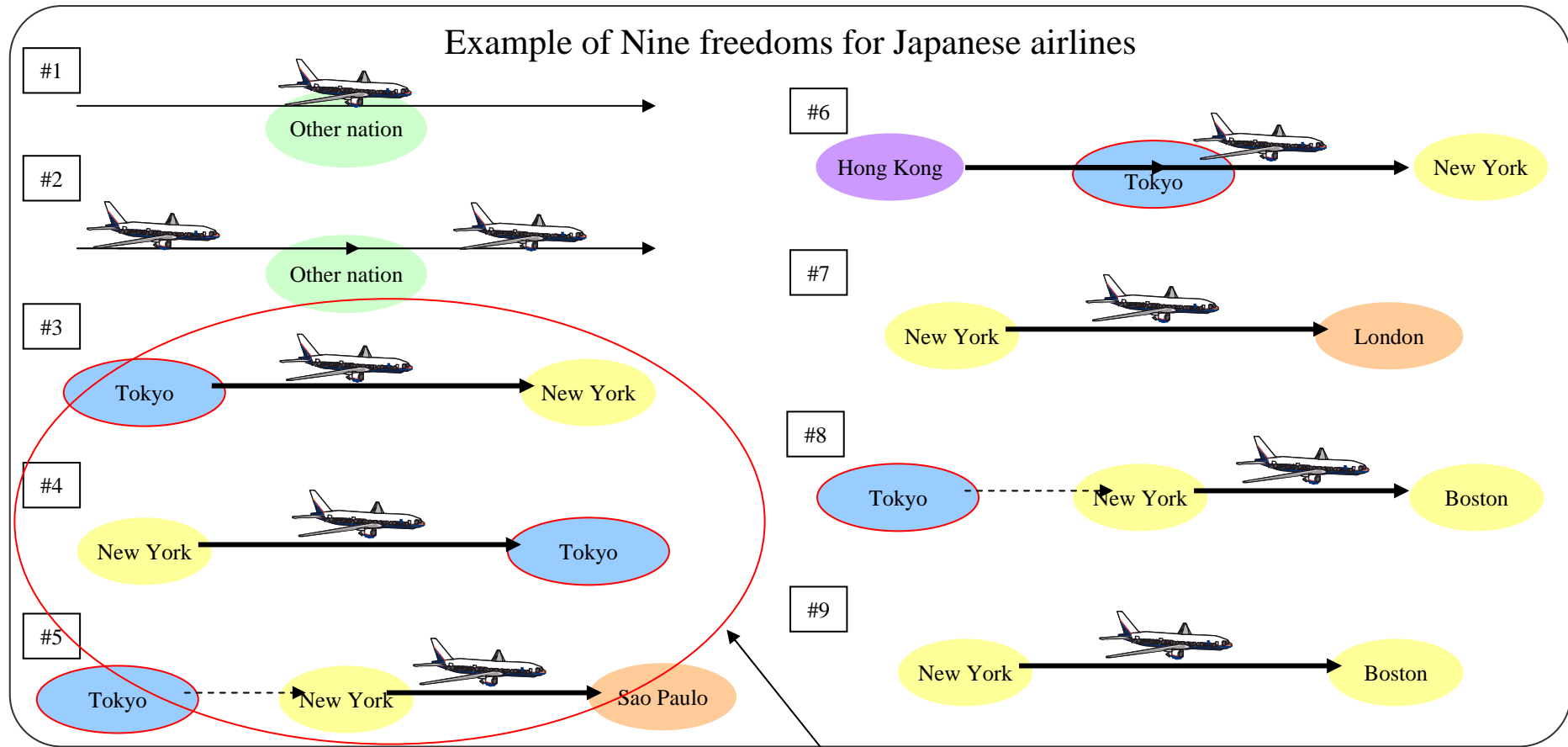
Current Regulatory Framework



Current Regulatory Framework

- Has limited growth of 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

Nine freedoms in international air transport



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

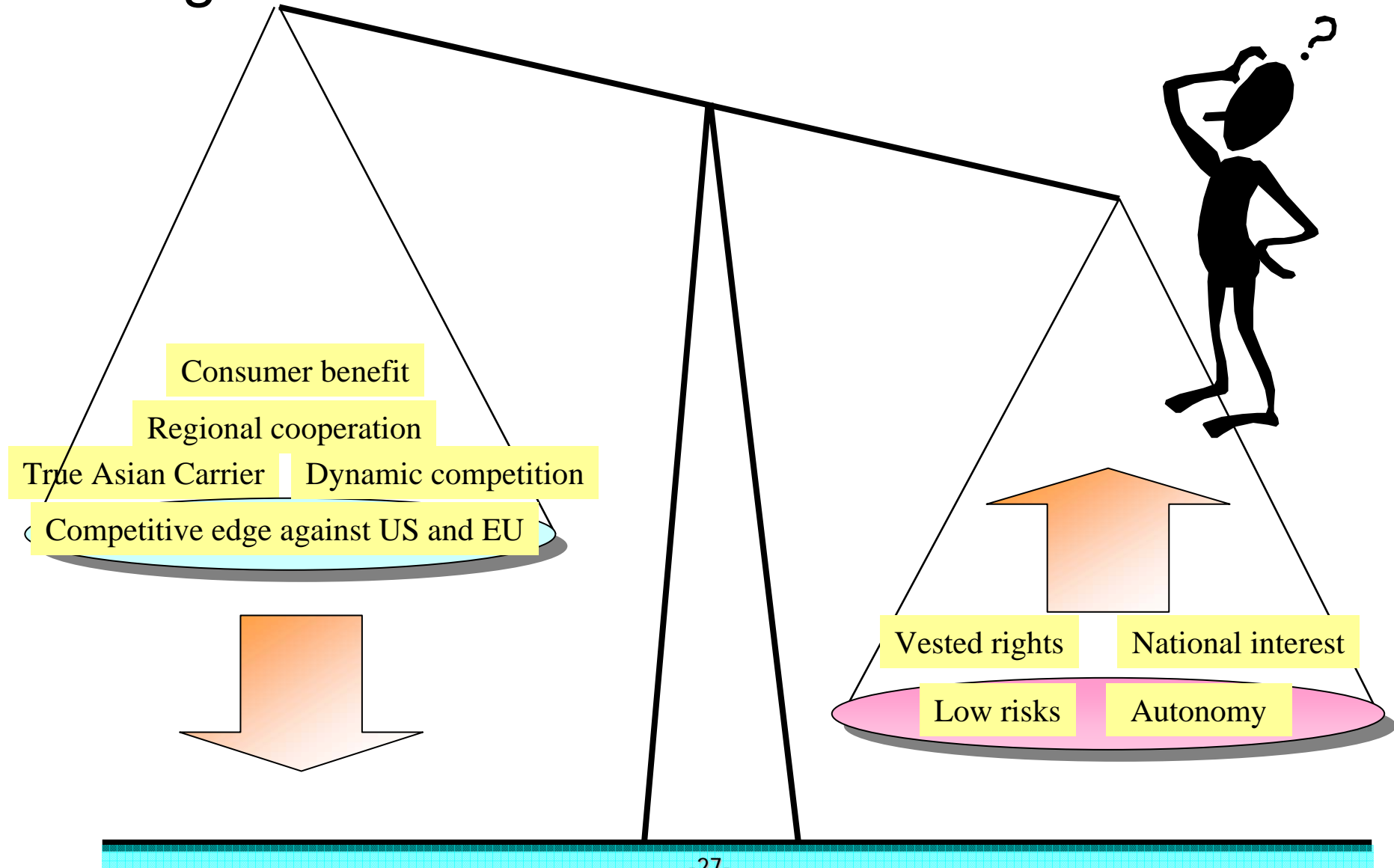
Challenges for Regulatory Reform

- Economic theory would point out that larger pool of free competition would improve economic welfare.
- However, undermining value that lies behind the current regulatory framework is the concept of national interest.

Challenges for Regulatory Reform

- ASAs are based on this framework.
- Negotiators are tasked to enhance and protect national interest.
- The game is “non cooperative” in nature and they are driven to achieve necessary traffic rights for the national flag carriers and reject traffic rights for counterpart’s carriers that do not balance.
- In this world “tough negotiators” are respected.

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



Challenges for Regulatory Reform

- Recent discussions in international political economy suggests that anarchical perception could be changed through repeated interaction and common goal setting.
- This “Constructivism” approach would foster development of common grounds that may facilitate market integration.
- It is, therefore, important to identify area or agenda that is suitable for repeated interaction and common goal setting.

Challenges for Regulatory Reform

- East Asian countries should seriously consider revising the regulatory framework to develop efficient regional air transport networks.
- Key to integrating East Asian air transport system is to foster close relationship.
- Establishment of a forum consisting of governments, industries and academia is imminent.