JITI Aviation Seminar
Future of the U.S.-Japan Market
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Remarks By

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Introduction

- **I am honored to participate in today's important seminar on Japan-U.S. aviation relations.**

- **Mr. Washizu, Mr. Nagai, and all of the JITI team: Let me commend your hard work and dedication in expanding our knowledge and understanding of so many aspects of transportation—on the land, on the sea, and in the air. Your efforts have made the Institute a thought leader in America, Japan, and beyond.**

Overview

- **I will seek to do three things this afternoon:**

    - **First, I will offer a snapshot of the status of our aviation relations, from both a legal and a market perspective.**
    - **Second, I will identify some factors that can affect future market growth.**
    - **And third, I will pose a few questions for policymakers on both sides of the Pacific.**

<u>A Snapshot of Japan-U.S. Aviation Relations: the Legal Framework</u>

- **Let's begin with that snapshot of bilateral aviation relations, starting with the legal framework.**

- **Four years ago, in December 2009, my esteemed Japanese friend and counterpart, Mr. Takiguchi, and I initialed the text of a Memorandum of Understanding to establish Open Skies between our countries.**

- **Following a decision by the U.S. Department of Transportation to grant antitrust immunity to alliances between United and ANA and between American and JAL, the Open Skies agreement was signed in October 2010.**

- **The agreement accomplished a number of important things:**

  - **Under the old agreement, a form of aviation apartheid existed between so-called "incumbent" airlines, which had broad traffic rights, and "non-incumbent" carriers, which were severely limited. The Open Skies agreement ended this discrimination, a pro-competitive, pro-growth, and pro-consumer change for the better.**
  - **The old agreement restricted the ability of airlines to price their services. Open Skies ended this anti-competitive constraint, getting governments out of the business of second-guessing the market.**
  - **The old agreement also contained rules on code sharing that were bizarrely complex and protectionist. Open Skies tossed these restrictions into the dumpster of aviation history.**

- **Two aspects of the agreement drew special attention. Both involved slots, a subject not explicitly addressed in a standard U.S. air services agreement.**

- **One set of provisions dealt with Narita airport, where Japan was implementing plans to expand capacity from 200,000 slots per year to as many as 300,000.**

- **For its part, the United States wished to ensure that U.S. carriers could add flights at Narita using some of these new slots. We were concerned that Japan might allocate the slots solely to other bilateral markets, a step it might have defended under the wide leeway permitted by international practice, including IATA's World Scheduling Guidelines.**
- **Japan, on the other hand, expressed concern that U.S. carriers, operating under what would be Japan's first agreement with a fully open frequency entitlement, might claim virtually unlimited access to all the new slots.**
- **Thinking back, I'm reminded of Akira Kurosawa's brilliant 1950 film, *Rashomon*, which explored how individuals' perception of truth and reality may radically differ.**
- **Returning to the more mundane world of aviation, suffice it to say that the provisions we negotiated on Narita, although complex, have met the needs of both sides in practice.**

- **With respect to Haneda, we negotiated a special annex against the backdrop of Japan's decision to build a fourth runway in Tokyo Bay and to make available some of the resulting new capacity to scheduled international air services.**

  - **It was not for the United States to dictate to Japan whether it should or should not re-open Haneda to international flights—any more than it would be appropriate for Japan to dictate to the United States whether opening Hobby Airport in Houston to international aviation is appropriate.**
  - **On the other hand, the United States was on firm ground in insisting on conditions to guarantee that, upon the very limited opening of Haneda originally decided by Japan, U.S. carriers would have a fair and equal opportunity to compete.**
  - **What we ended up with are rules that:**

- **First, as authorized by Japan, allow four frequencies for the carriers of each side to use during the late night and early morning hours at Haneda.**
- **Second, at U.S. insistence, do not allow departures before midnight from Haneda to the mainland U.S. so as not to give an unfair competitive advantage to Japanese carriers.**

➢ **Despite various discussions since 2010, Japan and the United States have been unable to agree on changes to the Haneda annex to expand frequencies and reduce operating restrictions. I'll return to this point later.**

<u>Snapshot Continued: the Commercial Side</u>

- **Let me turn now from the legal framework to a quick look at the bilateral passenger market.**

- **As so often, how one characterizes the market depends, in part, on the comparisons one draws: which time periods and which other markets are examined.**

- **Looking at DOT data, one sees a precipitous decline in passengers in the Japan-U.S. market from over 15 million in 2000 to 11 million in 2003, followed by an additional dip to only 10 million or so passengers in the period of 2009-to-2011. In 2012, the number of passengers recovered to 11.5 million.**

  ➢ **What do these numbers suggest? First, that the U.S.-Japan market, like many others, declined in the aftermath of 9/11. Second, that the market has recovered somewhat from the financial crisis that began in 2008. And third, that we remain far below the boom year total in 2000.**
  ➢ **In other trans-Pacific markets, one sees some similar ups and downs, but the overall trend is upward, not downward. The number of passengers departing the United States for South Korea was about 60%**

larger in 2012 than in 2000. The number headed to China increased fivefold in the same period.

- **Whether this is a matter of concern—and whether such comparisons are meaningful—can be debated. To round out the picture, the absolute number of passengers in the U.S.-Japan market continues to exceed by far the number for either Korea or China.**

- **Proving cause and effect is an impossible challenge. But I'd offer a few hypotheses:**

  - **First, the relative wealth of the American and Japanese economies and the maturity of our aviation relationship make massive upward surges in the bilateral market unlikely. In contrast, Korea and, in particular, China offer a much greater opportunity to tap the desire of an expanding middle class to travel.**
  - **Second, the early commitment of the Chinese and Korean governments to airport infrastructure development—think of the new airports at Beijing, Shanghai, and Incheon—may have played an important role in enabling market expansion.**
  - **Third—and here I'll go out on a limb here as a dyed-in-the-wool proponent of market liberalization—perhaps it's relevant that, 12 years before Japan, Korea had already concluded an Open Skies agreement with the United States and that China, in two landmark agreements with the U.S. in 2004 and 2007, massively expanded the number of authorized passenger frequencies.**

Determinants of Market Growth

- **Let's turn briefly to some of the key determinants of future market growth.**

- **Topping the list is the strength of our respective economies. It's a fundamental of aviation economics that the growth of airline revenue passenger miles closely tracks the growth of GDP.**

- **A second determinant is market access. It's axiomatic that, where governments restrict markets, growth will usually be limited.**

  - **By market access I refer not only to the legal right to operate air services but also to *de facto* access, which may be restricted due to limitations on airport slots or inefficient air traffic management.**

- **A third determinant consists of a hodge-podge of factors that affect, either positively or negatively, the disposition of individuals to travel.**

  - **For example, are visas required; is tourism facilitated; is it expensive to fly and to visit; are security and customs procedures easy or arduous?**

Questions for Policymakers and Stakeholders

- **If these are key determinants, what can aviation policymakers and stakeholders do to affect them?**

- **I suspect that there isn't anything more important for the growth of the U.S.-Japan market than continued strengthening of our national economies: a rise in GDP on both sides of the Pacific would hold great promise for an increase in passengers.**

  - **In Japan, Prime Minister Abe is committed to rousing the country from the economic doldrums of the infamous "lost decade" through a set of monetary, fiscal, and economic growth strategies to encourage private investment, to reverse deflation, and to correct excessive appreciation of the yen. "Abenomics" it's called—and let's all hope it works.**
  - **Here in the United States, the economy seems on an upward trend, notwithstanding what some might say are the best efforts of the U.S. Government, collectively, to smack it in the head with unending battles over the debt ceiling, government shutdowns, reform of our tax code, healthcare, and entitlement spending.**

- **Unfortunately, there's not much that aviation policymakers, as such, can do about these overarching macroeconomic challenges. What they can address, however, are issues of market access and that hodge-podge of factors that encourage, or discourage, travel.**

- **With regard to market access, the essential market-oriented legal framework was achieved with our Open Skies agreement in 2010.**

- **Moreover, the decision by Japan to expand the capacity of Tokyo's airports—both Narita and Haneda—is a welcome step forward in ensuring *de facto* market access.**

  - **By opening Haneda to at least some flights to the United States, Japan has also shrewdly moved to recapture the "leakage" of Japanese passengers from cities outside Tokyo, who had increasingly chosen to fly to the United States via third countries, especially Korea.**

- **With respect to Haneda, both Japan and the United States favor a further expansion of opportunities for each side's airlines. The disagreement is over the size, the shape, and potentially the timing of that expansion.**

  - **In brief, Japan has proposed an increase of frequencies in the small single digits, coupled with elimination of all time limits on when flights may be operated. Such an expansion would obviously be valuable to the airlines that receive the new frequencies. It would also help airlines that have struggled to mount Haneda service, especially from the eastern United States, in the limited time window allowed by the current annex.**
  - **American Airlines, for example, recently announced that it is ending JFK-Haneda service, and Delta earlier ended service from its Detroit hub. From a consumer perspective, it's unfortunate to see the very limited opportunities for Haneda service not put to full and optimal use.**
  - **There is absolutely no doubt that, had Japan made its current offer at the time of our negotiations in 2009, the United States would have**

snapped it up as much preferable to the more restrictive annex that was, in fact, negotiated.

- **Today, however, the U.S. Government appears to have decided that it would be a mistake to settle for a small deal rather than insist on a larger one.**
- **How much larger? That's not clear. Richard Anderson, Delta's CEO, has spoken of wanting 25 additional slot pairs at Haneda for Delta alone—enough to move his entire hub from Narita. Other U.S. carriers would doubtless have substantial requests as well.**
- **An agreement of this magnitude would require a major shift in Japan's airport policy—one that potentially transforms Haneda, Tokyo's primary domestic airport, into Tokyo's primary international gateway. A new and different role would probably have to be assigned to Narita, perhaps as a center for all-cargo and low cost carriers.**
- **Is such an agreement likely? Is it politically feasible in Japan? Could the two sides find common ground somewhere in-between? Do U.S. carriers risk losing the opportunity to obtain additional Haneda frequencies if the U.S. Government continues to hold out for a larger deal and Japan gives the new Haneda slots to airlines of third countries?**
- **I don't know the answers and, fortunately, I don't have to! Sometimes, it's just wonderful to be retired.**

- **There is an additional aspect of *de facto* market access that I would like to mention, namely the need to make maximum use of our existing airspace and airports. There is room for improvement on both sides, I think.**

  - **In Japan, the utilization of existing airports—that is, squeezing the maximum safe number of hourly operations out of existing runways—falls short of what is accomplished at hub airports in many other countries.**
  - **Also, further deconflicting Tokyo airspace, including the needs of the Yakota military air base, should be considered. Let me add that I am <u>not</u> advocating the opening of Yakota to regular civilian use: it seems to me that better utilizing Haneda and Narita is more valuable to our airlines than creating a third major civilian airport in the region.**

- **In the United States, let's hope that we can stay ahead of the *de facto* market access curve by addressing air traffic control and airport congestion issues through NextGen or other initiatives. There is a serious problem in New York, and the expansion of flying in coming years will worsen that problem and see it replicated in other large urban centers…unless we act.**

- **Finally, how about that hodge-podge I mentioned? Here are a few observations and suggestions.**

  - **Let's begin with tourism:**

    - **Both the United States and Japan score very well on the World Economic Forum's 2013 "travel and tourism competitiveness index." The United States ranks sixth among all countries, and Japan ranks fourteenth.**
    - **Japan's ranking is up an impressive eight places in only two years, notwithstanding the 2011 tsunami. Japan's rich cultural heritage and superb ground transportation are among its comparative strengths, as is its Number 1 ranking among all countries for having a customer-oriented culture. On the other hand, Japan is an expensive destination, ranking 130th in global price competitiveness.**
    - **The United States scores high for outstanding air transport and tourism infrastructure and for its extraordinary cultural and natural resources. Among the negatives are mediocre ground transport and poor perceptions of safety and security.**

  - **In brief, Japan and the United States are doing a pretty good job. And the challenges—things like the high cost of visiting Japan and issues of public safety and security in America—are not things that aviation stakeholders can easily tackle.**
  - **Both countries, however, could tackle the issue of the high fees and charges imposed on aviation. We used to have a running debate with our friends from MLIT about whether Narita or JFK was the more expensive airport. Wouldn't it be better if neither country's major**

airports were so near the top of the global expense charts? The costs that airlines have to pay—whether directly or as collection agents for governments—end up adding to the cost of flying and the relative expense of travel for consumers. Less would be more here!

- **There are also some additional things to consider.**

  - **For example, the failure of the United States, over a decade after 9/11, to restart the transit without visa program is detrimental to airlines, both Japanese and U.S., that would like to tap the demand of Brazilian and other Latin American citizens for travel to Japan and, in doing so, bolster load factors on flights between our two countries.**
  - **Likewise, shouldn't the United States allow Japanese citizens to join the Global Entry program, an opportunity currently available to Korean citizens?**
  - **And might Japan consider a parallel program at its airports that could speed the sometimes sluggish lines that I've seen at Narita?**

    - **By making Japan a country that is easier for Americans to visit, we might see an increase in tourism, notwithstanding high prices. Little things count, like the availability of ATM machines that work with American debit cards.**

  - **I know from personal experience that Japanese citizens are huge fans of America's national parks. Let us hope—and pledge—that never again will the United States shutter these most precious of national treasures to our own citizens and visitors from abroad.**

<u>Conclusion</u>

- **In closing, I'm guardedly optimistic about the prospects for the Japan-U.S. market. We have in place a legal framework that gives airlines the tools and the freedom with which to respond to customer demand. And I'm hopeful our economies will continue on the mend.**

- **We need to be realistic, however, about how we measure success. The rate of growth in the Japan-U.S. market cannot be expected to match the rate for China-U.S. traffic.**

- **We can, however, work on several issues to make good prospects for growth even better. We need further discussion of the Haneda question to forge a way ahead. And we should look at the little things that can make a difference to travelers, like Global Entry, Transit Without Visa, and those darned ATM machines.**

- **Thank you very much. I look forward to my colleagues' presentations and to the panel discussion.**